

## **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:

- [Overview - The Power of Three](#)
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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 2021 and 2020 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 - The Power of Three**

In 2021, we continued to execute against our Power of Three growth plan. We have achieved some of our key growth goals under this plan two years ahead of schedule. These include generating \$6 billion in net revenue, doubling our men's net revenue relative to fiscal 2018, and doubling our e-commerce net revenue relative to fiscal 2018 (which we achieved in 2020). We have seen the trends that we believe have fueled our business over the last few years continue. These include the desire to live an active and healthy lifestyle, the desire to be part of a diverse and inclusive community, and the desire to achieve wellness, both physically and mentally.

We achieved these goals while strategically managing a number of challenges related to the COVID-19 environment, including stores closures, capacity constraints, and challenges across our supply chain including certain supplier factory closures, port slowdowns, and reduced air freight capacity.

### **Product Innovation**

Our lens for product development and innovation continues to be what we refer to as the Science of Feel. In 2021, we continued to bring technical innovations to our guests including expanding our Yoga offering with the launch of our Instill franchise, made from our SmoothCover fabric; we continued to build out our high support bra offerings with the launch of the Air Support bra, our most tested bra to date, which took five years to research and develop and is made from our Ultralu fabric; and for men we launched the versatile License to Train short, made from our High Impact Swift Pique fabric and further built out our On The Move offering with the Bowline bottom. We are also particularly proud of our multi-year collaboration with the Canadian Olympic Committee and Paralympic Committee. This collaboration allows us to showcase the lululemon brand and our technical expertise within apparel on the world stage; and we believe it is a compelling platform that we can leverage to continue to grow our brand presence both inside and outside of Canada.

### **Omni Guest Experience**

We continue to see benefits from our omni business model and in 2021, net revenue in our company-operated store channel increased 70% and our e-commerce business increased 22%. We engaged with our guests both in real life (where and when it was safe to do so) and virtually. In our digital business, we continued to see the benefits of the investments we have made over the last several years, while we continue to invest in our websites and mobile apps as we work to elevate the guest

experience. In 2021, we continued to make foundational investments which included expanding our accepted payment methods, improving our storytelling, making search more predictive, and making the checkout process more seamless. When looking at MIRROR, we continue to focus on strategies and initiatives which we believe will allow us to build our community and increase guest loyalty. These include setting up MIRROR shop-in-shops in approximately 200 stores in North America, including launching in Canada, and continuing to enhance the offering with new classes and connected accessories.

### **Market Expansion**

We continued to expand our presence both in North America and in our international markets. During 2021, we opened 53 net new company-operated stores, including 31 stores in the PRC, seven stores in the rest of Asia Pacific, 10 stores in North America, and five stores in Europe.

In 2021, our net revenue in North America increased 40%. In our international markets, we saw revenue growth of 53%, which keeps us on track with our goal to quadruple the business from 2018 levels by 2023.

### **COVID-19 Update**

COVID-19 continues to impact the global economy and cause disruption and volatility. While most of our retail locations were open throughout 2021, certain locations were temporarily closed based on government and health authority guidance. We believe we will continue to experience differing levels of disruption and volatility, market by market. The pandemic has also impacted our product manufacturers and our distribution and logistics providers. There has been disruption in transportation and port congestion, an increase in freight costs, and we have increased our use of air freight. We expect this disruption and increased costs to continue throughout fiscal 2022.

### **Financial Highlights**

The summary below compares 2021 to 2020:

- Net revenue increased 42% to \$6.3 billion. On a constant dollar basis, net revenue increased 40%.
- Company-operated stores net revenue increased 70% to \$2.8 billion.
- Direct to consumer net revenue increased 22% to \$2.8 billion, or increased 20% on a constant dollar basis.
- Gross profit increased 46% to \$3.6 billion.
- Gross margin increased 170 basis points to 57.7%.
- Acquisition-related expenses of \$41.4 million were recognized in 2021 compared to \$29.8 million in 2020.
- Income from operations increased 63% to \$1.3 billion.
- Operating margin increased 270 basis points to 21.3%.
- Income tax expense increased 56% to \$358.5 million. Our effective tax rate for 2021 was 26.9% compared to 28.1% for 2020.
- Diluted earnings per share were \$7.49 for 2021 compared to \$4.50 in 2020. This includes \$40.0 million and \$26.7 million of after-tax costs related to the MIRROR acquisition in 2021 and 2020, respectively, which reduced diluted earnings per share by \$0.30 and \$0.20 in 2021 and 2020, respectively.

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:

	2021	2020	2021	2020
	<i>(In thousands)</i>		<i>(Percentage of revenue)</i>	
Net revenue	\$ 6,256,617	\$ 4,401,879	100.0 %	100.0 %
Cost of goods sold	2,648,052	1,937,888	42.3	44.0
Gross profit	3,608,565	2,463,991	57.7	56.0
Selling, general and administrative expenses	2,225,034	1,609,003	35.6	36.6
Amortization of intangible assets	8,782	5,160	0.1	0.1
Acquisition-related expenses	41,394	29,842	0.7	0.7
Income from operations	1,333,355	819,986	21.3	18.6
Other income (expense), net	514	(636)	—	—
Income before income tax expense	1,333,869	819,350	21.3	18.6
Income tax expense	358,547	230,437	5.7	5.2
Net income	\$ 975,322	\$ 588,913	15.6 %	13.4 %

## Comparison of 2021 to 2020

### Net Revenue

Net revenue increased \$1.9 billion, or 42%, to \$6.3 billion in 2021 from \$4.4 billion in 2020. On a constant dollar basis, assuming the average foreign currency exchange rates in 2021 remained constant with the average foreign currency exchange rates in 2020, net revenue increased \$1.8 billion, or 40%.

The increase in net revenue was primarily due to increased company-operated store net revenue, which was the result of more extensive temporary store closures and COVID-19 operating restrictions that were in place during 2020. Direct to consumer net revenue and other net revenue also increased.

Net revenue for 2021 and 2020 is summarized below.

	2021	2020	2021	2020	Year over year change	
	<i>(In thousands)</i>		<i>(Percentage of revenue)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Company-operated stores	\$ 2,821,497	\$ 1,658,807	45.1 %	37.7 %	\$ 1,162,690	70.1 %
Direct to consumer	2,777,944	2,284,068	44.4	51.9	493,876	21.6
Other	657,176	459,004	10.5	10.4	198,172	43.2
Net revenue	\$ 6,256,617	\$ 4,401,879	100.0 %	100.0 %	\$ 1,854,738	42.1 %

**Company-Operated Stores.** The increase in net revenue from our company-operated stores segment was primarily due to most of our stores being open throughout 2021, while almost all were temporarily closed for a significant portion of the first two quarters of 2020, and open with reduced operating hours and occupancy restrictions for the last two quarters of 2020 as a result of COVID-19.

During 2021, we opened 53 net new company-operated stores, including 38 stores in Asia Pacific, 10 stores in North America, and five stores in Europe.

**Direct to Consumer.** Direct to consumer net revenue increased 22%, and increased 20% on a constant dollar basis. The increase in net revenue from our direct to consumer segment was primarily the result of increased traffic and higher dollar value per transaction, partially offset by a decrease in conversion rates. 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 2021.

**Other.** The increase in other net revenue was primarily due to most of our outlet and pop up locations being open throughout 2021, while almost all were temporarily closed for a significant portion of the first two quarters of 2020, and open with reduced operating hours and occupancy restrictions for the last two quarters of 2020 as a result of COVID-19. The increase in net revenue from our other retail locations was partially offset by a decrease in net revenue from MIRROR.

**Gross Profit**

	2021	2020	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Gross profit	\$ 3,608,565	\$ 2,463,991	\$ 1,144,574	46.5 %
Gross margin	57.7 %	56.0 %	170 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 130 basis points, driven primarily by the increase in net revenue;
- a decrease in costs related to our distribution centers and product departments as a percentage of net revenue of 30 basis points, driven primarily by the increase in net revenue; and
- a favorable impact of foreign currency exchange rates of 30 basis points.

The increase in gross margin was partially offset by a decrease in product margin of 20 basis points, primarily due to higher air freight costs as a result of global supply chain disruption, partially offset by lower markdowns.

**Selling, General and Administrative Expenses**

	2021	2020	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Selling, general and administrative expenses	\$ 2,225,034	\$ 1,609,003	\$ 616,031	38.3 %
Selling, general and administrative expenses as a percentage of net revenue	35.6 %	36.6 %	(100) basis points	

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

- an increase in costs related to our operating channels of \$286.4 million, comprised of:
  - an increase in employee costs of \$150.8 million primarily due to an increase in salaries and wages expense and incentive compensation expenses in our company-operated store and other retail locations, primarily due to the increased number of hours worked as a result of COVID-19 impacts in 2020, and increased wage rates in 2021, as well as performance and growth in our business;
  - an increase in variable costs of \$78.1 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 \$37.6 million primarily due to an increase in digital marketing expenses; and
  - an increase in other costs of \$19.9 million primarily due to an increase in depreciation, professional fees, and technology costs;
- an increase in head office costs of \$287.7 million, comprised of:
  - an increase of \$163.9 million primarily due to increases in professional fees, brand and community costs, technology costs, and other head office costs; and
  - an increase in employee costs of \$123.8 million primarily due to increased salaries and wages expense, and incentive compensation, stock-based compensation expense, and employee benefit costs;
- a decrease in government payroll subsidies of \$36.5 million as no government payroll subsidies were recognized in 2021; and
- an increase in net foreign exchange and derivative revaluation losses of \$5.3 million.

**Amortization of Intangible Assets**

	2021	2020	Year over year change	
	(In thousands)		(In thousands) (Percentage)	
Amortization of intangible assets	\$ 8,782	\$ 5,160	\$ 3,622	70.2 %

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**

	2021	2020	Year over year change	
	(In thousands)		(In thousands) (Percentage)	
Acquisition-related expenses	\$ 41,394	\$ 29,842	\$ 11,552	38.7 %

In connection with our acquisition of MIRROR, we recognized acquisition-related compensation expenses of \$38.4 million and \$20.1 million in 2021 and 2020, respectively. We also recognized transaction and integration related costs of \$3.0 million and \$10.5 million in 2021 and 2020, respectively. Acquisition-related expenses in 2020 were partially offset by a \$0.8 million gain that was recognized on our existing investment.

Please refer to Note 6. Acquisition included in Item 8 of Part II of this report for information on the nature and recognition of acquisition-related compensation expense.

**Income from Operations**

On a segment basis, we determine income from operations without taking into account our general corporate expenses.

Segmented income from operations before general corporate expenses is summarized below.

	2021	2020	2021	2020	Year over year change	
	(In thousands)		(Percentage of net revenue of respective operating segment)		(In thousands) (Percentage)	
Segmented income from operations:						
Company-operated stores	\$ 727,735	\$ 212,592	25.8 %	12.8 %	\$ 515,143	242.3 %
Direct to consumer	1,216,496	1,029,102	43.8	45.1	187,394	18.2
Other	77,283	10,502	11.8	2.3	66,781	635.9
	\$ 2,021,514	\$ 1,252,196			\$ 769,318	61.4 %
General corporate expenses	637,983	397,208			240,775	60.6
Amortization of intangible assets	8,782	5,160			3,622	70.2
Acquisition-related expenses	41,394	29,842			11,552	38.7
Income from operations	\$ 1,333,355	\$ 819,986			\$ 513,369	62.6 %
Operating margin	21.3 %	18.6 %			270 basis points	

**Company-Operated Stores.** The increase in income from operations from company-operated stores was primarily the result of increased gross profit of \$712.8 million, driven by increased net revenue and higher gross margin. The increase in gross margin was primarily due to leverage on fixed costs. The increase in gross profit was partially offset by an increase in selling, general and administrative expenses, primarily due to higher employee and operating costs. Employee costs increased primarily due to the increased number of hours worked as a result of COVID-19 impacts in 2020, as well as increased wage rates in 2021, and performance and growth in our business. Store operating costs increased, primarily due to increases in credit card fees, packaging costs and distribution costs as a result of higher net revenue, and due to government payroll subsidies during 2020 that partially offset selling, general and administrative expenses. Income from operations as a percentage of company-operated stores net revenue increased, primarily due to higher gross margin and leverage 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 \$311.2 million, driven by increased net revenue, partially offset by lower gross margin. The

decrease in gross margin was primarily due to increased air freight and distribution center costs relative to net revenue. 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 and credit card fees as a result of higher net revenue, as well as higher digital marketing expenses, depreciation, employee costs and technology costs. Income from operations as a percentage of direct to consumer net revenue has decreased primarily due to a decrease in gross margin and deleverage on selling, general and administrative expenses.

*Other.* The increase in income from operations was primarily the result of increased gross profit of \$120.6 million, driven by increased net revenue and higher gross margin. The increase in gross margin was primarily due to higher product margin. The increase in gross profit was partially offset by an increase in selling, general and administrative expenses, driven by higher overall salaries and wages expense, incentive compensation, MIRROR marketing expenses and professional fees. Income from operations as a percentage of other net revenue increased primarily due to leverage on selling, general and administrative expenses and a higher gross margin.

*General Corporate Expenses.* The increase in general corporate expenses was primarily the result of increases in employee costs primarily from the growth in our business, as well as increased professional fees, brand and community costs, technology costs, and supplies. An increase in net foreign exchange and derivative losses of \$5.3 million also contributed to the increase in general corporate expense. 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**

	2021	2020	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Other income (expense), net	\$ 514	\$ (636)	\$ 1,150	(180.8)%

The increase in other income, net was primarily due to a decrease in expenses related to our credit facilities, including for the 364-day credit facility that was in place during 2020. This was partially offset by a decrease in interest income primarily due to lower interest rates. We did not have any borrowings on our revolving credit facilities during 2021 or 2020.

**Income Tax Expense**

	2021	2020	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Income tax expense	\$ 358,547	\$ 230,437	\$ 128,110	55.6 %
Effective tax rate	26.9 %	28.1 %	(120) basis points	

The decrease in the effective tax rate was primarily due to a net increase in tax deductions related to stock-based compensation, and adjustments upon filing of certain income tax returns, partially offset by non-deductible expenses in international jurisdictions. Certain non-deductible expenses related to the MIRROR acquisition increased the effective tax rate by 70 basis points in 2021 compared to 60 basis points in 2020.

**Net Income**

	2021	2020	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Net income	\$ 975,322	\$ 588,913	\$ 386,409	65.6 %

The increase in net income in 2021 was primarily due to an increase in gross profit of \$1.1 billion, an increase in other income (expense), net of \$1.2 million partially offset by an increase in selling, general and administrative expenses of \$616.0 million, an increase in income tax expense of \$128.1 million, an increase in acquisition-related expenses of \$11.6 million, and an increase in amortization of intangible assets of \$3.6 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 believe 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 or 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 net revenue.

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 currency exchange rates for the period remained constant with the average foreign currency 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 currency 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.

	2021		
	Net Revenue		Direct to Consumer Net Revenue
	<i>(In thousands)</i>	<i>(Percentages)</i>	<i>(Percentages)</i>
Change	\$ 1,854,738	42 %	22 %
Adjustments due to foreign currency exchange rate changes	(95,494)	(2)	(2)
Change in constant dollars	\$ 1,759,244	40 %	20 %

### 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 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 and term deposits.

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

	2021	2020	Year over year change
<i>(In thousands)</i>			
Total cash provided by (used in):			
Operating activities	\$ 1,389,108	\$ 803,336	\$ 585,772
Investing activities	(427,891)	(695,532)	267,641
Financing activities	(844,987)	(80,788)	(764,199)
Effect of foreign currency exchange rate changes on cash and cash equivalents	(6,876)	29,996	(36,872)
Increase in cash and cash equivalents	\$ 109,354	\$ 57,012	\$ 52,342

### **Operating Activities**

The increase in cash provided by operating activities was primarily as a result of:

- increased net income of \$386.4 million;
- an increase in cash flows from changes in operating assets and liabilities of \$176.7 million. This increase was driven by changes in income taxes, accrued compensation, and accounts payable, partially offset by cash flows related to inventories; and
- changes in adjusting items of \$22.7 million primarily related to an increase in depreciation and amortization, stock-based compensation, and higher cash inflows related to derivatives not designated in a hedging relationship, partially offset by changes in deferred income taxes.

### **Investing Activities**

The decrease in cash used in investing activities was primarily due to the acquisition of MIRROR, net of cash acquired for \$452.6 million during 2020. This was partially offset by an increase in capital expenditures.

Capital expenditures for our company-operated stores segment were \$189.6 million and \$134.2 million in 2021 and 2020, 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 capital expenditures for our company-operated stores segment also included \$47.1 million to open 56 company-operated stores and \$41.0 million to open 40 company-operated stores, in 2021 and 2020 respectively. We expect to open approximately 70 new company-operated stores in 2022.

Capital expenditures for our direct to consumer segment were \$81.7 million and \$37.2 million in 2021 and 2020, respectively. The capital expenditures in 2021 were primarily related to our distribution centers as well as other technology infrastructure and system initiatives.

Capital expenditures related to corporate activities and other were \$123.2 million and \$57.8 million in 2021 and 2020, respectively. The capital expenditures in each fiscal year were primarily related to investments in technology and business systems, and for capital expenditures related to opening retail locations other than company-operated stores. The increase in capital expenditures for our corporate activities and other was partially due to more larger scale projects, this was partially offset by a continued shift to cloud computing in 2021. Implementation costs related to cloud service arrangements are recognized within other non-current assets in the consolidated balance sheets and the associated cash flows are included in operating activities.

### **Financing Activities**

The increase in cash used in financing activities was primarily the result of an increase in our stock repurchases. During 2021, 2.2 million shares were repurchased at a cost of \$812.6 million. During 2020, 0.4 million shares were repurchased at a cost of \$63.7 million. 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.

### **Liquidity Outlook**

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 expenditures out of our cash and cash equivalents and cash generated from operations.

The following table includes certain measures of our liquidity:

	January 30, 2022
	<i>(In thousands)</i>
Cash and cash equivalents	\$ 1,259,871
Working capital excluding cash and cash equivalents <sup>(1)</sup>	(50,352)
Capacity under committed revolving credit facility	396,976

(1) Working capital is calculated as current assets of \$2.6 billion less current liabilities of \$1.4 billion.

Capital expenditures are expected to range between \$600.0 million and \$625.0 million in fiscal 2022.

Our current commitments with respect to inventory purchases are included within our purchase obligations outlined below. The timing and cost of our inventory purchases will vary depending on a variety of factors such as revenue growth, assortment and purchasing decisions, product costs including freight and duty, and the availability of production capacity and speed. Our inventory balance as at January 30, 2022 was \$966.5 million, an increase of 49% from January 31, 2021. Increased air freight usage and cost has contributed to the increase in inventory. On a number of units basis, our inventory increased 33% compared to January 31, 2021. We expect that our inventory balance will continue to grow in fiscal 2022 and we expect the growth rate will exceed net revenue growth in fiscal 2022.

Our existing North America credit facility provides for \$400.0 million in commitments under an unsecured five-year revolving credit facility. The credit facility has a maturity date of December 14, 2026, subject to extension under certain circumstances. As of January 30, 2022, aside from letters of credit of \$3.0 million, we had no other borrowings outstanding under this credit facility. Further information regarding our credit facilities and associated covenants is outlined in Note 11. Revolving Credit Facilities included in Item 8 of Part II of this report.

### 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 30, 2022.

*One-time transition tax payable.* The U.S. tax reforms enacted in December 2017 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 one-time transition tax payable is net of foreign tax credits, and 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 30, 2022, and the timing and effect that such commitments are expected to have on our liquidity and cash flows in future periods:

	Total	2022	2023	2024	2025	2026	Thereafter
<i>(In thousands)</i>							
Operating leases (minimum rent)	\$ 944,809	\$ 210,956	\$ 199,274	\$ 177,606	\$ 117,844	\$ 72,586	\$ 166,543
Purchase obligations	993,480	945,092	10,199	17,829	4,698	—	15,662
One-time transition tax payable	43,150	5,076	9,518	12,691	15,865	—	—
Deferred consideration	24,306	24,298	8	—	—	—	—

As of January 30, 2022, our operating lease commitments for distribution center operating leases which have been signed, but not yet commenced, was \$379.7 million, which is not reflected in the table above.

We enter into standby letters of credit to secure certain of our obligations, including leases, taxes, and duties. As of January 30, 2022, letters of credit and letters of guarantee totaling \$4.4 million had been issued, including \$3.0 million under our committed revolving credit facility.

### **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 significant 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 of January 30, 2022 the net carrying value of our inventories was \$966.5 million, which included provisions for obsolete and damaged inventory of \$35.7 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, or more frequently if events or circumstances indicate it is more likely than not that an impairment may have occurred.

We have allocated \$362.5 million of goodwill to the MIRROR reporting unit. As of November 1, 2021, we performed a quantitative impairment analysis of the MIRROR reporting unit and concluded that the fair value of the MIRROR reporting unit exceeded its carrying value, and no impairment has been recognized.

We used a discounted cash flow model to estimate the fair value, supplemented by market analysis, which indicated the fair value of MIRROR was at least 18% higher than its carrying value. The key assumptions of the fair value of the MIRROR reporting unit are the revenue growth rates, operating profit margins, and the discount rate. Our ability to generate expected cashflows is dependent on several factors including, but not limited to, trends in the Connected Fitness industry and the desire to exercise at home, our ability to attract new subscribers to grow the community, and to maintain a loyal subscriber base. The fair value of MIRROR is also dependent on the ability of MIRROR to leverage fixed costs and therefore achieve long term profitability. Declining cashflow trends compared to forecast, or other internal or external indicators, could cause us to conclude that impairment indicators exist, and goodwill may be impaired.

#### ***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 structured as a return of capital, rather than as a dividend, and would not be subject to Canadian withholding tax.

As of January 30, 2022, the paid-up-capital balance of the Canadian subsidiaries for tax purposes was \$2.0 billion. The net investment in our Canadian subsidiaries was \$2.5 billion, of which \$1.1 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 \$3.8 million have been recognized in relation to the portion of our net investment in our Canadian subsidiaries that is not indefinitely reinvested, 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 \$3.2 million.

In future periods, if the net investment in our Canadian subsidiaries exceeds their paid-up-capital balance, whether due to the accumulation of profits by these subsidiaries or due to a change in the amount that is indefinitely reinvested, we will record additional deferred tax liabilities for Canadian withholding taxes and our effective tax rate will increase. Absent any changes to paid-up-capital of our Canadian subsidiaries, or permanent re-investment amounts, we expect the effective tax rate to increase in fiscal 2022.

### **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 international 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 international 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 currency exchange differences which arise on translation of our international subsidiaries' balance sheets into U.S. dollars are recorded as other comprehensive income (loss), net of tax in accumulated other comprehensive income or loss within stockholders' equity.

We also have exposure to changes in foreign currency 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 foreign currency 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 30, 2022, 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 currency 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 currency 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
  - net investment hedge losses from derivative valuation losses on forward currency contracts, entered into as net investment hedges of a Canadian subsidiary.

During 2021, the change in the relative value of the U.S. dollar against the Canadian dollar resulted in a \$3.4 million increase in accumulated other comprehensive loss within stockholders' equity. 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.

A 10% appreciation in the relative value of the U.S. dollar against the Canadian dollar compared to the foreign currency exchange rates in effect for 2021 would have resulted in lower income from operations of approximately \$16.2 million in 2021. This assumes a consistent 10% appreciation in the U.S. dollar against the Canadian dollar over 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 currency 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 30, 2022, aside from letters of credit of \$3.0 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, and short-term deposits 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 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. During 2021 our product margin was impacted by higher air freight costs compared to 2020 as a result of global supply chain disruption. Sustained air freight cost increases or other inflationary pressures 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, or we cannot identify cost efficiencies.