

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](#)
- [Financial Highlights and Market Conditions and Trends](#)
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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 2022 and 2021 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://corporate.lululemon.com/investors>), the social media channels identified on our investor relations website, press releases, SEC filings, public conference calls, and webcasts.

Overview

In 2019 we announced our Power of Three growth plan which established our goal to double our total net revenue by 2023 and outlined our plans to double men's revenue, double digital net revenue, and to quadruple international net revenue. We achieved our goal to double our total net revenue ahead of schedule, and in 2022 we launched our new 5-year growth plan, the Power of Three x2.

Our Power of Three x2 plan leverages the success of our prior growth strategy, and is comprised of three key pillars – Product Innovation, Guest Experience, and Market Expansion. We continue to see opportunity to grow our men's, direct to consumer, and international net revenue, while continuing to grow our core businesses.

2022 was the inaugural year of our new plan and we successfully executed against our goals by delivering 30% net revenue growth. Our strength was balanced across channel, region, and merchandise category; and was achieved in a challenging macroeconomic backdrop with ongoing supply chain disruptions. The underlying trends that have fueled our business continue to do so, and include a desire for guests to live an active and healthy lifestyle, the desire for apparel that offers versatility, the desire to be part of a diverse and inclusive community, and the desire to achieve wellness, both physically and mentally.

Product Innovation

We continue to solve for the unmet needs of our guest by bringing new technical innovations into our merchandise assortment. In 2022, we expanded our core running category with the launch of Senseknit, a proprietary fabric technology offering zoned compression. We entered new activities with our capsule collections for golf, tennis, and hiking. And we launched footwear, enabling us to provide a head-to-toe solution to our guests. The footwear collection currently includes three technical styles – Blissfeel, Chargefeel, and Strongfeel – all designed specifically for women. In addition, we launched a dual gender slide for pre- and post-workouts.

Guest Experience and Membership

Our omni operating model allows us to efficiently and effectively serve our guests in the ways most convenient to them – either in store or online. We saw strength across both channels in 2022 as net revenue in our company-operated store channel increased 29% and our direct to consumer net revenue increased 33%.

Community is at the core of our brand. In 2022, we continued to engage with guests via in-store events, 10K runs in Atlanta and Houston, ambassador-led activations, and our Summer Sweat Games in China Mainland, among other in-person events. In addition, we connect with our community of guests through our connected fitness content provided by lululemon Studio.

In October 2022, we launched our new two-tier membership program. The Essential membership tier is free and provides access to select content, as well as certain benefits in-store and online. We rebranded MIRROR to become lululemon Studio, the premium paid tier of the program which offers members a connected fitness experience via in-home hardware. As part of our membership launch, we also enhanced the lululemon Studio offering to include access to exclusive content provided by outside studio partners, as well as a discount on lululemon product purchases.

As concerns with the COVID-19 pandemic have subsided the connected fitness industry has experienced challenging market conditions, and as a result we have seen weakening demand for our in-home fitness hardware. Hardware unit sales did not meet our expectations during the peak holiday selling period and the reduction in customer acquisition costs was less than anticipated. As a result, in the fourth quarter, we reviewed our strategy and we plan to evolve lululemon Studio to focus on digital app-based services. Building on the two-tier membership program, we will be expanding the lululemon Studio premium tier by enabling guests to access digital fitness content via a new app, launching in summer 2023, for a lower monthly fee. We believe this strategy will enable more guests to experience our digital fitness content, while also building a larger community of guests with a deeper connection to lululemon.

In 2022 we recognized post-tax charges totaling \$442.7 million related to lululemon Studio, including the impairment of goodwill, intangible assets, and property and equipment, and provisions against hardware inventory. See the section "Critical Accounting Policies and Estimates", Goodwill Impairment Assessment below and Note 8. Impairment of Goodwill and Other Assets included in Item 8 of Part II of this report for further information.

Market Expansion

We continued to expand our presence both in North America and in our international markets. During 2022, we opened 81 net new company-operated stores, including 31 stores in the PRC, nine stores in the rest of Asia Pacific, 32 stores in North America, and nine stores in Europe, including our first locations in Spain.

In 2022, our net revenue in North America increased 29%. In our international markets, despite certain COVID-19 closures in the PRC, we saw net revenue growth of 35%.

Financial Highlights

The summary below compares 2022 to 2021 and provides both GAAP and non-GAAP financial measures. The adjusted financial measures for 2022 exclude \$442.7 million of post-tax impairment and other charges recognized in relation to our lululemon Studio business unit (formerly MIRROR) and the post-tax net gain on the sale of an administrative building of \$8.5 million. The adjusted financial measures for 2021 exclude acquisition-related expenses, and their related tax effects.

- Net revenue increased 30% to \$8.1 billion. On a constant dollar basis, net revenue increased 32%.
- Total comparable sales increased 25%, or 28% on a constant dollar basis.
 - Comparable store sales increased 16%, or 19% on a constant dollar basis.
 - Direct to consumer net revenue increased 33%, or 35% on a constant dollar basis.
- Gross profit increased 24% to \$4.5 billion. Adjusted gross profit increased 26% to \$4.6 billion.
- Gross margin decreased 230 basis points to 55.4%. Adjusted gross margin decreased 150 basis points to 56.2%.
- Income from operations was consistent at \$1.3 billion. Adjusted income from operations increased 30% to \$1.8 billion.

- Operating margin decreased 490 basis points to 16.4%. Adjusted operating margin increased 10 basis points to 22.1%.
- Income tax expense increased 33% to \$477.8 million. Our effective tax rate for 2022 was 35.9% compared to 26.9% for 2021. The adjusted effective tax rate was 28.1% and 26.2% for 2022 and 2021, respectively.
- Diluted earnings per share were \$6.68 for 2022 compared to \$7.49 in 2021. Adjusted diluted earnings per share were \$10.07 for 2022 compared to \$7.79 in 2021.

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 the above adjusted non-GAAP financial measures and the most directly comparable measures calculated in accordance with GAAP.

Market Conditions and Trends

Macroeconomic conditions, the recent COVID-19 pandemic, and supply chain disruption impacted our business and operating costs in 2022 and 2021. Certain trends are expected to continue into 2023, with the impact varying by market.

Macroeconomic Conditions

Macroeconomic conditions, including foreign currency fluctuations, inflationary pressures, and labor shortages have impacted our financial results. This includes higher air freight costs during the first half of 2022 and increased wage rates during 2022 compared to 2021. We have not increased the retail prices on the significant proportion of our products. Inflation, an anticipated economic downturn, and other macroeconomic factors could also impact consumer purchasing behaviors and sustained increases in costs may have an adverse effect on our operating margins.

COVID-19 Pandemic

Most of our retail locations were open throughout 2022 and 2021, with certain locations temporarily closed due to COVID-19 resurgences, including certain closures during 2022 in the PRC.

Supply chain disruption

In 2021 and 2022 we experienced supply chain disruption, including delays in inbound delivery of our products as well as in manufacturing. This supply chain disruption caused us to use higher cost modes of transport, including increasing our use of air freight. The supply chain disruption we have experienced has contributed to the 50% increase in our inventory balance as of January 29, 2023 compared to January 30, 2022. We expect that while the growth rate in our inventories will exceed net revenue growth in the first half of 2023, the growth rate will be relatively in line with net revenue growth in the second half of 2023.

The use of air freight reduced our gross margin during the first half of 2022, however, we began seeing an improvement in the supply chain issues and experienced lower inbound freight costs in the second half of 2022, and this resulted in an overall improvement to our gross margin from air freight costs for 2022 compared to 2021. We expect that we will similarly see improvements in our gross margin from air freight costs in the first half of 2023 compared to the prior year when there was the supply chain disruption.

Results of Operations

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

	2022	2021	2022	2021
	<i>(In thousands)</i>		<i>(Percentage of revenue)</i>	
Net revenue	\$ 8,110,518	\$ 6,256,617	100.0 %	100.0 %
Cost of goods sold	3,618,178	2,648,052	44.6	42.3
Gross profit	4,492,340	3,608,565	55.4	57.7
Selling, general and administrative expenses	2,757,447	2,225,034	34.0	35.6
Amortization of intangible assets	8,752	8,782	0.1	0.1
Impairment of goodwill and other assets	407,913	—	5.0	—
Acquisition-related expenses	—	41,394	—	0.7
Gain on disposal of assets	(10,180)	—	(0.1)	—
Income from operations	1,328,408	1,333,355	16.4	21.3
Other income (expense), net	4,163	514	0.1	—
Income before income tax expense	1,332,571	1,333,869	16.4	21.3
Income tax expense	477,771	358,547	5.9	5.7
Net income	\$ 854,800	\$ 975,322	10.5 %	15.6 %

Comparison of 2022 to 2021

Net Revenue

Net revenue increased \$1.9 billion, or 30%, to \$8.1 billion in 2022 from \$6.3 billion in 2021. On a constant dollar basis, assuming the average foreign currency exchange rates in 2022 remained constant with the average foreign currency exchange rates in 2021, net revenue increased \$2.0 billion, or 32%.

The increase in net revenue was primarily due to increased direct to consumer net revenue, as well as due to company-operated store net revenue, including from new company-operated stores and increased comparable store sales. Other net revenue also increased.

Total comparable sales, which includes comparable store sales and direct to consumer, increased 25% in fiscal 2022 compared to fiscal 2021. Total comparable sales increased 28% on a constant dollar basis.

Net revenue for 2022 and 2021 is summarized below.

	2022	2021	2022	2021	Year over year change	
	<i>(In thousands)</i>		<i>(Percentage of revenue)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Company-operated stores	\$ 3,648,127	\$ 2,821,497	45.0 %	45.1 %	\$ 826,630	29.3 %
Direct to consumer	3,699,791	2,777,944	45.6	44.4	921,847	33.2
Other	762,600	657,176	9.4	10.5	105,424	16.0
Net revenue	\$ 8,110,518	\$ 6,256,617	100.0 %	100.0 %	\$ 1,853,901	29.6 %

Company-Operated Stores. The increase in net revenue from our company-operated stores was driven by net revenue from company-operated stores that were opened or significantly expanded since 2021 which contributed \$435.9 million to the increase. During 2022, we opened 81 net new company-operated stores, including 40 stores in Asia Pacific, 32 stores in North America, and nine stores in Europe. The increase in net revenue from our company-operated stores was also driven by increased comparable store sales. Comparable store sales increased 16%, or 19% on a constant dollar basis. The increase in comparable store sales was primarily a result of increased store traffic, partially offset by a decrease in conversion rates. Dollar value per transaction was consistent year over year.

Direct to Consumer. Direct to consumer net revenue increased 33%, or 35% on a constant dollar basis. The increase in net revenue from our direct to consumer segment was primarily a result of increased traffic, partially offset by a decrease in conversion rates and a lower dollar value per transaction.

Other. The increase in other net revenue was primarily due to increased outlet sales, sales to wholesale accounts, license and supply arrangement revenue, recommerce revenue, and revenue from our pop up locations. The increase in net revenue was partially offset by a decrease in net revenue from lululemon Studio.

Gross Profit

	2022	2021	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Gross profit	\$ 4,492,340	\$ 3,608,565	\$ 883,775	24.5 %
Gross margin	55.4 %	57.7 %	(230) basis points	

Our updated lululemon Studio strategy will focus on digital app based services and means we no longer expect to be able to sell all of the in-home hardware inventory above cost. We recognized a provision of \$62.9 million against hardware inventory during the fourth quarter of 2022. This reduced 2022 gross margin by 80 basis points. Please refer to Note 8. Impairment of Goodwill and Other Assets included in Item 8 of Part II of this report.

The remaining 150 basis point decrease in gross margin was primarily the result of:

- a decrease in product margin of 100 basis points primarily due to higher markdowns, sales mix, and increased damages and shrink, partially offset by lower air freight costs;
- an increase in costs related to our product departments and distribution centers as a percentage of net revenue of 60 basis points; and
- an unfavorable impact of foreign currency exchange rates of 40 basis points.

The decrease in gross margin was partially offset by leverage on occupancy and depreciation costs of 50 basis points, driven primarily by the increase in net revenue.

Selling, General and Administrative Expenses

	2022	2021	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Selling, general and administrative expenses	\$ 2,757,447	\$ 2,225,034	\$ 532,413	23.9 %
Selling, general and administrative expenses as a percentage of net revenue	34.0 %	35.6 %	(160) basis points	

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

- an increase in head office costs of \$283.7 million, comprised of:
 - an increase in costs of \$142.2 million primarily due to increased depreciation of \$43.5 million and increased technology costs, including cloud computing amortization, of \$35.7 million, as well as increased brand and community costs and professional fees; and
 - an increase in employee costs of \$141.5 million primarily due to an increase in salaries and wages expense of \$76.5 million and incentive compensation of \$34.8 million, as well as increased stock-based compensation expense and travel costs, primarily as a result of headcount growth and increased wage rates.
- an increase in costs related to our operating channels of \$249.5 million, comprised of:
 - an increase in variable costs of \$127.6 million primarily due to an increase in distribution costs and credit card fees, primarily as a result of increased net revenue;
 - an increase in employee costs of \$104.2 million primarily due to an increase in salaries and wages expense and incentive compensation in our company-operated store and direct to consumer channels, primarily due to growth in our business and increased wage rates;
 - an increase in other costs of \$15.3 million primarily due to an increase in repairs and maintenance costs, depreciation, and technology costs, partially offset by a decrease in professional fees; and

- an increase in brand and community costs of \$2.4 million primarily due to an increase in digital marketing expenses related to our direct to consumer channel, partially offset by a decrease in marketing expenses related to lululemon Studio.

The increase in selling, general and administrative expenses was partially offset by a decrease in net foreign exchange and derivative revaluation losses of \$0.8 million.

Amortization of Intangible Assets

	2022	2021	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Amortization of intangible assets	\$ 8,752	\$ 8,782	\$ (30)	(0.3)%

The amortization of intangible assets was primarily the result of the amortization of intangible assets recognized upon the acquisition of MIRROR.

Impairment of Goodwill and Other Assets

	2022	2021	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Impairment of goodwill and other assets	\$ 407,913	\$ —	\$ 407,913	n/a

During the fourth quarter of 2022, we recognized an impairment of goodwill and other long-lived assets in relation to our lululemon Studio business unit (formerly MIRROR). Please refer to the Critical Accounting Policies and Estimates section of this Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as Note 8. Impairment of Goodwill and Other Assets included in Item 8 of Part II of this report for further information.

Acquisition-Related Expenses

	2022	2021	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Acquisition-related expenses	\$ —	\$ 41,394	\$ (41,394)	(100.0)%

In connection with our acquisition of MIRROR, we recognized acquisition-related compensation expenses of \$38.4 million and transaction and integration related costs of \$3.0 million in 2021. There were no acquisition-related expenses in 2022. Please refer to Note 9. Acquisition-Related Expenses included in Item 8 of Part II of this report for further information.

Gain on Disposal of Assets

	2022	2021	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands)</i>	<i>(Percentage)</i>
Gain on disposal of assets	\$ (10,180)	\$ —	\$ (10,180)	n/a

During the second quarter of 2022, we completed the sale of an administrative office building, which resulted in a pre-tax gain of \$10.2 million.

Income from Operations

On a segment basis, we determine income from operations without taking into account our general corporate expenses and certain other expenses. Segmented income from operations is summarized below.

	2022	2021	2022	2021	Year over year change	
	(In thousands)		(Percentage of net revenue of respective operating segment)		(In thousands)	(Percentage)
Segmented income from operations:						
Company-operated stores	\$ 991,067	\$ 727,735	27.2 %	25.8 %	\$ 263,332	36.2 %
Direct to consumer	1,562,538	1,216,496	42.2	43.8	346,042	28.4
Other	107,083	77,283	14.0	11.8	29,800	38.6
	\$ 2,660,688	\$ 2,021,514			\$ 639,174	31.6 %
General corporate expenses	862,867	637,983			224,884	35.2
lululemon Studio obsolescence provision	62,928	—			62,928	n/a
Amortization of intangible assets	8,752	8,782			(30)	(0.3)
Impairment of goodwill and other assets	407,913	—			407,913	n/a
Acquisition-related expenses	—	41,394			(41,394)	(100.0)
Gain on disposal of assets	(10,180)	—			(10,180)	n/a
Income from operations	\$ 1,328,408	\$ 1,333,355			\$ (4,947)	(0.4)%
Operating margin	16.4 %	21.3 %			(490) basis points	

Company-Operated Stores. The increase in income from operations from company-operated stores was primarily the result of increased gross profit of \$413.7 million, driven by increased net revenue. The increase in gross profit was partially offset by an increase in selling, general and administrative expenses, primarily due to higher salaries and wages expense and higher incentive compensation as a result of the growth in our business and increased wage rates. Store operating costs increased, primarily due to increases in credit card fees and distribution costs as a result of higher net revenue, as well as increased repairs and maintenance. Income from operations as a percentage of company-operated stores net revenue increased due to 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 \$527.9 million, driven by increased net revenue, partially offset by lower gross margin. The decrease in gross margin was primarily due to higher markdowns, sales mix, deleverage on distribution center and product team costs, and unfavorable foreign exchange, partially offset by lower air freight costs. The increase in gross profit was partially offset by an increase in selling, general and administrative expenses primarily due to higher 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 decreased primarily due to a decrease in gross margin, partially offset by leverage on selling, general and administrative expenses.

Other. The increase in income from operations was primarily the result of a reduction in lululemon Studio marketing expenses and increased operating profit from our other lululemon retail operations. Increased net revenue from outlets, sales to wholesale accounts, license and supply arrangements, recommerce, and pop up locations resulted in increased gross profit. This was partially offset by a decrease in net revenue from lululemon Studio. Selling, general, and administrative expenses decreased due to lower lululemon Studio marketing costs, partially offset by higher people costs as a result of growth in our other lululemon retail locations. Income from operations as a percentage of other net revenue increased primarily due to leverage on selling, general and administrative expenses, partially offset by lower gross margin.

General Corporate Expenses. The increase in general corporate expenses was primarily due to increased employee costs, primarily from headcount growth and increased wage rates, as well as increased depreciation, technology costs including cloud computing amortization, brand and community costs, and professional fees. The increase in general corporate expenses was partially offset by a decrease in net foreign exchange and derivative losses of \$0.8 million. 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

	2022	2021	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands) (Percentage)</i>	
Other income (expense), net	\$ 4,163	\$ 514	\$ 3,649	709.9 %

The increase in other income, net was primarily due to an increase in interest income from higher interest rates, partially offset by an increase in other expenses.

Income Tax Expense

	2022	2021	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands) (Percentage)</i>	
Income tax expense	\$ 477,771	\$ 358,547	\$ 119,224	33.3 %
Effective tax rate	35.9 %	26.9 %	900 basis points	

The increase in the effective tax rate was primarily due to certain non-deductible expenses related to the impairment of goodwill and other assets recognized in relation to our lululemon Studio business unit (formerly MIRROR) partially offset by the gain on sale of an administrative building in 2022 which increased the effective tax rate by 780 basis points. Certain non-deductible expenses related to the MIRROR acquisition increased the effective tax rate by 70 basis points in 2021. The increase in the effective tax rate was also due to the accrual of U.S. state tax and Canadian withholding taxes on unremitted earnings which are not considered to be permanently reinvested, adjustments upon filing of certain income tax returns, and a decrease in deductions for stock-based compensation, partially offset by a decrease in non-deductible expenses in international jurisdictions.

Excluding the impairment of goodwill and other assets recognized in relation to our lululemon Studio business unit and the gain on sale of an administrative building in 2022, and the MIRROR acquisition-related expenses in 2021, and their tax effects, our adjusted effective tax rates were 28.1% and 26.2% for 2022 and 2021, respectively.

Net Income

	2022	2021	Year over year change	
	<i>(In thousands)</i>		<i>(In thousands) (Percentage)</i>	
Net income	\$ 854,800	\$ 975,322	\$ (120,522)	(12.4)%

The decrease in net income in 2022 was primarily due to an increase in selling, general and administrative expenses of \$532.4 million, an impairment charge recognized in 2022 of \$407.9 million, an increase in income tax expense of \$119.2 million, partially offset by an increase in gross profit of \$883.8 million, a decrease in acquisition-related expenses of \$41.4 million, a gain on disposal of assets of \$10.2 million, and an increase in other income (expense), net of \$3.6 million. Excluding the impairment of goodwill and other assets in relation to our lululemon Studio business unit (formerly MIRROR) and the gain on sale of an administrative building in 2022, and the MIRROR acquisition-related expenses in 2021, and their tax effects, adjusted net income increased \$273.7 million or 27.0%.

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.

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, total comparable sales, comparable store sales, 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.

Adjusted gross profit, gross margin, income from operations, operating margin, income tax expense, effective tax rates, net income, and diluted earnings per share exclude the impairment of goodwill and other assets recognized in relation to our lululemon Studio business unit (formerly MIRROR), the gain on disposal of assets for the sale of an administrative office building, the MIRROR acquisition-related expenses, and the related income tax effects of these items. We believe these adjusted financial measures are useful to investors as they provide supplemental information that enable evaluation of the underlying trend in our operating performance, and enable a comparison to our historical financial information. Further, due to the finite and discrete nature of these items, we do not consider them to be normal operating expenses that are necessary to operate the business, or impairments or disposal gains that are expected to arise in the normal course of our operations.

Management uses these adjusted financial measures and constant currency metrics internally when reviewing and assessing financial performance.

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

Constant Dollar Changes in Net Revenue

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

	2022		
	Net Revenue		Direct to Consumer Net Revenue
	<i>(In thousands)</i>	<i>(Percentages)</i>	<i>(Percentages)</i>
Change	\$ 1,853,901	30 %	33 %
Adjustments due to foreign currency exchange rate changes	147,728	2	2
Change in constant dollars	\$ 2,001,629	32 %	35 %

Constant Dollar Changes in Total Comparable Sales, Comparable Store Sales, and Direct to Consumer Net Revenue

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

	2022		
	Total Comparable Sales ^{1,2}	Comparable Store Sales ²	Direct to Consumer Net Revenue
Change	25 %	16 %	33 %
Adjustments due to foreign currency exchange rate changes	3 %	3	2
Change in constant dollars	28 %	19 %	35 %

⁽¹⁾ Total comparable sales includes comparable store sales and direct to consumer net revenue.

⁽²⁾ Comparable store sales reflects net revenue from company-operated stores that have been open for at least 12 full fiscal months, or open for at least 12 full fiscal months after being significantly expanded.

Adjusted financial measures

The following tables reconcile adjusted financial measures with the most directly comparable measures calculated in accordance with GAAP. The 2022 adjustments relate to the impairment of goodwill and other assets in relation to our lululemon Studio business unit (formerly MIRROR) and the gain on sale of an administrative office building, and their related tax effects. The 2021 adjustments relate to MIRROR acquisition-related expenses, and their related tax effects. Please refer to Note 5. Property and Equipment, Note 8. Impairment of Goodwill and Other Assets, and Note 9. Acquisition-Related Expenses included in Item 8 of Part II of this report for further information on the nature of these amounts.

	2022							
	Gross Profit	Gross Margin	Income from Operations	Operating Margin	Income Tax Expense	Effective Tax Rate	Net Income	Diluted Earnings Per Share
<i>(In thousands, except per share amounts)</i>								
GAAP results	\$ 4,492,340	55.4 %	\$ 1,328,408	16.4 %	\$ 477,771	35.9 %	\$ 854,800	\$ 6.68
lululemon Studio charges:								
Obsolescence provision	62,928	0.8	62,928	0.8			62,928	0.49
Impairment of goodwill			362,492	4.4			362,492	2.83
Impairment of intangible assets			40,585	0.5			40,585	0.32
Impairment of property and equipment			4,836	0.1			4,836	0.04
Gain on disposal of assets			(10,180)	(0.1)			(10,180)	(0.08)
Tax effect of the above					26,510	(7.8)	(26,510)	(0.21)
Adjusted results (non-GAAP)	\$ 4,555,268	56.2 %	\$ 1,789,069	22.1 %	\$ 504,281	28.1 %	\$ 1,288,951	\$ 10.07

	Fourth Quarter 2022
<i>(In thousands)</i>	
Income from operations	\$ 314,426
lululemon Studio related charges:	
Obsolescence provision	62,928
Impairment of goodwill	362,492
Impairment of intangible assets	40,585
Impairment of property and equipment	4,836
Adjusted income from operations (non-GAAP)	\$ 785,267

	2021					
	Income from Operations	Operating Margin	Income Tax Expense	Effective Tax Rate	Net Income	Diluted Earnings Per Share
<i>(In thousands, except per share amounts)</i>						
GAAP results	\$ 1,333,355	21.3 %	\$ 358,547	26.9 %	\$ 975,322	\$ 7.49
Transaction and integration costs	2,989	—			2,989	0.02
Acquisition-related compensation	38,405	0.7			38,405	0.29
Tax effect of the above			1,417	(0.7)	(1,417)	(0.01)
Adjusted results (non-GAAP)	\$ 1,374,749	22.0 %	\$ 359,964	26.2 %	\$ 1,015,299	\$ 7.79

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:

	2022	2021	Year over year change
	<i>(In thousands)</i>		
Total cash provided by (used in):			
Operating activities	\$ 966,463	\$ 1,389,108	\$ (422,645)
Investing activities	(569,937)	(427,891)	(142,046)
Financing activities	(467,487)	(844,987)	377,500
Effect of foreign currency exchange rate changes on cash and cash equivalents	(34,043)	(6,876)	(27,167)
Increase (decrease) in cash and cash equivalents	\$ (105,004)	\$ 109,354	\$ (214,358)

Operating Activities

The decrease in cash provided by operating activities was primarily as a result of a decrease in cash flows from changes in operating assets and liabilities of \$726.1 million. This decrease was primarily driven by changes in accounts payable, inventories, and income taxes. The decrease in cash provided by operating activities was also due to lower cash inflows related to derivatives not designated in a hedging relationship.

The decrease in cash provided by operating activities was partially offset by an increase in depreciation and stock-based compensation expense.

Investing Activities

The increase in cash used in investing activities was primarily due to increased capital expenditures, partially offset by the settlement of net investment hedges and other investing activities. The increase in capital expenditures was primarily due to corporate expenditures and from our company-operated stores segment.

Capital expenditures for our company-operated stores segment were \$303.7 million and \$189.6 million in 2022 and 2021, respectively. The capital expenditures for our company-operated stores segment in each period were primarily for opening new company-operated stores, for the remodeling or relocation of certain stores, ongoing store refurbishment, and increased investment in our new and existing distribution facilities. The capital expenditures for our company-operated stores segment also included \$78.9 million to open 87 company-operated stores and \$47.1 million to open 56 company-operated stores, in 2022 and 2021 respectively. We expect to open 45 to 50 new company-operated stores in 2023.

Capital expenditures for our direct to consumer segment were \$57.1 million and \$81.7 million in 2022 and 2021, respectively. Capital expenditures in 2022 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 \$277.9 million and \$123.2 million in 2022 and 2021, respectively. The increase in capital expenditures in each fiscal year was primarily due to investments in technology and business systems, and for increased capital expenditures on corporate office renovations. The proceeds of the sale of an administrative office building during the second quarter of 2022 are included in other investing activities.

Financing Activities

The decrease in cash used in financing activities was primarily the result of a decrease in our stock repurchases. During 2022, 1.4 million shares were repurchased at a total cost including commissions and excise taxes of \$444.0 million. During 2021, 2.2 million shares were repurchased at a total cost including commissions of \$812.6 million. The 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 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 29, 2023
	<i>(In thousands)</i>
Cash and cash equivalents	\$ 1,154,867
Working capital excluding cash and cash equivalents ⁽¹⁾	512,388
Capacity under committed revolving credit facility	393,480

(1) Working capital is calculated as current assets of \$3.2 billion less current liabilities of \$1.5 billion.

Capital expenditures are expected to range between \$660.0 million and \$680.0 million in 2023.

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 of January 29, 2023 was \$1.4 billion, an increase of 50% from January 30, 2022. Increased air freight usage and cost have contributed to the increase in inventory. On a number of units basis, our inventory increased 58% compared to January 30, 2022. We expect that while the growth rate in our inventories will exceed net revenue growth in the first half of 2023, the growth rate will be relatively in line with net revenue growth in the second half of 2023.

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 29, 2023, aside from letters of credit of \$6.5 million, we had no other borrowings outstanding under this credit facility. Further information regarding our credit facilities and associated covenants is outlined in Note 12. 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 two and 15 years, and generally can be extended in increments between two and five years, 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 29, 2023.

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.

The following table summarizes our contractual arrangements due by fiscal year as of January 29, 2023, and the timing and effect that such commitments are expected to have on our liquidity and cash flows in future periods:

	Total	2023	2024	2025	2026	2027	Thereafter
	<i>(In thousands)</i>						
Operating leases (minimum rent)	\$1,174,024	\$ 238,343	\$ 265,787	\$ 197,934	\$ 143,603	\$ 117,639	\$ 210,718
Purchase obligations	884,382	841,341	15,843	3,430	5,184	2,930	15,654
One-time transition tax payable	38,073	9,518	12,691	15,864	—	—	—

As of January 29, 2023, our operating lease commitments for distribution center operating leases which have been committed to, but not yet commenced, was \$632.0 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 29, 2023, letters of credit and letters of guarantee totaling \$8.6 million had been issued, including \$6.5 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 Accounting Policies included in Item 8 of Part II for additional information:

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 acquired Curiouser Products Inc., dba "MIRROR" in 2020, subsequently re-branded "lululemon Studio," and \$362.5 million of goodwill was allocated to the lululemon Studio reporting unit.

We performed a quantitative impairment analysis on October 31, 2022 for the lululemon Studio reporting unit. The result of this annual test concluded that the fair value of the lululemon Studio reporting unit exceeded its carrying value. We used a discounted cash flow model to estimate the fair value, supplemented by market analysis, which indicated the fair value of lululemon Studio was approximately 4% higher than its carrying value. The key assumptions of the fair value of the lululemon Studio reporting unit as of October 31, 2022 were the revenue growth rates, operating profit margins, and the discount rate. The test indicated that failure to increase the growth rate of new subscribers in the near term, or failure to reduce customer acquisition costs, or other internal or external factors could cause a material impairment of goodwill.

Sales of hardware units did not meet our fourth quarter expectations and the reduction in customer acquisition costs was less than anticipated, and therefore our short and long term forecasts for lululemon Studio were revised downwards with an adverse impact on future expected cash flows. As a result, we reviewed our strategy and we plan to evolve lululemon Studio to focus on digital app-based services.

We determined the lower than forecasted subscriber growth, and the shift in strategy, were triggering events which indicated we should conduct an impairment test as of January 29, 2023. We used a discounted cash flow model to estimate the fair value of the lululemon Studio reporting unit based on our updated strategic plans, supplemented by market comparable analysis. This led to the recognition of an impairment of goodwill of \$362.5 million. The key assumptions in estimating the fair value of the lululemon Studio reporting unit were the revenue growth rates, operating profit margins, and the discount rate. The fair value of the lululemon Studio reporting unit is a Level 3 fair value measurement.

Finite-lived intangible asset impairment assessment

As of January 29, 2023, the performance of lululemon Studio in the fourth quarter of 2022 and our change in strategy were also triggering events which indicated we should test the related intangible assets for impairment. The undiscounted cash flows of the asset group to which the intangible assets belong were less than their carrying value, and therefore we calculated the fair value of the asset group, which was also less than its carrying value. This resulted in an impairment of \$40.6

million, relating to the MIRROR brand, which is associated with in-home hardware and to the customer relationship intangible assets that were recognized as part of the acquisition. The carrying value of individual long-lived assets was not reduced to lower than their fair value. The fair values of the brand and the customer relationships were based on a relief from royalty method and a discounted cash flow model respectively, and are Level 3 fair value measurements.

The relief from royalty method is dependent on certain key estimates, including forecast hardware and hardware subscriber revenues, the royalty rate, and the discount rate.

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 29, 2023 the net carrying value of our inventories was \$1.4 billion, which included provisions for obsolete and damaged inventory of \$123.2 million. The provision is determined based upon assumptions about product quality, damages, future demand, selling prices, and market conditions, and includes a provision of \$62.9 million against lululemon Studio hardware inventory.

Our change in strategy related to lululemon Studio means we no longer expect to be able to sell all of the hardware inventory above cost. The net realizable value of the lululemon Studio inventory was determined based on hardware sales forecasts and assumptions regarding liquidation value. If we do not achieve our sales forecasts, have to sell the hardware at prices lower than our forecasts, or are unable to liquidate excess inventory and the prices we anticipate, this could reduce the net realizable value of this inventory below our estimate and we would increase our provision in the period in which we made such a determination.

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 is 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 made as a return of capital, rather than as a dividend, and therefore would not be subject to Canadian withholding tax.

As of January 29, 2023, the net investment in our Canadian subsidiaries was \$2.4 billion, of which \$1.3 billion was determined to be indefinitely reinvested. The paid-up-capital balance of the Canadian subsidiaries was \$740.6 million.

We have recognized a deferred tax liability of \$20.2 million as of January 29, 2023 which represents the Canadian withholding taxes payable on the portion of our Canadian earnings that are not indefinitely reinvested and cannot be repatriated as a return of capital, and U.S. state income taxes payable upon repatriation of the amounts which are not indefinitely reinvested.

In future periods, if the net investment in our Canadian subsidiaries continues to grow, 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, including both Canadian withholding taxes for the amount in excess of the paid-up capital balance and U.S. state income taxes, and our effective tax rate will increase. Absent any changes to the permanently reinvested amounts, or the paid-up-capital of our Canadian subsidiaries, we expect the effective tax rate to increase in 2023, where we will accrue Canadian withholding taxes and U.S. state income taxes for profits generated in our Canadian subsidiaries.

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 29, 2023, 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 16. 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 strengthening of the U.S. dollar against the Canadian dollar results in:

- the following impacts to the consolidated statements of operations:
 - a decrease in our net revenue upon translation of the sales made by our Canadian operations into U.S. dollars for the purposes of consolidation;
 - a decrease in our selling, general and administrative expenses incurred by our Canadian operations upon translation into U.S. dollars for the purposes of consolidation;
 - foreign currency exchange revaluation gains by our Canadian subsidiaries on U.S. dollar denominated monetary assets and liabilities; and
 - derivative valuation losses on forward currency contracts not designated in a hedging relationship;
- the following impacts to the consolidated balance sheets:
 - a decrease in the foreign currency translation adjustment which arises on the translation of our Canadian subsidiaries' balance sheets into U.S. dollars; and
 - net investment hedge losses from derivative valuation losses on forward currency contracts, entered into as net investment hedges of a Canadian subsidiary.

During 2022, the change in the relative value of the U.S. dollar against the Canadian dollar resulted in a \$54.5 million increase in accumulated other comprehensive loss within stockholders' equity. 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.

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 2022 would have resulted in lower income from operations of approximately \$30.9 million in 2022. 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 29, 2023, aside from letters of credit of \$6.5 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 investment grade 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, as well as overhead costs and capital expenditures may adversely affect our operating results. During 2021 and the first half of 2022, our operating margin was impacted by higher air freight costs compared to fiscal 2021 and 2020 as a result of global supply chain disruption, as well as increased wage rates. Sustained increases in transportation costs, wages, and raw material costs, or other inflationary pressures in the future may have an adverse effect on our ability to maintain current levels of operating margin if the selling prices of our products do not increase with these increased costs, or we cannot identify cost efficiencies.