

Research Report

Lululemon Athletic Inc.

Nurture Enduring Wealth, Embrace Insightful Change

2024/12/04

Reporter: Amber



Executive Summary

Objective

- The purpose of the research is to evaluate Lululemon Athletica Inc.'s (LULU) promotional strategies and product innovation trends ahead of its 3Q 2024 earnings report. It aims to assess the effectiveness of discounting practices, new product launches, and their potential impact on consumer engagement, revenue growth, and holiday season performance, providing insights to guide investment decisions and gauge the company's market positioning.

Scope

The research focuses on Lululemon Athletica Inc. (LULU), specifically analyzing the following aspects:

- Data:
 - Promotability trends, including discount breadth and depth, and targeted promotions such as membership discounts.
 - Newness metrics, tracking the proportion of new products relative to total offerings.
 - Financial performance indicators like revenue, EBITDA, EPS, and valuation metrics (P/E, EV/EBITDA, etc.).
- Period Covered:
 - Historical data from earlier quarters in 2024.
 - Projections for financial performance spanning 2024 to 2027.
 - Specific focus on trends leading up to the 3Q 2024 earnings, which are scheduled for release on December 5, 2024.
- Market:
 - Global operations of Lululemon, with particular emphasis on key markets like North America and China.
 - The broader athletic apparel and accessories market.

Key Findings

- **Improved Promotional Management:**

Lululemon has effectively controlled its promotional activities in 2024. The breadth and depth of discounts on its website have decreased year-over-year, reflecting stronger management of promotionality. While there was a slight uptick in recent weeks, overall discounting remains below prior-year levels.

- **Positive Momentum in New Product Offerings:**

The proportion of new products in Lululemon's catalog has shown positive year-over-year growth in the third quarter of 2024. This uptick in "newness" is expected to enhance consumer engagement during the holiday season, although the levels are still below historical peaks.

- **Strong Financial Outlook with Steady Growth:**

Lululemon's financial projections indicate sustained growth, with revenue expected to rise from \$9.6 billion in 2024 to \$12.4 billion in 2027. EPS is forecasted to grow steadily during this period, accompanied by declining valuation multiples, signaling long-term business stability and robust financial health.

Market Overview

Context

The research specifically focuses on the **premium athletic apparel and accessories industry**, with Lululemon Athletica Inc. as the primary case study. It delves into the company's performance and strategic positioning in key markets such as North America and China. This industry caters to consumers who value both functionality and fashion, covering product categories like yoga wear, running gear, training apparel, and accessories. The study highlights Lululemon's competitive advantages in the high-end market, including its strong brand positioning, product innovation (e.g., increased proportion of new product launches), and strategies for optimizing promotional activities through online platforms like the "We Made Too Much" section. These elements are key drivers of its growth in the athletic apparel sector.

Trends

1. Key Market Trends:

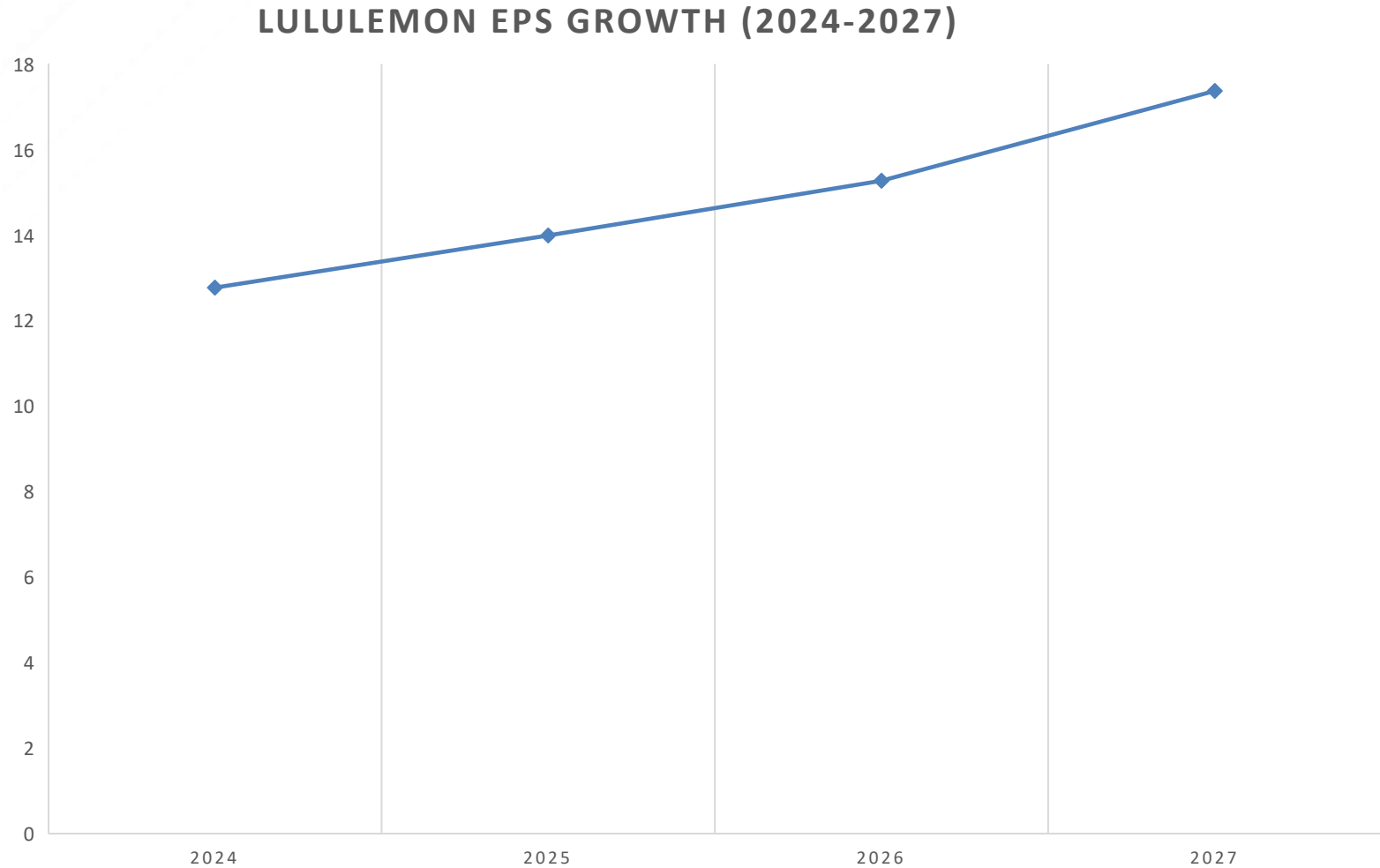
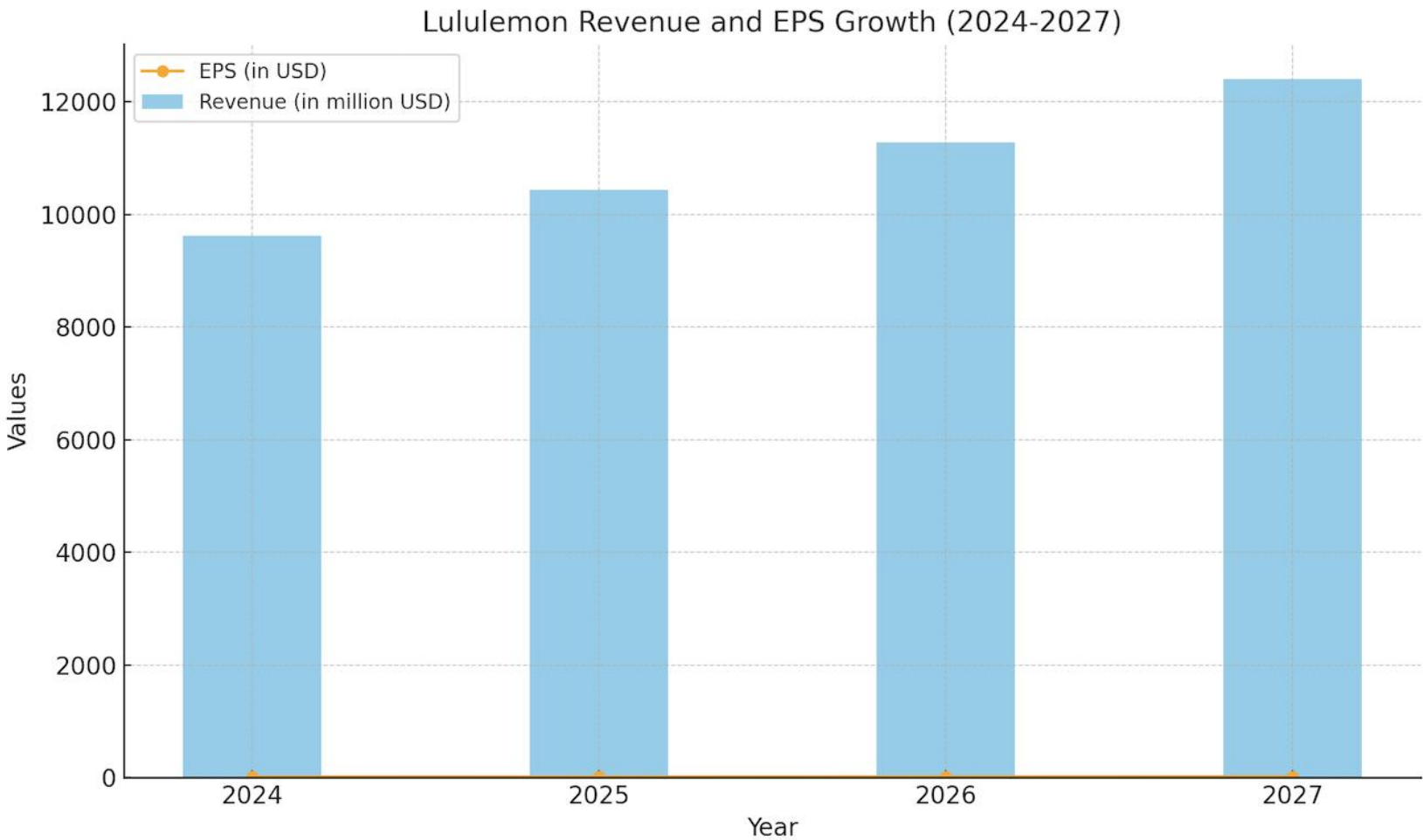
- 1. Controlled Promotional Activity:** Lululemon has improved its promotionality management in 2024, reducing the breadth and depth of discounts compared to the prior year. The company strategically uses targeted promotions, such as member-specific discounts, to maintain engagement without heavily relying on broad markdowns.
- 2. Increased New Product Introduction:** The ratio of new products to total offerings has grown year-over-year in Q3 2024, indicating a focus on innovation to drive consumer interest and sales momentum during peak seasons like the holidays.

2. Macroeconomic Conditions:

- 1. Resilience Amid Challenges:** While macroeconomic headwinds such as inflation and changing consumer spending patterns affect discretionary spending, Lululemon's premium positioning and targeted marketing strategies help mitigate risks.
- 2. Regional Growth Opportunities:** The report hints at growth opportunities in international markets like China, where Lululemon's momentum continues, driven by an expanding middle class and growing health consciousness.

3. Sector-Specific Data:

- 1. Revenue Projections:** Lululemon’s revenue is expected to grow from \$9.6 billion in 2024 to \$12.4 billion by 2027, representing consistent growth within the athletic apparel sector.
- 2. EPS Growth:** Earnings per share (EPS) are projected to rise steadily from \$12.77 in 2024 to \$17.37 in 2027, reflecting strong operational efficiency.
- 3. Market Positioning:** The company maintains a competitive edge through a focus on premium product offerings, limited discounting, and enhanced customer loyalty strategies.



Takeaway

Financial Forecast

1. Lululemon's revenue is projected to grow steadily from \$9.6 billion in 2024 to \$12.4 billion in 2027, achieving a compound annual growth rate (CAGR) of approximately 8.9%.
2. The company's gross margin is expected to remain stable between 58.4% and 58.6%, reflecting strong pricing power and effective cost management.
3. EBIT margins are forecasted to stay consistent at approximately 23%, indicating sustained operational efficiency.
4. Free cash flow (FCF) is anticipated to range from \$1.29 billion in 2025 to \$1.76 billion in 2027, despite rising capital expenditures, showcasing the company's robust cash generation ability.
5. The current stock price is \$320.66, but analysts have set a 12-month price target of \$291.00, implying a 9.2% downside due to market risks and valuation adjustments.
6. Despite strong financial performance, the cautious stock rating highlights concerns over macroeconomic challenges and competitive pressures in the athletic apparel industry.

Risk Management

Market Risks:

- **Economic Downturns:** Slowing global economic growth or inflationary pressures may reduce discretionary spending, impacting demand for premium athletic apparel.
- **Industry Saturation:** High competition in the athletic apparel sector, particularly in North America, could limit market share expansion and revenue growth.
- **Consumer Preferences:** Shifts in consumer trends or preferences toward lower-priced competitors could erode Lululemon's premium market positioning.

Operational Risks:

- **Inventory Management:** Inefficient inventory control could lead to overstocking, markdowns, and higher costs, affecting profit margins.
- **Supply Chain Disruptions:** Dependence on global suppliers exposes the company to risks like production delays, rising material costs, or geopolitical tensions.
- **International Expansion:** Challenges in penetrating new markets, such as regulatory barriers or cultural misalignment, may hinder growth.

Credit and Financial Risks:

- **Valuation Pressure:** High valuation multiples could make the stock vulnerable to market corrections, especially during periods of broader equity market volatility.
- **Currency Fluctuations:** As Lululemon expands internationally, adverse currency exchange rate movements may impact revenue and profitability.

Reputational Risks:

- **Brand Perception:** Any issues related to product quality, labor practices, or sustainability could harm the company's reputation and consumer trust.
- **Social and Ethical Issues:** Misalignment with evolving societal values (e.g., diversity, sustainability) could lead to negative public sentiment.

Technological Risks:

- **E-commerce Dependence:** Increasing reliance on digital platforms makes the company vulnerable to cybersecurity threats, data breaches, or IT system failures.
- **Innovation Competition:** Failing to keep pace with competitors in product innovation could lead to a loss of market relevance.

Your Idea

Core Strategy Alignment:

- Reduced promotional dependency, increased product innovation, and stable profit margins align well with current market demands.
- Positions Lululemon for sustained growth in the premium athletic apparel sector.

Opportunities for Expansion:

- Diversify into fast-growing markets such as Southeast Asia or the Middle East to reduce reliance on North America and China.

Sustainability Initiatives:

- Adopt recycled materials and eco-friendly production methods to appeal to environmentally conscious consumers.
- Strengthen brand image through enhanced sustainability efforts.

Digital Innovation:

- Invest in e-commerce tools like virtual fitting rooms and AI-driven personalized shopping experiences to improve customer engagement.
- Explore wearable technology that integrates fitness tracking with apparel for a competitive edge.

Community Building:

- Host yoga sessions, fitness events, and collaborate with influencers to enhance customer loyalty and drive organic growth.

Operational Excellence:

- Focus on inventory management and supply chain diversification to mitigate risks and maintain profitability.

Long-Term Benefits:

- These strategies would solidify Lululemon's market leadership and support sustained growth.