

lululemon athletica inc.
Form 10-Q
December 09, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended November 1, 2015

or

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

For the transition period from _____ to _____

Commission file number 001-33608

lululemon athletica inc.
(Exact name of registrant as specified in its charter)

Delaware	20-3842867
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1818 Cornwall Avenue	V6J 1C7
Vancouver, British Columbia	(Zip Code)
(Address of principal executive offices)	

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer <input checked="" type="radio"/>	Accelerated filer <input type="radio"/>
Non-accelerated filer <input type="radio"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="radio"/>

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

At December 3, 2015, there were 128,749,784 shares of the registrant's common stock, par value \$0.005 per share, outstanding.

Exchangeable and Special Voting Shares:

At December 3, 2015, there were outstanding 9,803,819 exchangeable shares of Lulu Canadian Holding, Inc., a wholly-owned subsidiary of the registrant. Exchangeable shares are exchangeable for an equal number of shares of the registrant's common stock.

In addition, at December 3, 2015, the registrant had outstanding 9,803,819 shares of special voting stock, through which the holders of exchangeable shares of Lulu Canadian Holding, Inc. may exercise their voting rights with respect to the registrant. The special voting stock and the registrant's common stock generally vote together as a single class on all matters on which the common stock is entitled to vote.

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PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

lululemon athletica inc.

CONSOLIDATED BALANCE SHEETS

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

	November 1, 2015	February 1, 2015
ASSETS		
Current assets		
Cash and cash equivalents	\$403,446	\$664,479
Accounts receivable	12,463	13,746
Inventories	357,753	208,116
Prepaid income taxes	124,776	40,547
Other prepaid expenses and other current assets	30,066	24,124
	928,504	951,012
Property and equipment, net	346,705	296,008
Goodwill and intangible assets, net	25,407	26,163
Deferred income tax assets	10,759	16,018
Other non-current assets	10,184	7,012
	\$1,321,559	\$1,296,213
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$5,845	\$9,339
Accrued inventory liabilities	40,250	22,296
Accrued compensation and related expenses	44,074	29,932
Income taxes payable	46,829	20,073
Unredeemed gift card liability	35,123	46,252
Other accrued liabilities	36,207	31,989
	208,328	159,881
Deferred income tax liabilities	3,524	3,633
Other non-current liabilities	49,748	43,131
	261,600	206,645
Stockholders' equity		
Undesignated preferred stock, \$0.01 par value, 5,000 shares authorized, none issued and outstanding	—	—
Exchangeable stock, no par value, 60,000 shares authorized, issued and outstanding 9,804 and 9,833	—	—
Special voting stock, \$0.000005 par value, 60,000 shares authorized, issued and outstanding 9,804 and 9,833	—	—
Common stock, \$0.005 par value, 400,000 shares authorized, issued and outstanding 129,581 and 132,112	648	661
Additional paid-in capital	246,814	241,695
Retained earnings	1,003,331	1,020,619
Accumulated other comprehensive loss	(190,834)	(173,407)
	1,059,959	1,089,568
	\$1,321,559	\$1,296,213

See accompanying notes to the unaudited interim consolidated financial statements

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CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

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

	Thirteen Weeks Ended November 1, 2015	Thirteen Weeks Ended November 2, 2014	Thirty-Nine Weeks Ended November 1, 2015	Thirty-Nine Weeks Ended November 2, 2014
Net revenue	\$479,693	\$419,396	\$1,356,247	\$1,194,722
Cost of goods sold	254,896	208,308	713,548	590,583
Gross profit	224,797	211,088	642,699	604,139
Selling, general and administrative expenses	156,619	129,932	439,906	385,294
Income from operations	68,178	81,156	202,793	218,845
Other income (expense), net	(2,890)	) 1,814	(1,519)	) 5,347
Income before income tax expense	65,288	82,970	201,274	224,192
Income tax expense	12,135	22,519	52,643	96,012
Net income	\$53,153	\$60,451	\$148,631	\$128,180
Other comprehensive loss:				
Foreign currency translation adjustment	(665)	) (29,256)	) (17,427)	) (13,202)
Comprehensive income	\$52,488	\$31,195	\$131,204	\$114,978
Basic earnings per share	\$0.38	\$0.42	\$1.05	\$0.89
Diluted earnings per share	\$0.38	\$0.42	\$1.05	\$0.88
Basic weighted-average number of shares outstanding	140,282	143,180	141,198	144,581
Diluted weighted-average number of shares outstanding	140,457	143,441	141,470	144,949

See accompanying notes to the unaudited interim consolidated financial statements

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited; Amounts in thousands)

	Exchangeable Stock		Special Voting Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Par Value	Shares	Par Value	Shares	Par Value				
Balance at February 1, 2015	9,833		9,833	\$—	132,112	\$661	\$241,695	\$1,020,619	\$ (173,407)	\$1,089,568
Net income								148,631		148,631
Foreign currency translation adjustment									(17,427)	(17,427)
Common stock issued upon exchange of exchangeable shares	(29)		(29)	—	29	—	—			—
Stock-based compensation expense							6,639			6,639
Excess tax benefit from stock-based compensation							666			666
Common stock issued upon settlement of stock-based compensation					336	2	4,438			4,440
Shares withheld related to net share settlement of stock-based compensation					(41)	—	(2,439)			(2,439)
Repurchase of common stock					(2,855)	(15)	(4,040)	(165,919)		(169,974)
Registration fees associated with prospectus supplement							(145)			(145)
	9,804		9,804	\$—	129,581	\$648	\$246,814	\$1,003,331	\$ (190,834)	\$1,059,959

Balance at
November 1,
2015

See accompanying notes to the unaudited interim consolidated financial statements

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited; Amounts in thousands)

	Thirty-Nine Weeks Ended November 1, 2015	Thirty-Nine Weeks Ended November 2, 2014	
Cash flows from operating activities			
Net income	\$ 148,631	\$ 128,180	
Items not affecting cash			
Depreciation and amortization	52,498	41,709	
Stock-based compensation expense	6,639	5,382	
Deferred income taxes	5,105	20,917	
Excess tax benefits from stock-based compensation	(666)	) (53)
Other, including net changes in other non-cash balances			
Prepaid income taxes	(83,564	) (18,054)
Other prepaid expenses and other current assets	(6,097	) (6,054)
Inventories	(151,317	) (44,595)
Accounts payable	(3,448	) (2,980)
Accrued inventory liabilities	18,415	27,222	
Other accrued liabilities	4,416	4,706	
Income taxes payable	27,166	2,347	
Accrued compensation and related expenses	14,448	13,815	
Other non-cash balances	(6,286	) (5,701)
Net cash provided by operating activities	25,940	166,841	
Cash flows from investing activities			
Purchase of property and equipment	(108,061	) (89,373)
Net cash used in investing activities	(108,061	) (89,373)
Cash flows from financing activities			
Proceeds from settlement of stock-based compensation	4,440	2,452	
Excess tax benefits from stock-based compensation	666	53	
Taxes paid related to net share settlement of equity awards	(2,439	) (4,020)
Repurchase of common stock	(169,974	) (130,266)
Registration fees associated with prospectus supplement	(145) —)
Net cash used in financing activities	(167,452	) (131,781)
Effect of exchange rate changes on cash and cash equivalents	(11,460	) (10,754)
Decrease in cash and cash equivalents	(261,033	) (65,067)
Cash and cash equivalents, beginning of period	664,479	698,649	
Cash and cash equivalents, end of period	\$ 403,446	\$ 633,582	
See accompanying notes to the unaudited interim consolidated financial statements			

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NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share and store count information, unless otherwise indicated)

NOTE 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of operations

lululemon athletica inc., a Delaware corporation ("lululemon" and, together with its subsidiaries unless the context otherwise requires, the "Company") is engaged in the design, distribution, and retail of healthy lifestyle inspired athletic apparel, which is sold through a chain of company-operated stores, direct to consumer through e-commerce, showrooms, a network of wholesale accounts, outlets and warehouse sales. The Company operates stores in the United States, Canada, Australia, New Zealand, the United Kingdom, Singapore, Hong Kong, Germany, and Puerto Rico. There were a total of 354 and 302 company-operated stores in operation as of November 1, 2015 and February 1, 2015, respectively.

Basis of presentation

The unaudited interim consolidated financial statements as of November 1, 2015 and for the thirteen and thirty-nine weeks ended November 1, 2015 and November 2, 2014 are presented in United States dollars and have been prepared by the Company under the rules and regulations of the Securities and Exchange Commission ("SEC"). The financial information is presented in accordance with United States generally accepted accounting principles ("GAAP") for interim financial information and, accordingly, does not include all of the information and footnotes required by GAAP for complete financial statements. The financial information as of February 1, 2015 is derived from the Company's audited consolidated financial statements and notes for the fiscal year ended February 1, 2015, included in Item 8 in the Company's fiscal 2014 Annual Report on Form 10-K filed with the SEC on March 26, 2015. These unaudited interim consolidated financial statements reflect all adjustments which are in the opinion of management necessary to a fair statement of the results for the interim periods presented. These unaudited interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's fiscal 2014 Annual Report on Form 10-K.

The Company's fiscal year ends on the Sunday closest to January 31 of the following year, typically resulting in a 52 week year, but occasionally giving rise to an additional week, resulting in a 53 week year. Fiscal 2015 will end on January 31, 2016 and will be a 52 week year.

The Company's business is affected by the pattern of seasonality common to most retail apparel businesses.

Historically, the Company has recognized a significant portion of its operating profit in the fourth fiscal quarter of each year as a result of increased sales during the holiday season.

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

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued ASC Topic 606, Revenue from Contracts with Customers ("ASC 606"), which supersedes the revenue recognition requirements in ASC Topic 605 Revenue Recognition, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. This guidance requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services, and expands the related disclosure requirements. In July 2015, the FASB deferred the effective date for public companies to years, and interim periods within those years, beginning after December 15, 2017, with early application permitted only as of years, and interim periods within those years, beginning after December 15, 2016. This guidance will be effective for the Company beginning in its first quarter of fiscal 2018. The Company is currently evaluating the timing of adoption and impact that this new guidance may have on its consolidated financial statements.

In June 2014, the FASB amended ASC Topic 718, Compensation - Stock Compensation ("ASC 718") for share-based payments in which the terms of the award provide that a performance target can be achieved after the requisite service

period. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. This guidance is effective for public companies for years, and interim periods within those years, beginning on or after December 15, 2015, and early application is permitted. This guidance will be effective for the Company beginning in its first quarter of fiscal 2016. The Company is currently evaluating the impact that this new guidance may have on its consolidated financial statements.

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In April 2015, the FASB amended ASC Subtopic 350-40, Intangibles - Goodwill and Other - Internal-Use Software ("ASC 350-40") to provide guidance to customers about whether a cloud computing arrangement includes a software license. This guidance requires that if a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. This guidance is effective for public companies for years, and interim periods within those years, beginning on or after December 15, 2015, and early application is permitted. This guidance will be effective for the Company beginning in its first quarter of fiscal 2016. The Company is currently evaluating the impact that this new guidance may have on its consolidated financial statements.

In July 2015, the FASB amended ASC Topic 330, Inventory ("ASC 330") to simplify the measurement of inventory. The amendments require that an entity measure inventory at the lower of cost and net realizable value instead of the lower of cost and market. This guidance is effective for public companies for years, and interim periods within those years, beginning on or after December 15, 2016, with earlier application permitted as of the beginning of an interim or annual reporting period. This guidance will be effective for the Company beginning in its first quarter of fiscal 2017. The Company is currently evaluating the impact that this new guidance may have on its consolidated financial statements.

NOTE 3. STOCK-BASED COMPENSATION**Stock-based compensation plans**

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

Stock-based compensation expense charged to income for the plans was \$6,639 and \$5,382 for the thirty-nine weeks ended November 1, 2015 and November 2, 2014, respectively. Total unrecognized compensation cost for all stock-based compensation plans was \$33,247 at November 1, 2015, which is expected to be recognized over a weighted-average period of 2.5 years.

Company stock options, performance-based restricted stock units, restricted shares and restricted stock units

A summary of the Company's stock option, performance-based restricted stock unit, restricted share and restricted stock unit activity as of November 1, 2015 and changes during the thirty-nine week period then ended is presented below:

	Stock Options		Performance-Based Restricted Stock Units		Restricted Shares		Restricted Stock Units	
	Number	Weighted-Average Exercise Price	Number	Weighted-Average Grant Date Fair Value	Number	Weighted-Average Grant Date Fair Value	Number	Weighted-Average Grant Date Fair Value
Balance at February 1, 2015	879	\$ 39.25	452	\$ 59.27	62	\$ 42.86	186	\$ 45.75
Granted	388	57.74	152	63.86	19	66.07	230	62.16
Exercised/vested	228	19.43	55	67.26	30	39.08	37	44.98
Forfeited	140	55.55	134	63.35	4	38.25	39	50.95
Balance at November 1, 2015	899	\$ 49.74	415	\$ 58.57	47	\$ 54.97	340	\$ 56.33
Exercisable at November 1, 2015	253	\$ 37.85						

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The fair value of each stock option granted is estimated on date of grant using the Black-Scholes model. The assumptions used to calculate the fair value of options granted are evaluated and revised, as necessary, to reflect market conditions and the Company's historical experience. The expected term of the options is based upon historical experience of similar awards, giving consideration for expectations of future employee behavior. Expected volatility is based upon the historical volatility of the Company's common stock for the period corresponding with the expected term of the options. The risk-free interest rate is based on the U.S. Treasury yield curve for the period corresponding with the expected term of the options. The following assumptions were used in calculating the fair value of stock options granted in fiscal 2015:

	Stock Options Granted During Fiscal 2015	
Expected term	4.0 years	
Expected volatility	42.73	%
Risk-free interest rate	0.98	%
Dividend yield	—	%

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

The fair value of the restricted shares and restricted stock units is based on the closing price of the Company's common stock on the award date.

Employee stock purchase plan

The Company's board of directors and stockholders approved the Company's Employee Share Purchase Plan ("ESPP") in September 2007. Contributions are made by eligible employees, subject to certain limits as defined in the ESPP, and the Company matches one-third of the contribution. The maximum number of shares available under the ESPP is 6,000 shares. During the thirteen weeks ended November 1, 2015, there were 29 shares purchased under the ESPP in the open market.

NOTE 4. EARNINGS PER SHARE

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

	Thirteen Weeks Ended November 1, 2015	Thirteen Weeks Ended November 2, 2014	Thirty-Nine Weeks Ended November 1, 2015	Thirty-Nine Weeks Ended November 2, 2014
Net income	\$53,153	\$60,451	\$148,631	\$128,180
Basic weighted-average number of shares outstanding	140,282	143,180	141,198	144,581
Assumed conversion of dilutive stock options and awards	175	261	272	368
Diluted weighted-average number of shares outstanding	140,457	143,441	141,470	144,949
Basic earnings per share	\$0.38	\$0.42	\$1.05	\$0.89
Diluted earnings per share	\$0.38	\$0.42	\$1.05	\$0.88

The Company's calculation of weighted-average shares includes the common stock of the Company as well as the exchangeable shares. Exchangeable shares are the equivalent of common shares in all material respects. All classes of stock have in effect the same rights and share equally in undistributed net income. For the thirty-nine weeks ended November 1, 2015 and November 2, 2014, 77 and 369 stock options and awards, respectively, were anti-dilutive to earnings per share and therefore have been excluded from the computation of diluted earnings per share.

On June 11, 2014, the Company's board of directors approved a program to repurchase shares of the Company's common stock up to an aggregate value of \$450,000. The common stock is to be repurchased in the open market at prevailing market prices, with the timing and actual number of shares to be repurchased depending upon market conditions and other factors. The repurchases may be made up until June 2016. During the thirty-nine weeks ended November 1, 2015 and November 2, 2014, 2,855 and 3,261 shares, respectively, were repurchased under the program at a total cost of \$169,974 and \$130,266, respectively. Subsequent to November 1, 2015, and up to December 3, 2015, 832 shares were repurchased at a total cost of \$40,817.

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NOTE 5. SUPPLEMENTARY FINANCIAL INFORMATION

A summary of certain balance sheet accounts is as follows:

	November 1, 2015	February 1, 2015
Inventories:		
Finished goods	\$364,079	\$214,113
Provision to reduce inventory to market value	(6,326)	) (5,997
	\$357,753	\$208,116
Property and equipment:		
Land	\$59,086	\$60,548
Buildings	32,226	29,099
Leasehold improvements	219,620	176,677
Furniture and fixtures	67,769	55,320
Computer hardware	43,774	35,457
Computer software	109,634	84,854
Equipment and vehicles	12,058	11,908
Accumulated depreciation	(197,462)	) (157,855
	\$346,705	\$296,008
Goodwill and intangible assets:		
Goodwill	\$25,496	\$25,496
Changes in foreign currency exchange rates	(1,252)	) (1,083
	24,244	24,413
Intangibles—reacquired franchise rights	10,150	10,150
Accumulated amortization	(8,879)	) (8,264
Changes in foreign currency exchange rates	(108)	) (136
	1,163	1,750
	\$25,407	\$26,163
Other accrued liabilities:		
Sales tax collected	\$9,833	\$8,579
Accrued rent	5,425	5,567
Other	20,949	17,843
	\$36,207	\$31,989
Other non-current liabilities:		
Deferred lease liability	\$25,149	\$20,837
Tenant inducements	24,599	22,294
	\$49,748	\$43,131

NOTE 6. LEGAL PROCEEDINGS

In addition to the legal matters described below, the Company is, from time to time, involved in routine legal matters incidental to the conduct of its business, including legal matters such as initiation and defense of proceedings to protect intellectual property rights, personal injury claims, product liability claims, and similar matters. The Company believes the ultimate resolution of any such current proceeding will not have a material adverse effect on its continued financial position, results of operations or cash flows.

On July 15, 2015, plaintiffs Hallandale Beach Police Officers and Firefighters' Personnel Retirement Fund and Laborers' District Council Industry Pension Fund filed in the Delaware Court of Chancery a derivative lawsuit on behalf of lululemon against certain current and former directors of lululemon, captioned Laborers' District Council Industry Pension Fund v. Bensoussan, et al., C.A. No. 11293-CB. This proceeding is discussed in the Company's Quarterly Report on Form 10-Q filed with the SEC on September 10, 2015. On August 18, 2015, the individual defendants (including Mr. Wilson) filed motions to

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dismiss the action pursuant to Court of Chancery Rules 23.1 and 12(b)(6) for failure to adequately plead that demand on the board was excused and for failure to state a claim upon which relief may be granted. Also on August 18, 2015, the Company filed a motion to dismiss the action pursuant to Court of Chancery Rule 23.1 for failure to adequately plead that demand on the board was excused.

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

NOTE 7. INCOME TAXES

During the third quarter of fiscal 2015, the Company recorded certain tax and related interest adjustments which resulted in a net income tax recovery of \$7,713 and a related net interest expense of \$3,606.

The components of the tax adjustments are as follows:

	Thirteen Weeks Ended November 1, 2015
Income tax expense, before tax adjustments	\$19,848
Advance Pricing Arrangement adjustments, net	(5,095)
Tax on foreign earnings expected to be repatriated	7,838
Tax adjustment on foreign tax credit calculations for fiscal 2014	(10,456)
Total tax adjustments	(7,713)
Income tax expense	\$12,135

A summary reconciliation of the effective tax rate is as follows:

	Thirteen Weeks Ended November 1, 2015		Thirteen Weeks Ended November 2, 2014		Thirty-Nine Weeks Ended November 1, 2015		Thirty-Nine Weeks Ended November 2, 2014	
Federal income tax at statutory rate	35.0	%	35.0	%	35.0	%	35.0	%
Foreign tax rate differentials, U.S. state taxes, and other	(6.2	)	(7.9	)	(5.5	)	(6.1)
Effective tax rate, excluding tax and related interest adjustments	28.8		27.1		29.5		28.9	
Advance Pricing Arrangement adjustments, net	(6.4	)	—		(2.0)	—	
Tax on foreign earnings expected to be repatriated	11.4		—		3.8		—	
Tax adjustment on foreign tax credit calculations for fiscal 2014	(15.2	)	—		(5.1	)	13.9	
Tax and related interest adjustments	(10.2	)	—		(3.3	)	13.9	
Effective tax rate	18.6	%	27.1	%	26.2	%	42.8	%

The tax and related interest adjustments impacted diluted earnings per share as follows:

Thirteen Weeks Ended November 1, 2015	Thirteen Weeks Ended November 2, 2014	Thirty-Nine Weeks Ended November 1, 2015	Thirty-Nine Weeks Ended November 2, 2014
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		2014		2014
Diluted earnings per share	\$0.38	\$0.42	\$1.05	\$0.88
Tax and related interest adjustments	(0.03) —	(0.03) 0.22
Diluted earnings per share, excluding tax and related interest adjustments	\$0.35	\$0.42	\$1.02	\$1.10

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Advance Pricing Arrangement adjustments, net

The Company evaluates its tax filing positions and for uncertain tax positions recognizes the largest amount of tax benefit that is considered more likely than not to be sustained upon examination by the relevant taxing authorities based on the technical merits of the position. This determination requires the use of significant judgment. Income tax expense is adjusted in the period in which the uncertain tax position is effectively settled, the statute of limitations expires, facts or circumstances change, tax laws change, or new information becomes available.

The Company's uncertain tax positions include the Company's inter-company transfer pricing policies and the allocation of income between tax jurisdictions. During the third quarter of fiscal 2015, the Company received new communications with respect to the bilateral Advance Pricing Arrangement ("APA") which the Company is in the process of finalizing with the Internal Revenue Service ("IRS") and the Canada Revenue Agency ("CRA"). This resulted in a reassessment of the expected probable outcome of the APA and the related estimates of the amount of tax payable in each jurisdiction, for fiscal 2011 through fiscal 2015.

The Company has determined that it is considered more likely than not that the outcome of the APA will result in a decrease in taxable income in the United States and an increase in taxable income in Canada. This change in the expected outcome of the APA also has an impact on the foreign tax credits relating to the dividends paid in fiscal 2014. These changes resulted in a net income tax recovery of \$5,095 during the third quarter of fiscal 2015. The Company has also recognized a related net interest expense of \$3,606 in other income (expense), net.

The Company anticipates that the APA will be finalized within the next twelve months. The Company's tax position will be updated as new information becomes available. Should the terms of the final APA differ to the Company's assessment of the most likely outcome, it is possible that the Company may record income tax adjustments of up to approximately \$10,000.

Tax on foreign earnings expected to be repatriated

The undistributed earnings of the foreign subsidiaries as of November 1, 2015 was approximately \$606,548.

As a result of the change in the expected outcome of the APA described above, it is now expected that a significant intercompany debt between one of the Company's U.S. subsidiaries and a Canadian subsidiary will arise upon the finalization of the APA, and that the ongoing net cash flow of the Company's U.S. operations will be lower than previously expected. As a result, the Company intends to distribute up to \$156,000 to the U.S. parent entity to finance the payment of this intercompany debt. As these foreign earnings are no longer considered indefinitely reinvested, the Company has recorded an incremental tax expense and deferred tax liability as of November 1, 2015 of \$7,838 to provide for U.S. income and applicable foreign withholding taxes on this expected distribution.

The remaining undistributed earnings of the foreign subsidiaries are indefinitely reinvested, and as a result, no provision has been made for the U.S. income or foreign withholding taxes which would be payable upon distribution of these earnings. In reaching the conclusion that the undistributed earnings of foreign subsidiaries are indefinitely reinvested, the Company considers its international expansion plans, projected working capital needs, projected head office capital investments, forecasted cash flow requirements within the United States, and other factors the Company believes are relevant.

Tax adjustment on foreign tax credit calculations for fiscal 2014

In fiscal 2014, the Company recorded a tax expense of \$33,746 representing the estimated U.S. income tax and foreign withholding tax payable on the repatriation of earnings in the form of dividends of \$473,700, which were distributed during fiscal 2014 by foreign subsidiaries to the U.S. parent entity to fund the share repurchase program. During the third quarter of fiscal 2015, the Company finalized the amount of U.S. income tax payable on these distributions and recognized an adjustment on the foreign tax credits that had been initially calculated for the prior year distributions, which resulted in the recognition of an income tax recovery of \$10,456 during the third quarter of fiscal 2015.

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NOTE 8. SEGMENT REPORTING

The Company applies ASC Topic 280, Segment Reporting ("ASC 280"), in determining reportable segments for its financial statement disclosure. The Company reports segments based on the financial information it uses in managing its business. The Company's reportable segments are comprised of company-operated stores and direct to consumer. Direct to consumer represents sales from the Company's e-commerce websites. Outlet sales, showroom sales, sales to wholesale accounts, warehouse sales, and sales from temporary locations have been combined into other. Information for these segments is detailed in the table below:

	Thirteen Weeks Ended November 1, 2015	Thirteen Weeks Ended November 2, 2014	Thirty-Nine Weeks Ended November 1, 2015	Thirty-Nine Weeks Ended November 2, 2014
Net revenue:				
Company-operated stores	\$353,399	\$310,014	\$1,007,272	\$892,156
Direct to consumer	89,330	77,203	255,205	206,658
Other	36,964	32,179	93,770	95,908
	\$479,693	\$419,396	\$1,356,247	\$1,194,722
Income from operations before general corporate expense:				
Company-operated stores	\$70,729	\$73,990	\$207,393	\$224,966
Direct to consumer	37,985	32,292	105,106	83,596
Other	1,569	3,279	4,370	9,507
	110,283	109,561	316,869	318,069
General corporate expense	42,105	28,405	114,076	99,224
Income from operations	68,178	81,156	202,793	218,845
Other (expense) income, net	(2,890)	) 1,814	(1,519)	) 5,347
Income before income tax expense	\$65,288	\$82,970	\$201,274	\$224,192
Capital expenditures:				
Company-operated stores	\$30,909	\$24,207	\$72,541	\$55,879
Direct to consumer	3,744	4,076	5,676	8,939
Corporate	8,290	8,988	29,844	24,555
	\$42,943	\$37,271	\$108,061	\$89,373
Depreciation and amortization:				
Company-operated stores	\$13,126	\$9,912	\$36,139	\$27,335
Direct to consumer	1,759	1,991	4,894	4,252
Corporate	4,822	3,710	11,465	10,122
	\$19,707	\$15,613	\$52,498	\$41,709

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Some of the statements contained in this Form 10-Q and any documents incorporated herein by reference constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included or incorporated in this Form 10-Q are forward-looking statements, particularly statements which relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts, such as statements regarding our future financial condition or results of operations, our prospects and strategies for future growth, the development and introduction of new products, and the implementation of our marketing and branding strategies. In many cases, you can identify forward-looking statements by terms such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "intends," "predicts," "potential" or the negative of these terms or other comparable terminology.

The forward-looking statements contained in this Form 10-Q and any documents incorporated herein by reference reflect our current views about future events and are subject to risks, uncertainties, assumptions and changes in circumstances that may cause events or our actual activities or results to differ significantly from those expressed in any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future events, results, actions, levels of activity, performance or achievements. Readers are cautioned not to place undue reliance on these forward-looking statements. A number of important factors could cause actual results to differ materially from those indicated by the forward-looking statements, including, but not limited to, those factors described in "Risk Factors" and elsewhere in this report.

The forward-looking statements contained in this Form 10-Q reflect our views and assumptions only as of the date of this Form 10-Q and are expressly qualified in their entirety by the cautionary statements included in this Form 10-Q. Except as required by applicable securities law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

This information should be read in conjunction with the unaudited interim consolidated financial statements and the notes included in Item 1 of Part I of this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes, and Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in our 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

lululemon is a designer, distributor, and retailer of technical athletic apparel. Since our inception, we have developed a distinctive corporate culture with a mission to produce products which create transformational experiences for people to live happy, healthy, fun lives. We promote a set of core values in our business which include, developing the highest quality products, operating with integrity, leading a balanced and fun life, and nurturing entrepreneurial spirit. These core values attract passionate and motivated employees who are driven to succeed and share our purpose of "elevating the world from mediocrity to greatness."

Our healthy lifestyle inspired athletic apparel is marketed under the lululemon athletica and ivivva athletica brand names. We offer a comprehensive line of apparel and accessories for women, men and female youth. Our apparel assortment includes items such as pants, shorts, tops and jackets designed for healthy lifestyle and athletic activities such as yoga, running, other sweaty pursuits, and dance-inspired apparel for female youth.

Financial Highlights

- Our net revenue increased from \$419.4 million in the third quarter of fiscal 2014 to \$479.7 million in the third quarter of fiscal 2015, representing a growth rate of 14%. This increase resulted primarily from the addition of 65 new company-operated stores since the third quarter of fiscal 2014, and increased direct to consumer net revenue.

• Total comparable sales, which includes comparable store sales and direct to consumer, increased 3% in the third quarter of fiscal 2015, and increased by 9% on a constant dollar basis.

Company-operated stores accounted for 73.7% of net revenue in the third quarter of fiscal 2015 compared to 73.9% of net revenue in the third quarter of fiscal 2014. Comparable store sales increased by 6% on a constant dollar basis for the third quarter of fiscal 2015 primarily as a result of increased traffic and increased dollar value per transaction.

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Our direct to consumer segment is an increasingly substantial part of our growth strategy, and represented 18.6% of our net revenue in the third quarter of fiscal 2015 compared to 18.4% in the third quarter of fiscal 2014. Direct to consumer net revenue increased 21% on a constant dollar basis primarily as the result of higher traffic and conversion rates on our e-commerce websites.

Gross profit for the third quarter of fiscal 2015 increased by 7% to \$224.8 million, from \$211.1 million in the third quarter of fiscal 2014. Gross profit as a percentage of net revenue, or gross margin, decreased to 46.9% compared to 50.3% in the third quarter of fiscal 2014. The decrease in gross margin was primarily due to increased product costs, increased fixed costs, including occupancy and depreciation, unfavorable foreign exchange rates, and increased markdowns and discounts.

Income from operations for the third quarter of fiscal 2015 decreased by 16% to \$68.2 million, from \$81.2 million in the third quarter of fiscal 2014. As a percentage of net revenue, income from operations decreased to 14.2% compared to 19.4% of net revenue in the third quarter of fiscal 2014.

The income tax expense for the third quarter of fiscal 2015 was \$12.1 million, which includes an income tax recovery of \$7.7 million related to the Company's transfer pricing arrangements and taxes associated with the repatriation of foreign earnings. In addition, there was a related net interest expense of \$3.6 million. The tax rate excluding these adjustments was 28.8% in the third quarter of fiscal 2015 compared to 27.1% in the third quarter of fiscal 2014. The effective tax rate in the third quarter of fiscal 2015 including these tax and related interest adjustments was 18.6%. Diluted earnings per share for the third quarter of fiscal 2015 were \$0.38 compared to \$0.42 in the third quarter of fiscal 2014. Excluding certain tax and related interest adjustments, diluted earnings per share were \$0.35 for the third quarter of fiscal 2015.

Refer to the non-GAAP reconciliation tables contained in the "Results of Operations" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations for reconciliations of constant dollar total comparable sales, constant dollar comparable store sales, constant dollar changes in direct to consumer net revenue, the effective tax rate excluding certain tax and related interest adjustments, and diluted earnings per share excluding certain tax adjustments to measures calculated in accordance with United States generally accepted accounting principles ("GAAP").

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Results of Operations

Thirteen Week Results

The following table summarizes key components of our results of operations for the thirteen weeks ended November 1, 2015 and November 2, 2014. The operating results are expressed in dollar amounts. The percentages are presented as a percentage of net revenue.

	Thirteen Weeks Ended November 1, 2015 and November 2, 2014					
	2015 (In thousands)	2014	2015 (Percentages)	2014		
Net revenue	\$479,693	\$419,396	100.0	% 100.0		%
Cost of goods sold	254,896	208,308	53.1	49.7		
Gross profit	224,797	211,088	46.9	50.3		
Selling, general and administrative expenses	156,619	129,932	32.7	30.9		
Income from operations	68,178	81,156	14.2	19.4		
Other income (expense), net	(2,890)	) 1,814	(0.6)	) 0.4		
Income before income tax expense	65,288	82,970	13.6	19.8		
Income tax expense	12,135	22,519	2.5	5.4		
Net income	\$53,153	\$60,451	11.1	% 14.4		%
Net Revenue						

Net revenue increased \$60.3 million, or 14%, to \$479.7 million for the third quarter of fiscal 2015 from \$419.4 million for the third quarter of fiscal 2014. Assuming the average exchange rates for the third quarter of fiscal 2015 remained constant with the average exchange rates for the third quarter of fiscal 2014, our net revenue would have increased \$85.0 million, or 20%.

The net revenue increase was driven primarily by sales from new company-operated stores and the growth of our direct to consumer segment. Total comparable sales, which includes comparable store sales and direct to consumer, increased 3% in the third quarter of fiscal 2015. Excluding the effect of foreign currency fluctuations, total comparable sales would have increased 9%.

Our net revenue on a segment basis for the thirteen weeks ended November 1, 2015 and November 2, 2014 is summarized below. Net revenue is expressed in dollar amounts. The percentages are presented as a percentage of total net revenue.

	Thirteen Weeks Ended November 1, 2015 and November 2, 2014					
	2015 (In thousands)	2014	2015 (Percentages)	2014		
Company-operated stores	\$353,399	\$310,014	73.7	% 73.9		%
Direct to consumer	89,330	77,203	18.6	18.4		
Other	36,964	32,179	7.7	7.7		
Net revenue	\$479,693	\$419,396	100.0	% 100.0		%

Company-operated Stores. Net revenue from our company-operated stores segment increased \$43.4 million, or 14%, to \$353.4 million in the third quarter of fiscal 2015 from \$310.0 million in the third quarter of fiscal 2014. The following contributed to the increase in net revenue from our company-operated stores segment:

Net revenue from company-operated stores we opened subsequent to November 2, 2014, and therefore not included in comparable store sales, contributed \$43.1 million to the increase. We have opened 65 new company-operated stores since the third quarter of fiscal 2014, including 51 stores in the United States, four stores in the United Kingdom, three stores in Canada, two stores in each of Hong Kong and Singapore, and one store in each of Australia, Germany, and Puerto Rico; and

▲ a comparable store sales increase of less than 1% in the third quarter of fiscal 2015 resulted in a \$0.3 million increase to net revenue, including the effect of foreign currency fluctuations. Excluding the effect of foreign currency

fluctuations,

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comparable store sales would have increased 6%, or \$16.2 million, in the third quarter of fiscal 2015. The increase in comparable store sales was primarily as a result of increased traffic and increased dollar value per transaction. Direct to Consumer. Net revenue from our direct to consumer segment increased \$12.1 million, or 16%, to \$89.3 million in the third quarter of fiscal 2015 from \$77.2 million in the third quarter of fiscal 2014. Excluding the effect of foreign exchange fluctuations, direct to consumer revenue would have increased 21%. The increase in net revenue was primarily the result of increased traffic and higher conversion rates on our e-commerce websites.

Other. Other net revenue increased \$4.8 million, or 15%, to \$37.0 million in the third quarter of fiscal 2015 from \$32.2 million in the third quarter of fiscal 2014. This increase was primarily the result of two warehouse sales held during the third quarter of fiscal 2015 and an increased number of outlets open during the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014.

Gross Profit

Gross profit increased \$13.7 million, or 7%, to \$224.8 million for the third quarter of fiscal 2015 from \$211.1 million for the third quarter of fiscal 2014.

Gross profit as a percentage of net revenue, or gross margin, decreased by 340 basis points, to 46.9% in the third quarter of fiscal 2015 from 50.3% in the third quarter of fiscal 2014. The decrease in gross margin was primarily the result of:

- a decrease in product margin of 130 basis points primarily due to increased product costs, partially offset by a decrease in air freight costs;
- an increase in fixed costs, including occupancy and depreciation, relative to the increase in net revenue, which contributed to a decrease in gross margin of 120 basis points. This was primarily due to higher store opening costs, international expansion, and renovations and relocations of existing locations;
- an unfavorable impact of foreign exchange rates on product costs which contributed to a decrease in gross margin of 90 basis points; and
- an increase in markdowns and discounts of 70 basis points.

The increase in gross margin was partially offset by a decrease in expenses related to our product and supply chain departments, relative to the increase in net revenue, of 70 basis points.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$26.7 million, or 21%, to \$156.6 million in the third quarter of fiscal 2015 from \$129.9 million in the third quarter of fiscal 2014. The increase in selling, general and administrative expenses was principally comprised of:

- an increase in head office costs of \$9.3 million primarily as a result of increased head office employee costs, professional fees, travel costs, and repairs and maintenance costs;
- an increase in employee costs of \$7.6 million primarily from a growth in bonuses and labor hours associated with new company-operated stores and showrooms;
- an increase in other costs, including depreciation, repairs and maintenance costs, and communication costs of \$4.4 million;
- an increase in net foreign exchange revaluation losses of \$3.4 million; and
- an increase in variable costs such as distribution costs, packaging, and credit card fees of \$2.9 million primarily as a result of increased sales volume from our direct to consumer segment as well as new company-operated stores.

The increase in selling, general and administrative expenses was partially offset by a decrease in administrative costs related to our direct to consumer segment of \$0.9 million.

As a percentage of net revenue, selling, general and administrative expenses increased 180 basis points, to 32.7% in the third quarter of fiscal 2015 from 30.9% in the third quarter of fiscal 2014.

Income from Operations

Income from operations decreased \$13.0 million, or 16%, to \$68.2 million in the third quarter of fiscal 2015 from \$81.2 million in the third quarter of fiscal 2014. The decrease was primarily the result of an increase in selling, general and administrative costs of \$26.7 million, partially offset by an increase in gross profit of \$13.7 million.

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

Income from operations before general corporate expenses for the thirteen weeks ended November 1, 2015 and November 2, 2014 is summarized below and is expressed in dollar amounts. The percentages are presented as a percentage of net revenue of the respective operating segments.

	Thirteen Weeks Ended November 1, 2015 and November 2, 2014				
	2015 (In thousands)	2014	2015 (Percentages)	2014	
Company-operated stores	\$70,729	\$73,990	20.0	% 23.9	%
Direct to consumer	37,985	32,292	42.5	41.8	
Other	1,569	3,279	4.2	10.2	
Income from operations before general corporate expense	110,283	109,561			
General corporate expense	42,105	28,405			
Income from operations	\$68,178	\$81,156			

Company-operated Stores. Income from operations from our company-operated stores segment decreased \$3.3 million, or 4%, to \$70.7 million for the third quarter of fiscal 2015 from \$74.0 million for the third quarter of fiscal 2014 primarily due to an increase in store employee costs as well as operating expenses associated with new stores, partially offset by increased gross profit of \$7.9 million. Income from operations as a percentage of company-operated stores revenue decreased by 390 basis points primarily due to lower gross margin and deleverage of selling, general and administrative expenses.

Direct to Consumer. Income from operations from our direct to consumer segment increased \$5.7 million, or 18%, to \$38.0 million for the third quarter of fiscal 2015 from \$32.3 million for the third quarter of fiscal 2014. The increase was primarily the result of increased gross profit of \$6.5 million primarily due to increased net revenue resulting from increased traffic and higher conversion rates on our e-commerce websites, partially offset by increased selling, general and administrative expenses. Income from operations as a percentage of direct to consumer revenue increased by 70 basis points.

Other. Other income from operations decreased \$1.7 million, or 52%, to \$1.6 million for the third quarter of fiscal 2015 from \$3.3 million for the third quarter of fiscal 2014. The decrease was primarily the result of increased selling, general and administrative expenses and decreased gross profit of \$0.6 million in the third quarter of fiscal 2015. Income from operations as a percentage of other net revenue decreased by 600 basis points primarily due to lower gross margin and due to an increased number of showrooms in new international markets which have a higher cost structure than North America.

General Corporate Expense. General corporate expense increased \$13.7 million, or 48%, to \$42.1 million for the third quarter of fiscal 2015 from \$28.4 million for the third quarter of fiscal 2014. This was primarily due to increased head office costs as a result of the overall growth of our business and investment in strategic initiatives and projects as well as an increase in net foreign exchange revaluation losses of \$3.4 million.

Other Income (Expense), Net

Other income (expense), net, decreased \$4.7 million, or 259%, to an expense of \$2.9 million for the third quarter of fiscal 2015 from income of \$1.8 million for the third quarter of fiscal 2014. The decrease was primarily due to a net interest expense of \$3.6 million related to certain tax adjustments that are outlined in Note 7 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report, as well as less interest earned on our decreased cash and cash equivalents balance compared to the third quarter of fiscal 2014.

Income Tax Expense

Income tax expense decreased \$10.4 million, or 46%, to \$12.1 million in the third quarter of fiscal 2015 from \$22.5 million in the third quarter of fiscal 2014. The third quarter of fiscal 2015 included certain tax adjustments totaling a recovery of \$7.7 million as outlined in Note 7 to the unaudited interim consolidated financial statements included in

Item 1 of Part I of this report. The effective tax rate excluding these tax adjustments and related interest was 28.8% in the third quarter of fiscal 2015 compared to 27.1% in the third quarter of fiscal 2014. The effective tax rate in the third quarter of fiscal 2015 including these tax adjustments was 18.6%.

Net Income

Net income decreased \$7.3 million to \$53.2 million for the third quarter of fiscal 2015 from \$60.5 million for the third quarter of fiscal 2014. The decrease in net income was primarily the result of an increase in selling, general and administrative

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expenses of \$26.7 million and a decrease in other income (expense), net of \$4.7 million, partially offset by an increase in gross profit of \$13.7 million and a decrease in income tax expense of \$10.4 million.

Thirty-Nine Week Results

The following table summarizes key components of our results of operations for the thirty-nine week periods ended November 1, 2015 and November 2, 2014. The operating results are expressed in dollar amounts. The percentages are presented as a percentage of net revenue.

	Thirty-Nine Weeks Ended November 1, 2015 and November 2, 2014					
	2015 (In thousands)	2014	2015 (Percentages)	2014		
Net revenue	\$1,356,247	\$1,194,722	100.0	% 100.0		%
Cost of goods sold	713,548	590,583	52.6	49.4		
Gross profit	642,699	604,139	47.4	50.6		
Selling, general and administrative expenses	439,906	385,294	32.4	32.2		
Income from operations	202,793	218,845	15.0	18.4		
Other income (expense), net	(1,519)	) 5,347	(0.1	) 0.4		
Income before income tax expense	201,274	224,192	14.9	18.8		
Income tax expense	52,643	96,012	3.9	8.1		
Net income	\$148,631	\$128,180	11.0	% 10.7		%
Net Revenue						

Net revenue increased \$161.5 million, or 14%, to \$1,356.2 million for the first three quarters of fiscal 2015 from \$1,194.7 million for the first three quarters of fiscal 2014. Assuming the average exchange rates for the first three quarters of fiscal 2015 remained constant with average exchange rates for the first three quarters of fiscal 2014, our net revenue would have increased \$222.1 million, or 19%.

The net revenue increase was driven by sales from new company-operated stores and the growth of our direct to consumer segment. Total comparable sales, which includes comparable store sales and direct to consumer, increased 4% in the first three quarters of fiscal 2015. Excluding the effect of foreign currency fluctuations, total comparable sales would have increased 9%.

Our net revenue on a segment basis for the thirty-nine week periods ended November 1, 2015 and November 2, 2014 is summarized below. Net revenue is expressed in dollar amounts. The percentages are presented as a percentage of total net revenue.

	Thirty-Nine Weeks Ended November 1, 2015 and November 2, 2014					
	2015 (In thousands)	2014	2015 (Percentages)	2014		
Company-operated stores	\$1,007,272	\$892,156	74.3	% 74.7		%
Direct to consumer	255,205	206,658	18.8	17.3		
Other	93,770	95,908	6.9	8.0		
Net revenue	\$1,356,247	\$1,194,722	100.0	% 100.0		%

Company-operated Stores. Net revenue from our company-operated stores segment increased \$115.1 million, or 13%, to \$1,007.3 million in the first three quarters of fiscal 2015 from \$892.2 million in the first three quarters of fiscal 2014. Net revenue from company-operated stores we opened subsequent to November 2, 2014, and therefore not included in comparable store sales, contributed \$125.6 million to the increase. We have opened 65 new company-operated stores since the third quarter of fiscal 2014, including 51 stores in the United States, four stores in the United Kingdom, three stores in Canada, two stores in each of Hong Kong and Singapore, and one store in each of Australia, Germany, and Puerto Rico. The increase in net revenue from our company-operated stores segment was offset by a comparable store sales decrease of 1% in the first three quarters of fiscal 2015, which resulted in a \$10.5 million decrease to net revenue, including the effect of foreign currency fluctuations. Excluding the effect of foreign

currency fluctuations, comparable store sales would have increased 4%, or \$28.0 million, in the first three quarters of fiscal 2015. The increase in comparable store sales, excluding the effect of foreign currency fluctuations, was primarily as a result of increased traffic and increased dollar value per transaction.

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Direct to Consumer. Net revenue from our direct to consumer segment increased \$48.5 million, or 23%, to \$255.2 million in the first three quarters of fiscal 2015 from \$206.7 million in the first three quarters of fiscal 2014. Excluding the effect of foreign exchange fluctuations, direct to consumer revenue would have increased 29%. The increase in net revenue was primarily the result of higher conversion rates and traffic on our e-commerce websites, partially offset by lower average order value.

Other. Other net revenue decreased \$2.1 million, or 2%, to \$93.8 million in the first three quarters of fiscal 2015 from \$95.9 million in the first three quarters of fiscal 2014. This decrease was primarily the result of fewer temporary locations being open during first three quarters of fiscal 2015 compared to the first three quarters of fiscal 2014.

Gross Profit

Gross profit increased \$38.6 million, or 6%, to \$642.7 million for the first three quarters of fiscal 2015 from \$604.1 million for the first three quarters of fiscal 2014.

Gross profit as a percentage of net revenue, or gross margin, decreased by 320 basis points, to 47.4% in the first three quarters of fiscal 2015 from 50.6% in the first three quarters of fiscal 2014. The decrease in gross margin was primarily the result of:

- an increase in fixed costs, including occupancy and depreciation, relative to the increase in net revenue, which contributed to a decrease in gross margin of 120 basis points. This was primarily due to higher store opening costs, international expansion, and renovations and relocations of existing locations;
- a decrease in product margin of 110 basis points primarily due to increased product and air freight costs;
- an unfavorable impact of foreign exchange rates on product costs which contributed to a decrease in gross margin of 80 basis points; and
- an increase in markdowns and discounts of 30 basis points.

The increase in gross margin was partially offset by a decrease in expenses related to our product and supply chain departments, relative to the increase in net revenue, of 20 basis points.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$54.6 million, or 14%, to \$439.9 million in the first three quarters of fiscal 2015 from \$385.3 million in the first three quarters of fiscal 2014. The increase in selling, general and administrative expenses was principally comprised of:

- an increase in employee costs of \$25.1 million primarily from a growth in bonuses and labor hours associated with new company-operated stores and showrooms;
 - an increase in head office costs of \$17.1 million primarily as a result of increased head office employee costs, professional fees, marketing costs, travel costs, and repairs and maintenance costs;
 - an increase in variable costs such as distribution costs, credit card fees, and packaging of \$7.1 million primarily as a result of new company-operated stores as well as increased sales volume from our direct to consumer segment; and
 - an increase in other costs, including repairs and maintenance costs, depreciation, and marketing costs of \$6.8 million.
- The increase in selling, general and administrative expenses was partially offset by a decrease in administrative costs related to our direct to consumer segment of \$0.9 million and an increase in net foreign exchange revaluation gains of \$0.6 million.

As a percentage of net revenue, selling, general and administrative expenses increased 20 basis points, to 32.4% in the first three quarters of fiscal 2015 from 32.2% in the first three quarters of fiscal 2014.

Income from Operations

Income from operations decreased \$16.1 million, or 7%, to \$202.8 million in the first three quarters of fiscal 2015 from \$218.8 million in the first three quarters of fiscal 2014. The decrease was primarily the result of an increase in selling, general and administrative costs of \$54.6 million, partially offset by increased gross profit of \$38.6 million.

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

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Income from operations before general corporate expenses for the thirty-nine week periods ended November 1, 2015 and November 2, 2014 is summarized below and is expressed in dollar amounts. The percentages are presented as a percentage of net revenue of the respective operating segments.

	Thirty-Nine Weeks Ended November 1, 2015 and November 2, 2014				
	2015 (In thousands)	2014	2015 (Percentages)	2014	
Company-operated stores	\$207,393	\$224,966	20.6	% 25.2	%
Direct to consumer	105,106	83,596	41.2	40.5	
Other	4,370	9,507	4.7	9.9	
Income from operations before general corporate expense	316,869	318,069			
General corporate expense	114,076	99,224			
Income from operations	\$202,793	\$218,845			

Company-operated Stores. Income from operations from our company-operated stores segment decreased \$17.6 million, or 8%, to \$207.4 million for the first three quarters of fiscal 2015 from \$225.0 million for the first three quarters of fiscal 2014 primarily due to an increase in employee costs as well as operating expenses associated with new stores, partially offset by increased gross profit of \$20.3 million. Income from operations as a percentage of company-operated stores revenue decreased by 460 basis points primarily due to lower gross margin and deleverage of selling, general and administrative expenses.

Direct to Consumer. Income from operations from our direct to consumer segment increased \$21.5 million, or 26%, to \$105.1 million for the first three quarters of fiscal 2015 from \$83.6 million for the first three quarters of fiscal 2014. The increase was primarily the result of increased gross profit of \$23.2 million primarily due to increased net revenue resulting from higher conversion rates and increased traffic on our e-commerce websites, partially offset by lower average order value. Income from operations as a percentage of direct to consumer revenue increased by 70 basis points primarily due to a reduction in selling, general and administrative expenses as a percentage of direct to consumer revenue.

Other. Other income from operations decreased \$5.1 million, or 54%, to \$4.4 million for the first three quarters of fiscal 2015 from \$9.5 million for the first three quarters of fiscal 2014. The decrease was primarily the result of decreased gross profit of \$5.0 million in the third quarter of fiscal 2015. Income from operations as a percentage of other net revenue decreased by 520 basis points primarily due to decreased net revenues, lower gross margin, deleverage of selling, general and administrative expenses, and due to an increased number of showrooms in new international markets which have a higher cost structure than North America.

General Corporate Expense. General corporate expense increased \$14.8 million, or 15%, to \$114.1 million for the first three quarters of fiscal 2015 from \$99.2 million for the first three quarters of fiscal 2014. This was primarily due to increased head office costs as a result of the overall growth of our business and investment in strategic initiatives and projects.

Other Income (Expense), Net

Other income (expense), net decreased \$6.9 million, or 128%, to an expense of \$1.5 million in the first three quarters of fiscal 2015 from income of \$5.3 million in the first three quarters of fiscal 2014. The decrease was primarily due to a net interest expense of \$3.6 million related to certain tax adjustments that are outlined in Note 7 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report as well as less interest earned on our decreased cash and cash equivalents balance compared to the first three quarters of fiscal 2014.

Income Tax Expense

Income tax expense decreased \$43.4 million, or 45%, to \$52.6 million in the first three quarters of fiscal 2015 from \$96.0 million in the first three quarters of fiscal 2014. The first three quarters of fiscal 2015 included certain tax adjustments totaling a recovery of \$7.7 million as outlined in Note 7 to the unaudited interim consolidated financial statements included in Item 1 of Part I of this report. The effective tax rate excluding these tax adjustments and related

interest was 29.5% in the first three quarters of fiscal 2015. The effective tax rate including these tax adjustments was 26.2%.

The first three quarters of fiscal 2014 includes a tax expense of \$31.3 million to provide for U.S. income and applicable foreign withholding taxes on dividends which were distributed during fiscal 2014 from foreign subsidiaries to the U.S. parent entity to fund the share repurchase program. The effective tax rate excluding this tax adjustment was 28.9% in the first three quarters of fiscal 2014. The effective tax rate including this tax adjustment was 42.8%.

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Net Income

Net income increased \$20.5 million to \$148.6 million for the first three quarters of fiscal 2015 from \$128.2 million for the first three quarters of fiscal 2014. The increase in net income was primarily a result of a decrease in income tax expense of \$43.4 million and an increase in gross profit of \$38.6 million, partially offset by an increase in selling, general and administrative expenses of \$54.6 million and a decrease in other income (expense), net of \$6.9 million.

Non-GAAP Financial Measures

Net revenue changes in constant dollars, total comparable sales in constant dollars, comparable store sales in constant dollars, changes in direct to consumer net revenue in constant dollars, the effective tax rate excluding certain tax and related interest adjustments, and diluted earnings per share excluding certain tax adjustments are non-GAAP performance measures.

We separately track comparable store sales, which reflect net revenue at company-operated stores that have been open for at least 12 months. Net revenue from a store is included in comparable store sales beginning with the first month for which the store has a full month of comparable prior year sales. Non-comparable store sales include sales from new stores that have not been open for 12 months or from stores which have been significantly remodeled or relocated. Also included in non-comparable stores sales are sales from direct to consumer sales, outlets, wholesale, warehouse sales, showrooms, temporary locations, and sales from company-operated stores which we have closed. Total comparable sales combines comparable store sales and direct to consumer sales. By measuring the change in year-over-year net revenue in stores that have been open for 12 months or more as well as direct to consumer sales, total comparable sales allows us to evaluate our performance eliminating the impact of newly opened stores.

We provide constant dollar changes in net revenue, total comparable sales, comparable store sales, and changes in direct to consumer net revenue because we use these measures to understand the underlying growth rate of net revenue excluding the impact of changes in foreign exchange rates, which are not under management's control. We believe that disclosing these measures on a constant dollar basis is useful to investors because it enables them to better understand the level of growth of our business.

We disclose the tax rate and diluted earnings per share excluding certain tax and related interest adjustments because of their comparability to our historical information as well as our diluted earnings per share guidance, which we believe is useful to investors.

The presentation of this financial information is not intended to be considered in isolation or as a substitute for, or superior 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 performance measures show the dollar and percentage change compared to the corresponding period in the prior year.

Constant dollar changes in net revenue

Thirteen Weeks Ended November 1, 2015 and November 2, 2014

	2015	2014	2015	2014	
	(In thousands)		(Percentages)		
Net revenue increase	\$60,297	\$39,496	14	% 10	%
Adjustments due to foreign exchange rate changes	24,746	7,506	6	2	
Net revenue increase in constant dollars	\$85,043	\$47,002	20	% 12	%

Thirty-Nine Weeks Ended November 1, 2015 and November 2, 2014

	2015	2014	2015	2014	
	(In thousands)		(Percentages)		
Net revenue increase	\$161,525	\$124,527	14	% 12	%

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Adjustments due to foreign exchange rate changes	60,534	22,605	5	2	
Net revenue increase in constant dollars	\$222,059	\$147,132	19	% 14	%

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Constant dollar total comparable sales

	Thirteen Weeks Ended November 1, 2015 and November 2, 2014		Thirty-Nine Weeks Ended November 1, 2015 and November 2, 2014	
	2015	2014	2015	2014
	(Percentages)		(Percentages)	
Total comparable sales ¹	3	% 1	% 4	% (1)%
Adjustments due to foreign exchange rate changes	6	2	5	2
Total comparable sales in constant dollars ¹	9	% 3	% 9	