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LULU - Q1 2015 Lululemon Athletica Inc Earnings Call

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OVERVIEW:

Co. reported 1Q15 total revenue of \$423.5m and net income of \$47.8m or \$0.34 per diluted share. Expects FY15 revenue to be \$2.00-2.05b and diluted EPS to be \$1.86-1.91. Expects 2Q15 revenue to be \$440-445m and diluted EPS to be \$0.31-0.33.



CORPORATE PARTICIPANTS

Chris Tham *lululemon athletica Inc - SVP of Finance*

Laurent Potdevin *lululemon athletica Inc - CEO*

Stuart Haselden *lululemon athletica Inc - CFO*

Tara Poseley *lululemon sthletica Inc - Chief Product Officer*

CONFERENCE CALL PARTICIPANTS

Oliver Chen *Cowen and Company - Analyst*

Matthew Boss *JPMorgan - Analyst*

Ed Yruma *KeyBanc Capital Markets - Analyst*

Matt McClintock *Barclays Capital - Analyst*

Adrienne Yih *Janney Capital Markets - Analyst*

Paul Alexander *BB&T Capital Markets - Analyst*

Brian Tunick *Royal Bank of Canada - Analyst*

Howard Tubin *Guggenheim Securities - Analyst*

Jim Duffy *Stifel Nicolaus - Analyst*

Janet Kloppenburg *JJK Research - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the lululemon athletica First Quarter 2015 Results conference call.

(Operator Instructions)

As a reminder, this conference may be recorded. I will now turn the call over to your host Chris Tham, Senior Vice President of Finance.

Chris Tham - *lululemon athletica Inc - SVP of Finance*

Thank you and good morning. Welcome to lululemon's first quarter 2015 earnings conference call. Joining me today to talk about our results are Laurent Potdevin, CEO, Stuart Haselden, CFO, along with Tara Poseley, our Chief Product Officer, who will be available during the Q&A portion of the call.

Before we get started, I'd like to take this opportunity to remind you that our remarks today will include forward-looking statements reflecting management's current forecasts of certain aspects of the Company's future. These statements are based on current information, which we have assessed, but by which by its nature is dynamic and subject to rapid and even abrupt changes.

Actual results may differ materially from those contained in or implied by these forward-looking statements, due to risks and uncertainties associated with the Company's business. Factors that could cause these results to differ materially are set forth in the Company's filings with the SEC including our annual report on Form 10-K and our quarterly reports on Form 10-Q. Any forward-looking statements that we make on this call are based on assumptions as of today, and we undertake no obligation to update these statements as a result of new information or future events.



During this call, we will present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release. The press release and accompanying quarterly report on Form 10-Q are available under the Investors section of our website at www.lululemon.com.

Today's call is scheduled for one hour, so please limit yourself to one question at a time to give others the opportunity to have their questions addressed. Now, I will turn the call over to Laurent.

Laurent Potdevin - *lululemon athletica Inc - CEO*

Thank you, Chris, and good morning, everyone. Today, I will provide a brief overview of our first-quarter performance, as well as give you an update on our progress with the key strategic initiatives planned for 2015. Stuart will then walk you through our financials and guidance in more detail.

We delivered strong results in our first quarter. Despite headwinds from weather, port-related delays and foreign exchange impacts. Specifically, we delivered first-quarter revenues above the high end of our guidance, generating overall comparable sales growth of 6%, driven in part by a 31% increase in our e-commerce channel.

Within our North American business, we saw another quarter of positive combined comps and a nice acceleration in our e-commerce business in both the US and Canada. Our women's business once again delivered positive comps in the quarter, driven by our bottoms category.

Our guests responded well to our assortment in the quarter, despite the impacts to our product flows coming out of the port disruption. We have seen an acceleration in our business in the latter part of the quarter, as our inventory positions began to improve, validating our new product flow and assortment.

Additionally, we saw further ramp in our men's business, delivering a 19% comp. And finally, ivivva delivered a 29% comp on a combined basis.

We achieved this growth across our key categories, despite the challenges related to the West Coast port disruption. We look forward to seeing how our guests respond in Q2 and through the second half of the year when our product assortments are properly balanced by season and quantity.

We ended the first quarter with elevated inventory levels as a result of the port-related delays. However, we're finally reaching better in-stock positions, and are confident in our plans to work through this inventory with no impact on brand equity and minimal markdown risk. Stuart will provide additional color on this during his remarks.

Before getting into further details on the quarter, I would like to pause and offer my sincere gratitude to Delaney Schweitzer, who left lululemon at the end of last month after 13 years with our collective. Under her leadership, Delaney developed incredible leaders, and as a result, we have a deep bench of talent poised to lead our global retail business.

We are empowering these leaders to oversee the Americas, Asia-Pacific and Europe. Collectively, our retail leadership team brings history, experience, passion and a commitment to our culture. Their energy will inspire our people and fuel our growth.

Our expansion into international markets continues to be a key growth driver. In Asia, we opened our second store in Singapore at Takashimaya Shopping Center on May 13th, and have already seen fantastic results well ahead of our expectations.

Additionally, our initial store in ION Mall continues to outperform our plans. And we're eagerly anticipating the opening of our first Hong Kong store at IFC Mall, which we expect to be amongst our most productive stores across our global portfolio.

We also have plans to open a second store in Hong Kong in Q3 in Hysan Place located in the heart of Causeway Bay. Last but not least, we're on track to open our first store in Dubai in Q3 of this year.

On our last call, I outlined both our short and long-term goals as a growth Company, building a global iconic brand across geographies and new categories. And we continue to make strategic investments in the key elements of our brand operating model: one, our product; two, our guest experience; and three, our brand and community.

Beginning with product, we continue to see the benefits from the ongoing work on our product engine conducted within Tara's group. Our design ecosystem is leveraging our culture of innovation. And we are achieving this by expanding our design organization, and through our relentless focus on functional innovation.

A key component of this project is the deep relationship and feedback loop we have built with our ambassador community. Our ambassadors are real-life inspirational leaders in their communities who live the sweat life to its full extent 365 days a year. They are an integral part of product development process.

Our ambassadors sweat in our product, and then give us valuable feedback to assist our whitespace R&D group. They truly love being a part of our early product feedback cycle, and we're always looking at new ways to deepen this aspect of our relationship with them.

Turning to some specific product highlights from the last quarter, we saw continued momentum in our women's pants business. Our earlier work to reinvigorate this key category continues to pay off. As an example, our Wunder Under franchise is performing extremely well, especially with the addition of new styles over the last year.

These strong positive signals bode very well for the relaunch of our pant wall expected in Q3. And our Tank line is evolving as well, with the introduction of higher support constructions, more diverse coverage options and a wider selection of fits.

These initial new offerings are hitting our stores in late Q2 and into Q3. And we look forward to creating the same level of excitement and energy with our tanks as we did with our bottoms. These efforts will continue to inform the full relaunch of the tank wall in the first half of 2016.

We're thrilled to see the accelerated momentum in the men's business, as evidenced by its 19% comp. And we have expanded options within popular categories, including our Metal Vent Tech t-shirts, which further reinforces the strong growth of our foundational sweat business.

We're also experimenting with different store formats and shopping experiences aimed at our male guest. The Joinery, currently found in our men's Soho store in New York and Robson store in Vancouver, allows a personalized experience where guys can customize the function of their shorts on the spot. The concept of the Joinery is firmly rooted in a function-first approach, letting men craft their own workout gear.

Creating an authentic best-in-class guest experience is the second key area investment. We continue to strengthen our omni-channel capabilities with projects targeting improvements both in-store and online.

For example, our website is undergoing a full global redesign to ensure we have a scalable transactional platform that will allow us to showcase a broader assortment of product online. Better enable product storytelling, and deepen our product education capabilities.

Some key features will include enhancements to the checkout process, and targeted recommendations, while ensuring the site is optimized across any device. Phase One will launch in the latter part of this year, and prior to holiday.

The final key area of investment for this year is within our brand community efforts. We continue to see the highest engagement with our guests when we powerfully tell our product stories in a way that is locally relevant for them.

As I mentioned earlier, we recognize and embrace the power of our ambassador community. And this past quarter, we hosted 130 of them from around the world at our annual Ambassador Summit in Whistler, British Columbia.



Our goal for this year's Summit was to intentionally deepen the integration between our local educators, our support center teams, whitespace and our global ambassador community. And just last week, just last Friday actually in Vancouver, we kicked off a 16 city global tour where we will connect with many facets of our collectives, including our educators, store support teams and ambassadors.

Our educators absolutely never cease to amaze me. They are the best at what they do, and hold the most important job within the Company. They create authentic connections with our guests by listening to their passion, understanding their needs and how they like to sweat, and most importantly, encouraging them in setting, pursuing and celebrating their goals.

This tour is one way to express our gratitude and connect with thousands of our educators and ambassadors around the globe. Our brand lives within our people and during the tour, we will reaffirm our mission and create our future together.

In conclusion, lululemon is a powerful and unique brand and our core values will continue to guide our future. Our business model gives us full control of the experiences we are creating, and we are relentless in our pursuit of innovation in everything that we do, resulting in unparalleled guest loyalty.

We have made the shift from playing defense to playing offense. And we have set a clear course for sustainable and profitable growth, both within North America and in our global markets.

Before turning the call over to Stuart, I would like to express my gratitude to the entire lululemon collective who make up our iconic brand. It is our combined passion and commitment that will allow us to capitalize on the many opportunities that lie ahead.

I'll now turn things over to Stuart for a more thorough review of our financial results and guidance. Stuart?

Stuart Haselden - lululemon athletica Inc - CFO

Thank you, Laurent. I'll begin today by reviewing the details of our first quarter in 2015, and then I will update you on our outlook for the second quarter and the full year of FY15.

For Q1, total revenue rose 10.1% to \$423.5 million from \$384.6 million in the first quarter of 2014. The increase in revenue was driven by total comparable sales growth on a combined basis, including e-commerce of 6%. Comprised of a bricks and mortar comp store sales decrease of 1%, and a 31% growth online, all on a constant dollar basis.

Also square footage growth of 21.8% versus last year driven by the addition of 53 net new Company-operated stores since Q1 of 2014. 35 net new stores in the United States, two stores in Canada, one store in New Zealand, one in Europe, one in Asia and 13 ivivva stores.

This was offset by both the impact of the West Coast port disruption, as we indicated during our Q4 call, and the foreign exchange impact of a weaker Canadian and Australian dollar. The latter of which had the effect of decreasing reported revenues by \$15.2 million or 3.6%.

During the quarter, we opened 14 net new Company-operated stores; six in the US, one in Canada and seven in ivivva. We ended the quarter with 316 total stores versus 263 a year ago.

There are now 240 stores in our comp base: 39 of those in Canada, 158 in the United States, 27 in Australia and New Zealand, 1 in Europe and 15 ivivva.

At the end of Q1, we also have a total of 86 showrooms in operation: 34 lululemon showrooms in North America, 15 internationally and 37 ivivva.

Company-operated stores represented 74.2% of total revenue or \$314.1 million, versus 74.9% or \$288.1 million in the first quarter of last year. Revenues from our direct to consumer channel totaled \$83.6 million or 19.7% of total revenue, versus \$66 million or 17.2% of total revenue in the

first quarter of last year. Other revenue, which includes strategic sales, showrooms, pop-ups and outlets totaled \$25.8 million or 6.1% of revenue for the first quarter, versus \$30.5 million or 7.9% of revenue in the first quarter of last year.

Gross profit for the first quarter was \$205.9 million or 48.6% of net revenue, compared to \$195.7 million or 50.9% of net revenue in Q1 2014. The factors which contributed to this 230 basis point decline in gross margin were a 100 basis points of deleverage due to higher airfreight costs incurred primarily to mitigate the West Coast port delays.

It should be noted that the market for airfreight in Q1 was highly competitive. And rates and surcharges increased significantly towards the end of the quarter.

70 basis points deleverage due to foreign exchange impact of a weaker Canadian and Australian dollar. 30 basis points deleveraged from continued strategic investments in our product and supply chain functions. And 130 basis points deleveraged from occupancy and depreciation, consistent with our guidance from last quarter, which was mostly due to higher lease costs associated with larger store formats, an increase in major renovations and relocations and our international expansion. These items were offset with 100 basis points of improvement in our product margins over prior year.

SG&A expenses were \$137.8 million or 32.5% of net revenue compared with \$125.9 million or 32.7% of net revenue for the same period last year. This 9.4% SG&A dollar increase is due to the following: an increase in operating expenses associated with new and existing stores, showrooms and outlets, including costs related to our international expansion; increased variable operating costs associated with the growth in our e-commerce business; and higher foreign exchange losses from the revaluation of monetary assets in our foreign subsidiaries.

These increases were offset with a weaker Canadian and Australian dollar, which on translation also decreased reported SG&A by \$8.4 million or 6%. As a result, operating income for the quarter was \$68 million or 16.1% of net revenue, compared with \$69.8 million or 18.2% of net revenue in Q1 2014.

Tax expense for the quarter was \$20.8 million or a tax rate of 30.3%, compared to \$52.5 million or a tax rate of 73.4% in the first quarter of 2014. As a reminder, last year's tax expense in the first quarter included the impact of the decision to repatriate cash from our Canadian subsidiary to our US parent company to fund the share repurchase program, which triggered a tax charge of \$30.9 million in Q1 of 2014.

Net income for the quarter was \$47.8 million or \$0.34 per diluted share compared to net income of \$19 million or \$0.13 per diluted share for the first quarter of 2014. This includes the year-over-year negative net impact from foreign currency of \$0.03 per share, versus our expectations of a \$0.01 per share impact.

Our weighted average diluted shares outstanding for the quarter were 142.3 million versus 145.9 million a year ago. Which takes into account the weighted impact of 300,000 shares repurchased during the quarter at an average price of \$66.51 per share. Capital expenditures were \$27.9 million for the quarter, compared with \$25.4 million in the first quarter last year.

Turning to our balance sheet highlights. We ended the quarter with \$655.9 million in cash and cash equivalents. Inventory at the end of the first quarter was \$236.5 million or 31% higher than at the end of the first quarter of 2014.

Late product deliveries as a result of the West Coast port issues elevated our inventory levels on hand and in transit at the end of the quarter. These late Q1 deliveries will combine with on-time deliveries in Q2 as our supply chain cadence normalizes. And as a result, our inventories will remain elevated for the next couple of quarters.

Compounding the year-over-year comparison for Q2 is the fact that we were significantly under inventory for Q2 last year, with essentially a zero build in stock levels from Q1. All that being said, we're glad to now be in a strong in stock position and have identified a number of strategies to work through these elevated product levels that will minimize markdown risk.

Specifically, this is great product and we have identified opportunities to reflow approximately two-thirds of this late arriving inventory into our second-half assortments at full price with little incremental markdown risk. The remaining third of these late arrivals will be sold down through our normal exit channels, which include our outlet stores, online warehouse sales and physical warehouse sales.

This now leads me to our outlook for the second quarter and full FY15. As Laurent mentioned, it has been good to see our comps accelerate at the end of Q1 and into the first five weeks of Q2 as our inventory position improved.

In particular, we have seen a strong guest response to our new spring and summer products. And with continuing momentum, our Canadian stores are now seeing a positive comp sales trend in Q2, driven in part by higher conversion. And likewise, our US stores are also posting a strong comp store sales trend in the initial weeks of the quarter.

As a result, we now expect Q2 revenue to be in the range of \$440 million to \$445 million. This is based on a comparable sales percentage increase in the high single digits on a constant dollar basis, compared to the second quarter of 2014. And assumes a Canadian dollar at \$0.80 to the US dollar, and 18 new store openings, 13 lululemon stores and 5 ivivva.

We anticipate our gross margin in the second quarter to be in a range of 48% to 49%. As we had discussed last quarter, we continue to expect to see merchandise margins stabilize and strengthen relative to last year. With offsets in foreign exchange, deleverage from continued investments in our product and supply chain functions, and store occupancy and depreciation.

Airfreight costs will remain a headwind in Q2 before abating in the second half of the year. We expect SG&A in the second quarter to delever slightly from Q2 2014.

Assuming a tax rate of 30.2% and a 142.3 million diluted weighted average shares outstanding, we expect diluted earnings-per-share in the second quarter to be in the range of \$0.31 to \$0.33 per share. For the full-year 2015, we now expect revenue to be in the range of \$2 billion to \$2.05 billion.

We remain on plan to open 60 Company-operated stores which includes up to eight new stores in Asia and Europe, and also 20 ivivva stores.

We expect gross margin for the year to delever from 2014 with merchandise margins stabilizing, but more than offset by the factors we mentioned earlier. We expect some deleverage in full-year SG&A versus 2014, driven by continued strategic investments in guest experience, our website, brand and our IT systems.

We now expect a net impact to earnings from foreign exchange for the year to increase from approximately \$0.04 to \$0.06 per share when compared to FY14. As a result, we expect operating margin to deleverage from 2014, and our FY15 diluted earnings-per-share to be in the range of \$1.86 to \$1.91 per share. This is based off of 142.4 million diluted weighted average shares outstanding, which does not reflect an estimate of shares repurchased after Q1 2015, and also assumes a effective tax rate of 30.2%.

We expect capital expenditures to range between \$130 million to \$135 million for the FY15. Reflecting new store openings, renovations, relocation capital, and also strategic IT and supply chain investments.

With that, I will open up the call for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Oliver Chen, Cowen and Company.



Oliver Chen - Cowen and Company - Analyst

Hey, guys, this is Courtney in for Oliver today. Could you just update us on what you are seeing in terms of raw materials going forward? And then also, just any update on your mobile strategy? Thanks very much.

Stuart Haselden - lululemon athletica Inc - CFO

Hey, Courtney, it's Stuart. Sure. On raw materials, we are seeing the benefits from our go-to-market calendar accrued to the cost that we're seeing for raw materials.

We're also seeing some of the costs related to raw materials are continuing to be consistent with what we have seen previously. I'm going to invite Tara to add anything to that, if there is anything.

Tara Poseley - lululemon athletica Inc - Chief Product Officer

No, I think you answered that well, Stuart. Thank you.

Stuart Haselden - lululemon athletica Inc - CFO

So I think the bigger point really is just as we continue to make progress on the go-to-market calendar and the strategies related there, we should see benefits in the input costs. Really more from how we are able to better synchronize our supply chain activities, and generate better leverage.

And how we are able to engage and negotiate with our vendors. And that will benefit a number of different areas, raw materials included. On the question on mobile, I'm going to let Laurent speak to that one.

Laurent Potdevin - lululemon athletica Inc - CEO

I thought in mobile, Courtney, I mentioned that in our earlier script. We're doing a full global web redesign that is obviously going to be mostly driven by the development is driven by mobile. And will be adapted to all devices.

But it's really -- we're seeing tremendous momentum with our mobile performance. And so it will be an integral part of our growth doing with the web redesign. And we're adding tremendous talent to the digital team.

So we are very excited with what we're seeing combined with our new account capture and our CRM effort. We've got a very large collective that's building very quickly. So mobile is a very [integral] of what we're doing, and how we're not only transacting but also doing our storytelling with our ambassadors.

Oliver Chen - Cowen and Company - Analyst

Thanks, guys. Congrats and good luck.

Stuart Haselden - lululemon athletica Inc - CFO

Thank you.



Operator

Matthew Boss, JPMorgan.

Matthew Boss - JPMorgan - Analyst

Hey, good morning, guys. Can you speak to the cadence of the comps as the quarter progressed? I know you spoke things getting better toward the end.

And then just drivers of the positive inflection that you saw in conversion. And more so, as you think about the positive store comp quarter to date, what's driven that? What should we keep an eye open for in stores today?

Stuart Haselden - lululemon athletica Inc - CFO

Hey, Matt. So yes, on the comp in Q1, we saw it track closely with our inventory positions. And obviously, that was impacted by what happened with the West Coast port issues. What we saw since we last spoke in the March earnings call, we did see our comps improve as our spring and summer product landed in April.

It's worth mentioning that when we did give guidance, the expectation was that we would see our spring and summer goods land closer to the beginning of April. They actually landed more into the middle of April. But what we were surprised by was the fact that our winter and holiday goods that we had in the first part of April to the higher mix is the result of the delays in the spring summer timing.

The winter and holiday product performed better than expected from a sell through standpoint. That product does have a lower product margin inherently. And so that weighed on the overall margin outcome, and explains part of the miss to the margin guidance that we had given.

The other thing we were surprised by in the last part of the quarter was the airfreight costs came in about 30% to 40% higher than expected. And that also weighed on margins in the quarter, and that cost was above what we had originally expected when we gave guidance.

But for the comps specifically, we did see a nice acceleration as our in stock positions improved. That acceleration was more or less a reflection of an increase in conversion.

The traffic over the course of the quarter was relatively consistent. And we saw, as in stock positions improved, conversion improved, costs improved. We saw that continue into the first part of the second quarter, as we mentioned in our prepared remarks, and it's a similar story.

We're seeing some continued acceleration in our Canadian traffic, and specifically along with the improved conversion. So it's an improving picture. It's very closely connected to the improving in stock positions that we have.

Matthew Boss - JPMorgan - Analyst

Great. And then just a follow-up. On the merchandise margin front, can you just talk about opportunities in the second half? And then more so, if you could just help rank the drivers of gross margin expansion as we move into next year? I think that would be really helpful.

Stuart Haselden - lululemon athletica Inc - CFO

Sure. I think as we look at the second half of the year from a margin standpoint, the guidance that we gave around the improved sales really relates to that third of the inventory, the elevated inventory levels, that we will be looking to exit in the balance of the year. We have assumed that those sales will essentially have, from an exit standpoint, the cost to exit those sales will essentially wash with the incremental margin that they will generate.



There may be some upside to that assumption. But we are not ready to call it at this point. So if I was to try to point to margin opportunities in the second half, it's probably just how effective we can be in moving through that elevated inventory position.

And from a gross margin expansion standpoint, and I think your question is more getting at the outlook into next year and the benefits of the activities and investments that we are making this year. Particularly in Tara's group. I think as we had said previously, we expect the go-to-market calendar to be able to help us reduce our fabric liability costs as we get more efficient in how we actually are able to synchronize the supply chain.

We will have less waste effectively. And that will reduce the amount of fabric liability that we will need to have in order to deliver the same amount of product. Additionally, and that's probably the first and foremost part of the gross margin opportunities as we think about that go-to-market calendar strategy.

We also have a fair amount of expedited airfreight costs. But into the production cycle to help us stay on track with our calendar. And then we have expedited airfreight costs out of the production cycle with finished goods to help us stay on track with our inventory flow cycle.

So again, as our calendar becomes more synchronized, we will be able to eliminate or at least materially reduce the airfreight costs. So I would say those are the top parts of that go-to-market calendar margin opportunity.

Certainly there are other things we are doing that will benefit the flow and how we are able from a fast turn standpoint be able to respond to trends that we see in the market. That's a smaller part of the equation today that we are investing into try and grow that a make it more meaningful.

Matthew Boss - *JPMorgan - Analyst*

Great. Nice quarter, guys.

Stuart Haselden - *lululemon athletica Inc - CFO*

Thank you.

Operator

(Operator Instructions)

Ed Yruma, KeyBanc Capital.

Ed Yruma - *KeyBanc Capital Markets - Analyst*

Hello, thanks for taking our questions. Just first, I know you have been testing a lot of different formats for men's. As you think about going forward growth, should we expect more separate doors? Is it more of a sidecar?

And then as a follow-up. I know you talked a little about inventory, but free cash generation was negative for the first time in some time. How should we think about free cash flow going forward? Thanks.

Laurent Potdevin - *lululemon athletica Inc - CEO*

On the men's side of the business, we've obviously been very, very excited. We're playing with different formats, whether it's a standalone store, whether it's increased square footage in some of our current stores or some expanded formats.



The one format that we are most excited right now about is expanded store. Where both men's and women's are co-located as our female guest still shops a lot for him. Our male guest does have a lot more permission to come into the lululemon collective, but she still shops a lot for him.

So the expanded format, co-located format, is one that we're seeing tremendous results with. And we'll continue in the right geographies, in the right cities, we'll continue to play with potential standalone stores as we see fit. As long as it's in very close proximity to the women's locations such as what you can experience in Soho.

Stuart Haselden - *Lululemon Athletica Inc - CFO*

And, Ed, on your second question on the cash flow. We were more aggressive in the quarter with the share repurchase program. Which that tipped us negative as you pointed out. But we still feel very good about the cash flow generation of this business, and feel that we will be in a good liquidity position going forward. Thanks.

Ed Yruma - *KeyBanc Capital Markets - Analyst*

Thank you.

Operator

Matt McClintock, Barclays.

Matt McClintock - *Barclays Capital - Analyst*

Hello, yes, good morning, everyone. Stuart, on the full year comp guide for guidance for mid-single digits. I was just wondering how to think about that in terms of you just put up a 6% increase in the first quarter, and your guidance for 2Q is high single-digits.

So the deceleration embedded in the guidance for the second half, just want to parse that out a bit. Could you talk to that?

Stuart Haselden - *Lululemon Athletica Inc - CFO*

Hey, Matt, yes. So the guidance in the second half from a comp sales standpoint, as you look under the covers at the range. We essentially -- the forecast that we used for the base to the guidance showed that the comp results would increase into the top end of that range. So we are essentially, in our model, on the cusp of a mid to beginning to close in on the high single-digit, so it's really just a question of where we fell in that range of mid single-digit comps.

Weren't ready yet to call more upside for the second half. So internally, we feel like the datapoints connect and it doesn't necessarily suggest deceleration.

It's just the current view in Q2, we have more clarity given where we are right now. And we're more comfortable calling that. But it's really, I would say, from where we were in the March call, we're just higher into the upper end of that mid-single-digit range on the comps.

Matt McClintock - *Barclays Capital - Analyst*

And then if I could follow up, Laurent or Tara, could you speak to some of the new product that you launched in the second quarter? Clearly, there's been strong response. But I was wondering if we could talk a little bit in more detail about women's tops, and specifically swim now that that's a new category for you.

Tara Poseley - *lululemon sthletica Inc - Chief Product Officer*

So, what we -- obviously the spring goods didn't get until April. But we saw a really strong positive by the guests, particularly the bottom trends continues, it bodes well for our pant wall relaunch in Q3.

Our effort to get tanks, we'll start seeing a lot of the new styles in the works there begin to get into stores towards the end of Q2. So we will have more to come on that that we can talk to. It's a little too early yet on that.

And we've been very pleased with swim. We have more opportunities to add additional coverage offerings in swim. So we've had some good learnings in spring, but the guest response has been really positive. And we could see more upside and opportunity as we move into designing next year for 2016.

Matt McClintock - *Barclays Capital - Analyst*

Thank you very much.

Operator

Adrienne Yih, Janney Capital.

Adrienne Yih - *Janney Capital Markets - Analyst*

Congratulations on the product progress. Well done.

Tara, my question is on two-thirds of the product that is going to live beyond the second quarter. Can you talk about the composition of that product, long top, long bottom or more core? And then how much is men's versus women's?

And then on the one-third that is going to be moved through the different channels. Do you feel that you have sufficient inventory to run the september, was it September or July and January, warehouse sales? And can you remind us if you ran them last year? Thank you very much.

Tara Poseley - *lululemon sthletica Inc - Chief Product Officer*

Okay. Yes, the composition of the two-thirds product, what the buying teams have done is we have re-flowed the spring [hike] into summer, and then have (inaudible) summer product that we could flow into fall. And the teams are really excited actually with the product and let it flow into fall felt that the addition of the color in August which is really still high summer into our fall merchandise was a good choice.

Our fourth-quarter product hasn't been placed yet, so it gave us a lot of movement to shift some of the core receipts that we needed to reflow from Q2 to Q3 to Q4. So I'm feeling really good about composition of that two-thirds.

We did had an online warehouse sale last year in October. We're actually going to move that forward into Q2 to clear through the holiday inventory.

Stuart had mentioned that we actually saw good guest response to the holiday inventory that we had to keep at regular price in our stores in February and March. And will be used in our warehouse sale to go through that, that's some of that one-third that we're talking about. And then we will then make choices to the remainder of the year if we do some additional pop-ups to warehouse or just use our regular outlets to go through that inventory.



Adrienne Yih - Janney Capital Markets - Analyst

Okay, great. Thank you so much.

Operator

Paul Alexander, BB&T Capital Markets.

Paul Alexander - BB&T Capital Markets - Analyst

Hello, thank you. Can you talk about the 31% increase in direct to consumer?

How sustainable is a growth rate like that, and was it inflated in the first quarter by people who couldn't get to the store when weather was really bad? Or by people who couldn't find what they wanted in stores because of the port slowdown? And what kind of impact on the 2Q direct to consumer growth rate should we see from the movement of that warehouse sale from October into Q2? Thank you.

Stuart Haselden - lululemon athletica Inc - CFO

Hey, Paul. So yes, we were very pleased with the e-comm sales growth that we saw in Q1. I would say there are a couple factors we would point to, certainly weather was an issue in the early part of Q1, which likely benefited the e-commerce results. I would also say that we began the quarter in e-commerce with a stronger inventory position, and we were able to accelerate or able to flow I should say inventory to the e-commerce business faster than we could the stores.

The additional step in the supply chain for getting the inventory from our distribution centers to our stores, which takes a little bit of time that in e-commerce you don't have that step. So we were able to have a better inventory position in e-commerce, which I think drove the upside.

And from the comp guidance that we gave for Q2, it certainly reflects an ongoing strength in our e-commerce business, as well as the improvement in the store comps. So there's nothing that we would look at from a direct standpoint that would suggest that the increases that we saw in the first quarter is not sustainable. We wouldn't necessarily plan it at that level, but there is nothing structural that would prevent us from delivering that type of an outcome go forward.

Laurent Potdevin - lululemon athletica Inc - CEO

And, Paul, especially when you consider all the enhancements from a CRM account and check out standpoint that we're putting into the global web redesign. And our educators at the store level have done an outstanding job.

But we've done a good job training them, and they've done an outstanding job using our back room app. Which has really been able to leverage our online inventory when we haven't had inventory in store. So that's really our strategy coming together from that standpoint.

Paul Alexander - BB&T Capital Markets - Analyst

Thank you.

Stuart Haselden - lululemon athletica Inc - CFO

Thanks.



Operator

Brian Tunick, Royal Bank of Canada.

Brian Tunick - *Royal Bank of Canada - Analyst*

Hello, thanks. Good morning. I will add my congrats on the progress.

I guess two questions, one on Canada. Very glad to hear about the positive comps there. I think it's been a while.

I know it's your most mature productive stores. Can you maybe give us more color on what you are doing in Canada as far as remodels, men's, product, what is taking hold there? And on the international stores, maybe some comments on where are you on building your team out?

What kind of leadtimes are you seeing for store leases? Learnings from early stores on pricing, anything you could help give us more comfort on the international store rollout and what you have seen so far? Thanks very much.

Laurent Potdevin - *lululemon athletica Inc - CEO*

We've been very focused on Canada as one of our -- as our first market, and it's been really coming across the three key [pillars] of what we do. We focused a lot on educator training.

We very much focused on the buy, how wide the buy is, and the depth of the buy. And we've seen tremendous results with that. And our brand community groups have really focused on how to have a campaign that was -- I hate the word campaign, but programs that were very much dedicated to Canada, and we have seen tremendous impact there.

I think another interesting to market to look at where we have been challenged is Australia. And I was in Australia a month ago spending time with our team there. And we've seen the same type of return to very healthy comps, simply by focusing on those markets, the buy, the training, and brand and community efforts that are locally relevant.

Especially in the context of Australia, really focusing on ambassadors that are relevant to Australia. So let's think about tri-athletes and surfers that are training in an environment that are hotter more you need. Obviously they have to deal with a lot more sun than we do here in Vancouver.

And using this market as a testing ground for new products. So really product, buy, branding community and training focus on those markets has really paid off in a very significant way.

Brian Tunick - *Royal Bank of Canada - Analyst*

And then on the international side?

Laurent Potdevin - *lululemon athletica Inc - CEO*

On the international side, sorry I knew, there was a second part to that question. On the international side, we are very much on track. We're exceeding our expectations both in Asia and in Europe.

As I mentioned, we are on track opening Dubai in September. We are probably seeing -- we're exceeding to a greater extent in Asia than in Europe. So that probably suggests the ability to maybe accelerate a little bit our expansion in Europe.

And we've just opened a showroom in Seoul that is performing extremely, extremely well. So an opportunity to do more in Asia with an awesome team, and in Europe like keeping the course but yet still very much exceeding our expectations.

So opening -- stores in France, we've just opened a store in Stockholm. We've relocated our store in Germany in Berlin, that's now performing at the level that suggests store rollouts. So very, very happy with the pace and the success of the international expansion so far.

Brian Tunick - *Royal Bank of Canada - Analyst*

All right. Thanks very much, and good luck.

Laurent Potdevin - *lululemon athletica Inc - CEO*

You're welcome.

Operator

Howard Tubin, Guggenheim Securities.

Howard Tubin - *Guggenheim Securities - Analyst*

Thanks, guys. Maybe just a question for Tara. Can you just update where you stand on your chase capabilities, and how quickly you can get back into things within season?

Tara Poseley - *lululemon athletica Inc - Chief Product Officer*

I think you said our chase capabilities? Okay, you cut off for a second there.

So we have established a fast turn team that can turn goods in about -- depending on if we have taken position on the fabric or we have liable fabrics. That team could turn product around in roughly 2.5 months. So it's a great mechanism for us to leverage as we see where sales are and chase into core product or as well as into seasonal fashion ideas as well.

Howard Tubin - *Guggenheim Securities - Analyst*

That's great. Thanks very much.

Operator

Jim Duffy, Stifel.

Jim Duffy - *Stifel Nicolaus - Analyst*

Thanks, good morning, everyone. More questions around the international opportunities.

Are you yet in a position to talk directionally about store model for international markets? How it may differ between the Asia and Europe, and what are some of the key differences in format and the economics you expect versus North America?



Stuart Haselden - *lululemon athletica Inc - CFO*

Yes, Jim. So the strategy at this point in the early store openings is focused on capital cities in these geographies, in Western Europe and in Asia. So these are some of the most productive retail centers or retail areas in the world. And so these initial store locations are -- they're rivaling some of the best stores in North America from a sales standpoint -- from a sales per square foot standpoint, and also from a four wall profit.

Obviously, the rent dynamics are different. We're seeing higher rents, we're having to pay key money in certain markets, but these are some of the most productive locations you can imagine. So we are picking the cherries, so to speak, in the initial phase to establish the brand.

It's important to have a very visible location in these key areas, these key cities and the shopping areas within them. So that you establish the brand in a manner that is consistent with how we want it to be established. So we need to build that presence and that brand recognition with the store footprint.

But it's not a marking activity. These stores are very profitable. And on a four wall basis, very attractive.

Obviously, you have the cost, the overhead cost, of investing in the teams, and the marketing, and the supply chain to get into those markets. So it takes you a while to reach the scale to really be able to leverage those investments.

And we're in early days of the strategy, but we're very excited by the results that we are seeing both in Asia and in Europe. And feel like it's going to be a great part of the overall growth story for years to come.

Laurent Potdevin - *lululemon athletica Inc - CEO*

And, Jim, all the work that we're doing with multi store formats in North America, whether it's smaller store like the one in Vail or whether it's the men's only store or the [expanded] formatting Miami, Santa Monica, are really informing the type of model that we can rollout. In parts of the world where we might have to play with different real estate.

Jim Duffy - *Stifel Nicolaus - Analyst*

Got you. And then in some of your earlier international markets like say the UK or Singapore, when would you expect to move beyond that Phase 1 and into Phase 2 where you are exploring some of these other formants maybe outside of the capital cities?

Laurent Potdevin - *lululemon athletica Inc - CEO*

I think in Asia we still have a fair amount of runway, probably a couple years before we start exploring the cities that are not a when but that are an if. In the UK, we will probably start exploring a couple of those locations next year, and then in the rest of Europe we'll still be in the capital cities for the midterm.

So we have tremendous runway ahead of us in leveraging the brand awareness that we have got in those capital city. And to Stuart's point, really planting our flag and claiming the market that we created. So a lot of runway in those cities that are a when.

Jim Duffy - *Stifel Nicolaus - Analyst*

Great. Thanks for that.



Laurent Potdevin - *lululemon athletica Inc - CEO*

You're welcome.

Operator

Janet Kloppenburg, JJK Research.

Janet Kloppenburg - *JJK Research - Analyst*

Good morning, everyone. Just a couple of questions. Number one, it seems like you are buying and occupancy pressure is increasing, Stuart, as you focus more on the international markets.

Maybe you could help us with the leverage point on comp there as we model going forward. And secondly, Tara, I was wondering as you broaden your bottoms assortment, if there is an opportunity for AUR elevation? Thank you.

Stuart Haselden - *lululemon athletica Inc - CFO*

Sure. Hey, Janet. So yes, buying and occupancy we're seeing elevated pressure from that into Q1 as we had in Q4. No surprise there. We expect that will be the story for the balance of the year, we expect that to moderate next year.

If you look over the last few years, and we haven't seen this level of occupancy pressure. We expect that to normalize into 2016. So on a year-to-year basis that should be a benefit.

But at this point, I would say it's attributable to just some of the discrete activities that we have ongoing this year from a real estate standpoint. And that's the combination of some of the higher rents for these big international flagships.

Some of the relocations and expansions that we have done in North America. And just the opening cadence that we have is higher than the Company has ever had. So for every store you open, you have a certain amount of preopening costs that are a drag from an occupancy standpoint, the initial rent before the store is open.

So we've got more of that. That will moderate as well as we go forward. So those are the factors that are part of that story.

I think over the long term, we'd expect to leverage our buying and occupancy in that high single-digit to low double-digit range just given the growth profile of the Company. We're not quite there right now. But that's how we would envision the long-term model.

Janet Kloppenburg - *JJK Research - Analyst*

Okay. Thank you, Stuart.

Tara Poseley - *lululemon sthletica Inc - Chief Product Officer*

And then, Janet, your question on the AUR elevation in bottoms.

Janet Kloppenburg - *JJK Research - Analyst*

You've noticed that Nike took their prices up on the bottoms, right? So I'm wondering what you guys are thinking?



Tara Poseley - *lululemon sthletica Inc - Chief Product Officer*

What we're really focused on is driving innovation in our bottoms category from and fabrics and fit. And we will price accordingly as we continue to drive forward in innovation.

So again, we are always looking forward. We are the leaders in driving innovation in the bottoms category, and we'll price accordingly.

Janet Kloppenburg - *JJK Research - Analyst*

Great. Congrats on a good quarter.

Stuart Haselden - *lululemon athletica Inc - CFO*

Thanks, Janet.

Operator

Thank you. That concludes the Q&A session. I will now turn the call back over to Chris Tham for closing remarks.

Chris Tham - *lululemon athletica Inc - SVP of Finance*

Thank you, operator. That concludes our call for today. Thank you everyone for joining us. Goodbye.

Operator

Thank you, ladies and gentlemen. That does conclude today's conference. You may all disconnect, and everyone have a great day.

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