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Q2 Fiscal 2020 Earnings Commentary

As a result of the COVID-19 pandemic, we have taken actions to temporarily close retail locations and to reduce operating hours. In February 2020, we temporarily closed all of our retail locations in Mainland China. In March 2020, we temporarily closed all of our retail locations in North America, Europe, and certain countries in Asia Pacific. The stores in Mainland China reopened during the first quarter of fiscal 2020, and stores in other markets began reopening during the second quarter of fiscal 2020. As of August 2, 2020, 492 of our 506 company-operated stores were open.

The financial measures discussed below include both GAAP and adjusted non-GAAP financial measures. Please see the section captioned "Reconciliation of Non-GAAP Financial Measures" included in the accompanying financial tables, which include more detail on the GAAP financial measures that are most directly comparable to the non-GAAP financial measures, and the related reconciliation between these financial measures.

This earnings commentary should be read in conjunction with our quarterly report on Form 10-Q filed with the Securities and Exchange Commission ("SEC") on, or about, September 8, 2020 and our annual report on Form 10-K filed with the SEC on March 26, 2020. These reports are available at www.sec.gov.

The below narrative compares the second quarter of fiscal 2020 to the second quarter of fiscal 2019, unless otherwise noted.

Sales

- **Total net revenue** increased 2% to $902.9 million, with the increase primarily due to increased direct to consumer net revenue. This was partially offset by a decrease in company-operated store net revenue, as well as a decrease in net revenue from our other channels driven by temporary retail location closures as well as reduced operating hours and limited guest occupancy levels as a result of COVID-19.

- **Company-operated store revenue** totaled $287.2 million, or 31.8% of total revenue, compared to $583.8 million, or 66.1% of total revenue, in Q2 2019.

- **E-commerce revenue** totaled $554.3 million, or 61.4% of total revenue, compared to $217.6 million, or 24.6% of total revenue, in Q2 2019. Direct to consumer net revenue increased 155%, or increased 157% on a constant dollar basis. We held an online warehouse sale during the second quarter of fiscal 2020 which generated net revenue of $43.3 million.

- **Other revenue** which includes net revenues from outlets, temporary locations, sales to wholesale accounts, license and supply arrangements, and from the sale of in-home fitness equipment and associated content subscriptions, totaled $61.4 million, or 6.8% of total net revenue, compared to $82.0 million, or 9.3% of total net revenue, in Q2 2019.

Store Count

- **New stores**: We opened eight company-operated stores in the U.S., seven company-operated stores in Asia, and two in Europe in Q2 2020.

- **Total company-operated stores**: At the end of Q2 2020, we had 506 total company-operated stores compared to 460 at the end of Q2 2019.

Gross Profit

- **Gross profit** was $489.5 million, or 54.2% of net revenue, compared to $485.8 million, or 55.0% of net revenue, in Q2 2019. Gross margin decreased 80 basis points compared to Q2 2019.

The decrease in gross margin was primarily the result of:

- an increase in costs as a percentage of revenue related to our distribution centers of 130 basis points; and
- an unfavorable impact of foreign exchange rates of 20 basis points.

This was partially offset by a decrease in costs related to our product departments as a percentage of revenue of 40 basis points, and a decrease in depreciation and occupancy costs as a percentage of revenue of 30 basis points. Product margin was consistent with the second quarter of fiscal 2019 primarily due to lower product costs, and a favorable mix of higher margin product, offset by higher markdowns.

Selling, General and Administrative Expenses

- **SG&A expenses** were $352.9 million, or 39.1% of net revenue, compared to $317.8 million, or 36.0% of net revenue, in Q2 2019. The deleverage of 310 basis points was primarily the result of 190 basis points of deleverage on operating channel costs primarily due to temporary retail location closures as well as reduced operating hours and limited guest occupancy levels as a result of COVID-19, and 60 basis points of deleverage on depreciation.

Amortization of Intangible Assets and Acquisition-Related Expenses

- **Amortization of intangible assets** was $0.7 million in the second quarter of fiscal 2020. This was primarily the result of the recognition of intangible assets of $85.0 million as a result of our acquisition of MIRROR in the second quarter of fiscal 2020. We did not recognize an expense for the amortization of intangible assets in the second quarter of fiscal 2019.

- **Acquisition-related expenses** of $11.5 million were recognized in the second quarter of fiscal 2020 as a result of our acquisition of MIRROR. We did not have acquisition-related expenses in the second quarter of fiscal 2019.

Operating Income

- **Operating income** was $124.4 million, or 13.8% of net revenue, compared to $168.0 million, or 19.0% of net revenue, in Q2 2019. Adjusted operating income, which excludes acquisition-related expenses, was $135.9 million, or 15.0% for Q2 2020.

Income Tax Expense

- **Income tax expense** was $37.3 million compared to $44.8 million in Q2 2019 and the effective tax rate was 30.0% compared to 26.4% in Q2 2019. The adjusted effective tax rate was 28.9% for Q2 2020. The increase in the adjusted effective tax rate was primarily due to new regulations which resulted in additional foreign tax credits being recognized in the second quarter of fiscal 2019.

Net Income

- **Net income** was $86.8 million, or $0.66 per diluted share, compared to $0.96 per diluted share in Q2 2019. Adjusted diluted earnings per share were $0.74 in Q2 2020.

Share Count

- Our diluted share count for both Q2 2020 and 2019 was 130.8 million.
- During the second quarter of fiscal 2020, we did not repurchase any shares.

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Capital Expenditures

- **Capital expenditures** were $52.6 million in Q2 2020 compared to $67.3 million in Q2 2019. The decrease was primarily the result a decrease in capital expenditures for our company-operated stores.

Balance Sheet Highlights

- Cash and cash equivalents were $523.0 million at the end of Q2 2020 and the available capacity under our committed revolving credit facilities was $697.7 million.
- Inventory increased 36% to $672.8 million at the end of Q2 2020 compared to Q2 2019.

Forward-Looking Statements and Non-GAAP Reconciliations

Forward-Looking Statements:

This supplemental disclosure includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. In many cases, you can identify forward-looking statements by terms such as "may," "will," "should," "expects," "plans," "anticipates," "outlook," "believes," "intends," "estimates," "predicts," "potential" or the negative of these terms or other comparable terminology. These forward-looking statements also include our guidance and outlook statements. These statements are based on management's current expectations but they involve a number of risks and uncertainties. Actual results and the timing of events could differ materially from those anticipated in the forward-looking statements as a result of risks and uncertainties, which include, without limitation: our ability to maintain the value and reputation of our brand; the current COVID-19 coronavirus pandemic and related government, private sector, and individual consumer responsive actions; the acceptability of our products to our guests; our highly competitive market and increasing competition; our reliance on and limited control over third-party suppliers to provide fabrics for and to produce our products; suppliers or manufacturers not complying with our Vendor Code of Ethics or applicable laws; the operations of many of our suppliers are subject to international and other risks; an economic recession, depression, or downturn or economic uncertainty in our key markets; increasing product costs and decreasing selling prices; our ability to anticipate consumer preferences and successfully develop and introduce new, innovative and updated products; our ability to accurately forecast guest demand for our products; our ability to safeguard against security breaches with respect to our information technology systems; any material disruption of our information systems; our ability to have technology-based systems function effectively and grow our e-commerce business globally; changes in consumer shopping preferences and shifts in distribution channels; the fluctuating costs of raw materials; our ability to expand internationally in light of our limited operating experience and limited brand recognition in new international markets; global economic and political conditions and global events such as health pandemics; our ability to deliver our products to the market and to meet guest expectations if we have problems with our distribution system; imitation by our competitors; our ability to protect our intellectual property rights; our ability to source and sell our merchandise profitably or at all if new trade restrictions are imposed or existing trade restrictions become more burdensome; our ability to realize the potential benefits and synergies sought with the acquisition of MIRROR, our operating flexibility given the significant costs incurred in connection with the acquisition of MIRROR, our ability to grow the MIRROR business and have it achieve profitability; changes in tax laws or unanticipated tax liabilities; our ability to manage our growth and the increased complexity of our business effectively; our ability to cancel store leases if an existing or new store is not profitable; increasing labor costs and other factors associated with the production of our products in South and South East Asia; our ability to successfully open new store locations in a timely manner; our ability to comply with trade and other regulations; the service of our senior management; seasonality; fluctuations in foreign currency exchange rates; conflicting trademarks and the prevention of sale of certain products; our exposure to various types of litigation; actions of activist stockholders; anti-takeover provisions in our certificate of incorporation and bylaws; and other risks and uncertainties set out in filings made from time to time with the United States Securities and Exchange Commission and available at www.sec.gov, including, without limitation, our most recent reports on Form 10-K and Form 10-Q. You are urged to consider these factors carefully in evaluating the forward-looking statements contained herein and are cautioned not to place undue reliance on such forward-looking statements, which are qualified in their entirety by these cautionary statements. The forward-looking statements made herein speak only as of the date of this disclosure and we undertake no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances, except as may be required by law.

Reconciliation of Non-GAAP Financial Measures

Unaudited; In thousands, except per share amounts

Constant dollar changes

The below changes in net revenue show the net change for Q2 2020 compared to Q2 2019.

	Direct to Consumer Net Revenue
Change	155 %
Adjustments due to foreign exchange rate changes	2
Change in constant dollars	157 %

Adjusted financial measures

The following table reconciles adjusted financial measures for Q2 2020 with the most directly comparable measures calculated in accordance with GAAP. The adjustments relate to the acquisition of MIRROR and its related tax effects. Please refer to Note 3 to the unaudited consolidated financial statements included in Item 1 of Part I of our Report on Form 10-Q to be filed with the SEC on or about September 8, 2020 for further information on these adjustments.

	Income from Operations	Operating Margin	Income Tax Expense	Effective Tax Rate	Net Income	Diluted Earnings Per Share
GAAP results	$ 124,409	13.8 %	$ 37,264	30.0 %	$ 86,801	$ 0.66
Transaction and integration costs	7,201	0.8			7,201	0.06
Gain on existing investment	(782)	(0.1)			(782)	(0.01)
Acquisition-related compensation	5,045	0.5			5,045	0.04
Tax effect of the above			1,967	(1.1)	(1,967)	(0.01)
Adjusted results (non-GAAP)	$ 135,873	15.0 %	$ 39,231	28.9 %	$ 96,298	$ 0.74