Q3 Fiscal 2020 Earnings Commentary

As a result of the COVID-19 pandemic, all of our retail locations in North America, Europe, and certain countries in Asia Pacific were temporarily closed during the first quarter of fiscal 2020. We began reopening our retail locations in these markets during the second quarter of fiscal 2020 and almost all locations were open during the third quarter of fiscal 2020. Subsequent to November 1, 2020, while almost all of our retail locations have remained open, we have experienced some temporary closures and are currently operating with tighter capacity restrictions in certain markets.

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, December 10, 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 third quarter of fiscal 2020 to the third quarter of fiscal 2019, unless otherwise noted.

Sales

- **Total net revenue** increased 22% to $1.1 billion, with the increase primarily due to increased direct to consumer net revenue, partially due to a shift in the way guests are shopping due to COVID-19, as well as due to an increase in net revenue from our other channels. The increase was partially offset by a decrease in company-operated store net revenue driven by reduced operating hours and restricted guest occupancy levels, as well as temporary closures as a result of COVID-19. Total comparable sales increased 19%, or increased 18% on a constant dollar basis.
- **Company-operated store revenue** totaled $511.8 million, or 45.8% of total revenue, compared to $579.5 million, or 63.3% of total revenue, in Q3 2019. Comparable store productivity was 83%, or 82% on a constant dollar basis, representing a comparable store sales decrease of 17%, or a decrease of 18% on a constant dollar basis.
- **E-commerce revenue** totaled $478.3 million, or 42.8% of total revenue, compared to $246.7 million, or 26.9% of total revenue, in Q3 2019. Direct to consumer net revenue increased 94%, or increased 93% on a constant dollar basis.
- **Other revenue** which includes net revenues from outlets, temporary locations, sales to wholesale accounts, license and supply arrangements, and the sales of in-home fitness equipment and associated content subscriptions, totaled $127.4 million, or 11.4% of total net revenue, compared to $89.9 million, or 9.8% of total net revenue, in Q3 2019.

Store Count

- **New stores**: We opened five net new company-operated stores in the U.S., three in Asia, and one in Europe in Q3 2020.
- **Total company-operated stores**: At the end of Q3 2020, we had 515 total company-operated stores compared to 479 at the end of Q3 2019. Of the 515 company-operated stores, 416 were in our comparable store base, including 266 stores in the U.S., 54 stores in Canada, 43 stores in Asia, 29 stores in Australia/New Zealand, and 24 stores in Europe.

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Gross Profit

- **Gross profit** was $627.4 million, or 56.1% of net revenue, compared to $505.0 million, or 55.1% of net revenue, in Q3 2019. Gross margin increased 100 basis points compared to Q3 2019.

  The increase in gross margin was primarily the result of:

  – a decrease in depreciation and occupancy costs as a percentage of revenue of 170 basis points, driven primarily by the increase in net revenue; and

  – a favorable impact of foreign exchange rates of 10 basis points.

  This was partially offset by a decrease in product margin of 80 basis points, primarily due to higher air freight costs as a result of COVID-19 capacity constraints and higher markdowns.

Selling, General and Administrative Expenses

- **SG&A expenses** were $411.7 million, or 36.8% of net revenue, compared to $329.2 million, or 35.9% of net revenue, in Q3 2019. The deleverage of 90 basis points was primarily the result of 170 basis points of deleverage from our operating channel costs primarily due to MIRROR, partially offset by 80 basis points of leverage from head office costs.

Amortization of Intangible Assets and Acquisition-Related Expenses

- **Amortization of intangible assets** was $2.2 million in the third quarter of fiscal 2020, an increase from less than $0.1 million in the third quarter of fiscal 2019. This increase 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.

- **Acquisition-related expenses** of $8.5 million were recognized in the third quarter of fiscal 2020 related to our acquisition of MIRROR. We did not have acquisition-related expenses in the third quarter of fiscal 2019.

Operating Income

- **Operating income** was $204.9 million, or 18.3% of net revenue, compared to $175.8 million, or 19.2% of net revenue, in Q3 2019. Adjusted operating income, which excludes acquisition-related expenses, was $213.5 million, or 19.1% for Q3 2020.

Income Tax Expense

- **Income tax expense** was $60.7 million compared to $51.8 million in Q3 2019 and the effective tax rate was 29.7% compared to 29.1% in Q3 2019. The adjusted effective tax rate was 28.9% for Q3 2020.

Net Income

- **Net income** was $143.6 million, or $1.10 per diluted share, compared to $0.96 per diluted share in Q3 2019. Adjusted diluted earnings per share were $1.16 in Q3 2020.

Share Repurchases

- During the third quarter of fiscal 2020, we did not repurchase any shares. On December 1, 2020, our board of directors approved an increase in the remaining authorization of our existing stock repurchase program from $263.6 million to $500.0 million.

Capital Expenditures

- **Capital expenditures** were $66.1 million in Q3 2020 compared to $78.5 million in Q3 2019. The decrease was primarily the result of decreased capital expenditures for our head office and company-operated stores, partially offset by increased capital spend in our direct to consumer segment.

Balance Sheet Highlights

- Cash and cash equivalents were $481.6 million at the end of Q3 2020 and the available capacity under our committed revolving credit facilities was $697.3 million. On December 4, 2020, we gave notice to terminate our $300.0 million 364-day unsecured revolving credit facility and it will be terminated without penalty on December 11, 2020. Following this termination, we will have available capacity of $397.3 million under our unsecured five-year revolving credit facility which matures on June 6, 2023.

- Inventory increased 23% to $771.0 million at the end of Q3 2020 compared to Q3 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; our highly competitive market and increasing competition; 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; changes in consumer shopping preferences and shifts in distribution channels; our ability to expand internationally in light of our limited operating experience and limited brand recognition in new international markets; our ability to realize the potential benefits and synergies sought with the acquisition of MIRROR; our ability to manage our growth and the increased complexity of our business effectively; our ability to successfully open new store locations in a timely manner; seasonality; our reliance on and limited control over third-party suppliers to provide fabrics for and to produce our products; the operations of many of our suppliers are subject to international and other risks; suppliers or manufacturers not complying with our Vendor Code of Ethics or applicable laws; our ability to deliver our products to the market and to meet guest expectations if we have problems with our distribution system; increasing labor costs and other factors associated with the production of our products in South and South East Asia; 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; an economic recession, depression, or downturn or economic uncertainty in our key markets; global economic and political conditions and global events such as health pandemics; 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; changes in tax laws or unanticipated tax liabilities; our ability to comply with trade and other regulations; fluctuations in foreign currency exchange rates; imitation by our competitors; our ability to protect our intellectual property rights; conflicting trademarks and the prevention of sale of certain products; our exposure to various types of litigation; 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 press release 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.

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Reconciliation of Non-GAAP Financial Measures

Unaudited; In thousands, except per share amounts

Constant dollar changes

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

	Quarter Ended November 1, 2020		
	Total Comparable Sales[1,2]	Comparable Store Sales[2]	Direct to Consumer Net Revenue
Change	19 %	(17)%	94 %
Adjustments due to foreign exchange rate changes	(1)	(1)	(1)
Change in constant dollars	18 %	(18)%	93 %

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

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

The below table shows comparable store sales[1] as a percentage of the net revenue generated from these company-operated stores in the corresponding period of the prior year.

	Quarter Ended November 1, 2020
Comparable store productivity	83 %
Adjustments due to foreign exchange rate changes	(1)
Comparable store productivity in constant dollars	82 %

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

Adjusted financial measures

The following table reconciles adjusted financial measures for Q3 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 December 10, 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	$ 204,920	18.3 %	$ 60,697	29.7 %	$ 143,643	$ 1.10
Transaction and integration costs	1,017	0.1			1,017	0.01
Acquisition-related compensation	7,514	0.7			7,514	0.06
Tax effect of the above			896	(0.8)	(896)	(0.01)
Adjusted results (non-GAAP)	$ 213,451	19.1 %	$ 61,593	28.9 %	$ 151,278	$ 1.16