2013 Valuation Report:

Lululemon Athletica Inc.

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lululemon athletica

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Introduction

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Chief Executive Officer

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Ending Date of Last Fiscal Year:

February 2, 2014

Principal Products and Service:

Lululemon's primary demographical focus is towards educated and sophisticated women who believe in maintaining a healthy lifestyle by exercising. These women tend to balance family and a career while trying to achieve a level of physical fitness. Lululemon reaches these women in stores and through online offers. The demographic goes beyond focusing on those who are athletes because Lululemon wants to provide products for females that want to live a balanced and healthy life. Their products include materials that are comfortable and quality. Not only is Lululemon providing athletic wear for women, but they are also trying to reach out to men by designing products specifically for them.

Products include:

- **Tops:** Tanks, short-sleeves, jackets, and hoodies
- **Pants**: Pants by fit, cropped pants, shorts, and skirts
- **Swim Apparel**
- **Accessories**: Headbands, yoga mats, props, socks, and undergarments

Lululemon even goes as far as having different types of fabrics and technologies for various uses. The fabrics used are:

- **Luon**: Signature fabric used to handle serious sweat and stretch.
- **Swift:** A versatile fiber that allows an easier flow for movement and stretch.
- **Luxtreme**: A high-performance fabric designed for long workouts and runs.
- **Natural Blends**: Multiple fibers that are used together to sustain breathability and shape.
- **Mesh and liners**: A material that keeps the user feeling lightweight and with a sense of stretchy ventilation.

Main Geographic Area of Activity:

Lululemon was founded in 1998 but became publicly traded in 2005. The first store was in the Kitsilano neighborhood of Vancouver, BC. Besides having various stores in seven areas of Canada, Lululemon has reached seven other countries, including major coverage in Australia and the United States. Within the United States, Lululemon has numerous stores in 45 of the 50 states. Lululemon has expanded greatly across the globe since it was first founded and continues to grow today.

Price of Companies Stock

All information as of March 18th, 2014

Ticker: LULU

Price	**$49.12**
Year to Date % Change	**-16.16%**
P/E	**24.82**
Beta	**1.24**
52 weeks	**44.32-82.50**
Market Cap	**7.12 billion**
Earnings Per Share	**1.90**

Industry Synopsis

Lululemon is a high-end athletic apparel provider, competing amongst a large variety of companies. It operates in the Textile – Apparel Clothing industry but concentrates on a niche of that market. It does not expand beyond athletic and yoga apparel/accessories, which has really helped Lululemon make a name for itself in that niche.

Lululemon

The popularity of this kind of apparel, associated with the recent growing interest in yoga, has increased rapidly over the past decade. Lululemon profited greatly from this growing market, but competitors also quickly sprang up to meet this new demand. Lululemon's perfect competitors—other brands of athletic/yoga apparel—are privately owned or supported by larger companies. There is no other publicly traded company that focuses on the same market niche as Lululemon. Some of its closest competitors are Athleta (by The Gap Inc.), Lily Lotus, Mika, Nike's yoga line, and Soybu. It is difficult to compare these companies because every other exclusively yoga-niche company is not publicly traded, and the other lines are supported by companies with various other products incorporated in their financials.

Athleta

However, although financial information may not be readily available for privately owned companies or a specific line of apparel, it is evident how this increasing competition has impacted Lululemon. Lululemon opened as a high-end option for the market. Its customers were loyal and the brand quickly gained esteem. But competitors to Lululemon are now producing products almost indiscernible from Lululemon's "high-quality" products and at a significantly cheaper price. Lululemon is losing many customers to these other companies that are providing almost identical products at a fraction of the cost.

Soybu

Even with these cheaper competitors, Lululemon continued to benefit from the perception of the brand. Many consumers splurge on higher-priced items, even if they possess little quality improvements, simply because of the name and status these products possess. The status appeal phenomenon attracts consumers in a variety of industries. However, Lululemon recently injured its status appeal in a highly publicized recall of its yoga pants.

The recalled pants were found to be somewhat transparent, naturally angering many customers who had spent so much money on a “quality” product. As if this was not bad enough PR, Founder and Chairman Chip Wilson added to the bad press by suggesting that the products’ sheerness was caused by thicker thighs. He also attributed the translucence potentially to seatbelts or purses that should not be rubbing against the material. The statement further injured perception on the quality of Lululemon’s products, as well as insulted its customers.

Comparative Analysis

Stock Price Over Past 5 Years

Lululemon's stock price has experienced a generally increasing trend over the past five years, despite the recent decrease from September 2013 to now. Although sometimes volatile, this growth in stock price is impressive when compared to other companies in the industry. Adidas AG, The Gap, Inc., and Nike, Inc. have all remained pretty consistent in stock price, experiencing a slight increase from 2010 to 2014. Lululemon has grown by nearly 900% and peaked in June of 2013 a little above 1400%. Despite its high stock price, it opens opportunities for growth.

Profit Margin

Company *(Year-end numbers)*	2013 Profit Margin Ratio	2012 Profit Margin Raito
Lululemon	19.74%	18.39%
Adidas AG	5.79%	5.31%
The Gap, Inc.	7.06%	7.25%
Nike, Inc.	9.82%	9.53%

Lululemon's goal is to sell apparel at full price and to train customers to buy an item when they first see it instead of waiting. Gear is consistently cycled out, creating a limited supply. Lululemon sells 95% of its gear at full price, charging higher prices than many of its competitors. Its pants cost between $78 and $128, while lower-priced competitors such as The Gap Inc.'s Athleta sells yoga pants in the $25 to $50 range. Items are rarely put on sale and a strict return policy is in place. Lululemon's small stores and high prices allow for large profit margins by widening the gap between the company's operating costs and revenue.

The characteristics described before give reason to why Lululemon's Profit Margin is much greater than many of its competitors. Many of its competitors that are publicly traded are much larger, resulting in greater operating costs. In addition, Lululemon's high prices generate greater revenue for the company. Based on the performance of the other companies, it can be concluded that Lululemon is performing high above the industry standard.

Cash Flow

Company *(Year-end numbers)*	2013 Cash Flow to Sales Ratio	2012 Cash Flow to Sales Ratio
Lululemon	20.44%	20.34%
Adidas AG	4.37%	6.33%
The Gap, Inc.	10.56%	12.37%
Nike, Inc.	11.96%	8.14%

The Cash Flow to Sales Ratio indicates a company's ability to turn revenue into cash, which indicates the size of a company's operating cycle. Given Lululemon's profit margin, it is no surprise that it demonstrates a strong cash flow to sales ratio. The other companies cash flow to sales ratio is to be expected from their profit margins. While the industry experienced some fluctuation, Lululemon's cash flow to sales ratio remained pretty constant.

Industry Information (April 1, 2014)

Direct Competitor Comparison

	LULU	ADDYY	GPS	NKE	Industry
Market Cap:	7.70B	22.88B	18.32B	65.63B	1.36M
Employees:	N/A	43,537	137,000	48,000	1.09K
Qtrly Rev Growth (yoy):	0.07	0.03	-0.03	0.13	0.00
Revenue (ttm):	1.59B	18.76B	16.15B	27.07B	127.09M
Gross Margin (ttm):	0.54	0.49	0.47	0.44	0.37
EBITDA (ttm):	457.93M	1.83B	2.67B	4.17B	31.00M
Operating Margin (ttm):	0.26	0.08	0.13	0.14	0.25
Net Income (ttm):	279.55M	1.02B	1.28B	2.70B	N/A
EPS (ttm):	1.91	2.43	2.74	2.93	2.80
P/E (ttm):	27.74	22.46	14.96	25.40	0.07
PEG (5 yr expected):	1.51	-3.86	1.04	2.03	N/A
P/S (ttm):	4.80	1.21	1.11	2.41	0.01

The chart displayed above is provided by Yahoo Finance and shows key statistics for Lululemon, its competitors that have been discussed previously, and the industry. The industry is

Textile – Apparel Clothing, which falls into the Consumer Goods sector. The data worth noting is described below.

Revenue Growth

Although not a huge number, Lululemon's quarterly revenue growth is greater than the industry and the majority of its competitors. The industry average is 0%, so the fact that Lululemon is continuing to grow is a positive sign. In 2013, CNN Money rated Lululemon Athletica number 21 out of 100 in fastest-growing companies. This has been done through opening new stores and increasing its online presence. Over three years, its revenue growth averages 43%. This growth is expected to continue with the recent announcement by Chief Executive Laurent Potdevin to speed up global expansion. Nike has a larger quarterly revenue growth, but that is to be expected due to the fact that Nike is such a large company compared to Lululemon. However, The Gap, Inc.'s numbers are not perfect for comparison because Athleta's growth might not be accurately displayed in these numbers.

Gross Margin

Lululemon's gross margin is also greater when compared to its competitors and the industry. However, it must be noted that gross margin contracted 300 basis points to 53.5% in comparison to the prior-year quarter. This is because of a significant decline in the product margin. Lululemon incurs a smaller cost of goods sold when compared to Adidas, The Gap, and Nike, which lead to this larger gross margin ratio.

Market Capitalization

Lululemon's market cap is significantly lower than its competitors, however above the industry average. This is to be expected being that it is the textile – apparel-clothing industry which includes a diverse set of companies. Since the market cap numbers of Lululemon's competitors are above $10 billion making them large cap companies, it can be concluded that athletic companies have a big presence in the industry. Lululemon's market cap can be considered mid cap, deeming it a smaller company within the athletic apparel world.

INCOME STATEMENT

(In Thousands of $)	2011	2012	2013	2014
GROSS PROFIT	394,947	569,351	762,826	840,076
INCOME FROM OPERATIONS	180,391	286,958	376,439	391,358
NET INCOME	122,847	184,964	271,432	279,547

Lululemon's gross profit has increased since 2011 due to its strategic sales. Lululemon Athletica has a Strategic Sales team that partners with local entrepreneurs and athletes that express the same enthusiasm about elevating their communities. The Strategic Sales initiative has three components. The first is the wholesale program, which includes working with fitness and yoga studios so they can supply their guests with technical gear. The second is the yoga hard goods program, offering yoga studios fundamentals such as yoga mats, blocks, and straps. The third is the team sales program, getting teams into technical athletic gear.

The income from operations and net income increased from 2011 to 2014. In 2012 the company planned to expand to 35 new stores, two outlet stores, and new showrooms in the UK and Hong Kong. In 2013, Lululemon planned to open 38 new stores. Lululemon conducts research before opening a retail store. They first set up a showroom in the market, then go into the community and attend local yoga classes and interact with the athletes. The sales team encourages members of the community to visit their website. Once the team feels as though they have an understanding of the community and have gained acceptance and followers as demonstrated through online sales, they decide the market is ready for a retail store.

BALANCE SHEET

(2014) (In Thousands of $)
Assets = Stockholder's Equity + Liabilities
$1,249,688 = $1,096,682 + $153,006

(2013) (In Thousands of $)
Assets = Stockholder's Equity + Liabilities
$1,051,078 = $887,299 + $163,779

(2012) (In Thousands of $)
Assets = Stockholder's Equity + Liabilities
$734,634 = $606,181 + $128,453

(2011) (In Thousands of $)
Assets = Stockholder's Equity + Liabilities
$499,302 = $394,293 + $105,009

STATEMENT OF CASH FLOWS

(In Thousands of $)	2011	2012	2013	2014
Total cash provided by (used in)				
OPERATING ACTIVITIES	$179,995	$203,615	$280,113	$278,339
INVESTING ACTIVITIES	(42,839)	(122,311)	(93,229)	(106,408)
FINANCING ACTIVITIES	13,699	(3,517)	(5,491)	8,907

Cash provided by operating activities increased from 2011 to 2013, which is mainly due to increased net income, an increase in items not affecting cash, and an increase in income taxes payable, alongside a decrease in accounts payable. An increase in depreciation and amortization, correlated to an increase in the number of stores, is the cause of the net increase in items not affecting cash.

The variation in investing activities is related to capital expenditures and acquisitions of franchises. Financing activities consist mainly of cash received on the exercise of stock options, excess tax benefits from stock-based compensation and cash paid to obtain the remaining non-controlling interest in Australia.

Liquidity Ratios

Ratios	2009	2010	2011	2012	2013	2014
Working Capital	$71,653	$157,732	$303,915	$423,654	$653,696	$829,000
Current Ratio	2.58	3.69	4.56	5.10	5.90	8.31
Acid Test Ratio	1.34	2.86	3.81	4.01	4.47	6.26
Accounts Receivable Turnover	84.87 times	73.84 times	82.02 times	139.80 times	237.23 times	174.34 times
Days' Sales Uncollected	4.30 days	4.94 days	4.45 days	2.61 days	1.54 days	2.09 days
Inventory Turnover	3.83 times	4.78 times	6.24 times	5.34 times	4.69 times	4.40 times
Days' Inventory on Hand	94.15 days	76.33 days	58.50 days	68.33 days	77.90 days	82.93 days
Payables Turnover	38.48 times	36.17 times	34.96 times	53.76 times	96.33 times	85.68 times
Days' Payable	9.48 days	10.09 days	10.44 days	6.79 days	3.79 days	4.26 days

Working capital, current ratio, and acid test (quick) ratio for Lululemon all steadily increased over the last six years. Initially, working capital began at $71,653 and increased to $829,000, which is ten times higher. With such an increase, Lululemon strengthened its liquidity position and was able to meet its current obligations more easily. Another measurement that strengthened Lululemon's liquidity position was the fact that the current ratio steadily developed from 2.58 in 2009 to 8.31 in 2014. They were able to yield a higher current ratio because their assets outweighed their liabilities. It is better for Lululemon to have more assets than liabilities because it means that its ability to pay back its short-term debts is more realistic. The steady increase in current ratio also applies to the acid test ratio due to the fact that the acid test ratio is quick assets as opposed to current assets. The acid test ratio increased from 1.34 in 2009 to 6.26 over six years. The more efficiently quick assets can be turned into cash the better off Lululemon will be because the short-term debts can be paid off that much faster. Overall, the steady increase in working capital, current ratio, and acid test ratio demonstrate that Lululemon has a strong liquidity position and can stay on top of paying off short-term debts.

Another positive for Lululemon's financial position is the measurements from the six-year period for Days' Sales Uncollected. The numbers for this ratio are significantly low, which benefits Lululemon. With lower numbers for days' sales uncollected, Lululemon can receive its funds from accounts receivable more quickly. At first, the amount of time took a little over four days, but in 2010, the amount of time it took to receive the accounts receivable increased to almost five days. Thankfully for Lululemon, after the slight spike in 2010 the amount of days dropped slightly to 4.45 days. The difference in time between 2011 and 2012 greatly benefited Lululemon's accounts receivable because the time decreased significantly from 4.45 days to 2.61 days. The steady decrease continued into 2013, and now Lululemon receives its funds in about one and a half days. Between 2013 and 2014 the amount of time it took for funds to return to Lululemon took about two days. Receiving cash so quickly benefits Lululemon and progresses its profitability while strengthening its liquidity. One weakness for Lululemon is its inventory turnover. Within a year the amount of times the inventory is turned over is significantly lower than it should be. In 2011 the inventory turnover was at its peak over the six years--6.24 times within the year. It is steadily decreasing now and is at 4.40 in 2014. Hopefully, it changes from decreasing to a steady increase like it did from 2009 to 2011 (3.83 times to 6.24). The more the inventory is turned over the more sales are being made. Days' sales in inventory is also presenting Lululemon with a problem. From 2009 to 2011 the inventory, reflected in inventory turnover, decreased, benefitting Lululemon although the amount of days were still very high. Between the three-year period (2009-2011) the amount of days it took for inventory to be sold decreased by 35 days (94.15 days in 2009 to 58.50 days in 2011). Until 2012, the decrease in the amount of days projected to sell the inventory put Lululemon on a good path, but then the amount of days it took to sell increased by ten days, then another nine days in 2013, followed by five days in 2014. New ways to sell inventory more quickly will lead to the need for inventory to be turned over more frequently. Both go hand in hand and need to be adjusted in years to come.

Lululemon is on top of its financials in regards to paying debts and paying it accounts payable. Both the payables turnover ratio and days' payable reflect its efficient and effective behavior. Payables were turned over by Lululemon a very small amount in 2009 (38.48 times within the year), but most recently in 2013 the payables are turned over much more quickly. In fact, they are turned over almost three times as fast (2.5 times). The smallest amount of times that the payables were turned over was in 2011 at 34.96 times in a year, but they were at an all time high of 96.33 times in 2013. Days' payable reflects positively on Lululemon, similar to payables turnover, because as of 2013 it only took Lululemon 3.79 days to pay its accounts payable, opposed to 9.48 days in 2009 or at the peak in 2011 of 10.44 days.

Overall, Lululemon can quickly and efficiently pay its short-term debts, which is apparent by its strong liquidity position (working capital, current ratio, and quick ratio), while paying its accounts payable quickly. Lululemon's inventory turnover and days' sales uncollected needs to improve in order to return to it's peak, but Lululemon should maintain their work in regards to assets, liabilities, accounts receivable, and accounts payable to continue being successful.

Profitability Ratios

Ratios	2009	2010	2011	2012	2013	2014
Profit Margin	11.46%	12.87%	17.17%	18.48%	19.81%	17.57%
Gross Margin	50.66%	49.26%	55.50%	56.89%	55.67%	52.8%
General Gross Takeaway	65.95%	61.04%	53.88%	49.60%	50.65%	44.70%
Asset Turnover	1.67 times	1.75 times	1.76 times	1.62 times	1.53 times	1.38 times
Return on Assets	19.14%*	22.46%	30.21%	29.83%	30.30%	24.30%
Return on Equity	26.16%*	30.05%	38.95%	36.98%	36.35%	28.18%

Profitability ratios are used to analyze a business' earnings in comparison to its expenses in the same period. They evaluate a company's ability to produce earnings and are beneficial when comparing to competitors in the same industry. Better profitability ratios suggest that the company is more efficiently earning a profit.

The profit margin of Lululemon has increased steadily each year since 2009, indicating that the company has progressively improved its ability to earn money from sales. In 2013 Lululemon kept $19.81 for every $100 in sales, whereas its closest publicly traded competitor, Nike, has a profit margin of only 9.82%. Lululemon's higher ratio suggests that it is more profitable and has better control over its costs than Nike. However, because Nike sells goods other than athletic clothing (such as shoes) this comparison may be skewed. The nature of the good produced and sold significantly affects profit margin, which is why the ratio is best used to compare companies within the same industry. The gross margin of Lululemon has increased over time but fluctuated slightly between years. It ended 2013 at 55.67%, indicating that the company retains this percentage of sales after cost of goods sold is removed. This fluctuation is caused by changing cost of goods sold relative to net sales. Reducing cost of goods sold while maintaining net sales would increase profit.

The increasing profitability of Lululemon can partially be attributed to the company spending a smaller percentage of its gross profit on administrative, selling, and general expenses. This percentage, referred to as “general gross takeaway,” has fallen 21.25% between 2009 and 2014, which demonstrates that the company has learned to better control these costs, thus increasing net income.

In contrast, Lululemon’s asset turnover began to increase from 2009-2011 but is now in a minor decline. However, its return on assets (ROA) has steadily increased, with more than a 10% increase from 2009-2013 until a drop of 6% in the past year. This suggests that Lululemon is improving its ability to generate profit from every dollar of assets. The higher the return on assets ratio, the greater profit Lululemon will be able to make from the same amount of assets.

Return on equity (ROE) measures how much profit a company can generate for every dollar shareholders have invested. Lululemon’s ROE has increased by 10% from 2009-2013, indicating that the company has made better usage of this investment. However, 2014 showed a sharp drop in ROE. According to the DuPont Analysis, ROE is affected by operating efficiency, measured by profit margin, asset use efficiency, measured by total asset turnover, and financial leverage, measured by the equity multiplier (assets/equity.) This makes sense considering that in 2014 there was also a drop in profit margin and total asset turnover. Lululemon’s ROE has become less efficient likely due to the decrease in sales caused by the recall and poor PR.

Lululemon’s profitability ratios had been constantly improving and growing with time but recently began to stagnate and drop slightly. This can be attributed to a high-profile recall on clothing and subsequent major PR issues in the past year. The company was forced to recall its black yoga pants due to transparency issues, and also suffered from founder Chip Wilson’s comment that some female body types were not ideal for Lululemon yoga pants. This comment triggered much negative attention and resulted in a sharp decline in sales. The company is currently trying to recover from these setbacks and have released statements that it has learned, grown, and improved and is entering 2014 with humility.

Long Term Solvency Ratios

Ratios	2009	2010	2011	2012	2013	2014
Liability to Equity	36.68%	31.81%	26.63%	21.19%	18.46%	13.95%
Debt to Equity	0.0	0.0	0.0	0.0	0.0	0.0

Long-term solvency ratios are used to indicate a company's capital structure by identifying its financing sources and foreshadowing a company's ability to meet its obligations in the long term. Remarkably, Lululemon has a debt-to-equity ratio of zero, indicating that the company finances itself solely through equity retained from shareholders.

Since Lululemon is growing at an exponential rate, the company is able to get away with relying solely on equity from shareholders to finance its growth. At the moment, its remarkable growth is able to support the company, however, in the future, as growth stagnates, Lululemon may need to seek alternative financing for its expansions, most likely through debt, but is currently considered very solvent.

This high solvency makes this company rather stable and less of a risk to shareholders for two reasons: first, the company shows strong ability to meet long term needs; and second, if the company were to fail, there are no creditors to be reimbursed so the remaining worth of the company would go directly to the shareholders.

Cash Flow Adequacy Ratios

Ratios	2009	2010	2011	2012	2013	2014
Cash Flow Yield	1.15	2.02	1.47	1.10	1.03	1.00
Cash Flows to Sales	13.14%	26.05%	25.29%	20.34%	20.44%	17.49%
Cash Flows to Assets	21.94%*	45.47%	44.63%	33.00%	31.37%	24.20%

Lululemon's cash flow yield remained between 1.00 and 2.02, with 2.02 being its peak in 2010. Both net cash flow from operating activities and net income experienced increasing trends from 2009 to 2013. In 2014 Lululemon experienced a decrease in net cash flow from operating activities, although net income continued to increase. The peak in 2010 resulted from a great increase in net cash flow from operating activities, which increased from $46,438 in 2009 to $117,960 in 2010. 2014 has the lowest cash flow yield within those six years. The decrease from 2010 to 2014 is not a good sign for investors.

Lululemon's cash flows to sales shows a similar trend as its cash flow yield. It increased from 2009 to 2010, but then decreased until 2012, remaining very similar until 2013 and then dropped in 2014. Operating cash flow and net sales increased from 2009, which is a positive sign. However, a consistent or improving percentage is appealing to investors, which is not exhibited by Lululemon. Lululemon's recent decrease in cash flows to sales demonstrates a reduction in its ability to convert its sales into cash.

Following the pattern, cash flow to assets decreased from 2010 to 2014. This ratio compares a company's cash to its size and is vital because a company must have cash moving. If cash flow to assets continues to decrease, Lululemon might encounter problems with cash.

Market Strength Ratio

Ratios	2009	2010	2011	2012	2013	2014
Earnings Per Share	$0.29	$0.41	$0.85	$1.27	$1.85	$1.91
Price Earnings per Share	$23.28	$68.88	$80.72	$50.49	$36.68	$28.34
Dividends Yields Per Share	0.0	0.0	0.0	0.0	0.0	0.0

The ratios above are rather conclusive and would suggest that Lululemon's market strength is somewhat low. The price earnings per share of Lululemon peaked in 2011, indicating the growth opportunities of the company have also peaked.

It would appear as if this peak could be attributed to the rapid influx of competition in Lululemon's market. Lululemon was one of the first companies in its market, allowing it to quickly gain popularity and initial market power. While the net income of the company has steadily increased over the years, which can be attributed to the huge expansion of buyers to the high quality yoga and exercise clothes market, Lululemon has lost its dominance and share of the market. Along with the increase in demand by changes in consumers' preferences, there has been a huge increase of the supply of the market as many competitors have noticed the demand and opened business. Essentially, while there has been growth in the market, Lululemon has lost its dominance and its large share of the market.

As far as dividend yields are concerned, Lululemon disclosed in its 2012 Annual Report that the company has "never declared nor paid any cash dividends on our [their] common stock and do not anticipate paying any cash dividends on our [their] common stock in the foreseeable future." This indicates that Lululemon reinvests all its earnings back into the company, which is typical of a young corporation. By not paying dividends, Lululemon, which has only been incorporated since 2005, is most likely retaining its cash to expand business—acquire new assets, launch new products, etc.—and attempt to regain a foothold in its market.

Overall, the market strength of Lululemon is rather low as its growth opportunities have already peaked and are steadily decreasing. While still a young and growing company, it would appear as though Lululemon's dominance and market power was short lived.

Lululemon has been very successful since its opening in 1998. The company has constantly improved and expanded, increasing its profitability through the years. The corporation is really strong and in a good position for continued future success. However, Lululemon has experienced a couple major setbacks over the past few years, which have impacted its performance. The company is still in recovery from these occurrences, but should be able to bounce back within the next year.

At the time of Lululemon's opening, there was not much competition in the market for an athletic/yoga brand. Lululemon filled this niche and gained exponentially from the growing demand for yoga apparel. Although Lululemon did so well because it jumped on board early, eventually others noticed the growing demand and success of Lululemon. This performance attracted many similar businesses to open, expanding the market niche and forcing Lululemon to begin competing with other companies. These competitors distinguished themselves from Lululemon by providing products similar in quality and appearance but at a much more affordable price point. In addition, these companies have more lenient return policies, which has attracted consumers frustrated with the severe restrictions of Lululemon's policy. Sales or clearance prices are extremely rare for Lululemon, because the company wants to keep its products on the high-end portion of the market niche. Finally, Lululemon is criticized for not offering plus-sized apparel. Lululemon's clothing sizes stop at size 12, whereas its competitors offer plus-sized products. The plus-sized apparel purchasing population makes up 67% of the market, which is a significant loss of potential profit for Lululemon.

However, Lululemon benefits from the status of its brand. Consumers are often willing to pay much higher prices for products of similar quality simply due to the "status" these products are believed to possess. Lululemon's concentration on the high-end portion of the market niche provides them with this status appeal, attracting consumers wishing to own a well-known, top quality brand of athletic or yoga apparel.

This is Lululemon's primary advantage against its competitors, but it has recently damaged this image due to a highly publicized recall of its yoga pants. The company had to recall 17% of its yoga pants due to transparency issues, angering consumers who had spent so much money for a quality product. In response to this recall, Founder and Chairman Chip Wilson attributed the sheerness of the pants to women whose bodies "just actually don't work" for yoga pants due to "the rubbing through the thighs, how much pressure is there over a period of time, and how much they use it." This controversial comment instigated a negative perception of the company and poor PR. Since then, a new CEO, Laurent Potdevin, has been hired with the intention of working with his co-workers to restore the image of Lululemon. Although the company is working on repairing the image of the brand, this comment has already caused the success of the company to take a sharp downturn and is reflected in its financial statements.

Lululemon's market strength peaked in 2011 and has continued to decrease since then by significant amounts. The company has lost its market power due to the influx of competitors into its niche of the market. With the increase of competitors, Lululemon was now substitutable and lost its dominance. While the company may never reach the same level of market power, we believe that the company is strong enough to recover from this and regain a hold in the market.

Lululemon's return on equity ratio has also reflected this recent trend as, like most of the company's ratios, it peaked in 2011, indicating that the company is utilizing its equity base less efficiently. Lululemon's inventory turnover and days' inventory on hand also display this trend as their values peaked in 2010. Lululemon prides itself on its ability to cycle inventory quickly in and out of its stores, but the rising days' inventory on-hand value indicates that they are not able to cycle its inventory as quickly as they would like. Inventory turnover and days' inventory on-hand values continued to decrease and increase respectively until 2012 when the values finally began to stabilize.

We believe that this stabilization is indicative of Lululemon's future. Through all of the strife, the company's net income and gross profit have continually increased by significant amounts each year along with their current and quick ratios. The money used in investing activities, found on the statement of cash flows, has also recently risen, indicating that the executives have an interest in expanding and growing the company. To this time, the company has been able to finance its growth solely through equity--it has no debt to date--which is again typical of a growing company.

For the reasons above, we recommend investors to **hold** this stock. While this stock may have peaked in 2011, we feel as if it will bounce back. Lululemon has always been a very financially strong company and experienced consistent and rapid growth over the past decade. It has struggled recently due to a rapid influx of competitors into the industry and bad publicity surrounding the highly publicized recall, but we believe that Lululemon is strong enough to recover from these events. While investors who bought during the peak may never be able to fully recover the investment, we believe if they hold this stock, they will be able to recover most of their losses. Lululemon is a sound corporation with loyal customers, superior status, and proven financial stability and therefore will soon recover from its recent financial downturn.

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