Lululemon Athletica (LULU)

Thesis and analysis — October 11, 2026

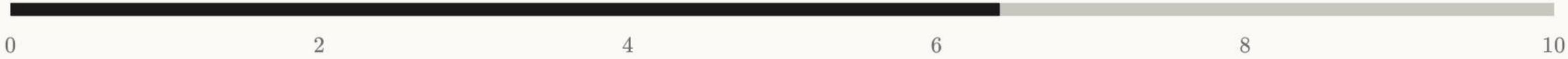
The thesis

HOLD

A premium athletic-apparel franchise still earning about 100% on tangible capital with net cash, de-rated to about five times normalized operating profit on an Americas demand break and a permanent tariff-driven margin reset; valued on honest post-tariff numbers (about 16.5% operating margin and flat sales, not the pre-tariff peak) it is worth about $130 a share probability-weighted against $94.5, but the value excluding the bull case is only about $101 — hold, add only on a pullback.

The score

6.4 / 10 — hold signal



Lifting it: Return on capital (ROIC)

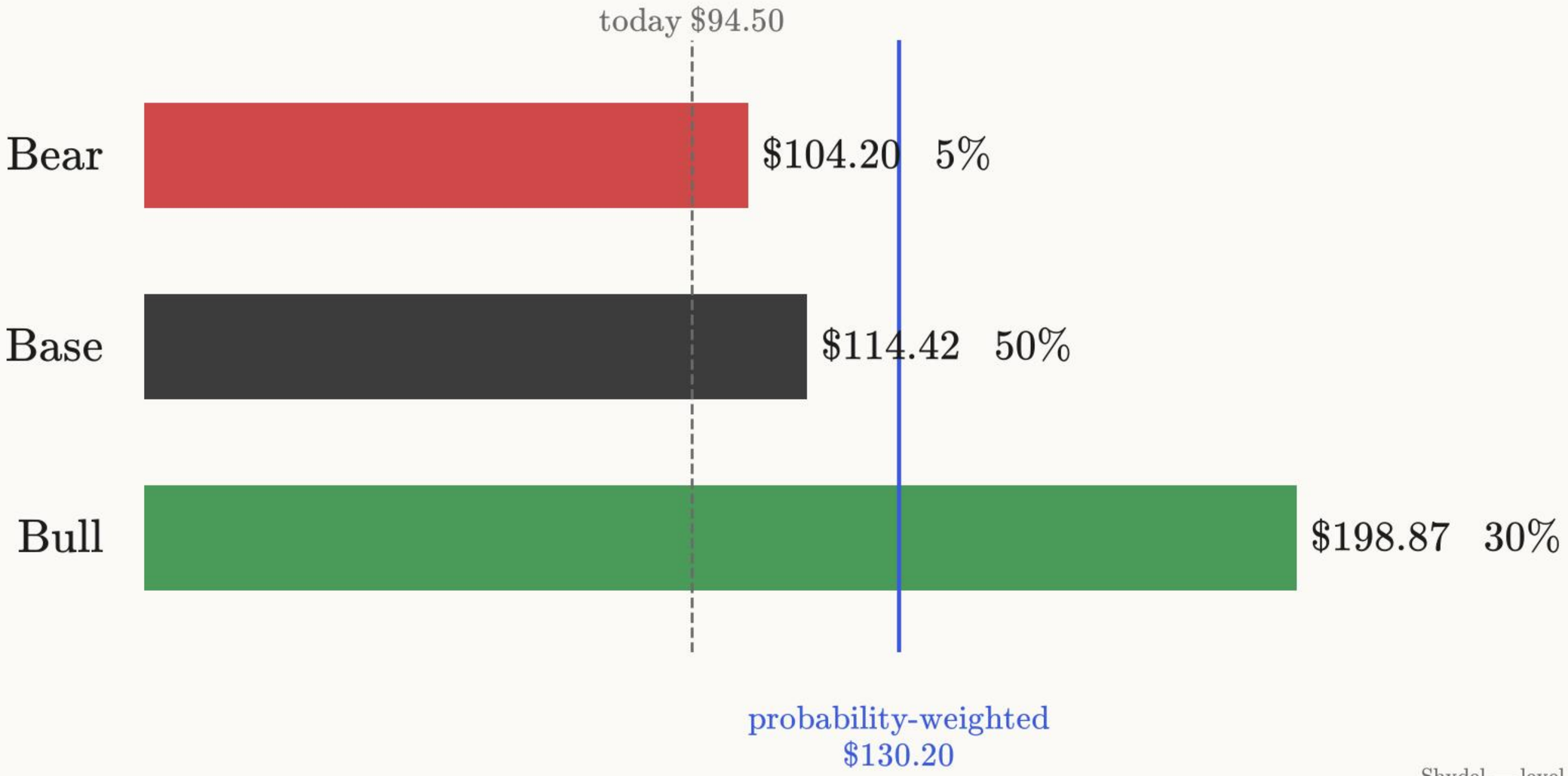
Holding it down: Free cash flow / EBIT, Risks

The key numbers

EV / EBIT, normalized	4.7×
P / E, normalized	5.7×
ROIC, normalized	101%
Operating margin, average	21.4%
Marginal return on capital	117%

normalized FY2020-FY2026

What one share is worth



Filings and accounting quality

Clean, consistent SEC filer; accounting quality high, earnings need normalizing only for two identified items.

- 7 annual and 21 quarterly reports on EDGAR, filed on time; latest FY2025 10-K sec:0001397187–26-000020, Q2 FY2026 10-Q sec:0001397187–26-000127.
- Only material non-recurring items: FY2023 impairment/loss about $397.7M and a one-off $134.5M IEEPA tariff refund in FY2026 — both normalized out.
- Normal tax rate 28–30%; negligible receivables, point-of-sale revenue; balance sheet ties.

Balance sheet

Fortress balance sheet: net cash before leases, capital-light, equity compounding.

- Cash $1.81B, revolver undrawn, no interest-bearing borrowings; the only "debt" is operating-lease liability $1.80B.
- After judging operations need about $300M of cash (2.7% of sales), excess cash $1.51B, net of lease-debt ~-$291M (roughly net-neutral); tangible operating capital about $3.2B, invested capital about $5.25B, equity $4.96B.
- Equity has compounded about 16.8%/yr FY2020-FY2026 despite heavy buybacks.

Cash flow statement

Cash generation is real but conversion is only moderate — reinvestment and seasonal working capital, not accrual games.

- FY2026 operating cash flow $1.60B, capex $0.68B, free cash flow $0.86B = 54% of net income.
- The gap is reinvestment and timing: maintenance capex $0.60B exceeds D&A $0.50B, and working capital absorbed $0.41B on a seasonal inventory build.
- Normalized free cash flow after stock-based pay about $1.24B = about 59% of normalized EBIT and about 73% of normalized net income.

Income statement

Industry-leading margins, now resetting on a structural tariff hit — the central issue for value.

- FY2026 gross margin 56.6%, operating margin 19.9%, net margin 14.2%; normalized operating margin 21.8% (5-yr avg), window 19.0%-23.4%.
- EBIT fell 11.8% FY2025→FY2026 despite +4.9% sales as tariffs and de minimis removal cut product margin; forward operating margin forecast 14.5–15.5%.
- Normalized adjusted EBIT $2.11B (EBITDA less maintenance capex) vs reported $2.21B.

Debt tables

No financial leverage — the only obligations are leases and ordinary trade commitments.

- No interest-bearing borrowings; $600M revolver undrawn, only $6.4M of letters of credit.
- The entire "long-term debt" of $1,798.4M is operating-lease liability (current $298.7M + non-current $1,499.7M), per the lease note; interest expense about 0, LULU earns net interest income.
- Net debt/EBIT is net cash; leases are counted as debt in EV by convention.

Commitments and contingencies

No financial leverage; obligations are leases and ordinary trade commitments only.

- Operating-lease obligations (present value $1,798.4M) are the main commitment — stores are leased, not owned.
- Inventory purchase commitments in the ordinary course; no material litigation or contingency disclosed.
- Tariff / de minimis exposure runs through the margin, not as a contingent liability.

Market and segment analysis

Concentrated in a declining Americas, with two still-growing international engines carrying the story.

- Americas about 71–73% of revenue (about $7.89B), segment margin down to about 19.1%; comps -12% in Q2 FY2026.
- China Mainland about 14% (about $1.56B), segment margin about 23.4%, revenue +30% on new stores though comps slipped to ~-2%; Rest of World about 13% (about $1.40B), +13%.
- The marginal return on capital is built segment by segment: China and Rest of World supply most of the profitable incremental growth.

Inventory analysis

Inventory is well controlled, but it is the main markdown risk if Americas demand stays soft.

- Inventory about $1.70B, up only about 2% year on year; inventory/sales about 15.3%, about 129 days.
- Disciplined so far — no sign of a glut — but a prolonged Americas demand break would force markdowns and pressure the already-reset gross margin.
- This is the working-capital item the operating-cash judgement ($300M, about 2.7% of sales) chiefly funds.

Leases and real estate analysis

A leased-store model with strong unit economics; real estate is an operating input, not a hidden asset.

- 816 company-operated stores (476 Americas, 173 China Mainland, 167 Rest of World), all leased; lease liability PV $1,798.4M.
- Store economics strong: sales to tangible capital about 3.8× and new-store marginal returns well above 100%.
- No owned real estate of note; right-of-use assets sit in PP&E.

Depreciation analysis

Depreciation and capex are clean; maintenance capex, not D&A, is the right charge against earnings.

- D&A $0.50B (about 4.5% of sales); estimated maintenance capex $0.60B exceeds D&A, so EBIT/EV-EBIT use EBITDA less maintenance capex.
- Total capex $0.68B with only about $84M growth capex in FY2026 as store openings slowed; amortization of acquired intangibles tiny (about $7M), so no acquisition-accounting distortion.
- This underpins the normalized adjusted EBIT $2.11B used in valuation.

Business quality and moat

A real but narrowing moat: a brand that earns exceptional returns, now proving it is not impregnable.

- For the moat: tangible ROIC about 105%, 5-year operating margin about 22%, historically strong pricing power — brand, vertical direct-to-consumer, community/ambassador model and technical fabric.
- Against: Americas comps -12%, gross margin -690bps and share loss to Alo, Vuori and Nike show the advantage is narrower and more contested than at the peak.
- Scorecard grade: narrow moat (+0.4).

Management and governance

Excellent capital allocation, but a leadership vacuum is the live governance risk.

- CEO has been vacant since 31 January 2026 (interim leadership), amid founder/activist noise.
- Capital allocation strong and counter-cyclical: 2.2M shares bought for $362M (about $164/share) in Q1 FY2026 at falling prices, funded by free cash flow with no debt; share count down from 131M (FY2020) to about 110.7M.
- Scorecard grade: average (strong allocation offset by the vacuum and the Americas demand misstep).

Valuation

The margin of safety is thin at $94.5: the price sits below the base ($114) and bear ($104) values, but the 15% permanent-impairment tail pulls the value-without-the-bull-case down to about $101, only 7% above the price.

- Chief risks: a structural tariff cost reset (IEEPA duties + de-minimis removal) permanently lowering the operating margin from about 21% toward about 15%; an Americas demand break that may be brand-driven, not cyclical; intensifying competition (Vuori, Alo, Nike) — scorecard risk graded "high" (-0.5).
- Downside is cushioned by a net-cash balance sheet (net debt -$8.8M; no interest-bearing borrowings, the $1.8B "long-term debt" is operating leases) and about $1.5B excess cash — key numbers steps/0002.

Risk and margin of safety

Score about 6.4/10 is a HOLD signal; keep LULU at its about 8.5% weight (already at the 8.4% target) and add only below about $80.

- Current weight 8.46% (CAD 105,258 of 1,243,462), target 8.4% — essentially at weight; no change.
- The signal is hold (score between the 7.0 buy and 4.0 sell thresholds); price $94.5 is below base ($114) and bear ($104) but the value without the bull case ($101) gives only a 7% cushion, so no add here.
- Portfolio fit: public equities are already 73% of the book and concentrated (HMM.A 37%), so there is no case to stretch for more LULU; the net-cash, high-return franchise is a fair core quality holding at about 8.5%.

Decision, sizing and portfolio fit

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- Portfolio fit: public equities are already 73% of the book and concentrated (HMM.A 37%), so there is no case to stretch for more LULU; a net-cash, about 100%-return franchise is a fair about 8.5% core quality holding.

Monitoring and selling

Hold at about 8.5%; the thesis turns on the Americas trough and the post-tariff margin, so monitoring centres on those each quarter.

- Americas comps: the base assumes a trough by FY2028; a fourth year of double-digit decline would confirm secular brand erosion (worst case $55) — Q2 FY2026 comps -12%.
- Operating margin ex one-offs: base 16.6%; sustained below about 12% with no mitigation path is a sell trigger — scorecard / valuation_LULU.
- Tariff mitigation (vendor terms, supply-chain shifts, selective price) and China Mainland + Rest of World growth: both must hold for the about 15% forecast margin and flat-sales base; a stall removes the international offset.

The decision

HOLD

The decision: hold. Buy below $80.00. Trim above $150.00. Target weight 8.4 percent of the portfolio.

The decision (continued)

HOLD

What would change our mind: Evidence that the Americas decline is secular (continued double-digit comp declines through FY2028) or that the sustainable operating margin settles below about 12% with no mitigation path would break the base case; conversely a stabilization in Americas comps with margins holding about 16%+ would support adding.