

lululemon athletica inc.
Form 10-Q
December 09, 2009

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended November 1, 2009**
- OR**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from to**

Commission file number 001-33608

lululemon athletica inc.

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

20-3842867

*(I.R.S. Employer
Identification No.)*

2285 Clark Drive,

Vancouver, British Columbia

(Address of principal executive offices)

V5N 3G9

(Zip Code)

Registrant's telephone number, including area code: 604-732-6124

Former name, former address and former fiscal year, if changed since last report: N/A

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

At December 7, 2009, there were 50,908,883 shares of the registrant's common stock, par value \$0.01 per share, outstanding.

Exchangeable and Special Voting Shares:

At December 7, 2009 there were outstanding 19,408,346 exchangeable shares of Lulu Canadian Holding, Inc., a wholly-owned subsidiary of the registrant. Exchangeable shares are exchangeable for an equal number of shares of the registrant's common stock.

In addition, at December 7, 2009, the registrant had outstanding 19,408,346 shares of special voting stock, through which the holders of exchangeable shares of Lulu Canadian Holding, Inc. may exercise their voting rights with respect to the registrant. The special voting stock and the registrant's common stock generally vote together as a single class on all matters on which the common stock is entitled to vote.

TABLE OF CONTENTS

| | Page |
|--|-------------|
| <u>PART I. FINANCIAL INFORMATION</u> | |
| <u>Item 1.</u> | |
| <u>FINANCIAL STATEMENTS:</u> | |
| <u>CONSOLIDATED BALANCE SHEETS</u> as of November 1, 2009 and February 1, 2009 | 3 |
| <u>CONSOLIDATED STATEMENTS OF OPERATIONS</u> for the thirteen and thirty-nine weeks ended November 1, 2009 and November 2, 2008 | 4 |
| <u>CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY</u> for the thirty-nine weeks ended November 1, 2009 | 5 |
| <u>CONSOLIDATED STATEMENTS OF CASH FLOWS</u> for the thirty-nine weeks ended November 1, 2009 and November 2, 2008 | 6 |
| <u>NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS</u> | 7 |
| <u>Item 2.</u> | |
| <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u> | 16 |
| <u>Item 3.</u> | |
| <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u> | 29 |
| <u>Item 4.</u> | |
| <u>CONTROLS AND PROCEDURES</u> | 29 |
| <u>PART II. OTHER INFORMATION</u> | |
| <u>Item 1.</u> | |
| <u>LEGAL PROCEEDINGS</u> | 30 |
| <u>Item 1A.</u> | |
| <u>RISK FACTORS</u> | 30 |
| <u>Item 2.</u> | |
| <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u> | 30 |
| <u>Item 6.</u> | |
| <u>EXHIBITS</u> | 30 |
| <u>SIGNATURES</u> | 31 |
| <u>EX-31.1</u> | |
| <u>EX-31.2</u> | |
| <u>EX-32.1</u> | |

Table of Contents**PART I****FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****lululemon athletica inc.****CONSOLIDATED BALANCE SHEETS**
(Amounts in thousands, except per share amounts)

| | November 1, 2009 (Unaudited) | February 1, 2009 |
|--|---|-----------------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 101,832 | \$ 56,797 |
| Accounts receivable | 6,515 | 4,029 |
| Inventories | 52,103 | 52,051 |
| Prepaid expenses and other current assets | 5,618 | 4,111 |
| | 166,068 | 116,988 |
| Property and equipment, net | 59,900 | 61,662 |
| Goodwill and intangible assets, net | 8,257 | 8,160 |
| Deferred income taxes | 6,128 | 19,373 |
| Other non-current assets | 6,415 | 5,453 |
| | \$ 246,768 | \$ 211,636 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 5,866 | \$ 5,269 |
| Accrued liabilities | 19,420 | 22,103 |
| Accrued compensation and related expenses | 7,351 | 5,862 |
| Income taxes payable | | 2,133 |
| Unredeemed gift card liability | 6,259 | 9,278 |
| Other current liabilities | 551 | 690 |
| | 39,447 | 45,335 |
| Other non-current liabilities | 14,541 | 11,301 |
| Deferred income taxes | 181 | 158 |
| | 54,169 | 56,794 |

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Stockholders' equity

Undesignated preferred stock, \$0.01 par value, 5,000 shares authorized, none issued and outstanding

Exchangeable stock, no par value, 30,000 shares authorized, issued and outstanding 19,408 and 19,517 shares

Special voting stock, \$0.00001 par value, 30,000 shares authorized, issued and outstanding 19,408 and 19,517 shares

Common stock, \$0.01 par value, 200,000 shares authorized, issued and outstanding 50,908 and 50,422 shares

Additional paid-in capital

Retained earnings

Accumulated other comprehensive income (loss)

| | | |
|--|------------|------------|
| | 509 | 504 |
| | 148,413 | 155,961 |
| | 39,358 | 9,528 |
| | 4,319 | (11,151) |
| | 192,599 | 154,842 |
| | \$ 246,768 | \$ 211,636 |

See accompanying notes to the interim consolidated financial statements

Table of Contents**lululemon athletica inc.****CONSOLIDATED STATEMENTS OF OPERATIONS****(Amounts in thousands, except per share amounts)**

| | Thirteen Weeks Ended November 1, 2009 | Thirteen Weeks Ended November 2, 2008 | (Unaudited) | | Thirty-Nine Weeks Ended November 1, 2009 | Thirty-Nine Weeks Ended November 2, 2008 |
|---|--|--|--------------------|--|---|---|
| Net revenue | \$ 112,891 | \$ 87,047 | \$ 292,292 | | \$ 249,565 | |
| Cost of goods sold | 56,553 | 45,154 | 155,766 | | 122,159 | |
| Gross profit | 56,338 | 41,893 | 136,526 | | 127,406 | |
| Selling, general and administrative expenses | 35,412 | 28,838 | 91,415 | | 86,886 | |
| Income from operations | 20,926 | 13,055 | 45,111 | | 40,520 | |
| Other income (expense), net | (3) | 145 | 98 | | 612 | |
| Income before income taxes | 20,923 | 13,200 | 45,209 | | 41,132 | |
| Provision for income taxes | 6,855 | 4,370 | 15,379 | | 11,571 | |
| Net income from continuing operations | 14,068 | 8,830 | 29,830 | | 29,561 | |
| Net income (loss) from discontinued operations | | 4 | | | (1,136) | |
| Net income | \$ 14,068 | \$ 8,834 | \$ 29,830 | | \$ 28,425 | |
| Basic earnings (loss) per share | | | | | | |
| Continuing operations | \$ 0.20 | \$ 0.13 | \$ 0.42 | | \$ 0.44 | |
| Discontinued operations | | | | | (0.02) | |
| Net basic earnings per share | \$ 0.20 | \$ 0.13 | \$ 0.42 | | \$ 0.42 | |
| Diluted earnings (loss) per share | | | | | | |
| Continuing operations | \$ 0.20 | \$ 0.13 | \$ 0.42 | | \$ 0.42 | |
| Discontinued operations | | | | | (0.02) | |
| Net diluted earnings per share | \$ 0.20 | \$ 0.13 | \$ 0.42 | | \$ 0.40 | |
| Basic weighted-average number of shares outstanding | 70,279 | 69,162 | 70,205 | | 68,316 | |
| Diluted weighted-average number of shares outstanding | 71,100 | 70,609 | 70,759 | | 71,008 | |

See accompanying notes to the interim consolidated financial statements

Table of Contents**lululemon athletica inc.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

(Amounts in thousands)

| | Exchangeable Stock | | Special Voting Stock | | Common Stock | | Additional Paid-in Capital | Retained Earnings | Other Comprehensive Income (Loss) | Total |
|---|-----------------------|--------------|-------------------------|--------------|--------------|--------------|----------------------------------|----------------------|--|------------|
| | Shares | Par Value | Shares | Par Value | Shares | Par Value | | | | |
| Balance at February 1, 2019 | 19,517 | \$ | 19,517 | \$ | 50,422 | \$ 504 | \$ 155,961 | \$9,528 | \$(11,151) | \$ 154,830 |
| Comprehensive income: | | | | | | | | 29,830 | | 29,830 |
| Net income | | | | | | | | | | |
| Foreign currency translation adjustment | | | | | | | | | 15,470 | 15,470 |
| Comprehensive income | | | | | | | | | | 45,300 |
| Stock-based compensation | | | | | | | 4,229 | | | 4,229 |
| Tax benefits from stock-based compensation | | | | | | | (12,024) | | | (12,024) |
| Common stock issued upon exchange of exchangeable debt securities | (109) | | (109) | | 109 | 1 | (1) | | | |
| Restricted stock issuance | | | | | 15 | | | | | |
| Stock options exercised | | | | | 362 | 4 | 248 | | | 254 |
| Balance at November 1, 2019 | 19,408 | \$ | 19,408 | \$ | 50,908 | \$ 509 | \$ 148,413 | \$39,358 | \$4,319 | \$ 192,537 |

See accompanying notes to the interim consolidated financial statements

Table of Contents**lululemon athletica inc.****CONSOLIDATED STATEMENTS OF CASH FLOWS**
(Amounts in thousands)

| | Thirty-Nine Weeks Ended November 1, 2009 | Thirty-Nine Weeks Ended November 2, 2008 |
|---|---|---|
| | (Unaudited) | |
| Cash flows from operating activities | | |
| Net income | \$ 29,830 | \$ 28,425 |
| Net loss from discontinued operations | | (1,136) |
| Net income from continuing operations | 29,830 | 29,561 |
| Items not affecting cash | | |
| Depreciation and amortization | 15,236 | 11,102 |
| Stock-based compensation | 4,229 | 5,234 |
| Deferred income taxes | 1,365 | (3,470) |
| Excess tax benefits from stock-based compensation | | (9,720) |
| Other, including net changes in other non-cash balances | | |
| Prepaid expenses | (1,189) | (221) |
| Inventory | 2,987 | (16,311) |
| Accounts payable | 842 | 3,051 |
| Accrued liabilities | (1,876) | 16,510 |
| Other non-cash balances | 70 | (7,539) |
| Net cash provided by operating activities continuing operations | 51,494 | 28,197 |
| Net cash provided by operating activities discontinued operations | | 1,007 |
| | 51,494 | 29,204 |
| Cash flows from investing activities | | |
| Purchase of property and equipment | (9,024) | (30,043) |
| Investment in and advances to franchise | (1,190) | (2,566) |
| Acquisition of franchises | | (3,030) |
| Net cash used in investing activities continuing operations | (10,214) | (35,639) |
| Net cash used in investing activities discontinued operations | | |
| | (10,214) | (35,639) |
| Cash flows from financing activities | | |
| Proceeds from exercise of stock options | 252 | 1,405 |
| Excess tax benefits from stock-based compensation | | 9,720 |
| Net cash provided by financing activities continuing operations | 252 | 11,125 |
| Net cash provided by financing activities discontinued operations | | |

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| | | | |
|---|------------|----|---------|
| Effect of exchange rate changes on cash | 252 | | 11,125 |
| | 3,503 | | (5,196) |
| Increase (decrease) in cash and cash equivalents from continuing operations | 45,035 | | (506) |
| Cash and cash equivalents from continuing operations, beginning of period | \$ 56,797 | \$ | 52,545 |
| Cash and cash equivalents from continuing operations, end of period | \$ 101,832 | \$ | 52,039 |

See accompanying notes to the interim consolidated financial statements

Table of Contents

lululemon athletica inc.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(Amounts in thousands, except per share amounts and store count information, unless otherwise indicated)

NOTE 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of operations

lululemon athletica inc., a Delaware corporation ("lululemon"), together with its subsidiaries unless the context otherwise requires, the "Company") is engaged in the design, manufacture and distribution of healthy lifestyle inspired athletic apparel, which is sold through a chain of corporate-owned and operated retail stores, direct to consumers through our e-commerce sales channel, through independent franchises and through a network of wholesale accounts. At November 1, 2009 the Company's primary markets were Canada and the United States where 41 and 65 corporate-owned stores were in operation, respectively. Additionally, at November 1, 2009, there were 8 franchised stores in operation in Australia. There were 106 and 103 corporate-owned stores in operation as of November 1, 2009 and February 1, 2009 respectively.

Basis of presentation

The unaudited interim consolidated financial statements as of November 1, 2009 and for the thirty-nine week periods ended November 1, 2009 and November 2, 2008 are presented using the United States dollar and have been prepared by the Company under the rules and regulations of the Securities and Exchange Commission ("SEC"). In the opinion of management, the financial information is presented in accordance with United States generally accepted accounting principles ("GAAP") for interim financial information and, accordingly, does not include all of the information and footnotes required by GAAP for complete financial statements. The financial information as of February 1, 2009 is derived from the Company's audited consolidated financial statements and notes for the fiscal year ended February 1, 2009, included in Item 8 in the fiscal 2008 Annual Report on Form 10-K. These unaudited interim consolidated financial statements reflect all adjustments which in the opinion of management are necessary to provide a fair statement of the results for the interim periods presented. These unaudited interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's 2008 Annual Report on Form 10-K filed with the SEC on March 27, 2009.

The Company's fiscal year ends on the Sunday closest to January 31st of the following year. This typically results in a fifty-two week year, but occasionally gives rise to an additional week, resulting in a fifty-three week year.

Our business is affected by the pattern of seasonality common to most retail apparel businesses. The results for the periods presented are not necessarily indicative of future financial results.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue recognition

Revenues from the Company's gift cards are recognized when tendered for payment, or upon redemption. Outstanding customer balances are included in "Unredeemed gift card liability" on the consolidated balance sheets. There are no expiration dates on the Company's gift cards, and lululemon does not charge any service fees that cause a decrement to customer balances.

While the Company will continue to honor all gift cards presented for payment, management may determine the likelihood of redemption to be remote for certain card balances due to, among other things, long periods of inactivity. In these circumstances, to the extent management determines there is no requirement for remitting card balances to government agencies under unclaimed property laws, card balances may be recognized in the consolidated statements of operations in Net revenue. For the thirteen and thirty-nine weeks ended November 1, 2009, net revenue recognized on unredeemed gift card balances was \$230 and \$1,886, respectively. There was no net revenue recognized on unredeemed gift card balances during the year ended February 1, 2009.

Table of Contents

lululemon athletica inc.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income Taxes

The Company follows the liability method with respect to accounting for income taxes. Deferred tax assets and liabilities are determined based on temporary differences between the carrying amounts and the tax basis of assets and liabilities. Deferred income tax assets and liabilities are measured using enacted tax rates that will be in effect when these differences are expected to reverse, except for the amount of earnings related to our foreign operations where repatriation is not contemplated in the foreseeable future. Deferred income tax assets are reduced by a valuation allowance, if based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The recognition of a deferred income tax asset is based primarily on management's forecasts, including current and proposed tax legislation, current and anticipated taxable income, utilization of previously unrealized non-operating loss carryforwards and regulatory reviews of tax filings. Given judgments and estimates required and the sensitivity of the results to the significant assumptions used, the accounting estimates used in relation to the recognition of deferred income tax assets are subject to measurement uncertainty and are susceptible to a material change if the underlying assumptions change.

We file income tax returns in the United States, Canada and various foreign and state jurisdictions. We are subject to income tax examination by tax authorities in all such jurisdictions from our inception to date. Our policy is to recognize interest expense and penalties related to income tax matters as tax expense. At February 1, 2009, we did not have any significant accruals for interest related to unrecognized tax benefits or tax penalties. Our intercompany transfer pricing policies will be subject to audits by various foreign tax jurisdictions. Although we believe that our intercompany transfer pricing policies and tax positions are reasonable, the final determination of tax audits or potential tax disputes may be materially different from that which is reflected in our income tax provisions and accruals.

United States income taxes and foreign withholding taxes are not provided on undistributed earnings of foreign subsidiaries which are considered to be indefinitely reinvested in the operations of such subsidiaries. The amount of these earnings was approximately \$89,369 at November 1, 2009.

During the second quarter of fiscal 2009, an adjustment was made to deferred tax assets and additional paid-in capital in the amount of \$12,024 relating to windfall taxes recorded in the year ended February 1, 2009 in excess of taxes payable. A similar entry for \$192 was recorded in the same period related to windfall taxes recorded in the first quarter of fiscal 2009. The Company has concluded that the adjustment was not material to the financial statements.

Recent accounting pronouncements

On July 1, 2009, the Accounting Standards Codification (ASC) became the Financial Accounting Standards Board's (FASB) officially recognized source of authoritative GAAP, superseding existing FASB, the American Institute of Certified Accountants, the Emerging Issues Task Force and related literature. Rules and interpretive releases of the SEC under the authority of federal securities law are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered non-authoritative. The switch to the ASC affects the way companies refer to GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content through the Topic, Section and Paragraph structure. This standard was effective

prospectively for reporting periods ended after September 15, 2009 and, accordingly, the Company adopted it during the third quarter of fiscal 2009. The adoption of this standard did not have an effect on the Company's consolidated financial position, results of operations or cash flows. As a result of adopting this standard, the Company's references to GAAP standards have been changed to refer to topics, subtopics, sections or subsections of the ASC, as appropriate.

In June 2009, the FASB amended ASC topic 810 *Consolidation* (ASC 810), which requires a qualitative approach to identifying a controlling financial interest in a variable interest entity (VIE), and requires ongoing assessment of whether an entity is a VIE and whether an interest in a VIE makes the holder a primary beneficiary of

Table of Contents

lululemon athletica inc.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the VIE. The amendment will be effective for the Company at the beginning of fiscal 2010. The Company is currently evaluating the impact that adoption may have on its consolidated financial statements.

In May 2009, the FASB issued ASC topic 855 *Subsequent Events* (ASC 855). ASC 855 establishes general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, ASC 855 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the consolidated financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its consolidated financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. Subsequent events were evaluated through December 9, 2009 which is the date the financial statements were issued. The Company has determined that the standard does not have any impact on its consolidated financial statements.

In April 2008, the FASB amended ASC topic 350, *Intangibles and Other* (ASC 350). This new accounting standard, currently contained in ASC 350-30-35, specifically amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The objective of this amendment is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset. This new standard is effective for fiscal years beginning after December 15, 2008. The effective date, as well as the adoption date for the Company, was February 2, 2009. Although ASC 350 may impact the Company's reporting in future financial periods, the Company has determined that the standard did not have any impact on its historical consolidated financial statements at the time of adoption.

In December 2007, the FASB revised the accounting standards for business combinations. This new standard (currently contained in ASC topic 805, *Business Combinations* (ASC 805)), among other things, generally requires that an acquirer recognize the assets acquired and liabilities assumed at their full fair values on the acquisition date. This practice replaces the practice, under predecessor accounting standards, of allocating the cost of an acquisition to the individual assets acquired and liabilities assumed based on their relative estimated fair values. This new standard further requires that acquisition-related costs be recognized separately from the related acquisition. In April 2009, the FASB issued ASC 805-20, *Business Combinations - Identifiable Assets and Liabilities and Any Non-controlling Interest*, which further amends and clarifies ASC 805 and applies to assets acquired and liabilities assumed that arise from contingencies in a business combination. This new standard and the amendment must be applied prospectively to business combinations consummated on or after the first annual reporting period beginning on or after December 15, 2008. The effective date, as well as the adoption date for the Company, was February 2, 2009. Although ASC 805 may impact the Company's reporting in future financial periods, the Company has determined that the standard did not have any impact on its historical consolidated financial statements at the time of adoption.

NOTE 3. STOCK-BASED COMPENSATION

Share option plans

The Company's employees participate in various stock-based compensation plans, which are either provided by the Company or by a principal stockholder of the Company.

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Stock-based compensation expense charged to income for the plans was \$4,229 and \$5,234 for the thirty-nine weeks ended November 1, 2009 and November 2, 2008, respectively. Total unrecognized compensation cost as at November 1, 2009 was \$13,201 for all stock option plans, which is expected to be recognized over a weighted-average period of 2.72 years.

Table of Contents**lululemon athletica inc.****NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Company stock options***

A summary of the Company's stock options and restricted shares activity as of November 1, 2009 and changes during the period then ended is presented below:

| | Number of Stock Options | Weighted- Average Exercise Price | Number of Restricted Shares | Weighted- Average Grant Fair Value |
|---------------------------------|--|---|--|---|
| Balance at February 1, 2009 | 1,905 | \$ 10.83 | 9 | \$ 24.04 |
| Granted | 867 | \$ 13.21 | 15 | \$ 13.83 |
| Exercised | 364 | \$ 0.79 | 7 | \$ 28.58 |
| Forfeited | 52 | \$ 25.76 | | \$ |
| Balance at November 1, 2009 | 2,356 | \$ 13.21 | 17 | \$ 17.72 |
| Exercisable at November 1, 2009 | 443 | \$ 13.59 | | \$ |

Stockholder-sponsored stock options

During the thirty-nine weeks ended November 1, 2009 holders of the exchangeable shares converted 109 exchangeable shares into 109 shares of common stock of the Company for no additional consideration. In connection with the exchange of exchangeable shares, an equal number of outstanding shares of the Company's special voting stock were cancelled.

During the thirty-nine weeks ended November 1, 2009 there were no grants or forfeitures related to any of the stock options issued and outstanding under the stockholder-sponsored awards.

Employee stock purchase plan

The Company's Board of Directors and stockholders approved the Company's Employee Stock Purchase Plan (ESPP) in September 2007. The ESPP allows for the purchase of common stock of the Company by all eligible employees. Eligible employees may elect to have whatever portion of his or her base salary equates, after deduction of applicable taxes, to either 3%, 6% or 9% of his or her base salary withheld during each payroll period for purposes of purchasing shares of our common stock under the ESPP. Additionally, we, or the subsidiary employing the participant, will make a cash contribution as additional compensation to each participant equal to one-third of the aggregate amount of that participant's contribution for that pay period, which will be used to purchase shares of our common stock, subject to certain limits as defined in the ESPP. The maximum number of shares available under the ESPP is 3,000 shares. During the quarter ended November 1, 2009, there were 12 shares purchased under the ESPP, which were funded by

the Company through open market purchases.

NOTE 4. PROVISION FOR IMPAIRMENT AND LEASE EXIT COSTS

In accordance with ASC topic 360, *Property, Plant and Equipment* (ASC 360), the Company reviews its long-lived assets for impairment when changes in circumstances indicate that the carrying amount of the asset may not be recoverable. ASC 360 requires that long-lived assets to be held and used be recorded at the lower of the carrying amount or the fair value. Long-lived assets to be disposed of are to be recorded at the lower of the carrying amount or the fair value, less estimated cost to sell.

During the thirty-nine weeks ended November 1, 2009, in conjunction with the Company's ongoing assessment to ensure that each of the Company's properties fit into the Company's strategy, the Company recorded a charge of \$820 in lease exit costs related to certain locations and reversed lease exit costs of \$714 previously recorded in the fourth quarter of fiscal 2008. The fair market values were estimated using an expected present value technique.

Table of Contents**lululemon athletica inc.****NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

A reconciliation of the associated accrued liability is as follows:

| | Lease Exit and Other Related Costs | | Asset Impairment | Total |
|---------------------------------------|---|----|-----------------------------|--------------|
| Accrued liability at February 1, 2009 | \$ 1,189 | \$ | | \$ 1,189 |
| Costs incurred | 1,620 | | | 1,620 |
| Cash payments | (800) | | | (800) |
| Reversals | (714) | | | (714) |
| Accrued liability at November 1, 2009 | \$ 1,295 | \$ | | \$ 1,295 |

NOTE 5. LEGAL PROCEEDINGS

On April 2, 2009, three former hourly Company employees filed a class action lawsuit in San Diego Superior Court entitled *Mia Stephens et al v. lululemon athletica inc.* The lawsuit alleges that the Company violated various California Labor Code sections by requiring employees to wear lululemon clothing during working hours without reimbursing such employees for the cost of the clothing and by paying certain bonus payments to its employees in the form of lululemon gift cards redeemable only for lululemon merchandise. The complaint also alleges that the Company owes waiting time penalties as the result of failing to pay employees all wages due at the time of termination. The Company and the plaintiffs have agreed upon the general terms of a settlement which has not yet been finalized and which must be submitted to the court for preliminary and final approval.

On March 26, 2009, a former hourly Company employee filed a class action lawsuit in Orange County Superior Court, California entitled *Brett Kohlenberg et al v. lululemon athletica inc.* The lawsuit alleges that the Company violated various California Labor Code sections by failing to pay its employees for certain rest and meal breaks and off the clock work, and for penalties related to waiting times and failure to provide itemized wage statements. The plaintiff is seeking an unspecified amount of damages. The Company intends to vigorously defend the matter.

We are a party to various other legal proceedings arising in the ordinary course of our business, but we are not currently a party to any legal proceeding that management believes would have a material adverse effect on our consolidated financial position or results of operations.

Table of Contents**lululemon athletica inc.****NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 6. EARNINGS PER SHARE**

The details of the computation of basic and diluted earnings per share are as follows:

| | Thirteen Weeks Ended November 1, 2009 | Thirteen Weeks Ended November 2, 2008 | Thirty-Nine Weeks Ended November 1, 2009 | Thirty-Nine Weeks Ended November 2, 2008 |
|---|--|--|---|---|
| Net income from continuing operations | \$ 14,068 | \$ 8,830 | \$ 29,830 | \$ 29,561 |
| Net income (loss) from discontinued operations | | 4 | | (1,136) |
| Net income | \$ 14,068 | \$ 8,834 | \$ 29,830 | \$ 28,425 |
| Basic earnings (loss) per share: | | | | |
| Net income from continuing operations | \$ 0.20 | \$ 0.13 | \$ 0.42 | \$ 0.44 |
| Net loss from discontinued operations | | | | (0.02) |
| Net income | \$ 0.20 | \$ 0.13 | \$ 0.42 | \$ 0.42 |
| Diluted earnings (loss) per share: | | | | |
| Net income from continuing operations | \$ 0.20 | \$ 0.13 | \$ 0.42 | \$ 0.42 |
| Net loss from discontinued operations | | | | (0.02) |
| Net income | \$ 0.20 | \$ 0.13 | \$ 0.42 | \$ 0.40 |
| Basic weighted-average number of shares outstanding | 70,279 | 69,162 | 70,205 | 68,316 |
| Effect of stock options assumed exercised | 821 | 1,447 | 554 | 2,692 |
| Diluted weighted-average number of shares outstanding | 71,100 | 70,609 | 70,759 | 71,008 |

Our calculation of weighted-average shares includes the common stock of the Company as well as the exchangeable shares. Exchangeable shares are the equivalent of common shares in all respects. For the thirteen and thirty-nine weeks ended November 1, 2009, 333 and 1,001 stock options were anti-dilutive to earnings and therefore have been excluded from the computation of diluted earnings per share. For the thirteen and thirty-nine weeks ended November 2, 2008, 830 and 637 stock options were anti-dilutive to earnings and therefore have been excluded from

the computation of diluted earnings per share.

Table of Contents**lululemon athletica inc.****NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 7. SUPPLEMENTARY FINANCIAL INFORMATION**

A summary of certain balance sheet accounts is as follows:

| | November 1, 2009 | February 1, 2009 |
|---|-----------------------------|-----------------------------|
| Accounts receivable: | | |
| Trade accounts receivable | \$ 4,243 | \$ 3,171 |
| Other accounts receivable | 2,272 | 863 |
| Allowance for doubtful accounts | | (5) |
| | \$ 6,515 | \$ 4,029 |
| Inventories: | | |
| Finished goods | \$ 51,836 | \$ 52,828 |
| Raw materials | 1,841 | 558 |
| Provision to reduce inventory to market value | (1,574) | (1,335) |
| | \$ 52,103 | \$ 52,051 |
| Property and equipment: | | |
| Leasehold improvements | \$ 58,549 | \$ 52,101 |
| Furniture and fixtures | 17,514 | 16,581 |
| Computer hardware and software | 23,992 | 19,411 |
| Equipment and vehicles | 380 | 279 |
| Accumulated amortization and depreciation | (40,535) | (26,710) |
| | \$ 59,900 | \$ 61,662 |
| Goodwill and intangible assets: | | |
| Goodwill | \$ 738 | \$ 738 |
| Changes in foreign currency exchange rates | 150 | 36 |
| | 888 | 774 |
| Reacquired franchise rights | 10,162 | 10,162 |
| Non-competition agreements | 694 | 694 |
| Accumulated amortization | (4,445) | (3,162) |
| Changes in foreign currency exchange rates | 958 | (308) |
| | 7,369 | 7,386 |
| | \$ 8,257 | \$ 8,160 |

| | | |
|--|-----------|-----------|
| Other non-current assets: | | |
| Prepaid rent and security deposits | \$ 800 | \$ 872 |
| Deferred lease cost | 1,562 | 1,718 |
| Advances to and investments in franchise | 4,053 | 2,863 |
| | \$ 6,415 | \$ 5,453 |
| Accrued liabilities: | | |
| Inventory purchases | \$ 10,190 | \$ 15,772 |
| Sales tax collected | 2,619 | 1,681 |
| Accrued rent | 1,126 | 1,147 |
| Impairment and lease exit costs | 1,295 | 1,189 |
| Other | 4,190 | 2,314 |
| | \$ 19,420 | \$ 22,103 |
| Other non-current liabilities: | | |
| Deferred lease liability | \$ 10,168 | \$ 7,326 |
| Tenant inducements | 4,373 | 3,975 |
| | \$ 14,541 | \$ 11,301 |

Table of Contents**lululemon athletica inc.****NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 8. SEGMENT REPORTING**

The Company's reportable segments are comprised of corporate-owned stores, franchises and other. Phone sales, warehouse sales, e-commerce sales and showrooms sales have been combined into other. Information for these segments from continuing operations is detailed in the table below:

| | Thirteen Weeks Ended November 1, 2009 | Thirteen Weeks Ended November 2, 2008 | Thirty-Nine Weeks Ended November 1, 2009 | Thirty-Nine Weeks Ended November 2, 2008 |
|---|--|--|---|---|
| Net revenue: | | | | |
| Corporate-owned stores | \$ 98,060 | \$ 77,559 | \$ 256,053 | \$ 225,244 |
| Franchises | 4,118 | 4,798 | 9,798 | 13,567 |
| Other | 10,713 | 4,690 | 26,441 | 10,754 |
| | \$ 112,891 | \$ 87,047 | \$ 292,292 | \$ 249,565 |
| Income from operations before general corporate expense: | | | | |
| Corporate-owned stores | \$ 30,760 | \$ 21,401 | \$ 72,408 | \$ 68,166 |
| Franchises | 1,272 | 2,206 | 3,323 | 6,415 |
| Other | 6,571 | 374 | 13,604 | 2,055 |
| | 38,603 | 23,981 | 89,335 | 76,636 |
| General corporate expense | 17,677 | 10,926 | 44,224 | 36,116 |
| Income from operations | 20,926 | 13,055 | 45,111 | 40,520 |
| Other income (expense), net | (3) | 145 | 98 | 612 |
| Income before income taxes | \$ 20,923 | \$ 13,200 | \$ 45,209 | \$ 41,132 |
| Capital expenditures: | | | | |
| Corporate-owned stores | \$ 2,719 | \$ 8,953 | \$ 5,729 | \$ 22,130 |
| Corporate | 962 | 1,806 | 3,295 | 7,914 |
| | \$ 3,681 | \$ 10,759 | \$ 9,024 | \$ 30,043 |
| Depreciation: | | | | |
| Corporate-owned stores | \$ 3,491 | \$ 3,357 | \$ 10,074 | \$ 7,977 |
| Corporate | 2,193 | 927 | 5,162 | 2,995 |

\$ 5,684 \$ 4,284 \$ 15,236 \$ 10,972

NOTE 9. DISCONTINUED OPERATIONS

During the first quarter of fiscal 2008 the Company committed to plans to wind-up operations in Japan and in the second quarter of fiscal 2008 the plans were finalized and disposition of the assets commenced with the closure of three of the four corporate-owned stores that the Company was operating as a joint venture with Descente Ltd. The fourth corporate-owned store was closed during the third quarter of fiscal 2008. The shut down costs related to the closure of the stores in Japan were fully accrued in the second quarter of fiscal 2008. The Company and Descente Ltd. agreed to end all operations as a joint venture in the third quarter of fiscal 2008.

Table of Contents**lululemon athletica inc.****NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The results of discontinued operations are summarized as follows:

| | Thirty-Nine Weeks Ended November 1, 2009 | Thirty-Nine Weeks Ended November 2, 2008 |
|-------------------------------------|---|---|
| Revenue | \$ | \$ 2,482 |
| Expenses | | (3,823) |
| Minority interest | | 205 |
| Net loss on discontinued operations | \$ | \$ (1,136) |

The net loss from discontinued operations represents all activity up to November 1, 2009.

Table of Contents

ITEM 2. *MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

Some of the statements contained in this Form 10-Q and any documents incorporated herein by reference constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included or incorporated in this Form 10-Q are forward-looking statements, particularly statements which relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts, such as statements regarding our future financial condition or results of operations, our prospects and strategies for future growth, the development and introduction of new products, and the implementation of our marketing and branding strategies. In many cases, you can identify forward-looking statements by terms such as *may*, *will*, *should*, *expects*, *plans*, *anticipates*, *believes*, *estimates*, *intends*, *predicts*, *potential* these terms or other comparable terminology.

The forward-looking statements contained in this Form 10-Q and any documents incorporated herein by reference reflect our current views about future events and are subject to risks, uncertainties, assumptions and changes in circumstances that may cause events or our actual activities or results to differ significantly from those expressed in any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future events, results, actions, levels of activity, performance or achievements. Readers are cautioned not to place undue reliance on these forward-looking statements. A number of important factors could cause actual results to differ materially from those indicated by the forward-looking statements, including, but not limited to, those factors described in *Risk Factors* and *Management's Discussion and Analysis of Financial Condition and Results of Operations* of our Annual Report on Form 10-K for fiscal 2008 filed on March 27, 2009. These factors include without limitation:

our ability to sustain operational and performance levels in a volatile worldwide economy;

our ability to manage operations at our current size or manage growth effectively;

our ability to locate suitable locations to open new stores and to attract customers to our stores;

our ability to successfully expand in new markets outside of North America;

our ability to finance our growth and maintain sufficient levels of cash flow;

increased competition causing us to reduce the prices of our products or to increase significantly our marketing efforts in order to avoid losing market share;

our ability to effectively market and maintain a positive brand image and to protect the lululemon brand and related goodwill;

our ability to maintain our historical levels of comparable store sales or average sales per square foot;

our ability to continually innovate and provide our consumers with improved products;

the ability of our suppliers or manufacturers to produce or deliver our products in a timely or cost-effective manner;

our lack of long-term supplier contracts;

our lack of patents or exclusive intellectual property rights in our fabrics and manufacturing technology;

our ability to attract and maintain the services of our senior management and key employees;

the availability and effective operation of management information systems and other technology;

changes in consumer preferences or changes in demand for technical athletic apparel and other products;

our ability to accurately forecast consumer demand for our products;

our ability to accurately anticipate and respond to seasonal or quarterly fluctuations in our operating results;

our ability to maintain effective internal controls; and

changes in general economic or market conditions, including as a result of political or military unrest or terrorist attacks.

Table of Contents

The forward-looking statements contained in this Form 10-Q reflect our views and assumptions only as of the date of this Form 10-Q and are expressly qualified in their entirety by the cautionary statements included in this Form 10-Q. Except as required by applicable securities law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

Our fiscal year ends on the Sunday closest to January 31st of the following year. This typically results in a fifty-two week year, but occasionally gives rise to an additional week, resulting in a fifty-three week year.

Overview

The world economy and capital markets are currently undergoing a period of unprecedented volatility. During fiscal 2008, there was a considerable slow down as problems in global financial markets became more widespread and consumers cut back on retail spending amid fears of a global recession. Our sales growth slowed in the latter part of fiscal 2008, driven in part by this reduced spending. This challenging economic climate and the continued weakness of the Canadian dollar continued to negatively affect our financial results during the beginning of fiscal 2009. Recently, the global economy has shown some signs of improvement, as reflected in our current quarter net revenues growth, and the Canadian dollar has strengthened relative to the United States dollar. This growth however, does not match the rapid growth we realized in prior years. Management recognizes the difficult economic situation that many of our consumers are still facing and does not expect our rate of growth to significantly change throughout the remainder of the fiscal year.

In response to the changes in the world economy and the impact on our operating results, we have taken several steps to address the deterioration in the retail environment and to address our support structure. These steps, which we discussed in our Annual Report on Form 10-K for fiscal 2008 filed with the SEC on March 27, 2009, included the development and implementation of several important initiatives as part of our strategy designed to increase customer traffic in our corporate-owned store locations, reduce infrastructure expenses and improve our operating results.

We continue to realize the positive effects of our cost reductions and efficiency initiatives, and expect that such initiatives, combined with modest net revenue growth, will continue to impact our financial results through the remainder of fiscal 2009. These targeted cost reductions and associated efficiency efforts were designed to structure our business for long-term profitable growth and to protect our brand integrity. We believe our continued strong cash flow generation, solid balance sheet and healthy liquidity provide us with the financial flexibility to continue executing the initiatives we implemented at the end of fiscal 2008 as well as make investments at strategic times going forward which will benefit our company.

Operating Segment Overview

lululemon is a designer and retailer of technical athletic apparel operating in North America and Australia. Our yoga-inspired apparel is marketed under the lululemon athletica brand name. We offer a comprehensive line of apparel and accessories including fitness pants, shorts, tops and jackets designed for athletic pursuits such as yoga, dance, running and general fitness. As of November 1, 2009, our branded apparel was principally sold through 119 corporate-owned and franchised stores that are primarily located in Canada and the United States. We believe our vertical retail strategy allows us to interact more directly with and gain insights from our customers while providing us with greater control of our brand. For the third quarter of fiscal 2009, approximately 61% of our net revenue was derived from sales of our products in Canada, 39% of our net revenue was derived from the sales of our products in the United States and an immaterial amount of our net revenue was derived from sales of our products outside of North America.

Our net revenue has grown from \$40.7 million in fiscal 2004 to \$353.5 million in fiscal 2008. This represents a compound annual growth rate of 72%. Our net revenue from continuing operations also increased from \$249.6 million in the first three quarters of fiscal 2008 to \$292.3 million in the first three quarters of fiscal 2009, representing a 17% increase. Our increase in net revenue from fiscal 2004 to fiscal 2008 resulted from the addition of retail locations in North America, including 34 net openings in fiscal 2008 and 31 net openings in fiscal 2007, and comparable store sales growth as high as 34%, which we realized in fiscal 2007. Our ability to open new stores and

Table of Contents

grow sales in existing stores has been driven by increasing demand for our technical athletic apparel and a growing recognition of the lululemon athletica brand. We believe our superior products, strategic store locations, inviting store environment, grassroots marketing approach and distinctive corporate culture are responsible for our strong financial performance.

We have three reportable segments: corporate-owned stores, franchises and other. We report our segments based on the financial information we use in managing our businesses. While we receive financial information for each corporate-owned store, we have aggregated all of the corporate-owned stores into one reportable segment due to the similarities in the economic and other characteristics of these stores. Our franchises segment accounted for 3% of our net revenues in the first three quarters of fiscal 2009, 5% of our net revenues from continuing operations in fiscal 2008 and 7% of our net revenues from continuing operations in fiscal 2007. Opening new franchised stores is not a significant part of our near-term growth strategy, and we therefore expect that if the revenue derived from our franchised stores continues to comprise less than 10% of the net revenue we report in future fiscal years, we will re-evaluate our segment reporting disclosures. Our other operations accounted for less than 10% of our net revenues from continuing operations in each of the first three quarters of fiscal 2009, fiscal 2008 and fiscal 2007.

Results of Continuing Operations***Thirteen Weeks Results***

The following table summarizes key components of our results of operations for the thirteen weeks ended November 1, 2009 and November 2, 2008. The operating results are expressed in dollar amounts as well as relevant percentages, presented as a percentage of net revenue.

| | Thirteen Weeks Ended November 1, 2009 and November 2, 2008 | | | |
|--|---|-------------|----------------------|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (In thousands) | | (Percentages) | |
| Net revenue | \$ 112,891 | \$ 87,047 | 100.0 | 100.0 |
| Cost of goods sold | 56,553 | 45,154 | 50.1 | 51.9 |
| Gross profit | 56,338 | 41,893 | 49.9 | 48.1 |
| Selling, general and administrative expenses | 35,412 | 28,838 | 31.4 | 33.1 |
| Income from operations | 20,926 | 13,055 | 18.5 | 15.0 |
| Other income (expense), net | (3) | 145 | | 0.2 |
| Income before income taxes | 20,923 | 13,200 | 18.5 | 15.2 |
| Provision for income taxes | 6,855 | 4,370 | 6.0 | 5.0 |
| Net income from continuing operations | 14,068 | 8,830 | 12.5 | 10.2 |
| Net income from discontinued operations | | 4 | | |
| Net income | \$ 14,068 | \$ 8,834 | 12.5 | 10.2 |

Net Revenue

Net revenue increased \$25.8 million, or 30%, to \$112.9 million for the third quarter of fiscal 2009 from \$87.0 million for the third quarter of fiscal 2008. This increase was the result of increased comparable store sales and sales from new stores opened. Assuming the average exchange rate between the Canadian and United States dollars for the third quarter of fiscal 2008 remained constant, our net revenue would have increased \$24.8 million, or 28%, for the third quarter of fiscal 2009.

Table of Contents

| | Thirteen Weeks Ended November 1, 2009 | Thirteen Weeks Ended November 2, 2008 |
|--------------------------------|--|--|
| Net revenue by segment: | | |
| Corporate-owned stores | \$ 98,060 | \$ 77,559 |
| Franchises | 4,118 | 4,798 |
| Other | 10,713 | 4,690 |
| Net revenue | \$ 112,891 | \$ 87,047 |

Corporate-Owned Stores. Net revenue from our corporate-owned stores segment increased \$20.5 million, or 26%, to \$98.1 million for the third quarter of fiscal 2009 from \$77.6 million for the third quarter of fiscal 2008. The following contributed to the \$20.5 million increase in net revenue from our corporate-owned stores segment:

Net revenue from corporate-owned stores we opened during the first three quarters of fiscal 2009, and other corporate-owned stores we opened, or reacquired the franchise rights for, subsequent to November 2, 2008 and therefore not included in the comparable store sales growth, contributed \$12.0 million of the increase. Net new store openings (closings) since the third quarter of fiscal 2008 included (one) store in Canada and nine stores in the United States; and

Comparable store sales increase of 10% in the third quarter of fiscal 2009 resulted in a \$7.5 million increase to net revenue, excluding the effect of foreign currency fluctuations. Including the effect of foreign currency fluctuations, comparable stores sales increased 11%, or \$8.5 million, in the third quarter of fiscal 2009.

Franchises. Net revenue from our franchises segment decreased \$0.7 million, or 14%, to \$4.1 million for the third quarter of fiscal 2009 from \$4.8 million for the third quarter of fiscal 2008. The decrease in net revenue from our franchises segment resulted primarily from our reacquisition of two franchised stores in Victoria, British Columbia and one franchised store in Bellevue, Washington in the third quarter of fiscal 2008.

Other. Net revenue from our other segment increased \$6.0 million, or 128%, to \$10.7 million for the third quarter of fiscal 2009 from \$4.7 million for the third quarter of fiscal 2008. The \$6.0 million increase was primarily the result of an increase in sales from the launch of our e-commerce channel in the first quarter of fiscal 2009 which contributed \$4.2 million in net revenues, as well as increased sales from wholesale and outlet sales which contributed \$1.8 million in net revenues.

Gross Profit

Gross profit increased \$14.4 million, or 34%, to \$56.3 million for the third quarter of fiscal 2009 from \$41.9 million for the third quarter of fiscal 2008. The increase in gross profit was driven principally by:

an increase of \$20.5 million in net revenue from our corporate-owned stores segment related to an increase in corporate-owned stores; and

an increase of \$6.0 million in net revenue from our other segment related primarily to an increase in sales from the launch of our e-commerce channel in the first quarter of fiscal 2009 as well as increased sales from

wholesale, outlet and warehouse sales.

These amounts were partially offset by:

an increase in product costs of \$7.3 million associated with our sale of goods through corporate-owned stores related primarily to increased revenues and unfavorable foreign exchange differences;

an increase in fixed costs, such as occupancy costs and depreciation, of \$2.3 million related to an increase in corporate-owned stores which has a deleveraging effect on gross profit;

an increase in product costs of \$1.5 million associated with the increase in the sale of our goods through our other segment including the launch of our e-commerce channel in the first fiscal quarter of 2009 as well as increased sales from outlet and warehouse locations;

Table of Contents

a decrease of \$0.8 million in gross profit from our franchises segment related primarily to the reacquisition of franchised stores late in the third quarter of fiscal 2008; and

an increase of \$0.3 million in cost of sales support departments related to increased costs for production, design, merchandising and distribution.

Gross profit as a percentage of net revenue, or gross margin, increased 1.8%, to 49.9% for the third quarter of fiscal 2009 from 48.1% for the third quarter of fiscal 2008. The increase in gross margin resulted primarily from:

an increase in corporate-owned stores product margin of 1.1% related primarily to sourcing initiatives, reduced markdowns and other;

a decrease in fixed costs, such as occupancy costs and depreciation, relative to the increase in net revenue, which had a leveraging effect on gross margin and contributed an increase of 1.0%; and

a decrease in expenses related to our production, design, merchandising and distribution departments, relative to the increase in net revenue, which had a leveraging effect on gross margin and contributed an increase of 0.8%.

This increase in gross margin was offset by unfavorable foreign exchange differences on inventory of 1.2%.

Our costs of goods sold in the third quarter of fiscal 2009 and the third quarter of fiscal 2008 included \$0.1 million and \$0.2 million, respectively, of stock-based compensation expense.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$6.6 million, or 23%, to \$35.4 million for the third quarter of fiscal 2009 from \$28.8 million for the third quarter of fiscal 2008. As a percentage of net revenue, selling, general and administrative expenses decreased 1.8%, to 31.4% from 33.1%. The \$6.6 million increase in selling, general and administrative expenses was principally comprised of:

an increase in administrative costs associated with the launch in the first fiscal quarter of 2009 of our new e-commerce channel of \$1.2 million;

an increase of \$1.2 million primarily related to professional fees and legal costs associated with ongoing litigation including legal settlement costs;

an increase of \$1.0 million related to higher management incentive based compensation;

an increase of \$0.9 million primarily related to an increase in store labor hours due to a larger store base than in the third quarter of fiscal 2008;

an increase in depreciation costs of \$0.9 million primarily related to IT projects placed into use during the third quarter of fiscal 2009;

an increase in other administrative costs of \$0.9 million primarily related to a one-time charge arising from a sales tax audit and our store support center's efforts to support a larger store base than in the third quarter of fiscal 2008; and

an increase in foreign exchange losses of \$0.6 million related to unfavorable fluctuations in the Canadian-United States dollar exchange rate.

These amounts were partially offset by a decrease in travel, meals and entertainment and supplies during the third quarter of fiscal 2009 of \$0.5 million related to our efforts to reduce discretionary spending.

Our selling, general and administrative expenses in the third quarter of fiscal 2009 and the third quarter of fiscal 2008 included \$1.3 million and \$1.3 million, respectively, of stock-based compensation expense.

Income from Operations

Income from operations increased \$7.9 million, or 60%, to \$20.9 million for the third quarter of fiscal 2009 from \$13.1 million for the third quarter of fiscal 2008. The increase of \$7.9 million in income from operations for

Table of Contents

the third quarter of fiscal 2009 was primarily due to an increase of \$14.4 million in gross profit resulting from increased comparable store sales and additional sales from corporate-owned stores opened, and was partially offset by a \$6.6 million increase in selling, general and administrative expenses.

On a segment basis, we determine income from operations without taking into account our general corporate expenses such as corporate employee costs, travel expenses and corporate occupancy cost. For purposes of our management's analysis of our financial results, we have allocated some general product expenses to our corporate-owned stores segment. For example, all expenses related to our production, design, merchandise, and distribution departments have been allocated to this segment.

Income from operations (before general corporate expenses) from:

our corporate-owned stores segment increased \$9.4 million, or 44%, to \$30.8 million for the third quarter of fiscal 2009 from \$21.4 million for the third quarter of fiscal 2008. The increase in corporate-owned stores net revenue of \$20.5 million was offset by an increase of \$7.3 million cost of goods sold and an increase in store operating expenses of \$3.8 million;

our franchises segment decreased \$0.9 million, or 42%, to \$1.3 million for the third quarter of fiscal 2009 from \$2.2 million for the third quarter of fiscal 2008, primarily as a result of franchises net revenue included in the comparative period shifting to corporate-owned stores income from operations when we reacquired two franchised stores in Victoria, British Columbia and one franchised store in Bellevue, Washington in the third quarter of fiscal 2008; and

our other segment increased \$6.2 million, or 1655%, to \$6.6 million for the third quarter of fiscal 2009 from \$0.4 million for the third quarter of fiscal 2008, primarily due to the introduction of online sales through our e-commerce channel as well as increased outlet, warehouse and wholesale activity.

Other income (expense), net decreased \$0.1 million to \$nil for the third quarter of fiscal 2009 from \$0.1 million for the third quarter of fiscal 2008. The decrease was primarily due to lower interest rates earned on cash balances.

Provision for Income Taxes

Income tax expense for the third quarter of fiscal 2009 was \$6.9 million compared to \$4.4 million for the corresponding period in fiscal 2008. The Company's financial statement effective tax rate for the third quarter of fiscal 2009 was 32.8% compared to 33.1% for the third quarter of fiscal 2008. The decrease is due to a one-time true-up from the recognition of deferred tax assets in the third quarter of fiscal 2009 which was partially offset by state taxes and a true-up in a foreign jurisdiction. The effective tax rate will vary from the statutory rate because (i) stock-based compensation expense recorded is a permanent difference in certain jurisdictions, (ii) the realization of the benefits of the tax assets from stock-based compensation, and (iii) the realization of the benefits of the tax assets related primarily to historical tax differences between financial and tax bases of assets and liabilities.

Net Income from Continuing Operations

Net income from continuing operations increased \$5.2 million, to \$14.1 million for the third quarter of fiscal 2009 from \$8.8 million for the third quarter of fiscal 2008. The increase in net income of \$5.2 million for the third quarter of fiscal 2009 was primarily due to an increase of \$14.4 million in gross profit resulting from increased comparable store sales and additional sales from corporate-owned stores opened, partially offset by an increase of \$6.6 million in selling, general and administrative expenses, an increase of \$2.5 million in income tax expense and a decrease in other income (expense), net of \$0.1 million. During both the third quarter of fiscal 2009 and fiscal 2008 there were

immaterial revenues, expenses or losses from discontinued operations, resulting in a \$nil impact on basic and diluted earnings per share.

Table of Contents**Thirty-Nine Weeks Results**

The following table summarizes key components of our results of operations for the thirty-nine weeks ended November 1, 2009 and November 2, 2008. The operating results are expressed in dollar amounts as well as relevant percentages, presented as a percentage of net revenue.

| | Thirty-Nine Weeks Ended November 1, 2009 and November 2, 2008 | | | |
|--|--|-------------|-------------------------------------|-------------|
| | 2009 (In thousands) | 2008 | 2009 (Percentages) | 2008 |
| Net revenue | \$ 292,292 | \$ 249,565 | 100.0 | 100.0 |
| Cost of goods sold | 155,766 | 122,159 | 53.3 | 48.9 |
| Gross profit | 136,526 | 127,406 | 46.7 | 51.1 |
| Selling, general and administrative expenses | 91,415 | 86,886 | 31.3 | 34.8 |
| Income from operations | 45,111 | 40,520 | 15.4 | 16.2 |
| Other income, net | 98 | 612 | 0.1 | 0.3 |
| Income before income taxes | 45,209 | 41,132 | 15.5 | 16.5 |
| Provision for income taxes | 15,379 | 11,571 | 5.3 | 4.7 |
| Net income from continuing operations | 29,830 | 29,561 | 10.2 | 11.8 |
| Net (loss) from discontinued operations | | (1,136) | | (0.4) |
| Net income | \$ 29,830 | \$ 28,425 | 10.2 | 11.4 |

Net Revenue

Net revenue increased \$42.7 million, or 17%, to \$292.3 million for the first three quarters of fiscal 2009 from \$249.6 million for the first three quarters of fiscal 2008. This increase was the result of sales from new stores opened and sales through other sales channels. Assuming the average exchange rate between the Canadian and United States dollars for the first three quarters of fiscal 2008 remained constant, our net revenue would have increased \$60.0 million, or 24%, for the first three quarters of fiscal 2009.

| | Thirty-Nine Weeks Ended November 1, 2009 | Thirty-Nine Weeks Ended November 2, 2008 |
|--------------------------------|---|---|
| Net revenue by segment: | | |
| Corporate-owned stores | \$ 256,053 | \$ 225,244 |
| Franchises | 9,798 | 13,567 |
| Other | 26,441 | 10,754 |

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| | | | | |
|-------------|----|---------|----|---------|
| Net revenue | \$ | 292,292 | \$ | 249,565 |
|-------------|----|---------|----|---------|

Corporate-Owned Stores. Net revenue from our corporate-owned stores segment increased \$30.8 million, or 14%, to \$256.1 million for the first three quarters of fiscal 2009 from \$225.2 million for the first three quarters of fiscal 2008. The following contributed to the \$30.8 million increase in net revenue from our corporate-owned stores segment:

Net revenue from corporate-owned stores we opened during the first three quarters of fiscal 2009, and other corporate-owned stores we opened subsequent to November 2, 2008 and therefore not included in the comparable store sales growth, contributed \$42.7 million of the increase. Net new store openings (closings) since the third quarter of fiscal 2008 included (one) store in Canada and nine stores in the United States;

Comparable store sales remained constant in the first three quarters of fiscal 2009 resulting in a \$0.6 million increase to net revenue, excluding the effect of foreign currency fluctuations. Including the effect of foreign currency fluctuations, comparable stores sales decreased 6%, or \$13.8 million, in the third quarter of fiscal 2009; and

Table of Contents

Net revenue related to gift card breakage contributed \$1.9 million of the increase. Based on historical gift card breakage, we recognize into revenue a portion of gift card sales for which we estimate redemption is remote over the estimated period of redemption. In the first quarter of 2009 we recorded a one-time credit of \$1.3 million related to a change in our estimated rate of redemption.

Franchises. Net revenue from our franchises segment decreased \$3.8 million, or 28%, to \$9.8 million for the first three quarters of fiscal 2009 from \$13.6 million for the first three quarters of fiscal 2008. The decrease in net revenue from our franchises segment resulted primarily from our reacquisition of two franchised stores in Victoria, British Columbia and one franchised store in Bellevue, Washington in the third quarter of fiscal 2008.

Other. Net revenue from our other segment increased \$15.7 million, or 146%, to \$26.4 million for the first three quarters of fiscal 2009 from \$10.8 million for the first three quarters of fiscal 2008. The \$15.7 million increase was primarily the result of an increase in sales from the launch of our e-commerce channel in the first quarter of fiscal 2009 which contributed \$7.5 million in net revenues, as well as increased sales from wholesale, outlet and warehouse sales which contributed \$8.2 million in net revenues.

Gross Profit

Gross profit increased \$9.1 million, or 7%, to \$136.5 million for the first three quarters of fiscal 2009 from \$127.4 million for the first three quarters of fiscal 2008. The increase in gross profit was driven principally by:

an increase of \$30.8 million in net revenue from our corporate-owned stores segment related to an increase in corporate-owned stores;

an increase of \$15.7 million in net revenue from our other segment related primarily to an increase in sales from the launch of our e-commerce channel in the first quarter of fiscal 2009 as well as increased sales from wholesale, outlet and warehouse sales; and

a decrease of \$1.0 million in cost of sales support departments related to increased costs for production, design, merchandising and distribution.

These amounts were partially offset by:

an increase in product costs of \$17.1 million associated with our sale of goods through corporate-owned stores related primarily to increased revenues and unfavorable foreign exchange differences;

an increase in fixed costs, such as occupancy costs and depreciation, of \$9.1 million related to an increase in corporate-owned stores which has a deleveraging effect on gross profit;

an increase in product costs of \$7.6 million associated with the increase in the sale of our goods through our other segment, including the launch of our e-commerce channel in the first fiscal quarter of 2009 as well as increased sales from outlet and warehouse locations;

a decrease of \$3.1 million in gross profit from our franchises segment related primarily to the reacquisition of franchised stores late in the third quarter of fiscal 2008; and

an increase in shrinkage and write-down of inventory held by corporate-owned stores of \$1.6 million related to the growth of our business.

Gross profit as a percentage of net revenue, or gross margin, decreased 4.4%, to 46.7% for the first three quarters of fiscal 2009 from 51.1% for the first three quarters of fiscal 2008. The decrease in gross margin resulted primarily from:

unfavorable foreign exchange differences of 2.2%;

a decrease in corporate-owned stores product margin, which contributed a decrease in gross margin of 1.8% as a result of increased direct product costs, shrinkage and write-downs; and

an increase in fixed costs, such as occupancy costs and depreciation, relative to the increase in net revenue, which had a deleveraging effect on gross margin and contributed a decrease of 1.4%.

Table of Contents

This was offset by a decrease in expenses related to our production, design, merchandising and distribution departments, relative to the increase in net revenue, which had a leveraging effect on gross margin and contributed an increase of 1.1%.

Our cost of goods sold in the first three quarters of fiscal 2009 and the first three quarters of fiscal 2008 included \$0.6 million and \$0.7 million, respectively, of stock-based compensation expense.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$4.5 million, or 5%, to \$91.4 million for the first three quarters of fiscal 2009 from \$86.9 million for the first three quarters of fiscal 2008. As a percentage of net revenue, selling, general and administrative expenses decreased 3.5%, to 31.3% from 34.8%. The \$4.5 million increase in selling, general and administrative expenses was principally comprised of:

- an increase of \$2.9 million primarily associated with employment-related legal matters, professional fees and legal costs associated with ongoing litigation including legal settlement costs;

- an increase in administrative costs associated with the launch in the first fiscal quarter of 2009 of our new e-commerce channel of \$2.0 million;

- an increase in depreciation costs of \$1.3 million related to IT projects placed into use as well as the retirement of fixed assets no longer in use;

- an increase of \$1.2 million related to higher management incentive based compensation;

- an increase in provision for impairment and lease exit costs of \$0.6 million; and

- an increase in occupancy costs of \$0.5 million related to our other segment as we opened additional locations after the third quarter of fiscal 2008.

These amounts were partially offset by:

- a decrease in employee compensation, including options expense, of \$2.5 million related to a reduction in employee head count in our corporate-owned store locations and store support center, as part of our efforts to reduce operating expenses, as well as a one-time charge in the first quarter of fiscal 2008 related to the acceleration of performance-based awards, partially offset by increased store labor hours due to opening additional corporate-owned stores; and

- a decrease in discretionary spending of \$1.5 million related to travel, meals and entertainment and supplies.

Our selling, general and administrative expenses in the first three quarters of fiscal 2009 and the first three quarters of fiscal 2008 included \$3.7 million and \$4.5 million, respectively, of stock-based compensation expense.

Income from Operations

Income from operations increased \$4.6 million, or 11%, to \$45.1 million for the first three quarters of fiscal 2009 from \$40.5 million for the first three quarters of fiscal 2008. The increase of \$4.6 million in income from operations for the first three quarters of fiscal 2009 was primarily due to an increase of \$9.1 million in gross profit resulting from

increased comparable store sales and additional sales from corporate-owned stores opened, partially offset by a \$4.5 million increase in selling, general and administrative expenses.

On a segment basis, we determine income from operations without taking into account our general corporate expenses such as corporate employee costs, travel expenses and corporate occupancy costs. For purposes of our management's analysis of our financial results, we have allocated some general product expenses to our corporate-owned stores segment. For example, all expenses related to our production, design and distribution departments have been allocated to this segment.

Table of Contents

Income from operations (before general corporate expenses) from:

our corporate-owned stores segment increased \$4.2 million, or 6%, to \$72.4 million for the first three quarters of fiscal 2009 from \$68.2 million for the first three quarters of fiscal 2008, primarily due to an increase in corporate-owned stores net revenue of \$30.8 million offset by an increase of \$18.8 million in cost of sales and \$7.8 million in store operating expenses such as occupancy and depreciation;

our franchises segment decreased \$3.1 million, or 48%, to \$3.3 million for the first three quarters of fiscal 2009 from \$6.4 million for the first three quarters of fiscal 2008 primarily as a result of franchises net revenue included in the comparative period shifting to corporate-owned stores income from operations when we reacquired two franchised stores in Victoria, British Columbia and one franchised store in Bellevue, Washington in the third quarter of fiscal 2008; and

our other segment increased \$11.5 million, or 562%, to \$13.6 million for the first three quarters of fiscal 2009 from \$2.1 million for the first three quarters of fiscal 2008, primarily due to the introduction of online sales through our e-commerce channel as well as increased outlet, warehouse and wholesale activity.

Other income (expense), net decreased \$0.5 million to \$0.1 million for the first three quarters of fiscal 2009 from \$0.6 million for the first three quarters of fiscal 2008. The decrease was primarily due to lower interest rates offered on cash balances.

Provision for Income Taxes

Income tax expense for the first three quarters of fiscal 2009 was \$15.4 million compared to \$11.6 million for the corresponding period in fiscal 2008. The Company's financial statement effective tax rate for the first three quarters of fiscal 2009 was 34.0% compared to 28.1% for the first three quarters of fiscal 2008. The increase is a result of a true-up in fiscal 2008 related to amendments to our transfer pricing structure. The effective tax rate will vary from the statutory rate because (i) stock-based compensation expense recorded is a permanent difference in certain jurisdictions, (ii) the realization of the benefits of the tax assets from stock-based compensation, and (iii) the realization of the benefits of the tax assets related primarily to historical tax differences between financial and tax bases of assets and liabilities.

During the second quarter of fiscal 2008, after considering a number of factors, including a history of cumulative earnings, utilization of previously generated NOL carryforwards and estimated taxable income in future years, we determined we would more likely than not realize substantial future tax benefits from our deferred income tax assets generated in the United States prior to February 1, 2009. As a result of this analysis the Company recorded deferred tax assets of (i) \$1.4 million related primarily to historical tax differences between financial and tax bases of assets and liabilities, (ii) \$0.9 million cumulative tax benefit recorded from stock-based compensation expense prior to the second quarter of fiscal 2008, and (iii) \$2.7 million excess tax benefit from the exercise of stock options during and prior to the second quarter of fiscal 2008.

During the second quarter of fiscal 2009, an adjustment was made to deferred tax assets and additional paid-in capital in the amount of \$12.0 million relating to windfall taxes recorded in the year ended February 1, 2009 in excess of US taxes payable. A similar entry for \$0.2 million was recorded in the same period related to windfall taxes recorded in the first quarter of fiscal 2009. The Company has concluded that the adjustment was not material to the financial statements.

Net Income from Continuing Operations

Net income from continuing operations increased \$0.3 million, to \$29.8 million for the first three quarters of fiscal 2009 from \$29.6 million for the first three quarters of fiscal 2008. The increase in net income of \$0.3 million for the first three quarters of fiscal 2009 was primarily due to an increase of \$9.1 million in gross profit resulting from increased comparable store sales and additional sales from corporate-owned stores opened, partially offset by an increase of \$4.5 million in selling, general and administrative expenses, an increase of \$3.8 million in income tax expense and a decrease in other income (expense), net of \$0.5 million.

Table of Contents

Discontinued Operations

During the first three quarters of fiscal 2009, there were no revenues, expenses or losses from discontinued operations. The loss from discontinued operations was \$1.1 million for the first three quarters of fiscal 2008, resulting in a reduction of basic and diluted earnings per share of \$0.02. The shut down costs related to the closure of our stores in Japan were fully accrued in the second quarter of fiscal 2008.

Seasonality

Historically, we have recognized a significant portion of our income from operations in the fourth fiscal quarter of each year as a result of increased sales during the holiday selling season. Despite the fact that we have experienced a significant amount of our net revenue and gross profit in the fourth quarter of each fiscal year, we believe that the true extent of the seasonality or cyclical nature of our business may have been overshadowed by our rapid growth to date.

Liquidity and Capital Resources

Our cash requirements are principally for working capital and capital expenditures, including the build-out cost of new stores, renovations of existing stores, and improvements to our distribution facility and corporate infrastructure. Our need for working capital is seasonal, with the greatest requirements from August through the end of November each year as a result of our inventory build-up and concentration of new store openings during this period for our holiday selling season. Historically, our main sources of liquidity have been cash flow from operating activities and borrowings under our existing and previous revolving credit facilities, and our initial public offering that closed on August 2, 2007.

At November 1, 2009, our working capital (excluding cash and cash equivalents) was \$24.8 million and our cash and cash equivalents were \$101.8 million.

The following presents the major components of net cash flows provided by and used in operating, investing and financing activities for the periods indicated:

Operating Activities

Operating Activities consist primarily of net income adjusted for certain non-cash items, including depreciation and amortization, deferred income taxes, stock-based compensation expense and the effect of the changes in non-cash working capital items, principally accounts receivable, inventories, accounts payable and accrued expenses.

Cash provided by operating activities increased \$22.3 million, to \$51.5 million for the thirty-nine weeks ended November 1, 2009 compared to cash used by operating activities of \$29.2 million for the thirty-nine weeks ended November 2, 2008. The \$22.3 million increase was primarily a result of a decrease in inventories and an increase in items not affecting cash and was offset by a decrease in miscellaneous accruals. The net decrease in the change in inventories is a result of selling our on-hand spring inventories we had built up at the end of fiscal 2008 for a larger store base. The net increase in items not affecting cash is primarily a result of increased depreciation and amortization for a larger store base and decreased deferred income tax assets. The net change in miscellaneous accruals are a result of changes in the timing of receipts and payments of invoices from and to third parties.

Investing Activities

Investing Activities relate to capital expenditures, advances to and investments in franchise and acquisition of franchises.

Cash used in investing activities decreased \$25.4 million to \$10.2 million for the thirty-nine weeks ended November 1, 2009 from \$35.6 million for the thirty-nine weeks ended November 2, 2008. The \$25.4 million decrease was a result of reduced corporate-owned store openings in the thirty-nine weeks ended November 1, 2009 compared to the same period in fiscal 2008 and the reacquisition of franchise rights for three stores in the thirty-nine weeks ended November 2, 2008.

Table of Contents

Financing Activities

Financing Activities consist primarily of cash received on the exercise of stock options. Cash provided by financing activities decreased to \$0.3 million for the thirty-nine weeks ended November 1, 2009 from \$11.1 million of cash used in financing activities for the thirty-nine weeks ended November 2, 2008.

We believe that our cash from operations and borrowings available to us under our revolving credit facility will be adequate to meet our liquidity needs and capital expenditure requirements for at least the next 24 months. Our cash from operations may be negatively impacted by a decrease in demand for our products as well as the other factors described in *Risk Factors* of our Annual Report on Form 10-K for fiscal 2008 filed on March 27, 2009. In addition, we may make discretionary capital improvements with respect to our stores, distribution facility, store support center, or other systems, which we would expect to fund through the issuance of debt or equity securities or other external financing sources to the extent we were unable to fund such capital expenditures out of our cash from operations.

Revolving Credit Facility

In April 2007, we executed a credit facility with the Royal Bank of Canada that provided for a CDN\$20,000,000 uncommitted demand revolving credit facility to fund our working capital requirements. This agreement cancelled our previous CDN\$8,000,000 credit facility. Borrowings under this uncommitted credit facility are made on a when-and-as-needed basis at our discretion.

Borrowings under the credit facility can be made either as i) *Revolving Loans* Revolving loan borrowings will bear interest at a rate equal to the Bank's CA\$ or US\$ annual base rate (defined as zero% plus the lender's annual prime rate) per annum, ii) *Offshore Loans* Offshore rate loan borrowings will bear interest at a rate equal to a base rate based upon LIBOR for the applicable interest period, plus 1.125% per annum, iii) *Bankers Acceptances* Bankers acceptance borrowings will bear interest at the bankers acceptance rate plus 1.125% per annum, or iv) *Letters of Credit and Letters of Guarantee* Borrowings drawn down under letters of credit or guarantee issued by the banks will bear a 1.125% per annum fee.

At November 1, 2009, aside from letters of credit and guarantees, there were no borrowings outstanding under this credit facility.

Off-Balance Sheet Arrangements

We enter into documentary letters of credit to facilitate the international purchase of merchandise. We also enter into standby letters of credit to secure certain of our obligations, including insurance programs and duties related to import purchases. As of November 1, 2009, letters of credit and letters of guarantee totaling \$2.2 million have been issued.

Other than these standby letters of credit and guarantee, we do not have any off-balance sheet arrangements, investments in special purpose entities or undisclosed borrowings or debt. In addition, we have not entered into any derivative contracts or synthetic leases.

Critical Accounting Policies

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. Predicting future events is inherently an imprecise activity and, as such, requires the use of judgment. Actual results may vary from estimates in amounts that may be material to the financial statements. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been

used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact our consolidated financial statements. Our critical accounting policies and estimates are discussed in our Annual Report on Form 10-K for our 2008 fiscal year end filed with the SEC on March 27, 2009 and in Note 2 included in Item 1 of Part 1 of this Quarterly Report on Form 10-Q. We believe that there have been no other significant changes during the thirty-nine weeks ended November 1, 2009 to our critical accounting policies.

Table of Contents**Operating Locations**

Our operating locations by country, state and province as of November 1, 2009 are summarized in the table below.

| | Corporate-Owned Stores | Franchise Stores | Total Stores |
|--|-----------------------------------|-----------------------------|-------------------------|
| Canada | | | |
| Alberta | 8 | | 8 |
| British Columbia | 10 | | 10 |
| Manitoba | 1 | | 1 |
| Nova Scotia | 1 | | 1 |
| Ontario | 17 | | 17 |
| Québec | 4 | | 4 |
| Saskatchewan | | 1 | 1 |
| Total Canada | 41 | 1 | 42 |
| United States | | | |
| Arizona | 1 | | 1 |
| California | 19 | 1 | 20 |
| Colorado | | 3 | 3 |
| Connecticut | 2 | | 2 |
| District of Columbia | 2 | | 2 |
| Florida | 2 | | 2 |
| Hawaii | 1 | | 1 |
| Illinois | 6 | | 6 |
| Maryland | 2 | | 2 |
| Massachusetts | 5 | | 5 |
| Michigan | 1 | | 1 |
| Nevada | 1 | | 1 |
| New Jersey | 2 | | 2 |
| New York | 7 | | 7 |
| Oregon | 1 | | 1 |
| Pennsylvania | 1 | | 1 |
| Texas | 7 | | 7 |
| Virginia | 2 | | 2 |
| Washington | 3 | | 3 |
| Total United States | 65 | 4 | 69 |
| International | | | |
| Australia | | 8 | 8 |
| Total International | | 8 | 8 |
| Overall total, as of November 1, 2009 | 106 | 13 | 119 |

| | | | |
|--|-----|----|-----|
| Overall total, as of February 1, 2009 | 103 | 10 | 113 |
|--|-----|----|-----|

Table of Contents

ITEM 3. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in interest rates and foreign currency exchange rates. We do not hold or issue financial instruments for trading purposes.

Foreign Currency Exchange Risk. We currently generate a majority of our net revenue in Canada. The reporting currency for our consolidated financial statements is the United States dollar. Historically, our operations were based largely in Canada. As of November 1, 2009, we operated 42 stores in Canada. As a result, we have been impacted by changes in exchange rates and may be impacted materially for the foreseeable future. For example, because we recognize net revenue from sales in Canada in Canadian dollars, if the United States dollar strengthens it would have a negative impact on our Canadian operating results upon translation of those results into United States dollars for the purposes of consolidation. Any hypothetical loss in net revenue could be partially or completely offset by lower cost of sales and lower selling, general and administrative expenses that are generated in Canadian dollars. A 10% appreciation in the relative value of the United States dollar compared to the Canadian dollar would have resulted in lost income from operations of approximately \$3.6 million for the first three quarters of fiscal 2009. To the extent the ratio between our net revenue generated in Canadian dollars increases as compared to our expenses generated in Canadian dollars, we expect that our results of operations will be further impacted by changes in exchange rates. We do not currently hedge foreign currency fluctuations. However, in the future, in an effort to mitigate losses associated with these risks, we may at times enter into derivative financial instruments, although we have not historically done so. These may take the form of forward sales contracts and option contracts. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

Interest Rate Risk. In April 2007, we entered into an uncommitted senior secured demand revolving credit facility with Royal Bank of Canada which replaced our prior credit facility. Because our revolving credit facility bears interest at a variable rate, we will be exposed to market risks relating to changes in interest rates, if we have a meaningful outstanding balance. At November 1, 2009, we had no outstanding borrowings under our revolving facility. We do not believe we currently are significantly exposed to changes in interest rate risk. We currently do not engage in any interest rate hedging activity and currently have no intention to do so in the foreseeable future. However, in the future, if we have a meaningful outstanding balance, in an effort to mitigate losses associated with these risks, we may at times enter into derivative financial instruments, although we have not historically done so. These may take the form of forward sales contracts, option contracts, and interest rate swaps. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

ITEM 4. *CONTROLS AND PROCEDURES*

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer), to allow timely decisions to be made regarding required disclosure. We have established a Disclosure Committee, consisting of certain members of management, to assist in this evaluation. The Disclosure Committee meets on a regular quarterly basis, and as needed.

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act), at November 1, 2009. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, at November 1, 2009, our disclosure controls and procedures were effective.

There was no change in internal control over financial reporting during the thirty-nine weeks ended November 1, 2009 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Table of Contents**PART II****OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

The Company is, from time to time, involved in routine legal matters incidental to its business. Management believes that the ultimate resolution of any such current proceedings will not have a material adverse effect on the Company's continued financial position, results of operations or cash flows. Refer to Note 5 included in Item 1 of Part 1 of this Quarterly Report on Form 10-Q for information regarding specific legal proceedings.

ITEM 1A. RISK FACTORS

In addition to other information set forth in this report, you should carefully consider the Risk Factors discussed in our Annual Report on Form 10-K for our 2008 fiscal year filed on March 27, 2009. There have been no material changes to the Risk Factors previously disclosed in our Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(c) The following table provides information regarding the Company's purchases of its common stock during the thirteen week period ended November 1, 2009:

| Period(1) | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(2) | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs(2) |
|------------------------------------|---|---|--|--|
| August 3, 2009 – August 30, 2009 | 3,783 | \$ 21.05 | 3,783 | 2,891,467 |
| August 31, 2009 – October 4, 2009 | 5,143 | 23.55 | 5,143 | 2,886,324 |
| October 5, 2009 – November 1, 2009 | 3,251 | 26.32 | 3,251 | 2,883,073 |
| Total | 12,177 | | 12,177 | |

(1) Monthly information is presented by reference to our fiscal months during our third quarter of fiscal 2009.

(2) Our Employee Share Purchase Plan (ESPP) was approved by our Board of Directors and stockholders in September 2007. All shares purchased under the ESPP are purchased on the Toronto Stock Exchange or the

Nasdaq Global Select Market (or such other stock exchange as we may designate from time to time). Unless our Board of Directors terminates the ESPP earlier, the ESPP will continue until all shares authorized for purchase under the ESPP have been purchased. The maximum number of shares available for issuance under the ESPP is 3,000,000.

ITEM 6. EXHIBITS

| Exhibit No. | Exhibit Title | Filed Herewith | Form | Incorporated by Reference | | |
|-------------|--|-------------------|------|---------------------------|----------|-------------|
| | | | | Exhibit No. | File No. | Filing Date |
| 31.1 | Certification of Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a) | X | | | | |
| 31.2 | Certification of Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a) | X | | | | |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | X | | | | |

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

lululemon athletica inc.

By: /s/ John E. Currie

John E. Currie
Chief Financial Officer
(Principal Financial Officer and
Principal Accounting Officer)

Dated: December 9, 2009

Table of Contents

Exhibit Index

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| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | X | | | | |

32