

Lululemon Athletica (NASDAQ: LULU)

Fat pitch or value trap? One of the most profitable brands in athletic apparel is priced for permanent decline, and the evidence still splits both ways. We are starting with a small position.

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01 Summary

Lululemon built the athleisure category, compounded revenue at about 20% a year from 2017 to 2025, and still earns gross margins most apparel companies never reach. Today its whole equity is worth about \$10.5 billion. That is roughly what Alo Yoga's owners reportedly discussed as a private valuation in 2023, for a business with perhaps one-fifth of Lululemon's revenue. The stock closed at \$94.46 on October 2, a new 52-week low and 81% below its December 2023 peak.

The decline was earned. Americas comparable sales fell 12% last quarter. Leggings, about a third of revenue, fell roughly 20%. Alo and Vuori are opening stores next door. The company cut full-year EPS guidance twice in three months, guides Q3 operating margin to about 6.5%, and spent the first half of 2026 in a proxy fight with its founder. The founder is now also going through a divorce with no prenuptial agreement.

Our view is that the market has moved from pricing a growth problem to pricing a terminal one, and the balance sheet buys the new CEO time to prove which it is:

- 1 The franchise is damaged, not broken.** Even excluding a one-time tariff refund, Q2 gross margin was 54.9%, against Nike's 42.9%. Inventory units are down 7%, so there is no glut to liquidate. International revenue still grew in constant currency.
- 2 The price assumes decline forever.** At \$94.46 the stock trades at 10.8x guided EPS excluding the refund, about 4.6x EV/EBITDA, and roughly a 9–13% free-cash-flow yield. A simple reverse DCF says the market expects free cash flow to shrink 1–3% a year in perpetuity.
- 3 The balance sheet is a weapon, finally used at sensible prices.** The company has \$1.39 billion of cash and no funded

KEY DATA

Price (Oct 2, 2026)	\$94.46
Peak close (Dec 2023)	~\$511
Shares incl. exchangeable	110.7M
Market cap	\$10.46B
Cash / funded debt	\$1.39B / \$0
Enterprise value	\$9.07B
Lease liabilities	\$2.14B
FY26 revenue guide	\$10.35–10.50B
FY26 EPS guide	\$9.48–9.73
...ex tariff refund	~\$8.75
P/E guide / ex-refund	9.8x / 10.8x
EV / FY26E EBITDA	~4.6x
TTM free cash flow	\$1.35B
Short interest (Sep 18)	12.8% float
Ratings (Buy/Hold/Sell)	1 / 21 / 7
Avg. price target	\$107
Founder family stake	8.6%

OUR CALL: LONG, SMALL SIZE

Bear \$70 · Base \$127 · Bull \$200
 Weighted value ≈ \$124 (+32%)
 Position: 2% of fund, 1-year hold, exit at a 20% max drawdown

debt. After spending \$4.2 billion on buybacks at an average of about \$239 a share, it is now retiring stock near \$120 and below.

- 4 **The governance overhang is mostly priced and partly resolved.** A new CEO started September 8 with options struck at \$99.72. Five directors have joined since March. The founder is under a standstill until roughly late 2027.
- 5 **The payoff is asymmetric but not yet safe.** Our scenarios run from \$70 (−26%) to \$200 (+112%), with a probability-weighted value of about \$124 (+32%). The next two reports, in December and March, will probably be bad. That is why the club voted for a **2% starter position, held for one year, sold if drawdown reaches 20%.**

02 How we got here

Lululemon's collapse was not one event. It was a slow loss of momentum in its home market, followed by a run of self-inflicted and external shocks in 2026, each of which made the next harder to absorb. The sequence matters because it separates what is cyclical (tariffs, the consumer) from what is structural (product relevance, competition) and what is governance (leadership vacuum, founder war).

Date	Event
Dec 29, 2023	Shares close near their all-time high of ~\$511.
2024	U.S. growth stalls. The Breezethrough leggings launch misfires. A securities class action follows (<i>Patel</i> , class period Dec 2023–Jul 2024).
2025	U.S. tariffs rise and the de minimis exemption is removed (Aug 29, 2025). Americas comps fall 3% for the year while China grows 29%. FY25 EPS: \$13.26, down from \$14.64.
Dec 11, 2025	CEO Calvin McDonald agrees to step down effective Jan 31, 2026. CFO Meghan Frank and CCO André Maestrini become interim co-CEOs. Chair Marti Morfitt becomes executive chair.
Dec 29, 2025	Founder Chip Wilson notifies the company he will nominate directors and propose board declassification. A proxy fight begins.
Feb 20, 2026	Supreme Court invalidates IEEPA tariffs. Lululemon had paid \$230M of them and files for refunds.
Mar 17, 2026	FY25 results. Initial FY26 guidance: revenue +2–4%, EPS \$12.10–12.30.
Mar 31, 2026	Court partly denies the motion to dismiss in <i>Patel</i> . The case moves to discovery.
April 2026	Texas AG issues a PFAS civil investigative demand (Apr 13). The Wilsons' family-law case is filed under seal in B.C. Supreme Court. Heidi O'Neill is named CEO (Apr 22).
May 26–30, 2026	Cooperation agreement with Wilson settles the proxy fight. Four days later, a Great Wall yoga event featuring Japanese-style drums sets off a nationalist backlash in China.
Jun 4, 2026	Q1 results. FY26 EPS guidance cut to \$10.95–11.15.
Jul–Sep 2026	Wilson entities sell ~334K shares and, on Sep 1, enter a two-year prepaid variable forward with Goldman Sachs on 1.27M shares.
Sep 3–4, 2026	Q2 results. FY26 EPS guidance cut again to \$9.48–9.73, including a one-time \$0.86 refund. Shares fall 17% to \$100.61. Michael Burry calls LULU a "fat pitch" below \$100. The divorce becomes public.

Sep 8–9, 2026 O'Neill starts as CEO. Her sign-on options are struck at \$99.72.

Oct 2, 2026 Shares close at \$94.46, a new 52-week low.

Sources: company 8-Ks, 10-K and 10-Qs; Schedule 13D/A amendments 23–25; price data from StockAnalysis.

03 The business

Lululemon designs and sells technical athletic apparel, mostly through its own stores (825 company-operated locations) and its own e-commerce. That vertical model is the source of its margins: there is no wholesaler taking a cut, and the brand controls price, presentation and the customer relationship. The model also means every lost customer shows up directly in comparable sales.

FY2025 (ended Feb 1, 2026)	Revenue	Share	Growth	Notes
Women's apparel	\$7.00B	63%	+5%	Leggings are roughly one-third of total revenue
Men's apparel	\$2.66B	24%	+4%	Held up best in Q2 (–1%)
Accessories & other	\$1.44B	13%	+8%	Includes footwear. Fell 13% in Q2.
Total	\$11.10B	100%	+5%	+7% excluding FY24's 53rd week
Americas	\$7.85B	71%	–1%	483 stores. Comps –3% in FY25, –12% in Q2 FY26.
China Mainland	\$1.75B	16%	+29%	174 stores. Highest segment margin (37% in Q2).
Rest of World	\$1.50B	14%	+16%	168 stores across APAC and EMEA
Stores / e-commerce / other	45% / 44% / 10%			"Other" = outlets, wholesale, license

Source: FY2025 10-K (revenue disaggregation and segment tables); leggings share per Fortune (Sep 12, 2026).

Three facts about the model matter for the thesis. First, **the margin structure is unusual**: FY25 gross margin was 56.6% and operating margin 19.9%, even after tariffs. At the FY24 peak those figures were 59.2% and 23.7%. Nike reported 42.9% gross margin in its latest fiscal year. Second, **sourcing is concentrated**: about 40% of product is made in Vietnam, and 34% of fabric comes from Taiwan. That exposes Lululemon to tariff policy and to cross-strait risk. Third, **the company has been a consistent cash generator**. Operating cash flow has exceeded capex in every year of the past decade, which has funded about \$4.6 billion of buybacks since FY21 with no borrowing.

04 What broke: four things at once

1. The core product went stale

The most important number from Q2 is not a financial line. It is that **women's leggings sales fell about 20%**, in a category that is roughly a third of the company. Management describes a shift in demand toward "away-from-body" silhouettes such as wide-leg pants, joggers and looser shapes. Its own newer styles (Groove Wide-Leg, Align Foldover Jogger, Dance Studio) are working, but not yet enough to offset the core. GlobalData's Neil Saunders summed up the outside view bluntly, calling it "an incredibly boring assortment." Expansion into footwear, outerwear and skirts spread design attention across more categories and filled more of the floor with product that ended up discounted. Markdowns rose 70 bps in Q2. Management has cut North American store SKU density by 15% and is "chasing" about

20% more volume in-season. Both moves are sensible, and both are admissions that the assortment was wrong.

2. Challengers took share, from next door

M Science data cited by Reuters showed Lululemon's share of its category falling about **10 points to 43.9% in August**, with Alo gaining 5.9 points and Vuori 2.2. These are not distant competitors: by one count, roughly 90% of Vuori's stores and 84% of Alo's sit within half a mile of a Lululemon. Alo's parent reportedly has close to \$2 billion of revenue and has explored a sale or IPO at a valuation around \$10 billion. Vuori raised capital at \$5.5 billion in late 2024 on roughly \$1 billion of revenue. Lululemon is still several times larger than either, but it no longer owns the "new" in its own category.

3. Prices went up just as customers got pickier

Tariffs forced price increases in 2025 just as the core customer's budget tightened. In Q2, management said tariffs had a gross negative impact of 160 bps before the refund. The 10-Q is explicit that Americas comps fell because of **lower traffic, lower conversion and lower average order value**, all three at once. When a premium brand loses all three, customers are not just trading down. They are trying alternatives and not coming back.

4. Self-inflicted brand damage

In China, the company's growth engine (+29% in FY25), a May 30 yoga event on the Great Wall featuring Japanese-style taiko drums drew more than 50 million views of criticism on Weibo and an apology. China comps went from +20% in FY25 to **-8% in constant currency** in Q2. In the U.S., the Texas Attorney General opened a PFAS ("forever chemicals") investigation in April. That is awkward for a wellness brand, even though the company says it phased PFAS out in FY23. Meanwhile, a public founder war, an interim co-CEO structure, and the August exit of the Chief AI & Technology Officer told customers and employees that nobody was clearly in charge.

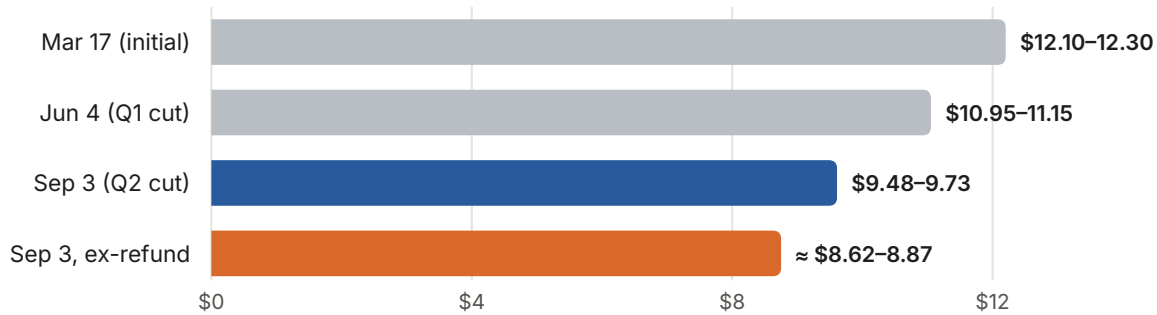
The result, in numbers

Q2 FY26 (ended Aug 2, 2026)	Reported	Ex tariff refund	Q2 FY25
Revenue	\$2,416M (-4%)	—	\$2,525M
Comparable sales: total / Americas / China (cc)	-10% / -12% / -8%	—	
Gross margin	60.5%	54.9%	58.5%
SG&A % revenue (incl. \$13.4M proxy costs)	41.7%	41.7%	37.7%
Operating margin	18.8%	13.2%	20.7%
Diluted EPS	\$2.92	\$2.06	\$3.10
Inventory: dollars / units	-1% / -7%		

Source: Q2 FY2026 earnings release, 10-Q and conference call (Sep 3, 2026). Ex-refund figures remove the \$134.5M IEEPA refund recorded in cost of goods sold and the \$0.86 per-share EPS benefit.

Underneath the refund, Q2 was not catastrophic. Ex-refund EPS of \$2.06 beat the company's own \$1.76–1.81 guidance. The problem was the outlook. **Q3 guidance calls for revenue down 10–11%, gross margin down about 250 bps, about 800 bps of SG&A deleverage and an operating margin of about 6.5%**, against 17% a year earlier. EPS is guided to \$0.93–0.98 versus \$2.59. The full-year guide implies Q4 revenue down about 11% and Q4 EPS near \$4.06 versus \$5.01.

FY26 EPS guidance has been cut twice in six months (guidance midpoint; range shown at bar end)



Source: company earnings releases (Mar 17, Jun 4, Sep 3, 2026). The Sep 3 guide includes \$0.86 of refunds already received; the ex-refund bar subtracts it.

05 Why we think the market is too pessimistic

We do not think the bear case is wrong about the last twelve months. We think it is wrong about what the price implies for the next five years. A \$10.5 billion market cap for an \$11 billion-revenue brand with best-in-class margins, no debt and 13% trailing FCF yield is the price of a business in permanent decline. Five pieces of evidence argue against permanence.

5.1 Pricing power is bruised, not gone

Ex-refund Q2 gross margin of 54.9% is down 360 bps year over year, mostly from tariffs (160 bps gross), markdowns (70 bps) and occupancy deleverage from new stores. It is within three points of Deckers (57.7%) and twelve points above Nike (42.9%). A brand whose customers had truly moved on would show it first in markdown depth. Lululemon's markdown increase is measured in tens of basis points, and management guides Q4 markdowns roughly flat year over year.

5.2 Inventory is clean

The worst turnarounds start with too much inventory. Lululemon's units are down 7% year over year, and full-year guidance calls for units roughly flat. That is the opposite of Nike's 2022–23 glut or Lululemon's own 2013 sheer-pants recall. A new CEO can reset the assortment without first spending a year clearing stock.

5.3 The problem is concentrated, not universal

Rest of World revenue grew 6% in constant currency in Q2, and men's apparel was nearly flat (–1%). The damage is concentrated in Americas women's bottoms and in China sentiment. Those are serious, but they are specific, and specific problems can be fixed with product and marketing. A brand that had lost relevance everywhere would show weakness in every region and category.

5.4 Time is the asset, and the balance sheet buys it

\$1.39 billion of cash, \$594 million of undrawn revolver, and no funded debt means O'Neill has no refinancing deadline and no need to sell assets. Compare VF Corp, which sold Supreme and Dickies to manage its debt, or Hanesbrands, which ended up inside Gildan. Even counting lease liabilities, debt-to-equity is about 0.45x, near the industry average and far below levered peers.

5.5 Expectations are already on the floor

Only one of 29 analysts tracked by MarketBeat rates the stock a Buy. Short interest is 12.8% of float. Post-earnings price targets run from \$70 (BMO, Underperform) through \$95 (Barclays, Wells Fargo, JPMorgan) to \$117 (Citi, Neutral); none of those firms rates it a Buy. Morgan Stanley (\$83, Underweight) argues the guidance cut lowered the bar but did not finish the reset, and expects new management to "shrink to grow." We take that seriously (see Risks). But this is also the setup Burry described when he wrote that he could "smell the stench of a kitchen sink." A first-time CEO's first annual guide, due in March 2027, is likely to be conservative. If it is, the bar for upside surprises in FY27 will be low.

Precedent, and its limits

Brand turnarounds from depressed prices have paid off before. Lululemon itself bottomed near \$48 in May 2017, replaced its CEO in early 2018, and was above \$400 by 2021. Ralph Lauren (2017) and Abercrombie & Fitch (2020–23) both re-rated sharply once product and full-price selling recovered. Burry cites all three. The honest caveat is that in 2017 Lululemon was still growing and traded above 20x earnings. A precedent shows that recovery is possible, not that it is likely.

06 Competition: an incumbent priced like a challenger

Company	Latest growth	Valuation	Gross margin	Balance sheet
Lululemon	–4% Q2; FY26 –5 to –7%	~10x fwd P/E; ~4.6x EV/EBITDA	~55% (Q2 ex-refund)	\$1.4B cash, no debt
Deckers (Hoka, UGG)	+9.8% FY26	~11x trailing	57.7%	Net cash
Nike	Flat FY26	~17x	42.9%	Some debt; pays a dividend
Ralph Lauren	+13% Q1 FY27	~18x fwd	n/m	Debt/equity ~1.1x
Amer Sports (Arc'teryx)	~+24% FY26 guide	~29x trailing	60.5–61% guide	Net cash
Alo Yoga (private)	+5.9 pts share (Aug)	~\$10B (2023 talks)	private	private
Vuori (private)	+2.2 pts share (Aug)	\$5.5B (Nov 2024 round)	private	private

Peer multiples approximate as of late September 2026; P/E bases differ. Private figures are unaudited press estimates. Sources: company filings and releases; Amer Sports Q2 2026 release; Deckers FY2026 release; M Science via Reuters/Fortune; CNBC (Vuori).

Two observations. First, **the whole group has de-rated**. Deckers is still growing about 10% and trades near 11x. The market currently pays up only for 20%+ growth (Amer). Lululemon's discount is not unique, which makes a sector re-rating a possible tailwind. Second, **Lululemon is priced like a challenger, not an incumbent**. Its market cap is roughly what Alo was reportedly valued at, on several times the revenue and with public, audited margins. If Alo's owners pursue the IPO or sale that has been reported, the price they get will be a public benchmark for what this category is worth.

Dupes are the other front. Alo and Vuori compete on fashion at similar prices; cheap look-alikes attack from below. The Q2 10-Q now names this risk explicitly: if "dupe" products spread through social-media trends and customers see less difference between Lululemon and cheaper alternatives, the brand premium and margins suffer. The company has gone to court over it. In June 2025 it sued Costco over

alleged knockoffs of its Scuba hoodie, Define jacket and ABC pants, and by May 2026 had settled every claim except one jacket. Lawsuits can stop exact copies but not cheaper products that are merely similar. The real defense is fabric and fit that customers can feel. That is why O'Neill's emphasis on "innovative and distinctive" product matters more than marketing spend, and why cutting prices to match dupes would be the wrong answer.

The bear rebuttal is that share loss compounds: Alo and Vuori take the trend-driven customer first, then the core. We do not dismiss it. The test is Americas comparable sales. If they do not improve sequentially from -12% by the Q4 report in March 2027, the share-loss story is winning.

07 Management, the board, and the founder

7.1 Heidi O'Neill: the right résumé, with an asterisk

O'Neill spent more than 25 years at Nike. She built Nike Women into a multibillion-dollar business, ran Nike Direct (stores, apps, e-commerce), then served as President, Consumer & Marketplace and finally President, Consumer, Product & Brand, a role that was eliminated in May 2025 under CEO Elliott Hill. The fit is obvious: Lululemon's core customer is the woman O'Neill spent a career selling to. Her first memo to staff said the company must "re-establish who we are at our core" and that "That starts with product." The asterisk is that critics, Chip Wilson included, tie her to Nike's direct-to-consumer push, which Nike has spent two years unwinding. She is also a first-time CEO. The stock fell about 5% the day she was named.

O'Neill compensation (8-K, Apr 22, 2026; Form 4, Sep 11, 2026)	Terms
Base salary / target bonus	\$1.4M / 200% of salary (max 2x target in FY26)
Annual equity	~\$10M: 60% performance RSUs, 40% options
Sign-on grant (Sep 9, 2026)	28,079 RSUs + 145,518 options at \$99.72
Severance (without cause / good reason)	24 months' salary + full vesting of equity

The sign-on options are struck almost exactly where we are buying, which is good alignment. The severance terms are generous: full vesting on a good-reason exit gives her a soft landing if the turnaround fails.

7.2 A board in transition

Since March, Chip Bergh (ex-Levi's CEO), Esi Eggleston Bracey, Laura Gentile (ex-ESPN CMO), Marc Maurer (ex-co-CEO of On) and O'Neill have joined, and long-time lead director David Mussafer retired. Two signals from the June 25 annual meeting stand out. Say-on-pay passed with only **63% support** (46.4M for, 27.0M against), a clear rebuke. The non-binding proposal to declassify the board passed with **99%**. Under the settlement, the company also committed to add a third director with apparel product and brand expertise **by October 1, 2026**, subject to Wilson's approval. As of October 4 we have not seen the 8-K announcing that appointment, so we will watch for it.

7.3 Chip Wilson and the cooperation agreement

The May 26 agreement ended the proxy fight on terms that favored Wilson's agenda without giving him control. Gentile and Maurer, two of his three nominees, joined the board. The company agreed to the

product-expert director. In lieu of reimbursing Wilson's expenses, the company paid **\$4 million toward Kitsilano Beach** in Vancouver, where Lululemon was founded. In exchange Wilson accepted standstill, voting and non-disparagement covenants until 30 days before the 2028 nomination deadline, which given the bylaws' 120–150 day notice window lands around late 2027.

Three details from the agreement text matter for us:

- **Ownership cap of 9.9%.** The family owns about 8.6%. Buybacks raise that percentage passively (to ~9.6% at 100M shares), so the cap is not a near-term issue.
- **Sales are allowed but constrained.** Open-market sales and widely-distributed offerings are permitted. Private sales that would put more than 4.9% in one buyer's hands need board approval, unless the buyer is a passive index or mutual fund.
- **Shannon Wilson signed it personally.** She is a named party alongside Chip and his holding companies, so the divorce does not release her shares from the standstill.

7.4 The divorce: what is known, what is not, and why it matters

What is known. Chip Wilson (71) and Shannon "Summer" Wilson, one of Lululemon's first employees and its founding lead designer, married in 2002, five years before the 2007 IPO. A family-law proceeding was filed in the Supreme Court of British Columbia in April 2026; the file is sealed. The split became public in early September. There was reportedly no prenuptial agreement. Under B.C.'s Family Law Act, property acquired during a relationship is presumptively divided equally regardless of whose name it is in, so almost all of Wilson's Lululemon wealth is likely in scope. Bloomberg puts his net worth at \$6.1 billion. The largest pieces are roughly 18% of Amer Sports (~\$3 billion) and the Lululemon stake.

What is not known: the settlement. As of October 4, 2026, **no settlement amount has been disclosed.** The court file is sealed, and neither side has commented on how assets will be split. Any figure for "what she got" is speculation. The most a 50/50 presumption implies is roughly \$3 billion of family property. In practice B.C. settlements often trade assets rather than splitting each one, so Shannon could take more of one asset class and less of another.

Wilson group LULU holdings (13D/A No. 25, Sep 3, 2026)	Shares	Value at \$94.46
Anamerd Investments (exchangeable shares)	4,755,217	\$449M
LIPO Investments (USA)	3,401,596	\$321M
Shannon Wilson (incl. her share of Wilson 5 Foundation)	1,092,596	\$103M
Low Tide Properties / Five Boys / Chip direct	321,442	\$30M
Group total (8.6% of shares)	9,570,851	\$904M

Shannon Wilson's line includes 823,612 shares held by the Wilson 5 Foundation, over which she shares voting power; she directly holds 268,984 exchangeable shares. The total is the 13D group figure and does not double-count.

What has already happened. The family has quietly raised liquidity. Low Tide sold 164,146 shares on July 17 and another 164,146 on July 31 as a Citibank forward contract expired. The Wilson 5 Foundation sold 5,713 shares at \$122.56 on August 4. On September 1, two days before Q2 results, LIPO entered a **two-year prepaid variable forward with Goldman Sachs on 1,274,318 shares**, about 13% of the family stake. That is a standard way to borrow against shares while hedging

them. The confirmation sets a **floor of \$94.17** and a cap of \$181.27, values on September 1, 2028, and allows cash drawdowns of up to roughly \$120 million. The floor was about 80% of that day's \$118.00 close. LULU closed at \$94.46 on October 2, essentially at Wilson's hedge floor. The filings state that none of this reflects a change in the family's view of the company.

Why it matters for us. (1) *Overhang*: if a settlement forced half the family stake onto the market, that would be ~4.8M shares, about 4.3% of the company and roughly one day of recent trading volume. The company has been buying back about 1M shares a month. (2) *Governance*: a founder busy with a divorce and bound by a standstill is a quieter founder for O'Neill's first year. (3) *A signal, read carefully*: hedging below \$94 is not a bullish act, but the cap at \$181 means Wilson kept nearly all the upside above today's price.

08 Legal, tax and regulatory

Matter	Alleged / at issue	Stage	Our read
<i>Patel v. Lululemon</i> (securities class action, SDNY) + consolidated derivative suits	Misleading statements on inventory and the Breezethrough launch, Dec 2023–Jul 2024	Motion to dismiss partly denied Mar 31, 2026; discovery. Derivatives stayed.	Most likely to cost cash. Even \$200M, partly insured, is ~\$1.80/share.
Tariff-refund consumer class actions (<i>Neuman</i> , E.D. Mich., Mar 27; <i>Alsaady</i> , W.D. Wash., Jun 30)	Raised prices for tariffs, then kept the refunds	Early; similar suits target other retailers	Medium. The facts are admitted, but the legal theory is untested.
Texas AG PFAS civil investigative demand (Apr 13)	"Forever chemicals" vs. wellness marketing	Investigation; no suit filed	Low legal cost, high brand sensitivity
IRS transfer pricing (APA)	U.S.–Canada profit allocation; prior APA expired 2020	IRS withdrew from bilateral talks, Aug 2026	New and under-discussed. Could raise the tax rate or bring a back-tax audit.
Post-crash law-firm "investigations"	Solicitations after the Sep 4 drop	Advertising, not suits	Watch for a second class action
IEEPA refunds (upside)	\$230M paid; \$134.5M recovered in Q2	~\$105M outstanding per management; excluded from guidance	Potential ~\$0.65/share after-tax one-time gain

Sources: Q2 FY2026 10-Q (Note 12, Risk Factors); Q2 conference call; Texas AG and law-firm releases.

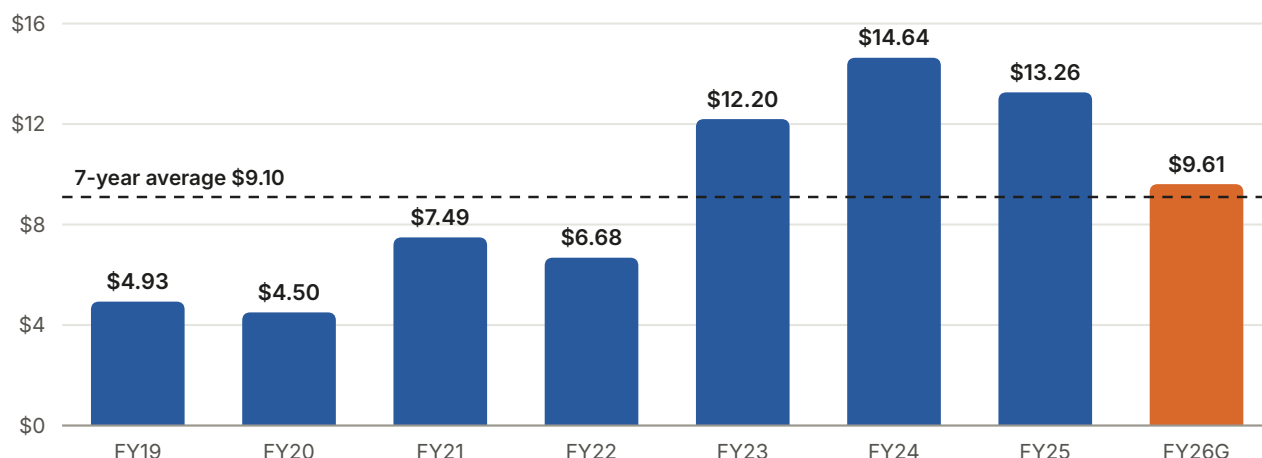
09 Valuation

9.1 Which "E" do you believe?

Lululemon's earnings have been volatile, and the right multiple depends on which year is "normal." We think FY26 guidance excluding the refund (~\$8.75) is close to a trough, though Q3's 6.5% operating margin says it may not be the bottom quarter. The seven-year average of reported EPS is \$9.10. That average includes the FY22 Mirror impairment (~\$443M) and the FY20 pandemic year, so it is a conservative "normal." For perspective, the stock spent most of the past decade at roughly **20–45x forward earnings**; it now trades near 10x.

Diluted EPS by fiscal year (dashed line = seven-year average, FY19–FY25)

■ Reported diluted EPS ■ FY26 guidance midpoint (incl. \$0.86 refund)



EPS basis	EPS	P/E at \$94.46
FY24 peak	\$14.64	6.5x
FY25 actual	\$13.26	7.1x
Seven-year average (FY19–FY25)	\$9.10	10.4x
FY26 guidance midpoint	\$9.61	9.8x
FY26 guidance ex-refund	~\$8.75	10.8x

9.2 Cash-flow view and what the price implies

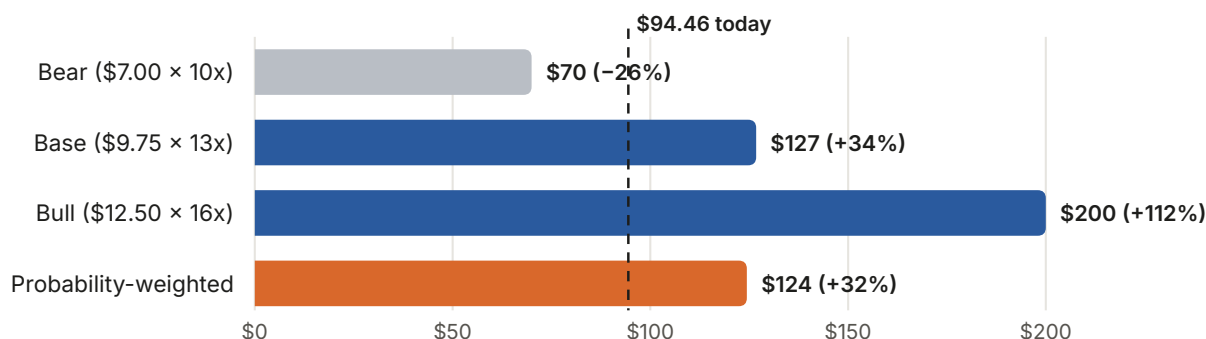
Trailing twelve-month free cash flow through Q2 was **\$1.35 billion**: \$1.98 billion of operating cash flow less \$628 million of capex. That is a 13% yield on market cap, but it is flattered by working capital and includes the refund. Our FY26 estimate is closer to \$1.0 billion, a ~9.4% yield: guided net income of ~\$1.07 billion, plus ~\$560 million of D&A and ~\$95 million of stock comp, less \$680–700 million of capex and some inventory build. On enterprise value (\$9.07 billion), a 9–10% discount rate and \$1.0–1.15 billion of normalized FCF imply the market expects free cash flow to **shrink 1–3% a year forever**. That is a demanding bear case for a brand still opening 35 stores a year.

9.3 Scenarios: two-year horizon

Case	What has to happen	Revenue	EBIT margin	Shares	EPS	P/E	Value	Return	Weight
Bear	Decline continues through FY27; China stays weak; tariffs stick	~\$9.6B	~11%	~108M	\$7.00	10x	\$70	–26%	30%
Base	Sales stabilize in FY27; margins recover partly; buybacks continue	~\$10.35B	~14%	~105M	\$9.75	13x	\$127	+34%	50%
Bull	Product reset works; Americas comps turn positive; FY28 approaches FY25 earnings	~\$10.8B	~16.5%	~102M	\$12.50	16x	\$200	+112%	20%
Probability-weighted value							\$124	+32%	

Illustrative student assumptions, not forecasts. EPS includes ~\$30–40M of interest income and a ~30% tax rate. Multiples are below Lululemon's own pre-2025 history (rarely under 20x) and near today's de-rated peer group.

Scenario values vs. today's price (dashed line = \$94.46 close, Oct 2, 2026)



The deck we presented to members used \$100.58 (the September 28 close) and arrived at nearly the same cases: \$70 / \$126 / \$216. Since then the stock has fallen another 6% without new information, which improves the asymmetry.

9.4 Recovery value: if average earnings and a historical multiple return

The deck closed its valuation section with a simple question: what is the stock worth if Lululemon merely earns its seven-year average again and the market pays something like its old multiple? This is not our price target. It assumes both a full earnings recovery and a full re-rating, which is more than our bull case does. It shows how far the current price sits from the company's own history.

Seven-year average diluted EPS (\$9.10) ×	Value per share	vs. \$94.46
20x (low end of the historical forward range)	\$182.00	+93%
25x	\$227.50	+141%

Seven-year average of reported diluted EPS, FY19–FY25 (\$4.93, \$4.50, \$7.49, \$6.68, \$12.20, \$14.64, \$13.26). For reference, 20x FY25 EPS (\$13.26) would be about \$265; we do not use that figure because FY25 was near peak earnings.

Both figures are far above the price today, and both sit on an average that includes a pandemic year and the Mirror write-off. We lean on the scenarios in 9.3 instead because they require less to go right. But the gap explains why investors like Burry call this a fat pitch: the stock does not need a return to peak earnings to be worth much more, only a return to average.

9.5 What must be true for LULU to earn 15x again?

A low P/E means little while earnings are still falling, and Lululemon's are. The market will pay up again only when it believes the "E" has bottomed. On our base-case EPS of \$9.75, 15x would be about \$146, roughly 55% above today. We think four things would have to be visible first:

- **Americas comparable sales back to roughly flat** for two consecutive quarters, from -12% in Q2. That is the clearest evidence that share loss to Alo, Vuori and dupes has stopped.
- **Operating margin back to about 15%** excluding one-time items, from roughly 13% in FY26 guidance and about 6.5% in Q3. That would show pricing power survived the reset.
- **China comps positive in constant currency**, from -8% in Q2, so the Great Wall damage looks temporary.
- **An FY27 outlook that grows EPS**, even modestly, giving investors a believable stabilization date.

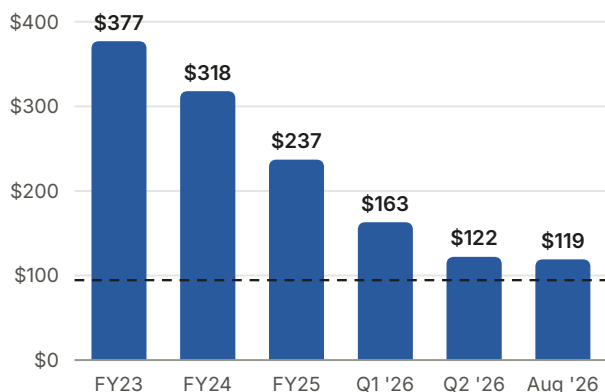
Peers suggest the bar is real: Deckers grows about 10% and still trades near 11x. Stabilization alone probably earns a low-teens multiple, which is our base case. 15x likely requires visible growth.

9.6 Floors: net cash and a take-private test

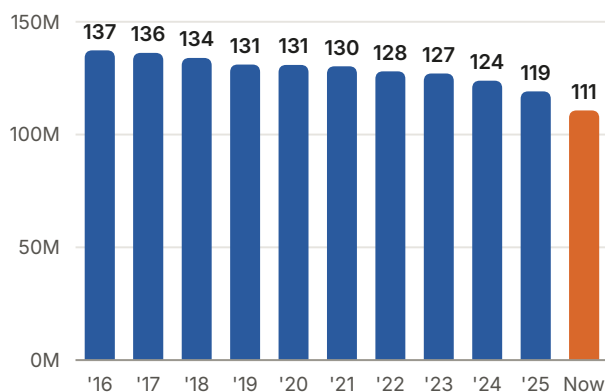
Net cash is about **\$12.55 per share**. More useful as a floor is what a financial buyer could pay. On our FY26 EBITDA estimate excluding the refund (~\$1.95 billion), a sponsor paying 6–8x EBITDA plus the cash on the balance sheet implies **\$118–154 per share**. Burry has floated that a founder-led or private-equity buyout becomes tempting around \$150. We do not underwrite a takeover, and apparel LBOs have a mixed record. The arithmetic simply says that at \$94 the stock trades well below what the cash flows could support under private ownership. That gives some comfort that the bear case is a temporary price, not a permanent one.

10 Capital allocation: a costly lesson, now being applied

Average price paid for buybacks (\$ per share; dashed line = \$94.46, Oct 2 close)



Diluted share count (millions, by fiscal year; "Now" = shares outstanding incl. exchangeable, Aug 28, 2026)



Since FY23, Lululemon has spent **\$4.18 billion** repurchasing about 17.5 million shares at an average of roughly **\$239**. Those shares are worth about \$1.65 billion today, so roughly \$2.5 billion of value went to departing shareholders. Add the ~\$500 million Mirror acquisition in 2020, largely written off in FY22, and the record is poor. The board bought aggressively at 20–30x earnings and slowly at 10x.

The good news is that the pattern has started to reverse. Buybacks averaged \$163 in Q1, \$122 in Q2 and \$119 in August. About \$594 million of authorization remains, enough to retire **~5.7% of the company** at today's price. Management said FY26 repurchases should be roughly in line with FY25 (\$1.18 billion). Through August 28 it had spent \$814 million, which leaves room for roughly \$365 million more this fiscal year. Diluted shares have already fallen from 137M in FY16 to about 111M. At under \$100, every share retired adds more to per-share value than any repurchase in the company's history.

11 Risks: what would make us wrong

At our third discussion we asked members to rank six risks from "thesis-breaking" to "noise."

Our ranking:

#	Risk	Why it matters	What we watch
1	Americas sales keep falling (thesis-breaking)	71% of revenue. If Alo and Vuori's gains are structural, margins de-lever for years and no multiple is cheap enough.	Americas comps in Q3 (Dec) and Q4 (Mar); full-price sell-through
2	New CEO "shrinks to grow"	Store closures, SKU cuts and reinvested margin could reset FY27 guidance lower. That would be healthy long term but painful inside our one-year window. It is the main reason for small size.	FY27 outlook (late Mar 2027); any investor day
3	China keeps shrinking	17% of revenue and the highest-margin segment (37%). Nationalist backlash can last.	China comps; Singles' Day (Nov 11)
4	Tariffs and trade	Guidance assumes a 20% tariff rate after September. About 40% of production is in Vietnam and 34% of fabric comes from Taiwan.	Trade policy; gross margin guide
5	Tax (new)	The IRS walked away from APA talks in August 2026. A higher tax rate or back-tax claim is possible.	10-Q tax disclosures; effective tax rate
6	Founder stake dumped	A temporary price event. Roughly one day of volume, against an active buyback.	13D/A filings; divorce news
7	Securities suit, tariff suits, PFAS	Mostly noise financially unless PFAS testing finds something	Court dockets; Texas AG

The risk we worry about most is that **this is a fashion cycle, not a product cycle**: athleisure leggings become what skinny jeans became. That is the scenario where a 10x multiple is still too high. Our partial answer is that Lululemon's newer styles are working, and that men's and international, which are less dependent on leggings, are holding up. We will not know the answer for at least two quarters.

12 Catalysts and calendar

When	Event	What would change our mind
October 2026	Third new director (apparel product expertise), committed by Oct 1	A credible product leader is a positive; a further delay is a governance flag
November 11, 2026	Singles' Day in China; Super Brand Day with Tmall	Read-through on China sentiment
Early December 2026	Q3 results: O'Neill's first earnings call	Americas comps vs. -12%; markdowns; any early cost actions
January 2027	Holiday sales update	Full-price holiday sell-through
Late March 2027	FY26 results + FY27 outlook (her first full plan)	A credible margin floor and a stabilization date
June 2027	Annual meeting (first under declassification pressure)	Board accountability
Ongoing	Divorce settlement; IEEPA refunds (~\$105M); <i>Patel</i> discovery	Overhang removal; one-time cash; legal cost

~Late 2027	Wilson standstill ends	Founder can campaign again if the plan is failing
Sep 1, 2028	Goldman forward valuation date (1.27M shares)	Possible share delivery if not cash-settled

13 Position and risk management

On October 1, 2026, members voted on five sizing options, from 0% to 10% of the fund. **Option B, a 2% starter position, passed.** The position is to be held for one year (to October 2027), with a rule to **sell if its maximum drawdown reaches 20%.**

Note the mismatch in horizons: our scenarios in section 9 are two-year values, but the position is a one-year hold. We do not expect the full base case to be reached by October 2027. What we expect by then is evidence. Two more quarterly reports and O'Neill's first full-year outlook (late March 2027) should show whether the base case is on track. The October 2027 review is therefore a decision point: extend the position, resize it, or exit, put to a member vote.

Outcome at 2% of fund	Stock move	Impact on whole fund
Stress: stock halves (to ~\$47)	-50%	-1.00%
Bear case (if held to \$70)	-26%	-0.52%
Exit at 20% max drawdown	-20%	-0.40% (more if the stock gaps through)
Base case	+34%	+0.68%
Bull case	+112%	+2.23%

Why 2% and not more. The expected value is attractive, but the path is not. The next two earnings reports are more likely to disappoint than surprise, the new CEO has not yet shown her plan, and a single report can gap the stock: it fell 17% overnight on September 4. A 2% position lets us own the asymmetry while capping the realistic loss at under half a percent of the fund. Even in the stress case where the stock halves, the fund loses 1%. At 10%, the largest option on the ballot, the same halving would have cost 5% of the fund. The 20% drawdown rule matters most in the bear case: the stock would hit our exit (near the mid-\$70s from a ~\$95 entry) before it reached our \$70 bear value.

What we will watch. Signs the thesis is working: Americas comps improving for two quarters in a row, stable or lower markdowns, and an FY27 outlook with a credible margin floor. Signs it is failing: Americas comps worse than -12% with promotions rising, a further China decline, or a "shrink to grow" plan with no date for stabilization. Any change to the position size is a decision for a future member vote, not part of this recommendation.

14 Conclusion

Lululemon is not a fallen angel because the market misunderstands it. It fell because its core product lost the customer's attention, competitors moved in next door, and leadership spent a year fighting itself. The question we asked members on day one was not whether it is a good company. It was whether it is a good stock at this price, for us, right now.

At \$94.46 we think the answer is a qualified yes. The price assumes free cash flow shrinks forever. The balance sheet gives the new CEO time. Buybacks are finally being made at prices that create value. And the governance fight that consumed 2026 is, for now, contained. The qualification is timing: the evidence that O'Neill's product reset is working will not arrive before 2027. A small position is how we take an asymmetric bet without having to be right on the timing.

A Appendix: financial summary

Fiscal year	Revenue	Growth	Gross margin	Op. margin	Diluted EPS	Op. cash flow	Capex	FCF	Buybacks	Dil. shares
FY19	\$3,979	+21%	55.9%	22.3%	\$4.93	\$669	\$283	\$386	\$173	131.0
FY20	\$4,402	+11%	56.0%	18.6%	\$4.50	\$803	\$229	\$574	\$64	130.9
FY21	\$6,257	+42%	57.7%	21.3%	\$7.49	\$1,389	\$395	\$995	\$813	130.3
FY22*	\$8,111	+30%	55.4%	16.4%	\$6.68	\$967	\$639	\$328	\$444	128.0
FY23	\$9,619	+19%	58.3%	22.2%	\$12.20	\$2,296	\$652	\$1,644	\$559	127.1
FY24	\$10,588	+10%	59.2%	23.7%	\$14.64	\$2,273	\$689	\$1,584	\$1,637	123.9
FY25	\$11,103	+5%	56.6%	19.9%	\$13.26	\$1,602	\$681	\$922	\$1,178	119.1
FY26 guide	\$10,350–10,500	–5 to –7%	~55.8%	~14.6%	\$9.48–9.73	—	\$680–700	~\$1,000E	~\$1,180E	~111

\$ millions except per share; shares in millions. *FY22 includes the Mirror impairment. FY26 gross and operating margins derived from guidance ("down ~80 bps" and "down ~530 bps," both including a ~130 bps refund benefit). Sources: 10-K filings via SEC XBRL; Q2 FY2026 release and call; FY26 FCF and buyback figures are our estimates.

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