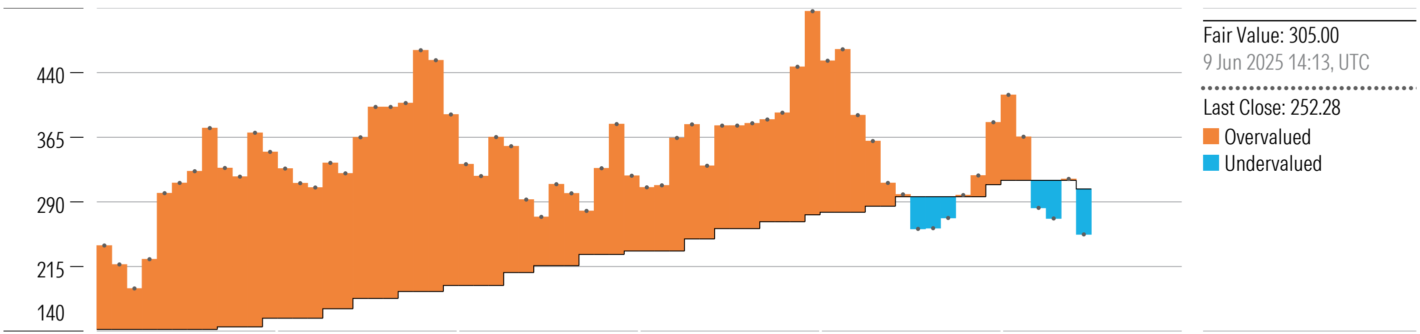
Morningstar Equity Analyst Report | Report as of 12 Jun 2025 22:30, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

Lululemon Athletica Inc LULU ★★★★ 12 Jun 2025 21:36, UTC

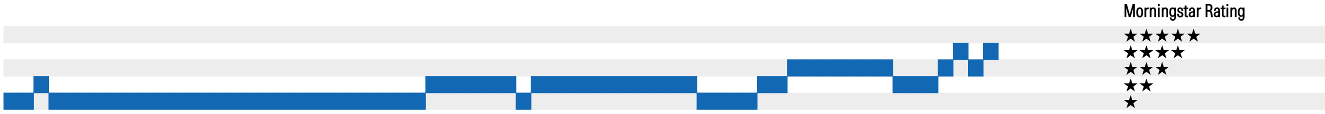
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
252.28 USD 11 Jun 2025	305.00 USD 9 Jun 2025 14:13, UTC	0.83	29.61 USD Bil 12 Jun 2025	Narrow	Mid Blend	High	Exemplary	4 Jun 2025 05:00, UTC

Price vs. Fair Value



	2020	2021	2022	2023	2024	YTD	
	2.25	2.03	1.38	1.86	1.23	0.83	Price/Fair Value
	50.23	12.48	-18.16	59.59	-25.21	-34.03	Total Return %

Morningstar Rating



Total Return % as of 11 Jun 2025. Last Close as of 11 Jun 2025. Fair Value as of 9 Jun 2025 14:13, UTC.

Contents

[1]The ESG Risk Rating Assessment is a representation of Sustainalytics' ESG Risk Rating.

Lululemon Counters Heavy Competition With Product Innovation, International Growth, and E-Commerce

Business Strategy & Outlook David Swartz, Senior Equity Analyst, 9 Jun 2025

We think Lululemon has a solid plan to expand its product assortment and geographic reach while building its core business. While many firms are looking to compete in its categories, we believe Lululemon benefits from the athleisure fashion trend and will continue to achieve premium pricing due to the brand's popularity and the styling and quality of its products. Our narrow moat rating is based on the company's intangible brand asset.

We view the five-year plan laid out at Lululemon's April 2022 investor event as sound. Its three priorities are product innovation, e-commerce, and international expansion. We think product innovation is critical, as many competitors sell women's leggings and other athleisure items of similar quality. Thus, Lululemon must introduce new fabrics and technology to hold its popularity in this critical category. The firm also plans to add to its men's assortment (24% of 2024 revenue) and expand its nascent athletic footwear line. While we believe these categories fit the Lululemon brand, they also bring it into direct competition with athletic apparel firms like Nike.

We see an opportunity for Lululemon to expand outside its home region. Sales outside the Americas accounted for just 25% of its 2024 total, but this was up from 16% just two years prior. We believe Lululemon is building its brand overseas and has a large opportunity for new stores and larger online

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Sector	Industry
Consumer Cyclical	Apparel Retail

Business Description

Lululemon Athletica designs, distributes, and markets athletic apparel, footwear, and accessories for women, men, and girls. The company offers pants, shorts, tops, and jackets for both leisure and athletic activities such as yoga and running. Lululemon also sells fitness accessories, such as bags, yoga mats, and equipment. It sells its products through digital channels, a small number of wholesale partners, more than 760 company-owned stores in about two dozen countries in North America, Asia, and Western Europe, and about 40 franchised locations in the Middle East. The company was founded in 1998 and is based in Vancouver, Canada.

sales in China, the second-largest activewear market. We project the firm will have more than 170 stores in mainland China by the end of 2025, an increase of about 75% from the end of 2022. In 2034, we forecast Lululemon's sales outside the Americas will reach $11.2 billion (up from $2.7 billion in 2024) and account for nearly half its total sales.

Like others in its space, Lululemon outsources its production to factories in Asia. Thus, it is exposed to higher tariffs on US imports. We think the company can offset some, but not all, of the added costs with price increases and supply chain changes.

Bulls Say David Swartz, Senior Equity Analyst, 9 Jun 2025

- Despite having many rivals, Lululemon's productivity stands out in the sportwear space. Its sales per square foot were nearly $1,600 in 2024, and its operating margins of around 22%-23% are very high.
- Lululemon has a big opportunity in mainland China, which accounted for just 13% of its 2024 sales. China is already the second-largest sportswear market in the world.
- Lululemon is often credited with the development of athleisure, a major change in how people dress. It is one of the few strong areas in the low-growth apparel industry.

Bears Say David Swartz, Senior Equity Analyst, 9 Jun 2025

- Competition is ubiquitous in all of Lululemon's key apparel categories. The firm faces challenges from firms like Athleta, Vuori, and Alo Yoga, and Nike is improving its competitiveness through its Skims partnership.
- Lululemon's sales growth in the US has slowed due to competitive threats and its own missteps. Now, it could be negatively affected by tariffs and economic strife brought on by trade conflicts.
- Lululemon is expanding aggressively in countries in which awareness of its brand is relatively low. It may not have as much success in these regions as it has in North America.

Economic Moat David Swartz, Senior Equity Analyst, 9 Jun 2025

Our narrow moat rating on Lululemon is based on an intangible brand asset. While the firm operates in an industry with many participants and low barriers to entry, its brilliant performance through challenges like covid, inflation, and a general slowdown in activewear spending suggests that its brand is strong enough to outperform peers consistently. Although its merchandise is mass-produced, Lululemon's prices, productivity, products, and selling model separate it from traditional sportswear firms. Rather than being just a fad, we believe that Lululemon has permanently changed how many people regularly dress. For these reasons, we think a narrow moat is justified.

Lululemon is often credited as the creator of the athleisure apparel trend and has grown rapidly to be a market leader in North America. In 2024, the firm had 6.3% share of the $111 billion North American sports apparel market, second only to wide-moat Nike, per Euromonitor. Indicative of Lululemon's superior growth as compared with many peers, its share of this market was less than 3% as recently as

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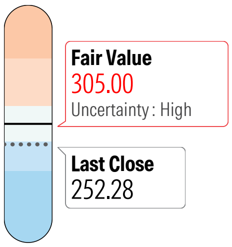
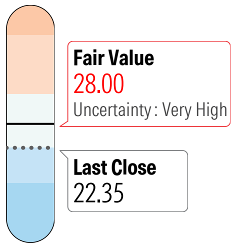
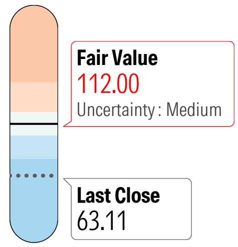
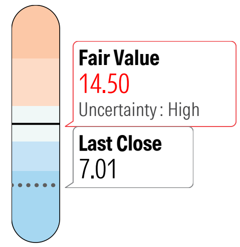
Competitors

	Lululemon Athletica Inc LULU	Gap Inc GAP	Nike Inc Class B NKE	Under Armour Inc Class A UAA









	Lululemon Athletica Inc LULU	Gap Inc GAP	Nike Inc Class B NKE	Under Armour Inc Class A UAA
Economic Moat	Narrow	None	Wide	None
Currency	USD	USD	USD	USD
Fair Value	305.00 9 Jun 2025 14:13, UTC	28.00 21 Mar 2025 22:34, UTC	112.00 2 Jan 2025 16:19, UTC	14.50 25 Nov 2024 05:23, UTC
1-Star Price	472.75	49.00	151.20	22.48
5-Star Price	183.00	14.00	78.40	8.70
Assessment	Undervalued 12 Jun 2025	Undervalued 12 Jun 2025	Undervalued 12 Jun 2025	Undervalued 12 Jun 2025
Morningstar Rating	★★★★12 Jun 2025 21:36, UTC	★★★★12 Jun 2025 21:31, UTC	★★★★★12 Jun 2025 21:31, UTC	★★★★★12 Jun 2025 21:35, UTC
Analyst	David Swartz, Senior Equity Analyst	David Swartz, Senior Equity Analyst	David Swartz, Senior Equity Analyst	David Swartz, Senior Equity Analyst
Capital Allocation	Exemplary	Standard	Exemplary	Standard
Price/Fair Value	0.83	0.77	0.56	0.47
Price/Sales	2.88	0.57	1.98	0.59
Price/Book	7.37	2.53	6.65	1.58
Price/Earning	17.16	9.72	20.97	—
Dividend Yield	0.00%	2.75%	2.49%	0.00%
Market Cap	29.61 Bil	8.07 Bil	92.69 Bil	2.91 Bil
52-Week Range	226.01—423.32	16.99—29.29	52.28—98.04	4.78—11.89
Investment Style	Mid Blend	Small Value	Large Value	Small Blend

2017. Its gains since that time have come at the expense of Nike, narrow-moat Adidas, no-moat Under Armour, and others. Lululemon has also had incredible growth outside of North America. Just about 10 years after opening its first stores in Europe and Asia, the firm recorded more than $2.6 billion in sales outside of North America in 2024.

Providing support for our narrow moat rating, Lululemon's adjusted returns on invested capital including goodwill have averaged 39% over the past 10 years, far above our 10% estimated weighted average cost of capital and very high for any apparel retailer or manufacturer. At an annual average of 32%, we forecast its adjusted ROICs including goodwill will greatly exceed its WACC over the next 10 years as well. The firm's returns benefit from its asset-light model since its production is outsourced, but this is true throughout the industry.

Founded in 1998, Lululemon opened its first store in 2000 in Vancouver and then, in 2003, its first store in the US. Since then, it has achieved double-digit sales growth in every year as it has expanded its owned store base to over 760 stores in about two dozen countries and launched e-commerce that now generates about half its revenue. Its annual sales have grown to an expected $11.2 billion in 2025 from just $41 million in 2004. Moreover, its profit margins have remained very high even as it has become much larger; its 2024 operating and EBITDA margins of 23.7% and 27.9%, respectively, were its highest in more than a decade.

Although the athleisure and sportswear markets are highly competitive, we think Lululemon's combination of high prices, direct selling, quality products, and international success allows it to claim a narrow moat based on a brand-intangible asset. The firm has consistently performed strongly despite the presence of many rivals and copycats. In 2024, the company achieved sales per square foot of $1,574, certainly among the highest for any apparel retailer, and its total revenue growth was 10%. For comparison, rivals like Under Armour, no-moat VF's Vans, and Nike have recently been reporting declining sales.

In addition to quantitative factors, we evaluate sportswear producers like Lululemon using five specific criteria: geographic reach; pricing; sponsorships/visibility; product quality/performance; and control over distribution. We rate Lululemon as high in pricing, product quality/performance, and control over distribution. We rate its geographic reach and sponsorships/visibility as moderate as it lacks the integration with global sports as some peers.

We think Lululemon's significant control over its sales provides an advantage. Unlike many competitors with large wholesale operations, Lululemon generates less than 10% of its sales through third-party retailers (mostly specialty yoga shops and the like). Instead, the company mainly sells its merchandise through company-owned, full-price physical stores and e-commerce. The company's model allows for control over pricing, discounting, expenses, product assortment, and marketing. Competitors who sell through partners lack this level of control and must share margin with retailers. Moreover, competing brands may lose their integrity if their product is discounted or sold through struggling stores.

Supporting our narrow moat rating, the combination of direct selling and premium pricing allows Lululemon to achieve strong pricing and gross margins. Over the past four years, the firm's gross margins have averaged 58%, well above peers' 45%-50% due, in part, to its superior pricing power. Lululemon's bestselling products, women's leggings, typically retail for more than $100 per unit. For comparison, premium yoga clothing competitors Vuori and Athleta sell similar leggings for about 20% less. Lululemon's other products, ranging from jackets that cost over $400 to $50 water bottles, also carry high prices relative to those of competitors.

The quality of Lululemon's products allows the brand to remain popular and achieve premium prices. To support innovation, the firm consistently develops new fabrics. Although fabrics cannot be patented,

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its signature Luon fabric was developed two decades ago and was trademarked in 2005. It consists of a greater amount of nylon microfibers than a traditional polyester blend. Lululemon has produced several other performance fabrics, some of which are also trademarked (but not patented). Its apparel is designed to be bacteria- and smell-resistant, feel great, and survive many washes. The material in its apparel is significantly more expensive than in traditional athletic shirts and pants, partly accounting for its relatively high pricing. Many of its competitors sell apparel with cheaper materials at lower price points. We think Lululemon protects the integrity of its brand by selling only high-quality apparel, and it has continued to grow and improve margins despite the availability of many similar products.

From its origins as a women's yoga brand, Lululemon has expanded into men's clothing over the past decade. Menswear accounted for 24% of its 2024 sales. In contrast, some of its main athleisure competitors sell almost exclusively to women. Although male participation in yoga is increasing, most men purchase Lululemon gear for running. While the men's running category is very crowded, we think the high quality of the company's fabrics, styling, and the popularity of its brand has attracted consumers. Like its women's merchandise, its men's apparel retails at premium prices. Most of its men's jackets, for example, retail for $150-$300, with some styles priced as high as $500. Lululemon generated nearly $2.6 billion in men's sales in 2024, an increase of 14% from the previous year.

Lululemon can sell its merchandise in high volumes even though it only spends about 4.5%-5% of its sales on advertising. For comparison, most of its competitors spend 8%-13% of their annual revenue on marketing. In contrast to Nike, Adidas, and others, Lululemon's online and TV advertising is limited, and its athletic sponsorships are small (but growing). Instead, the firm engages in more personal forms of marketing, such as through its seemingly ubiquitous reusable shopping bags and by offering yoga and fitness classes in its stores. These popular classes increase customer goodwill and encourage loyal customers to visit its stores frequently. Lululemon also sponsors yoga and fitness instructors (known as ambassadors), who promote the brand. We believe the firm has local connections to its customer base that other apparel retailers do not have. Thus, we view its physical stores as a strength for the brand rather than the weakness they are perceived to be for many others.

Lululemon generated 75% of its 2024 sales in the Americas, but its international sales are growing rapidly. In mainland China, the world's second-largest sportswear market after the US, the firm's yearly sales increased to $1.36 billion in 2024 from about $430 million in 2021. Moreover, the company's profitability appears to be as high in China as in North America as, over the past four years, its segment operating margins averaged 37% in the Americas and 36% in mainland China. Although expanding quickly in China, Lululemon has many years of potential growth as it only had 151 stores in the region at the end of 2024 while rivals Nike and Adidas have thousands of locations (mostly franchised). Lululemon held an analyst event in Shanghai in late 2024 to highlight its international expansion opportunities. Over the next decade, we forecast its sales in mainland China will increase at a compound average annual growth rate of 17%.

There are also growth opportunities in other regions. We forecast 14% compound average annual sales growth for Lululemon outside of the Americas and China through 2034 as it opens stores and builds awareness. The potential for expansion is large as the company still has 20 or fewer stores in such countries as the UK, Germany, South Korea, and Japan. As in its home market, Lululemon achieves high prices for its products in its international stores. For example, in the UK, many styles of its leggings are priced above GBP 100 per unit. Thus, we think it will hold its operating margins above 20% in Europe and Asia-Pacific even as its geographic focus shifts. We forecast its sales in the Americas will fall to 50% of its total sales in about 10 years as its international growth outpaces that of the more mature North America market.

We do not believe Lululemon has any moat sources besides its intangible brand asset. The company lacks efficient scale or a cost advantage as its production and distribution systems are like those of most apparel companies. Lululemon does not own any production facilities. Rather, its products are sourced from about 52 manufacturers and 67 fabric suppliers, nearly all of which are in Asia and supply competitors as well. Further, there are no switching costs or network effects.

Fair Value and Profit Drivers David Swartz, Senior Equity Analyst, 9 Jun 2025

We are lowering our per-share fair value estimate on Lululemon to $305 from $315 after the firm revealed its first-quarter results and reduced 2025 guidance. Lululemon reported in-line results in the quarter with 7% sales growth and $2.60 in earnings per share. However, it lowered its full-year EPS outlook to $14.58-$14.78 from $14.95-$15.15 previously due to the risk of markdowns and a gross margin reduction related to tariffs. For the year, we have lowered our sales growth estimate to 6% from 7%, and our earnings per share forecast to $14.73 from $15.23. Even so, Lululemon has a history of beating low guidance, and our long-term expectations are little changed. Our forecast implies 2025 adjusted price/earnings of 21 and enterprise value/adjusted EBITDA of about 11 on expected EBITDA of $2.9 billion (26% margin).

In the long run, we believe Lululemon's annual sales growth rates will settle at about 8%, a strong rate for any international apparel company, but below historical levels as the sales base has gotten larger and competition is unrelenting. In the Americas, we forecast compound average annual sales growth of 4% over the next decade. While Lululemon has achieved higher growth than this in the past, it already has over 460 stores in this region and competition is high. In its mainland China segment, we forecast 17% compound average annual sales growth on store openings and the growth of the nation's sportswear market. Finally, we estimate 14% compound average annual sales growth in the rest of the world, with most of the store openings in Western Europe and parts of Asia.

We forecast segment-level operating margins of 37% and 35% in the Americas and mainland China, respectively, over the next 10 years. We forecast a 22% operating margin in the rest of the world as

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Lululemon lacks store density in Western Europe and Asia and the brand's popularity is lower than in North America.

We believe Lululemon can hold its impressive gross margins of around 59% on premium pricing and lower costs. The company has made improvements in its supply chain, and we think it can achieve cost efficiencies as its men's and international businesses grow. We also forecast that Lululemon's annual operating margins over the next 10 years will hold around the recent low-20s levels.

Risk and Uncertainty David Swartz, Senior Equity Analyst, 9 Jun 2025

We assign a High Uncertainty Rating to Lululemon. The firm, like many others, is exposed to tariffs as most of its sales are generated by imports to the US from factories in Asia. In addition, Lululemon's sales could be reduced if a trade war leads to weakening economic conditions in North America or China.

Competition is heating up in Lululemon's core athleisure category. Although competition is nothing new, brands like Alo Yoga and Vuori have recently had a noticeable negative effect on Lululemon's US sales.

Women's bottoms are the highest-sales and -profit products for Lululemon and attract most of its new customers. The firm achieves premium pricing on women's leggings, with many styles priced above $100 per unit. Thus, Lululemon depends on the continuation of the athleisure trend that it helped create. While we believe athleisure is not a fad, fashion trends can change quickly. Also, many firms, from multinationals to tiny startups, sell low-priced leggings. Lululemon must continuously introduce innovative products to maintain its price leadership and remain popular with women. But as specific styles of clothing cannot be patented, the firm has limited ability to prevent copycats.

To meet expectations, Lululemon will need to generate significant growth in regions where it has limited history and brand recognition. In 2024, Lululemon generated just 25% of its sales outside the Americas. However, the firm has aggressive expansion plans, and we forecast its yearly sales outside the region will grow at double-digit percentage rates for at least the next decade.

We do not believe Lululemon has any material environmental, social, or governance risks. However, like its peers, it is subject to controversies related to the treatment of workers in the international clothing supply chain.

Capital Allocation David Swartz, Senior Equity Analyst, 9 Jun 2025

We assign an Exemplary Capital Allocation Rating to Lululemon. The company's 15-year average annual shareholder return (as of June 2025) of 19% is extraordinary and greatly exceeds the 13% average annual return of the apparel retail sector of the Morningstar US Market Total Return Index over the same period. Lululemon has experienced outstanding growth as its sales increased to over $10.5 billion

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in 2024 from $41 million in 2004.

Lululemon's consistent profitability and free cash flow have allowed it to grow without any debt. Over the past 10 years, the company has generated an annual average of about $575 million in free cash flow to the firm while spending $360 million per year on capital expenditures. Much of the investment has gone into new stores and expanded e-commerce, which we think has created significant value. Even as it has grown, adjusted ROICs including goodwill have largely remained in the 35%-40% range and operating margins have recently exceeded 22%. In future years, we expect Lululemon to continue to open new stores and increase its digital sales while maintaining high operating margins and ROICs. We estimate long-term operating margins in the low-20s and yearly ROICs of about 32%.

We expect Lululemon to remain debt-free and generate significant cash flow. We forecast annual free cash flow to the firm will average $2.3 billion over the next decade and expect most of this cash to be used for stock buybacks. Lululemon has repurchased nearly $5 billion in shares since the beginning of 2017. At times, the company has repurchased shares at high valuations that were well above our fair value estimates, which has potentially reduced shareholder value. However, in our view, the recent decline in its share price has made buybacks more favorable for shareholders.

Lululemon has grown organically, and we expect this will continue to be the case. We anticipate it will continue to expand geographically, introduce new products, and build its digital capabilities. The firm has had some missteps (such as its now defunct Ivivva chain) but has generally been very successful with its internal investments, and we think it will continue to be so. The company's only external investment came in mid-2020 when it bought Mirror for about $450 million. This acquisition proved to be a mistake, as the product has already been discontinued, and Lululemon had to write down its value. We do not believe acquisitions will be an integral part of the firm's plans going forward.

Analyst Notes Archive

Lululemon Earnings: Tariffs Take a Toll but Brand Remains Healthy; Shares Attractive David Swartz,Senior Equity Analyst,6 Jun 2025

Lululemon achieved 7% sales growth in 2025's first quarter. Due to an increase in costs, its operating margin fell 110 basis points to 18.5%. Shares plummeted more than 20% in after-hours June 6 trading as it lowered its full-year earnings outlook on tariff-related costs and economic uncertainty.Why it matters: Lululemon reported sales growth rates of 3%, 21%, and 16% in the Americas (71% of the total), mainland China (15%), and the rest of the world (14%). Although near our estimates, sales growth has slowed due to increasing competition and uneven demand for sportswear. The firm held its 2025 sales growth guidance (5%-7%) but lowered its EPS outlook to $14.58-$14.78 from $14.95-$15.15 previously due to the risk of markdowns and a 60-basis-point gross margin reduction related to tariffs (based on a 30% rate for China and 10% for most other countries). Much of the tariff impact is expected in the second quarter as Lululemon plans mitigation measures—such as supply changes and price increases—for the year's second half. Given our view that the firm has pricing power, we think these measures will be successful (unless tariffs are raised). The bottom line: We expect to reduce our $315 fair value estimate by a low-single-digit percentage on the tariffs, but shares are attractive. Our narrow moat rating on Lululemon is based on the value of its brand. The firm achieves strong margins, produces consistent cash flow, and has no debt. A return to double-digit percentage sales growth is unlikely, but high-single-digit rates are realistic through Lululemon's Power of Three x2 plan for product innovation, improvements in the guest experience, and international expansion. We are holding our Exemplary Capital Allocation Rating. Long-term operating margins of about 22% are also realistic, given Lululemon's direct-to-consumer model, its ability to offer products at high prices, and the attractiveness of the athleisure category.

Lululemon Earnings: Worrisome US Trends Overshadow Successful 2024 Close; Shares Fairly Valued
David Swartz,Senior Equity Analyst,28 Mar 2025

Even though we had lifted our estimates after its holiday sales update (see our Jan. 13 note), Lululemon’s fourth-quarter results eclipsed our forecast. However, shares fell about 10% in March 27 postmarket trading on weakening US sales trends that led to a disappointing 2025 outlook. Specifically, the firm guided to total sales growth and earnings per share of 5%-7% and $14.95-$15.15, respectively, versus our estimates of 8.6% and $15.52. Although we may lower our near-term forecast, Lululemon has a history of providing conservative guidance, and the effect on our $315 per share fair value estimate is likely to be immaterial. We think Lululemon’s brand strength, the source of our narrow moat rating, holds despite recent challenges related to rising competition and its product management. Shares trade close to our valuation but could become attractive if weakness persists.In a quarter that was one week longer than the previous year, Lululemon’s 12.7% sales growth outpaced our 11.5% estimate. Sales growth in the Americas (77% of total) matched our 7% estimate, but comparable sales that were flat were subpar, and the firm said that low consumer confidence related to tariffs and economic conditions is taking a toll on US traffic. It is also likely that rising competition in women’s athleisure is a factor. However, we think Lululemon’s recent apparel releases have been well-received, and 2025 product innovation should be an improvement over that of 2024.Meanwhile, Lululemon’s international growth is helping it to overcome US weakness. The firm achieved quarterly sales growth rates of 46% and 30% in its China mainland (12% of total) and rest of the world (11%) segments, respectively. These rates surpassed our respective 37% and 26% estimates, and we think Lululemon is outperforming peers in key regions. Over the next five years, we forecast sales growth rates in international territories of around 20%, above the mid-single-digit growth that we project for the Americas.

Lululemon: Fears Put to Rest as Holiday Sales Exceed Expectations; Shares Overvalued David Swartz,Senior Equity Analyst,13 Jan 2025

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Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
252.28 USD 11 Jun 2025	305.00 USD 9 Jun 2025 14:13, UTC	0.83	29.61 USD Bil 12 Jun 2025	Narrow	Mid Blend	High	Exemplary	4 Jun 2025 05:00, UTC

Lululemon raised its fourth-quarter guidance after strong holiday sales. We attribute this performance to the popularity of the company's brand, the source of our narrow moat rating, and a steady stream of new apparel releases. In addition, Lululemon has stepped up its marketing, including the sponsorship of more professional athletes. With solid recent results and more innovation expected in 2025, investors' pessimism about its slowing sales in North America and competition has dissipated; shares are up about 75% over the past five months. We are lifting our fair value estimate to $315 from $310 but rate shares as overvalued.In its fourth-quarter outlook, Lululemon currently projects 11%-12% sales growth and EPS of $5.81-$5.85, up from previous guidance of 8%-10% and $5.56-$5.64, respectively. Further, due to sales outperformance, it expects to achieve leverage on its gross margin and selling, general, and administrative expenses, implying an operating margin about 50 basis points better than previously expected, or approximately 28%. As such, we are increasing our sales growth and EPS estimates to 11.5% and $5.86, respectively, from 9.5% and $5.66. Our long-term expectations, including annual operating margins of about 22%-23% and 10% yearly sales growth, are unchanged.

Lululemon Earnings: International Growth Making Up for Slowdown in North America; Shares Expensive David Swartz,Senior Equity Analyst,6 Dec 2024

Narrow-moat Lululemon shook off the troubles of 2024's first half by posting third-quarter sales and earnings that surpassed our expectations. Although comparable sales fell 2% in the Americas (against 13% growth a year ago), there are reasons to be optimistic about upcoming product launches in 2025, and its international sales have soared. We expect to lift our $296 per share fair value estimate on Lululemon by a mid-single-digit percentage, but rate its shares as overvalued after rallying more than 40% over the past three months.Considering quarterly sales growth rates by region, 2% overall growth in the Americas (74% of total) aligned with our estimate, but growth rates of 39% and 27% in mainland China (13%) and other international (13%), respectively, were each 6 percentage points above our forecast. Lululemon recently restructured its product development team, and we expect new products in both established and newer categories will lift sales growth rates in the Americas to the midsingle digits in 2025 and beyond. Meanwhile, we model 10-year compound average annual sales growth rates of 23% and 19% in mainland China and other international, respectively, on store openings, greater consumer awareness of the brand, the growth of athleisure globally, and category extensions.Lululemon's gross and operating margins of 58.5% and 20.5%, respectively, beat our estimates by 60 and 70 basis points. Despite concerns that slow North America sales would necessitate discounting, the company reported higher initial prices and flat markdowns. In the long run, we think Lululemon can hold gross margins in the high 50s and post operating margins of around 22%.Lululemon's outlook for fourth-quarter EPS of $5.56-$5.64 appears to be overly conservative. We appreciate that the company wants to be cautious given the unusually short Christmas shopping season, but its stabilizing North America sales and international growth suggest that it could outperform guidance, as is typical.

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Lululemon Athletica Inc LULU ★★★★ 12 Jun 2025 21:36, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
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Lululemon Earnings: Near-Term Outlook Dims, but Profitability and Underlying Brand Strength Hold

David Swartz,Senior Equity Analyst,30 Aug 2024

Since the beginning of 2024, Lululemon's shares have plummeted nearly 50%, due primarily to concerns that its business in the Americas (73% of second-quarter sales) is being adversely affected by rising competition and changes in consumer tastes. Although its revenue growth in the region has slowed, it met our 1% estimate in the second quarter, and the firm's overall profitability held up well. Indeed, its shares rose 4% in Aug. 29 after-hours trading, likely because pessimism by some investors and analysts going into the report was unusually high. Despite some challenges, we still think that Lululemon's brand power, the source of our narrow moat rating based on an intangible asset, remains intact. We do not expect to make any material change to our $296 per share fair value estimate, leaving shares slightly undervalued.Lululemon's 7.3% sales growth in the quarter was short of our 9.5% estimate as international growth was a bit shy of our forecast, but still very high (34% in mainland China, 24% elsewhere). Despite the sales slowdown, its 59.6% quarterly gross margin was nearly 2 percentage points above our estimate. The gross margin benefited from lower costs and strong pricing. We are encouraged that the firm did not resort to damaging markdowns when sales were light. Bolstered by the gross margin performance, its operating margin was 22.8%, an increase of 110 basis points and nicely above our 21.1% estimate. We think Lululemon can hold operating margins in the low-20s in the long run.Lululemon lowered its 2024 guidance for earnings per share to $13.95-$14.15 (from $14.27-$14.47) on 8%-9% sales growth (from 11%-12%). Like many peers, the company faces an uncertain holiday season, given underwhelming consumer spending on apparel and a shorter Christmas selling season. We expect to lower our forecast to reflect this new outlook, but the impact on our valuation is likely to be small. Moreover, Lululemon has a history of beating earnings guidance.

Lululemon Earnings: On Track to Meet Expectations Despite Slowdown in Americas; Shares Expensive David Swartz,Senior Equity Analyst,6 Jun 2024

After dropping 40% since the beginning of the year, narrow-moat Lululemon's shares rose 10% in June 5 postmarket trading as its first-quarter results surpassed prior guidance and our estimates. The firm lifted its 2024 EPS outlook to $14.27-$14.47 from $14-$14.20, which should lead us to increase our $285 fair value estimate by a low-single-digit percentage. However, of some concern, sales growth in the Americas (73% of the total) was well below typical double-digit rates; comparable sales in the region were flat. The company cited some shortages of women's merchandise, but we also think that strong sales of bags over the past year may have masked a slowdown in core leggings. Competition in this category is nothing new, but we think it is intensifying.Lululemon matched our estimate with 10% sales growth in the quarter. Sales in mainland China (14% of the total) and the rest of the world (13% of the total) rose 45% and 27%, respectively, on comparable sales growth rates above 20% and store openings for each. We think Lululemon's store expansion opportunities in North America are limited, but we also believe it can add hundreds of stores to its current base of 127 in mainland China. We think the brand is increasingly seen as a premium brand and market leader in the region. However, it has also been a challenging market for non-Chinese activewear brands for political and other reasons in recent years. In our model, Lululemon's sales outside North America reach half its total sales in about 10 years.Lululemon's 57.7% gross margin in the quarter beat our estimate by 20 basis points, while its 19.6% operating margin was 80 basis points better. Its $2.54 in EPS was $0.15 above our estimate. We forecast the firm can hold current gross and operating margins of about 58% and 22%-23%, respectively, in the long run. Given competitive pressures and the likelihood of slower sales growth, we do not anticipate much improvement in these margins.

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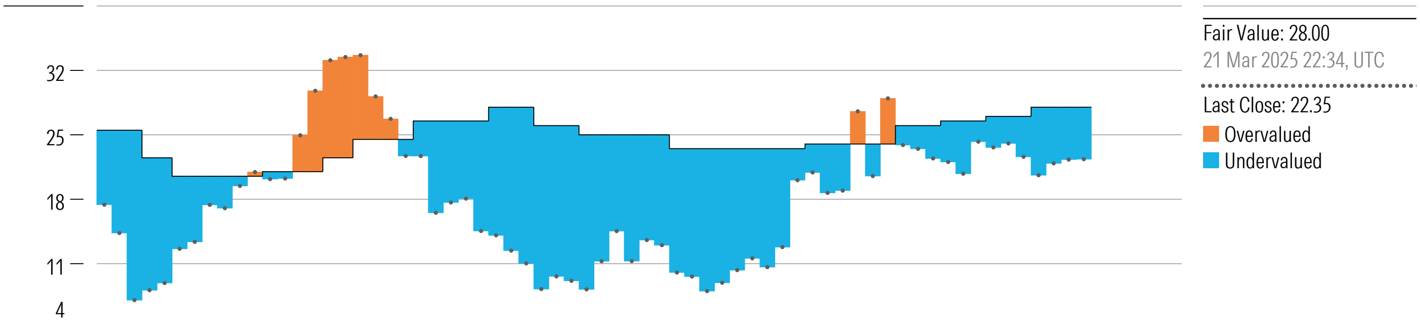
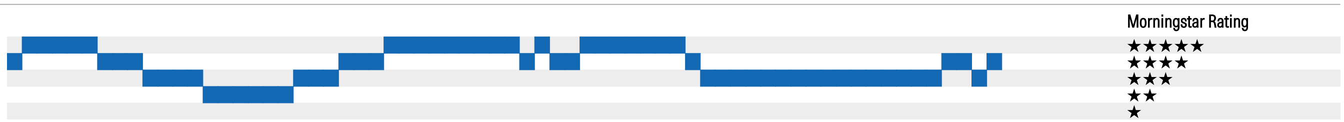
Lululemon Athletica Inc LULU ★★★★ 12 Jun 2025 21:36, UTC

Competitors Price vs. Fair Value

Gap Inc GAP

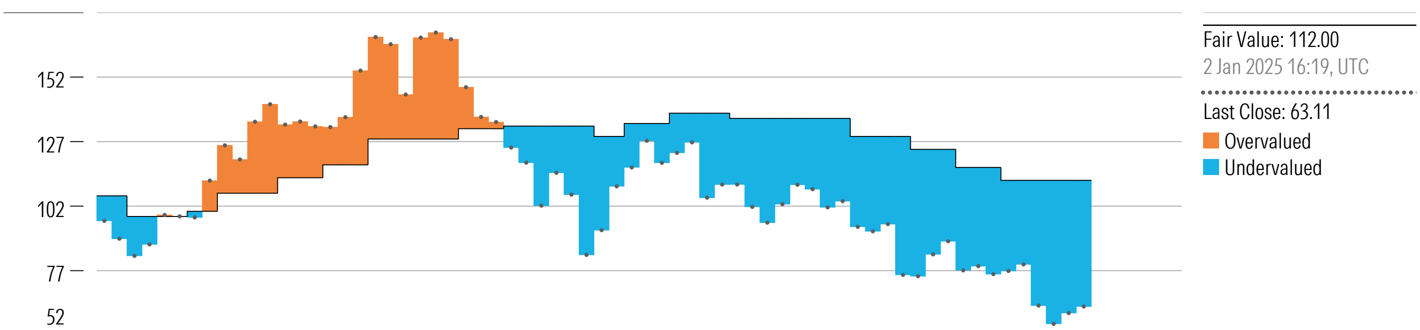


	2020	2021	2022	2023	2024	YTD
Price/Fair Value	0.96	0.67	0.45	0.87	0.88	0.77
Total Return %	15.57	-10.19	-32.86	90.69	15.88	-4.08

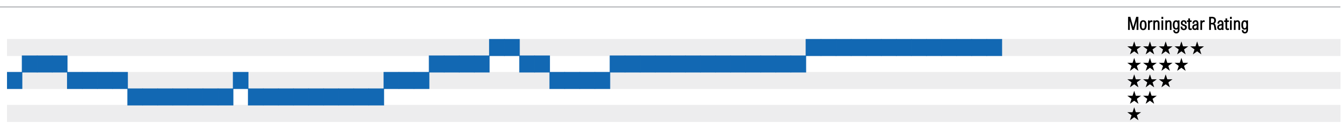


Total Return % as of 11 Jun 2025. Last Close as of 11 Jun 2025. Fair Value as of 21 Mar 2025 22:34, UTC.

Nike Inc Class B NKE



	2020	2021	2022	2023	2024	YTD
Price/Fair Value	1.32	1.30	0.87	0.80	0.65	0.56
Total Return %	40.64	18.61	-29.04	-6.03	-28.91	-15.54



Total Return % as of 11 Jun 2025. Last Close as of 11 Jun 2025. Fair Value as of 2 Jan 2025 16:19, UTC.

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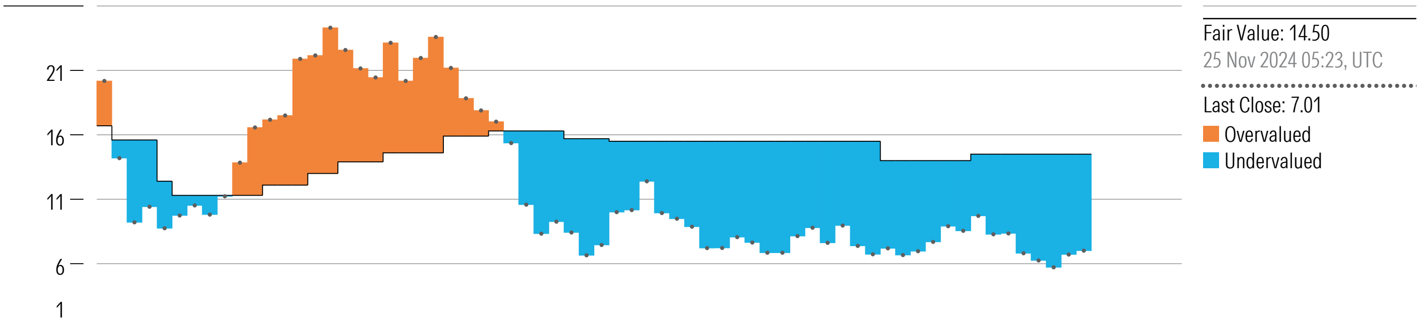
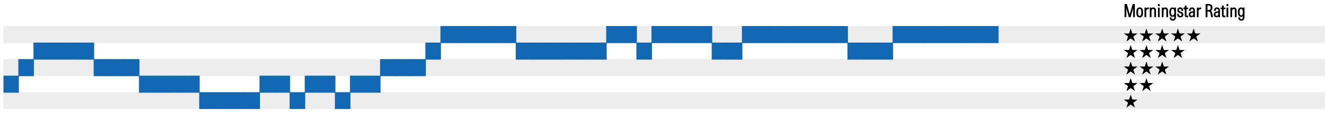
Lululemon Athletica Inc LULU ★★★★ 12 Jun 2025 21:36, UTC

Competitors Price vs. Fair Value

Under Armour Inc Class A UAA



	2020	2021	2022	2023	2024	YTD	
	1.42	1.33	0.66	0.57	0.57	0.47	Price/Fair Value
	-20.51	23.41	-52.05	-13.48	-5.80	-15.34	Total Return %



Total Return % as of 11 Jun 2025. Last Close as of 11 Jun 2025. Fair Value as of 25 Nov 2024 05:23, UTC.

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Morningstar Valuation Model Summary

Financials as of 07 Jun 2025	Actual			Forecast				
Fiscal Year, ends 31 Jan	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
Revenue (USD Mil)	8,111	9,619	10,588	11,245	12,124	13,163	14,333	15,591
Operating Income (USD Mil)	1,726	2,207	2,506	2,468	2,618	2,971	3,265	3,533
EBITDA (USD Mil)	1,620	2,512	2,952	2,940	3,127	3,524	3,867	4,188
Adjusted EBITDA (USD Mil)	2,018	2,587	2,952	2,940	3,127	3,524	3,867	4,188
Net Income (USD Mil)	855	1,550	1,815	1,771	1,869	2,119	2,328	2,519
Adjusted Net Income (USD Mil)	1,289	1,622	1,815	1,771	1,869	2,119	2,328	2,519
Free Cash Flow To The Firm (USD Mil)	673	1,751	1,212	1,426	1,662	1,834	2,004	2,162
Weighted Average Diluted Shares Outstanding (Mil)	128	127	124	120	115	110	104	99
Earnings Per Share (Diluted) (USD)	6.68	12.20	14.64	14.73	16.19	19.33	22.35	25.46
Adjusted Earnings Per Share (Diluted) (USD)	10.07	12.77	14.64	14.73	16.19	19.33	22.35	25.46
Dividends Per Share (USD)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Margins & Returns as of 07 Jun 2025		Actual			Forecast					
	3 Year Avg	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**5 Year Avg**
Operating Margin %	20.7	21.3	23.0	23.7	22.0	21.6	22.6	22.8	22.7	22.3
EBITDA Margin %	—	20.0	26.1	27.9	26.2	25.8	26.8	27.0	26.9	—
Adjusted EBITDA Margin %	—	24.9	26.9	27.9	26.2	25.8	26.8	27.0	26.9	26.5
Net Margin %	14.6	10.5	16.1	17.1	15.8	15.4	16.1	16.2	16.2	15.9
Adjusted Net Margin %	16.6	15.9	16.9	17.1	15.8	15.4	16.1	16.2	16.2	15.9
Free Cash Flow To The Firm Margin %	12.7	8.3	18.2	11.4	12.7	13.7	13.9	14.0	13.9	13.6

Growth & Ratios as of 07 Jun 2025		Actual			Forecast					
	3 Year CAGR	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**5 Year CAGR**
Revenue Growth %	19.2	29.6	18.6	10.1	6.2	7.8	8.6	8.9	8.8	8.1
Operating Income Growth %	22.2	25.6	27.9	13.5	-1.5	6.1	13.5	9.9	8.2	7.1
EBITDA Growth %	25.5	4.0	55.1	17.5	-0.4	6.4	12.7	9.7	8.3	7.3
Adjusted EBITDA Growth %	22.7	26.2	28.2	14.1	-0.4	6.4	12.7	9.7	8.3	7.2
Earnings Per Share Growth %	25.1	-10.8	82.7	20.0	0.6	9.9	19.4	15.7	13.9	11.7
Adjusted Earnings Per Share Growth %	25.1	29.2	26.8	14.7	0.6	9.9	19.4	15.7	13.9	11.7

Valuation as of 07 Jun 2025	Actual			Forecast				
	2023	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
Price/Earning	30.7	36.6	25.0	16.8	15.3	12.8	11.1	9.7
Price/Sales	4.8	6.0	4.8	2.6	2.4	2.2	2.1	1.9
Price/Book	12.6	14.0	10.5	6.0	5.5	5.4	5.1	4.8
Price/Cash Flow	—	—	—	—	—	—	—	—
EV/EBITDA	19.7	22.2	17.2	10.2	9.6	8.5	7.8	7.2
EV/EBIT	23.0	26.0	20.3	12.2	11.5	10.1	9.2	8.5
Dividend Yield %	—	—	—	—	—	—	—	—
Dividend Payout %	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Free Cash Flow Yield %	—	—	—	—	—	—	—	—

Operating Performance / Profitability as of 07 Jun 2025	Actual			Forecast				
Fiscal Year, ends 31 Jan	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
ROA %	15.3	21.9	23.9	21.0	21.1	23.5	24.9	25.7
ROE %	27.2	36.6	42.0	35.6	36.4	42.2	46.4	49.3
ROIC %	36.9	39.3	38.1	33.1	32.0	32.7	32.7	32.7

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Financial Leverage (Reporting Currency)

	Actual			Forecast				
Fiscal Year, ends 31 Jan	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
Debt/Capital %	2.0	2.7	2.4	0.0	0.0	0.0	0.0	0.0
Assets/Equity	1.8	1.7	1.8	1.7	1.7	1.8	1.9	1.9
Net Debt/EBITDA	-0.2	0.0	-0.3	-0.8	-0.7	-0.5	-0.4	-0.3
Total Debt/EBITDA	0.4	0.4	0.5	0.0	0.0	0.0	0.0	0.0
EBITDA/ Net Interest Expense	-484.7	-60.1	-41.9	-61.5	-60.7	-63.0	-63.5	-63.2

Forecast Revisions as of 9 Jun 2025

	2026		2027		2028	
Prior data as of 31 Mar 2025	**Current**	**Prior**	**Current**	**Prior**	**Current**	**Prior**
Fair Value Estimate Change (Trading Currency)	305.00	314.74	—	—	—	—
Revenue (USD Mil)	11,245	11,290	12,124	12,192	13,163	13,257
Operating Income (USD Mil)	2,468	2,536	2,618	2,754	2,971	3,019
EBITDA (USD Mil)	2,940	3,010	3,127	3,267	3,524	3,576
Net Income (USD Mil)	1,771	1,838	1,869	1,981	2,119	2,162
Earnings Per Share (Diluted) (USD)	14.73	15.23	16.19	17.10	19.33	19.64
Adjusted Earnings Per Share (Diluted) (USD)	14.73	15.23	16.19	17.10	19.33	19.64
Dividends Per Share (USD)	0.00	0.00	0.00	0.00	0.00	0.00

Key Valuation Drivers as of 07 Jun 2025

Cost of Equity %	9.0
Pre-Tax Cost of Debt %	5.8
Weighted Average Cost of Capital %	9.5
Long-Run Tax Rate %	30.0
Stage II EBI Growth Rate %	7.5
Stage II Investment Rate %	36.3
Perpetuity Year	15

Additional estimates and scenarios available for download at https://pitchbook.com/.

Discounted Cash Flow Valuation as of 07 Jun 2025

	USD Mil
Present Value Stage I	12,313
Present Value Stage II	4,682
Present Value Stage III	16,025
Total Firm Value	**33,020**
Cash and Equivalents	1,984
Debt	0
Other Adjustments	-38
Equity Value	**34,966**
Projected Diluted Shares	118
Fair Value per Share (USD)	**305.00**

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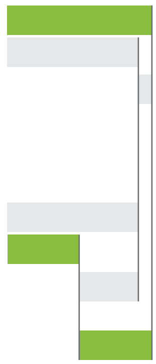
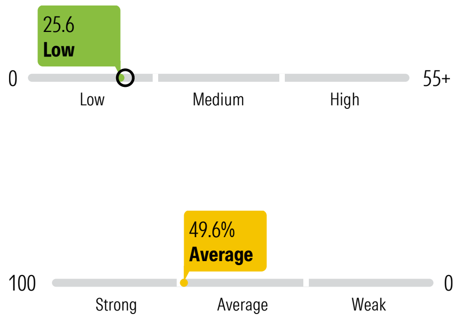
ESG Risk Rating Breakdown

Exposure	
Company Exposure[1]	25.6
– Manageable Risk	23.2
Unmanageable Risk[2]	**2.4**
Management	
Manageable Risk	23.2
– Managed Risk[3]	11.5
Management Gap[4]	**11.7**
Overall Unmanaged Risk	**14.1**



● Subject ○ Subindustry (27.0)



- Exposure represents a company's vulnerability to ESG risks driven by their business model
- Exposure is assessed at the Subindustry level and then specified at the company level
- Scoring ranges from 0-55+ with categories of low, medium, and high-risk exposure

- Management measures a company's ability to manage ESG risks through its commitments and actions
- Management assesses a company's efficiency on ESG programs, practices, and policies
- Management score ranges from 0-100% showing how much manageable risk a company is managing

ESG Risk Rating

ESG Risk Ratings measure the degree to which a company's value is impacted by environmental, social, and governance risks, by evaluating the company's ability to manage the ESG risks it faces.

1. A company's Exposure to material ESG issues 2. Unmanageable Risk refers to risks that are inherent to a particular business model that cannot be managed by programs or initiatives 3. Managed Risk = Manageable Risk multiplied by a Management score of 49.6% 4. Management Gap assesses risks that are not managed, but are considered manageable 5. ESG Risk Rating Assessment = Overall Unmanaged Risk = Management Gap plus Unmanageable Risk

ESG Risk Rating Assessment[5]

ESG Risk Rating is of Jun 04, 2025. Highest Controversy Level is as of Jun 08, 2025. Sustainalytics Subindustry: Retail Apparel. Sustainalytics provides Morningstar with company ESG ratings and metrics on a monthly basis and as such, the ratings in Morningstar may not necessarily reflect current Sustainalytics' scores for the company. For the most up to date rating and more information, please visit: sustainalytics.com/esg-ratings/.

Peer Analysis 04 Jun 2025

Peers are selected from the company's Sustainalytics-defined Subindustry and are displayed based on the closest market cap values

Company Name	Exposure		Management		ESG Risk Rating	
Lululemon Athletica Inc	25.6 | Low	0 – 55+	49.6 | Average	100 – 0	14.1 | Low	0 – 40+
Gap Inc	33.4 | Low	0 – 55+	56.4 | Strong	100 – 0	16.6 | Low	0 – 40+
Nike Inc	30.8 | Low	0 – 55+	44.1 | Average	100 – 0	18.6 | Low	0 – 40+
Under Armour Inc	32.1 | Low	0 – 55+	53.0 | Strong	100 – 0	16.8 | Low	0 – 40+
adidas AG	31.5 | Low	0 – 55+	55.0 | Strong	100 – 0	16.0 | Low	0 – 40+

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Appendix

Historical Morningstar Rating

Lululemon Athletica Inc LULU 12 Jun 2025 21:36, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	★★★★	★★★	★★★★	★★★	★★	★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★	★★	★	★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★	★	★★	★★	★★	★★	★★	★★	★★	★★	★★	★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★	★	★★	★★	★★	★★	★★	★★	★	★	★	★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★	★	★	★	★	★	★	★	★	★	★	★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★	★	★	★	★	★	★	★	★	★★	★	★

Gap Inc GAP 12 Jun 2025 21:31, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	★★★★	★★★	★★★★	★★★★	★★★	★★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
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Morningstar Equity Analyst Report | Report as of 12 Jun 2025 22:30, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 19 of 24

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Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
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Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
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Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
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Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
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Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
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Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, indepth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss shortterm market-price movements), but we believe these negatives are mitigated by deep analysis and our longterm approach.

Morningstar's equity research group ("we," "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our singlepoint star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

When considering a company's moat, we also assess whether there is a substantial threat of value destruction, stemming from risks related to ESG, industry disruption, financial health, or other idiosyncratic issues. In this context, a risk is considered potentially value destructive if its occurrence would eliminate a firm's economic profit on a cumulative or midcycle basis. If we deem the probability of occurrence sufficiently high, we would not characterize the company as possessing an economic moat.

2. Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in workingcapital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

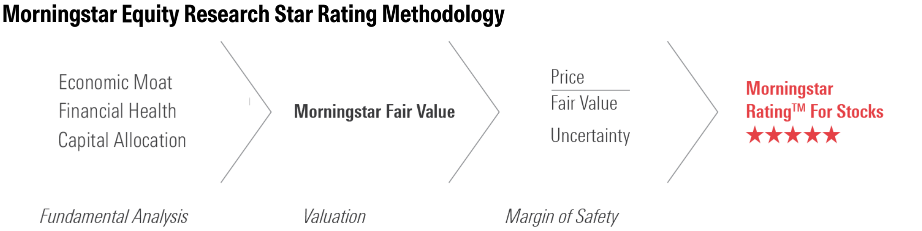
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty Around That Fair Value Estimate

Morningstar's Uncertainty Rating is designed to capture the range of potential outcomes for a company's intrinsic value. This rating is used to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating is aimed at identifying the confidence we should have in assigning a fair value estimate for a given stock.

Our Uncertainty Rating is meant to take into account anything that can increase the potential dispersion of future

Morningstar Equity Research Star Rating Methodology



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Research Methodology for Valuing Companies

outcomes for the intrinsic value of a company, and anything that can affect our ability to accurately predict these outcomes. The rating begins with a suggested rating produced by a quantitative process based on the trailing 12-month standard deviation of daily stock returns. An analyst overlay is then applied, with analysts using the suggested rating, historical rating data, and their own knowledge of the company to inform them as they make the final Uncertainty Rating decision. Ultimately, the rating decision rests with the analyst. Analysts take into account many characteristics when making their final decision, including cyclical factors, operational and financial factors such as leverage, company-specific events, ESG risks, and anything else that might increase the potential dispersion of future outcomes and our ability to estimate those outcomes.

Our recommended margin of safety—the discount to fair value demanded before we'd recommend buying or selling the stock—widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the potential dispersion of outcomes, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the Uncertainty Rating provides guidance in portfolio construction based on risk tolerance.

Our Uncertainty Ratings are: Low, Medium, High, Very High, and Extreme.

	Margin of Safety	
Qualitative Analysis Uncertainty Ratings	★★★★★Rating	★Rating
Low	20% Discount	25% Premium
Medium	30% Discount	35% Premium
High	40% Discount	55% Premium
Very High	50% Discount	75% Premium
Extreme	75% Discount	300% Premium

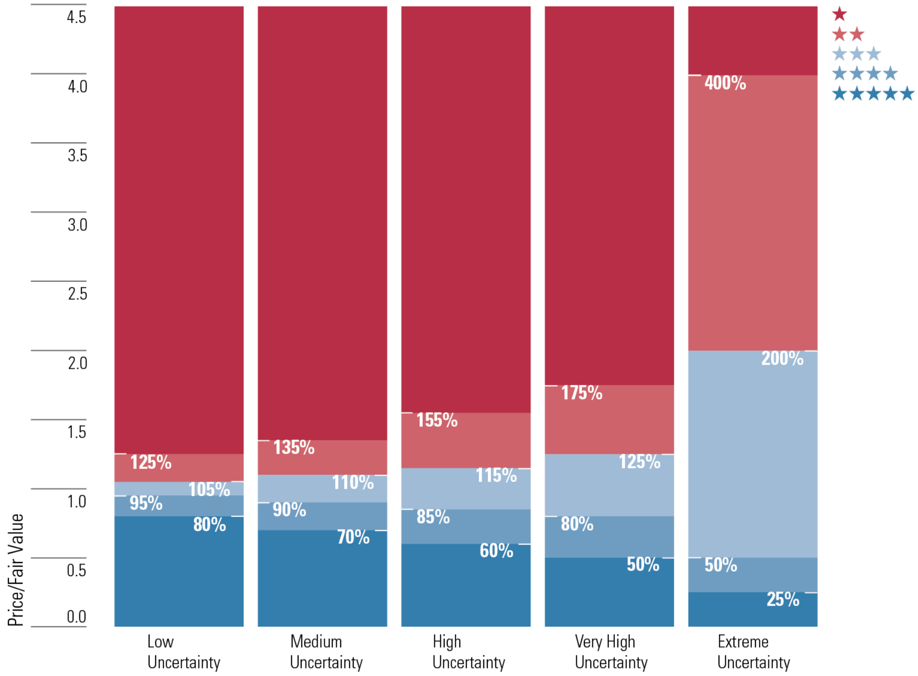
Our uncertainty rating is based on the interquartile range, or the middle 50% of potential outcomes, covering the 25th percentile–75th percentile. This means that when a stock hits 5 stars, we expect there is a 75% chance that the intrinsic value of that stock lies above the current market price. Similarly, when a stock hits 1 star, we expect there is a 75% chance that the intrinsic value of that stock lies below the current market price.

4. Market Price

The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more details about our methodology, please go to https://shareholders.morningstar.com

Morningstar Equity Research Star Rating Methodology



Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

★★★★★ We believe appreciation beyond a fair risk adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

★★★★ We believe appreciation beyond a fair risk-adjusted return is likely.

★★★ Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

★★ We believe investors are likely to receive a less than fair risk-adjusted return.

★ Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multi-year time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments,

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and shareholder distributions. Analysts consider companies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

Capital Allocation (or Stewardship) analysis published prior to Dec. 9, 2020, was determined using a different process. Beyond investment strategy, financial leverage, and dividend and share buyback policies, analysts also considered execution, compensation, related party transactions, and accounting practices in the rating.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider companies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

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Sustainalytics ESG Risk Rating Assessment: The ESG Risk Rating Assessment is provided by Sustainalytics; a Morningstar company.

Sustainalytics' ESG Risk Ratings measure the degree to which company's economic value at risk is driven by environment, social and governance (ESG) factors.

Sustainalytics analyzes over 1,300 data points to assess a company's exposure to and management of ESG risks. In other words, ESG Risk Ratings measures a company's unmanaged ESG Risks represented as a quantitative score. Unmanaged Risk is measured on an open-ended scale starting at zero (no risk) with lower scores representing less unmanaged risk and, for 95% of cases, the unmanaged ESG Risk score is below 50.

Based on their quantitative scores, companies are grouped into one of five Risk Categories (negligible, low, medium, high, severe). These risk categories are absolute, meaning that a 'high risk' assessment reflects a comparable degree of unmanaged ESG risk across all subindustries covered.

The ESG Risk Rating Assessment is a visual representation of Sustainalytics ESG Risk Categories on a 1 to 5 scale. Companies with Negligible Risk = 5 Globes, Low Risk = 4, Medium Risk = 3 Globes, High Risk = 2 Globes, Severe Risk = 1 Globe. For more information, please visit sustainalytics.com/esg-ratings/

Ratings should not be used as the sole basis in evaluating a company or security. Ratings involve unknown risks and uncertainties which may cause our expectations not to occur or to differ significantly from what was expected and should not be considered an offer or solicitation to buy or sell a security.

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