

# LULU Earnings Call Transcript

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**Quarter: 2**

Operator: Thank you for standing by. This is the conference operator. Welcome to the lululemon athletica inc. Second Quarter 2025 Financial Results Conference Call. [Operator Instructions] The conference is being recorded. I would now like to turn the conference over to Howard Tubin, Vice President, Investor Relations for lululemon athletica inc.

Howard Tubin: Thank you, and good afternoon. Welcome to lululemon's Second Quarter Earnings Conference Call. Joining me today to talk about our results are Calvin McDonald, CEO; and Meghan Frank, CFO. Before we get started, I'd like to take this opportunity to remind you that our remarks today will include forward-looking statements reflecting management's current forecast of certain aspects of lululemon's future. These statements are based on current information, which we have assessed, but by which its nature is dynamic and subject to rapid and even abrupt changes. Actual results may differ materially from those contained in or implied by these forward-looking statements due to risks and uncertainties associated with our business, including those we have disclosed in our most recent filings with the SEC, including our annual report on Form 10-K and our quarterly reports on Form 10-Q. Any forward-looking statements that we make on this call are based on assumptions as of today, and we expressly disclaim any obligation or undertaking to update or revise any of these statements as a result of new information or future events. During this call, we will present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in our quarterly report on Form 10-Q and in today's earnings press release. In addition, the comparable sales metrics given on today's call are on a constant dollar basis. The press release and accompanying quarterly report on Form 10-Q are available under the Investors section of our website at [www.lululemon.com](http://www.lululemon.com). Before we begin the call, I'd like to remind our investors to visit our investor site where you'll find a summary of our key financial and operating statistics for the quarter as well as our quarterly infographic. Today's call is scheduled for 1 hour, so please limit yourself to one question at a time to give others the opportunity to have their questions addressed. And now I would like to turn the call over to Calvin.

Calvin McDonald: Thank you, Howard, and welcome to our quarter 2 earnings call. As you've seen from our press release, while EPS this quarter exceeded our expectations, revenue fell short of our guidance, and we are reducing our revenue and earnings expectations for the year. While we continue to see positive momentum overall in our international regions, we're not happy with the current results in the U.S. business. lululemon has been in a period of hyper growth for several years, more than tripling our revenue in just 6 years, and we have successfully managed through a number of market shifts. We are facing yet another shift today within the industry related to tariffs and the cost of doing business. The increased rates and removal of the de minimis provision have played a large part in our guidance reduction for the year. As we navigate current market dynamics, I see an opportunity to reset some key areas of the business as we continue to drive long-term growth. During our time together today, I will provide an update on our business and my perspective on the near term as we continue to plan and adapt for the future. Specifically, I will share my insights on the state of the U.S. business, our assessment of our current product offering, what we've learned has worked and what has not worked and the actions our teams are taking to reaccelerate growth in the U.S., my perspective on our strength globally and the opportunities this continues to create for our brand going forward and the impact of the new trade environment, implications of higher tariffs and the removal of the de minimis exemption on

our revised guidance. Finally, we'll conclude by taking your questions. So let's begin. As I speak to the U.S., I'd like to set some context for you. During the second half of last year, our teams were focused on bringing our newness penetration back to historical levels. We achieved this, as we shared last quarter, through a combination of new styles and an increase in seasonal color within our core styles. While the guest is responding well to many of our new styles, they are not reacting as we had anticipated to the updated seasonal colors we brought into our core assortment. Given this, we have recently conducted a deeper product diagnostic, the results of which I will share with you today. I now believe we have let our product life cycles run too long within many of our core categories particularly in lounge and social. We have become too predictable within our casual offerings and missed opportunities to create new trends. At the same time, we are seeing shifts within the industry. The overall market for premium athletic wear in the U.S. remains challenging with declines continuing in quarter 2. Consumers are spending less on apparel overall, spending less in performance active wear and are being more selective in their purchases, seeking out truly new styles. This makes it even more important that we meet and exceed the expectations of our guests. For further context, let me provide some additional details on what we are seeing is working well and what is not working well within our product assortment. Our brand-building initiatives and several of our new product innovations are working. In addition, we continue to see growth in our performance apparel. Within our brand initiatives, our brand health continues to be strong with growth in both total and retained guests, and we continue to acquire new guests and retain existing guests across all age demographics. In addition, our membership program continues to build and now has approximately 30 million members. Within product, our guests continue to respond well to many of the new styles and innovations we bring into the assortment, including The Align No Line, Daydrift and BeCalm. By leveraging our Science of Feel product development platform, our view is that these offerings demonstrate the impact of our approach to innovation and our ability to solve the unmet needs of our guests. We also continue to differentiate lululemon from our competition with our performance apparel, and we're seeing continued growth overall across our key activities, yoga, run and train, golf and tennis. As you know, performance apparel is a key differentiator for us in the marketplace and an important launch pad for us to showcase innovation. And importantly, we have continued to gain market share within performance apparel even as the sector has declined according to the latest Circana market share data for the U.S. activewear space. So we know that we have a very loyal guest who continues to trust and prioritize the brand for their high-performance apparel needs. And when we deliver new innovation across the assortment, they respond and are ready to purchase. However, on the other side of the equation, let me now turn to what we believe has not been working well based upon our recent diagnostic. Our lounge and social product offerings have become stale and have not been resonating with guests. Specifically, we have seen a less enthusiastic response to some core franchises across lounge and social, such as Scuba, Softstreme and Dance Studio. And we feel that our opportunity remains in frequency and conversion, which is impacting their total spend. The data related to engagement and loyalty of our guests remains strong. My view now is that we have relied on the same product playbook across certain categories for too long. The competitive landscape is different today than it was even 2 or 3 years ago. And while no single competitor is having a meaningful impact on our business, there are now many players in the market. This makes it imperative that we are consistently better and stronger than ever and create the right balance of our core product and new styles across our merchandise mix. Let me zoom out and speak to what we now see as the root causes of our current product challenges in the U.S. The primary cause is that we relied too heavily on some of our core franchises across lounge and social for too long. We did not have the appropriate balance between existing and new styles across our casual offerings and the guests stopped responding as they had in the past. I would also mention as a secondary cause that in the current environment, we have the opportunity to create more agility within our go-to-market process to allow us to go faster, to test new styles and to react to guest demand. We introduced several great new styles this spring but couldn't chase into the demand quick enough unless some of our guests disappointed. Our teams are now focused on increasing the number and frequency of new styles we bring into the assortment and rebalancing our go-forward merchandise mix. I will now share details about the actions underway to elevate our product assortment and to improve how our teams continue to work to support our growing business. My view is that it's now time to reset many of our

practices related to how we develop and create the range of products that will fuel the next phase of our growth. We have seen that when we get our product right, everything else can follow. lululemon is a beloved brand with deeply loyal guests who have come to expect unparalleled product from us in terms of design, fabrication, innovation and newness. And I'm excited by the work of our Global Creative Director, Jonathan Cheung, who joined us early last year. In this time, he has built a strong team of lead designers for men and women who are infusing new energy into the lululemon product playbook. This is an essential investment in our future, both in terms of time and talent. Some areas of focus for our new design team include maintaining our momentum in performance activities, designing into several new products across lounge and social and giving a fresh perspective to some of our most iconic items. As a result of their work, we intend to increase new styles as a percentage of our overall assortment from the current 23% to approximately 35% next spring. We will continue to gauge guest behavior and adjust this penetration in future seasons based upon their response. We are also enhancing our capabilities to go faster within our go-to-market process. By working with our vendors, we have and will continue to improve our ability to chase into strong performing styles outside of our mainline product development process. We have also improved our fast-track design capabilities, which reduces lead times by several months for select styles. These have been fully incorporated into the upcoming seasons to give us added flexibility to anticipate, meet and potentially exceed guest response and demand. And through these actions, we expect to create the anticipated improvements in our product portfolio and business performance with the most meaningful impact beginning in 2026. I would also like to speak to the recent announcement that Ranju Das has joined lululemon as our new Chief AI and Technology Officer. This is a new role at lululemon and represents an elevated mandate to enable AI and technology to help expedite our product innovation process, improve our agility and speed to market and increase personalization across our guest experience. I'm excited Ranju has joined us, and I look forward to partnering with him as he and our technology teams implement and accelerate these strategies. These plans create a clear path forward and are intended to create a better balance across our product assortment, reaccelerate our business in the United States, and we feel these will also benefit each market where we operate. Our teams have been working with the right sense of urgency and focus, and I'm excited about the enhancements we're making to some of our existing capabilities and the new ones we are developing to set up our next phase of growth. I want to also touch on our international business, where our momentum remains strong overall and where our market expansion efforts continue at a steady pace. In China, our second largest market, total revenue increased 25% or 24% in constant currency. We opened 5 new stores in China Mainland this quarter, and we continue to drive brand awareness through a variety of activations and experiences, including our fifth annual highly visible summer sweat games. In our Rest of World segment, total revenue increased 19% and 15% on a constant currency basis. We continue to open new markets as part of our growth plans, including our new company-operated store in Italy, in Milan as well as franchise locations in Turkey and Belgium. And looking ahead, we announced the selection of our franchise partner for India with the goal of opening our first lululemon store in this market in the second half of 2026. We remain in the early stages of international growth and are seeing success across all our markets. The opportunity to drive unaided awareness, gain market share and grow our guest base is significant. And while our growth rates remain strong, I expect the changes I just detailed for you in the U.S. will benefit our business across all these important markets as well. Before I turn it over to Meghan, I'd like to speak more about the macro environment and specifically the reality of the new tariffs and the removal of the de minimis provision. Companies across our industry are looking at various levers to navigate this period, including opportunities across their supply chains, expense management and strategic pricing actions. We are doing the same. However, realizing additional benefits will take time. And given our financial strength and profitability, I am determined that we will not make any near-term decisions that could hurt or damage our brand positioning over the long term. For the year, we now expect revenue growth of 4% to 6%, excluding the 53rd week in 2024 and EPS to be in the range of \$12.77 to \$12.97. These reductions relative to our prior expectations are being driven predominantly by North America. In the U.S., we now expect a 1% to 2% decline in revenue. And in China, we anticipate growth in the 20% to 25% range. We continue to expect Rest of World will grow approximately 20%. When looking at China, quarter 2 revenue came in at the low end of our expectations as we're beginning to see some signs of

macro-driven headwinds in Tier 1 cities. We have adjusted our guidance for the year to factor in this continued performance. Looking out to 2026, I believe the product plans discussed today will benefit our business in China as well, given the importance of lounge and social products in this market. Meghan will share more with you on our revised guidance in just a few minutes. In summary, I see this period as an opportunity for lululemon. We have a brand people love with extremely loyal guests who respond well to our new styles and innovation. And we are clear on the path forward to meet and potentially exceed the expectations of our guests. I believe we will leverage our financial strength and once again demonstrate our agility to navigate this period while we steadily make progress on the product opportunities discussed today. We have learned a lot as a leadership team this year, and we are a stronger organization as a result. I expect to see the most impact of our learnings and insights into 2026 and beyond. With that, I will now hand it over to Meghan.

Meghan Frank: Thanks, Calvin. While Q2 earnings per share exceeded guidance, our top line results fell short of our expectations, driven predominantly by underperformance in North America. As you heard Calvin say, we have opportunity within our product assortment and the teams are in action on bringing in style newness, differentiation and increased agility. And you'll see the most meaningful impact of this work in 2026. In addition, we are navigating increased costs related to tariffs and the removal of the de minimis exemption. Given these factors, we believe it's appropriate to be prudent in our planning and financial outlook for the remainder of the year. We are taking actions in both the near term and long term to mitigate the increased tariff costs, including strategic pricing actions, supply chain initiatives, including vendor negotiations and enterprise-wide expense savings initiatives. While implementing these cost-saving strategies, we do not plan to take our eye off the long-term growth potential for lululemon. Given the strength of our balance sheet and strong cash flow generation, we will continue to invest strategically in our growth initiatives to help ensure we realize the full potential of our brand while also navigating today's dynamic environment. I'll share our detailed guidance with you in a moment, but let's first take a look at our Q2 results in detail. For Q2, total net revenue rose 7% or 6% in constant currency to \$2.5 billion. Comparable sales increased 1%. Within our regions, results were as follows: Americas revenue increased 1% on both a reported and constant currency basis with comparable sales down 3%. By country, revenue increased 1% in Canada on both a reported and constant currency basis and was flat in the U.S. China Mainland revenue increased 25% or 24% in constant currency, with comparable sales increasing 16% and in the Rest of World, revenue grew by 19% or 15% in constant currency with comparable sales increasing by 9%. In our store channel, total sales increased 3%, and we ended the quarter with 784 stores globally. Square footage increased 14% versus last year, driven by the addition of 63 net new lululemon stores since Q2 2024, which includes 18 locations in Mexico. During the quarter, we opened 14 net new stores and completed 6 optimizations. In our digital channel, revenues increased 9% and contributed \$1 billion of top line, 39% of total revenue. And by category, men's revenue increased 6% versus last year, women's increased 5% and accessories and other grew 15%. Gross profit for the second quarter was \$1.48 billion or 58.5% of net revenue compared to 59.6% in Q2 2024. The gross profit rate in Q2 decreased 110 basis points and was driven primarily by the following: an 80 basis point decrease in overall product margin driven by higher markdowns and tariff impact. Markdowns increased 60 basis points versus our expectations of 20 to 40 basis points, 40 basis points of deleverage on fixed costs and 10 basis points of favorable impact from foreign exchange. Relative to our guidance for a decline in gross margin of 200 to 210 basis points, the upside was driven predominantly by favorable mix, lower ocean freight costs, prudent management of fixed expenses, lower-than-expected tariff impact related to timing and a stock-based compensation accrual reversal. Moving to SG&A; Our approach continues to be grounded in prudently managing our expenses while also continuing to strategically invest in our long-term growth opportunities. SG&A; expenses were approximately \$952 million or 37.7% of net revenue compared to 36.8% of net revenue for the same period last year. This was favorable to our guidance for deleverage of 170 to 190 basis points due predominantly to the stock-based compensation accrual reversal. Operating income for the quarter was approximately \$524 million or 20.7% of net revenue compared to 22.8% of net revenue in Q2 2024. Tax expense for the quarter was \$162.6 million or 30.5% of pretax earnings compared to an adjusted effective tax rate of 29.6% a year ago. Net income for the quarter was \$371 million or \$3.10 per diluted share compared to \$3.15 for the second quarter of 2024. The

stock-based compensation reversal added \$0.15 to Q2. Excluding this reversal, EPS would have been above our guidance range of \$2.85 to \$2.90. Capital expenditures were approximately \$178 million for the quarter compared to approximately \$145 million in the second quarter last year. The increase relates primarily to timing of store openings. Turning to our balance sheet highlights. We ended the quarter with \$1.16 billion in cash and cash equivalents. Inventory increased 21% and was \$1.7 billion at the end of Q2. On a unit basis, inventory increased approximately 13% and was in line with our expectations. The difference between dollar inventory growth and unit inventory growth relates predominantly to higher tariff rates relative to last year and foreign exchange. We repurchased approximately 1.13 million shares at an average price of \$247 during the quarter. At the end of Q2, we had approximately \$860 million remaining on our \$1 billion repurchase program. Let me now share our updated guidance outlook for the full year 2025. We now expect revenue to be in the range of \$10.85 billion to \$11 billion. This range represents growth of 2% to 4% relative to 2024. Excluding the 53rd week that we had in the fourth quarter of 2024, we expect revenue to grow 4% to 6%. By region, we now expect revenue in the Americas to be flat to down 1%, with the U.S. down 1% to 2% and Canada approximately flat. China Mainland to be 20% to 25%, and we continue to expect Rest of World to be approximately 20%. Our updated expectations for the Americas and China Mainland take into account the most recent trends we're seeing in those regions. Looking out to 2026, we would expect all markets to benefit from the product-driven strategies we are currently implementing. We now expect to be at the high end of our 40 to 45 range for net new company-operated stores in 2025 and complete approximately 35 optimizations versus our prior guidance of 40. We expect overall square footage growth in the low double digits. Our new store openings in 2025 will include approximately 15 stores in the Americas with nearly half of those openings planned in Mexico. The remainder of our new stores are planned for our international markets, the majority of which will be in China. We remain pleased with our new store productivity and the results we are seeing from our optimization strategy. While we are taking a disciplined approach to capital spending, we continue to see positive returns from new store openings and store expansions as these strategies contribute to an improved shopping experience for our existing guests and new guest acquisition, along with building brand awareness and community engagement. For the full year, we now expect gross margin to decrease approximately 300 basis points versus 2024. Relative to our prior guidance for a 110 basis point decrease, we expect the additional 190 basis points decrease to be driven predominantly by increased tariffs, including the removal of the de minimis exemption, offset somewhat by several of our enterprise-wide efforts to mitigate these costs. We now expect markdowns to be approximately 50 basis points higher than last year versus our prior expectation of 10 to 20 basis points. This change reflects higher levels of seasonal clearance but does not contemplate a change to our markdown and promotional strategy. We will continue to clear end of season and end-of-life product through our normal channels, including in-store, online, our outlets and from time to time in the past, we've utilized warehouse sales. Let me provide some additional details on the increased tariff expense, which now includes 2 components: higher reciprocal rates and the removal of the de minimis exemption. Our prior guidance assumed a mitigated impact of 40 basis points for the year based on 10% incremental tariffs on most countries where we source and 30% on China. As rates in total have actualized higher and the de minimis exemption has been removed, we now expect a 220 basis point or approximately \$240 million mitigated impact on gross margin for the year. This impact reflects our best estimate, recognizing the actual effect could vary depending on how conditions evolve and our mitigation efforts perform. In terms of de minimis, given that we have DC infrastructure in Canada, we have been well positioned to ship some of our e-commerce orders to our U.S. guests. As most of these shipments were under \$800, they qualify for the de minimis exemption, and we realized meaningful duty savings. This removal will have a significant impact on our gross margin and represents approximately 170 basis points of the 220 basis point tariff-related decline we now expect for the year. Keep in mind that in 2025, based on timing, we are only benefiting from half a year of mitigation strategies. As we look out to 2026, while offsetting all the incremental de minimis expense will not be possible, we will benefit from a full year of mitigation and expect an approximate \$320 million net impact on operating margin related to both higher tariffs and the removal of de minimis. Turning to SG&A; for the full year. We now expect deleverage of approximately 80 to 90 basis points versus 2024, modestly above our prior guidance of 50 basis points.

While we have implemented several enterprise-wide cost savings initiatives, the modest increase in deleverage is driven by the impact of lower top line, FX headwinds and ongoing investments into our Power of Three x2 road map, including investments to support market growth and international expansion and continued investment in technology. When looking at operating margin for the full year 2025, we now expect a decrease of approximately 390 basis points versus 2024. As I mentioned, 220 basis points of the decrease is driven by increased tariffs and the removal of de minimis. For the full year 2025, we continue to expect our effective tax rate to be approximately 30%. For the fiscal year 2025, we now expect diluted earnings per share in the range of \$12.77 to \$12.97 versus EPS of \$14.64 in 2024. Our EPS guidance excludes the impact of any future share repurchases, but does include the impact of our repurchases year-to-date. We now expect capital expenditures to be approximately \$700 million to \$720 million in 2025 versus our prior estimate of \$740 million to \$760 million. This reduction reflects our discipline with regard to capital spend and relates to investments to support business growth, including a continuation of our multiyear distribution center project, store capital for new locations, relocations and renovations and technology investments. Shifting now to Q3. Looking at Q3, we expect revenue in the range of \$2.47 billion to \$2.5 billion, representing growth of 3% to 4%. We expect to open approximately 14 net new company-operated stores and complete 18 optimizations in Q3. We expect gross margin in Q3 to decrease approximately 410 basis points relative to Q3 2024. The decrease will be driven predominantly by the impact of increased tariffs and removal of de minimis, deleverage on fixed costs and our ongoing investment in our multiyear distribution center project. The impact from tariffs and de minimis combined will be approximately 230 basis points. We expect markdowns to be 80 basis points higher than 2024, driven by increased seasonal clearance. In Q3, we expect our SG&A rate to deleverage by approximately 150 basis points relative to Q3 2024. This will be driven predominantly by increased foundational investments and related depreciation and strategic investments, including those to build brand awareness. When looking at operating margin for Q3, we expect deleverage of approximately 560 basis points with 230 basis points related to tariffs and de minimis. Turning to EPS. We expect earnings per share in the third quarter to be in the range of \$2.18 to \$2.23 versus EPS of \$2.87 a year ago. We expect our effective tax rate in Q3 to be approximately 30.5%. When looking at inventory, we expect units to increase in the low double digits in Q3, with dollar inventories up in the low 20s due in large part to the impact of higher tariff rates and foreign exchange. We expect a similar dynamic in inventory growth for the remainder of the year. As we look out to next year, we aim to manage our inventory in line with sales trends, and we would expect our inventory growth on a unit basis to moderate beginning in Q1 2026. Before turning it back over to Calvin, I would emphasize that while there are external factors we are navigating, we know we can perform better, and we have several initiatives in place to reaccelerate our business, particularly in the U.S. Looking out to 2026, I believe we will see improvements in our product assortment when we have the full impact of our new creative team. In addition, we'll continue to work on and pull levers to navigate the new realities of higher tariffs. I will reiterate that while we're managing the near-term dynamics, we have the flexibility to keep our eyes on the future and continue to prudently and strategically invest in our growth potential. However, we are planning for multiple scenarios, and we continue to look across the enterprise for ways to operate more efficiently, including expense management, capital spend on square footage growth and inventory management. And with that, I will turn it back over to Calvin.

Calvin McDonald: Thanks, Meghan. We look forward to taking your questions in just a moment. As you heard me say, we are not satisfied with the results for the quarter, and we know our brand can and will perform better than these results. We are clear on our assessment of the situation, which takes into account the current dynamics within the consumer environment and competitive landscape. We are learning and adapting and are focused on the path forward to create and deliver product that lives into our high-performance and high-style philosophy. I feel confident in our leadership team and the plans we have in place. The guest is responding well to many of our new styles. Our future pipeline is strong and the positive impact of our new design vision remains in front of us. We will navigate this period successfully given the passion, commitment and agility of our leaders and teams. We will now take your questions.

Operator: [Operator Instructions] The first question is from Janine Stichter with BTIG.

Janine Hoffman Stichter: Would love to hear more about the product assortment changes you're

making. First, I would love to hear about how you can impact the back half. It sounds like there's a lot of expectations around the first half of next year. But what should we expect to see in the back half of the year? And then maybe help us understand how much of the assortment, this casual piece where you're seeing the slower sales trend, how much of the assortment is that? And what gives you confidence that this is the piece that needs to be fixed?

Calvin McDonald: Janine, in terms of the product pipeline, the team is focused really across 3 key areas supported by innovation and solving the unmet needs of our guests. The first is maintaining momentum in the performance activities, as I mentioned, those apparel categories are positive and growing through the quarter, and we want to continue that. Team is focused on designing into several new styles across lounge and social. We do have in the back half 2 new items launching Loungeful and Big cozy. And then third is continue to give a fresh perspective to some iconic items that we know our guests love. And the Scuba waffle that was launched a few weeks ago is a good example of that. Through the back half of this year, there is more new styles than we had in the first half. And as I mentioned, the spring 2026 has really been the focus of Jonathan since he joined last year and the team in bringing that new fresh energy across the product playbook, and we're very excited about these new styles and what we're seeing relative to the assortment and that mix of newness moving from 23% to 35%. From a casual perspective, it's about 40% of the mix, 60% is performance. On that performance, as I mentioned, sales are positive across those 5 key activities. And then within casual, there are new styles that are performing well, Daydrift, BeCalm and there are core franchises like Scuba, Softstream and Dance Studio, where we're seeing fatigue with the consumer, particularly our high-value consumer who's been with us longer. And that's the split of the sales and where we're seeing some of those product headwinds within that casual mix of the assortment.

Janine Hoffman Stichter: Great. And then maybe just a follow-up on tariffs. I'm curious what you've seen so far with some of the price increases you've taken. And it sounds like you're cautious on raising price, but just would be curious if the recent increase in tariffs change your view on pricing into next year at all.

Meghan Frank: Thanks, Janine. So we are instituting modest price increases on a small portion of our assortment as we discussed last quarter. What's reflected in our guidance is still that positioning. We continue to look at pricing. I would say those actions are in the process of rolling out, and we're pleased with them to date, but some still in front of us. We'll continue to look at it as a lever as we move through the second half of this year and into next.

Operator: The next question is from Alex Straton with Morgan Stanley.

Alexandra Straton: Perfect. Maybe a follow-up. Just on that lifestyle point of being 40% or so of the assortment. Is that the right mix, do you think over time? And are there any differences by geography? And then just separately, just on the performance versus casual kind of deviation. It just feels like the performance franchises are longer dated versus like your later entry into casual. So I'm just a little bit surprised by the fatigue there. So any color or thoughts on what's different would be helpful.

Calvin McDonald: In terms of the right mix, I do think a 60-40 split. It's what we've historically seen is a good benchmark. We'll let the guest sort of judge based on the new styles that we bring as well as I've shared before, we have plans to continue to develop into the activity strategy where we see opportunity. We have a very good position in run and yoga. We see an opportunity to continue to gain market share in train, golf and tennis, not just in North America, U.S., but around the globe. So as we innovate and lean into those, we see that driving growth. And on the casual side of the business, it really is split between social and lounge. Social has been an opportunity for us in our women's assortment. Daydrift is a good example of us playing with that high-performance high-style blend. There are new styles planned for that. And we've had a very strong lounge business supported by some of these key franchises that, as I mentioned, are doing well with newer guests and our high-value guests that have these in their wardrobe are looking and reacting more to new, and we have new lounge coming. So the 60-40 split, I think, is a good starting position for us, but we're constantly learning and adapting as we introduce new styles, we'll continue to do that through improved agility. Relative to growing in performance versus casual, we have a number of franchises in both of those segments that I would say, vary depending upon length of time. Within performance, because of the very nature of the fabrics and the innovations and solving the unmet needs of our guests, we've been

able to update and provide a variety of variations as well as continue to bring in new solutions. So it has been new styles and new innovation that has driven a lot of that growth and success that we're seeing, especially in some of the newer activities for us. So I'm not surprised that we're seeing and able to generate growth on that side of the business. And on the casual, it is attributed to some of these core franchises that we've had for a while that she's responding less to the core seasonal color interpretations and obviously to new and updates to those like the Scuba waffle that I mentioned when it is truly something she has not seen before responding well.

Operator: The next question is from Brooke Roach with Goldman Sachs.

Brooke Roach: Calvin, I was hoping that you could contextualize the magnitude of these key franchises that are down trending within the 40% of your business that is casual. How are you thinking about the time line that it might take for new innovation to scale in your spring '26 innovation pipeline to a large enough magnitude in which that newness will fully offset the incremental pressure that you're seeing from these select lounge and social platforms?

Calvin McDonald: Thanks, Brooke. When we look at the merchandising mix heading into spring and the shift from 23% to 35%, that will be new styles that the guest has not seen and I would say that slightly over-indexes into the areas of opportunity we've seen, which has been social and lounge, plus the newness that we've introduced this year that she has responded well to, Daydrift, the BeCalm franchise, plus those that we have coming, which Big Cozy, Loungeful being a couple of those. I feel that the mix is good to offset to give the guest choice and options around some of those core franchises. And we're obviously going to test and learn. And one of the key areas that I also mentioned is the agility to be able to chase into quicker the items that are successful. But I do think the mix of the assortment allows us to have the right new style and learn and see how the guest responds to it.

Operator: The next question is from Jay Sole with UBS.

Jay Sole: Calvin, you talked a lot about supply chain initiatives in your prepared remarks, specifically around speed and getting faster. Can you talk specifically about how much faster lead times need to get where they are today, where you really want to take them ultimately? And how you're going to manage that process of getting a company that's worked one way for a really long time around creating product, both in line and innovation into doing something really sounds pretty different.

Calvin McDonald: Yes. Thanks, Jay. The teams have been in that work, and we've been able to improve our go-to-market calendar over the last few quarters with plans to continue to be able to adapt how they work. A couple of examples is aligning at the beginning of the season across our supply chain with our vendor partners and our merchants, some of the key new items and fabrics and having our vendor base pull in some of those fabrics so we can move more quickly into action when we see and get a read from our guests. We've improved the ability to adjust within the process from a PO and a cut and sew into a different style or into a different silhouette depending upon, again, the read of the guest. So it is definitely a new way of working. It has been an area and focus for the team because we're excited about the new styles that we're bringing. We're excited about the percentage of our merchandising mix. And obviously, we know that agility and our ability to react quickly is an important muscle and the teams have been focusing on that, working both with vendor partner themselves. Equally, and as I mentioned, Ranju joins in a new role, which I'm very excited about, which really is a continuation of the focus that we put on our processes and technology to enable the teams to be able to have the right tools and processes to support this change and to move more quickly. And he'll be an important partner to the teams in driving that and leveraging technology to move even quicker.

Jay Sole: Got it. And then if I could just ask a little bit about marketing because you mentioned, I think, in the prepared remarks that if you get the product right, everything else kind of takes care of itself. But are there -- is there anything you feel like you can do with on the marketing side? Would you be willing to increase marketing as a percent of sales to maybe create some more traffic in the store and more excitement around the brand?

Calvin McDonald: We don't have plans to increase. It's 5% of our revenue. Plan is to maintain that. We definitely continue to test and learn, but lean into our grassroots community, local with some event activations. And we're pleased with the engagement and the guest metrics on a year-to-date basis. Our brand remains very healthy, and our guests are very loyal, as you know. And when I look at the guest data, we've continued to grow our guest base in the U.S. across all age demographics through the

quarter and year-to-date. And within our most recent guest cohort, those that are in our low to mid-spend range, all are spending more with us year-over-year. Opportunities are high-value guests. They're over-indexing on new styles and retention remains strong, but the opportunity is they're spending less with us linked, as I mentioned, to these core franchises, predominantly in lounge and social. And with this group, they've almost all opted in for direct marketing. So the teams are really focused on our ability to proactively showcase and present the new styles to them as they launch and we'll maintain our in-market activations around community and local, and we're seeing good success on brand awareness, and we'll continue playing that formula.

Operator: The next question is from Paul Lejuez with Citi.

Paul Lejuez: Can you maybe talk about the gross pressure from the reciprocal tariffs as well as the de minimis on an annualized basis? And maybe can you just share how much are you relying on pricing as a mitigation tool? And maybe just help me maybe connect the dots between using price, but then also guiding for higher markdowns year-over-year.

Meghan Frank: Yes. Thanks, Paul. So in terms of 2026, we shared \$320 million mitigated impact. We are offsetting about half of the growth within that impact. I would say about half of the offset would be expense actions and the balance would be pricing and vendor negotiations, pricing being a little bit bigger than the vendor negotiation piece. I would say we're being very mindful on a style-by-style basis looking at elasticities. I don't feel like there's overlap with the markdown pressure we're seeing this year. I think that's really related to -- we have more seasonal inventory than we need based on our sales trend, and we're focused on clearing that by end of year. We definitely have an eye on the relationship between those 2 pieces and feel well positioned today. As I said, we'll keep our eye on pricing as both our pricing rolls out and the performance of that as well as how the competitive environment evolves.

Paul Lejuez: Got it. And then will the pricing changes be isolated to the U.S.? Or do you think you have some pricing power globally that can help as a mitigation tool?

Meghan Frank: At this point, isolated to...

Operator: The next question is from Adrienne Yih with Barclays.

Adrienne Yih-Tennant: Calvin, I guess my question is on the inventory kind of that's in the pipeline. What can you be doing sort of between now and 2026 when the fixes come into play? How can you kind of chase into things that are suggesting that they're working and make any kind of like course corrections kind of before we get to that point? And then my other question is on the de minimis, and I'm not sure if we have enough information to back into it, but the e-commerce is roughly, let's call it, mid- to high 40% depending on the quarter. A portion of that comes into the U.S. So how should we think about what was being used on the de minimis exemption?

Calvin McDonald: On the inventory, a lot of what I laid out before, the new approach to being able to be quicker, faster has been in place. And although we still have some work and believe we can continue to refine and improve those items that we introduced through the second half of this year that we get a good read on, we'll be able to move quicker than we have in the past. Some of the new processes I mentioned such as upfront working with vendors on fabrications and having them ready allow us to eliminate up to 2 months through our chase process. So those are in place, and we'll be able to react, and we continue to look at ways in which we can improve that agility even more moving forward.

Meghan Frank: And then in terms of de minimis, so we fulfill approximately 2/3 of our U.S. e-commerce orders through Canada. Most of those shipments would have been under \$800 and would have qualified for the exemption. So it's a meaningful impact for us. I would share that we are looking actively at our DC network and part of our mitigation strategy is inventory placement and making sure we're most efficient as we move forward.

Operator: The next question is from Matthew Boss with JPMorgan.

Matthew Boss: So Calvin, on your revised outlook in both the U.S. and China for the year, could you elaborate on what you saw or how you saw traffic trends progress over the course of the second quarter? And any change so far in the third quarter that informed the more cautious outlook for the year?

Meghan Frank: Matt, so in terms of KPI trends throughout the quarter, May was our strongest month and July was our weakest. So we did see the trend decelerate as we move through the quarter. We did

see store and e-commerce traffic slow a bit as we move throughout the quarter. Conversion was relatively consistent and then AOV flat to slightly worse. I would share quarter-to-date, the U.S. trend is generally in line with our annual guide. Canada is a little bit lower than our annual guide for the Canada region. And then China is on the higher end. We do expect Q4 China will be on the lower end just given the shift of Chinese New Year out of Q4 and into Q1.

Matthew Boss: Great. And then, Calvin, could you maybe just elaborate on some of your comments before on changes in the industry that I think you said is challenging your core assortment. And then regionally, I mean, what do you think is different here in the U.S. relative to what you're seeing from the brand overseas?

Calvin McDonald: Thanks, Matt. So from an industry or competitive position, what I'd say is our brand remains strong. Our guests are loyal and our product is uniquely positioned. And as I've said before, there's lots of opportunity for us to keep growing across many categories. Competition in our space has always been intense, and there's lots of share for us to gain. And that said, competition is different today. There are more players across all of specialty, and they're offering athleisure and performance solutions. Our product is uniquely positioned. And as we continue to drive our unique approach of solving that needs of our guests, when we deliver, we win and continuing to grow our performance apparel this quarter, I think, is a good example of that. And as we've learned and I've shared the opportunity with some of our lounge and social core franchises is a reminder to the team that when we don't and the need for us to continue to create new styles so that we can stay ahead of those that are copying our successes. And we know we can do better for our guests, especially in these categories, and that's the focus. From a regional perspective, as I shared, our low to mid-value consumers, the newer guest cohorts in the U.S., we continue to see increase in spend. And when I look across international regional markets, we are earlier in our growth, earlier in share, earlier in guest acquisition and our relationship with those guests. So I think the overall assortment continues to resonate and drive our momentum and our international business was strong in the quarter. And all the changes that the team has been in for next year will benefit and serve the entire globe because we know new styles are resonating everywhere. So very positive that, that will just have an impact across all of our markets.

Operator: The next question is from Michael Binetti with Evercore.

Michael Binetti: Just a couple since we're on the international theme. Could you speak a little bit to Canada? I know in previous quarters, you said some of the issues you identified were isolated to the U.S., but your comment on the Canada trend recently. I just wanted to check if you're starting to see some of those issues in Canada or what's causing some slower trends there. And in China, maybe just a thought on where store profitability is today versus prior peak, so we can think about some of the guidance you gave within the context of how that market will affect the margins. And then I guess, Meghan, I don't want to exhaust this, but as you -- you gave us a lot of components to think about on the margin for 2026 between tariffs and de minimis. But it strikes me as the mix of new product keeps moving higher that usually comes with a placeholder for higher markdowns as well as you don't have as much data on what sell-through will be as you do for legacy products. Is that a fair assumption? Or any other building blocks we should be mindful of that wrap into next year?

Calvin McDonald: Thanks, Michael. I'll quickly go on Canada. We did see similar macro conditions in the Canadian market this quarter regarding some of the consumer uncertainties. And as guests are spending less overall, they are reacting well to new styles and spending less on styles they already have. And I expect the changes we're making in the U.S. will benefit our business across all the important markets, including Canada.

Meghan Frank: On China, we did see expansion in our operating margin in Q2. I would say in terms of where the growth came from, it was predominantly e-com, while our stores were a little bit more pressured in the quarter. So a little bit of opportunity, I would say, in our stores as we see the traffic there recover. From a margin perspective, we are actively planning 2026. There's 2 components really that are impacting us. So the first is revenue, and we're focused on driving that U.S. inflection. We will see a healthy flow-through on operating margin as we see that business recover. However, acknowledging, as you mentioned, newness and managing that dynamic, we are going to be very mindful of inventory as we get performance in on the new styles and chase that trend on the upside. So definitely looking to maintain our focus on full price component of our business and managing the

markdown piece. And then the second large impact to our business is obviously tariffs and de minimis. So we continue to work on mitigation strategies there and mentioned right now, our expectation is \$320 million impact. And then there'll be some puts and takes as we go through our planning process. There are some pieces of expense that we've pulled up this year that will contemplate add-backs as appropriate and obviously, all with protecting long-term brand health and our potential for the brand.

Operator: The last question is from Sharon Zackfia with William Blair.

Sharon Zackfia: I was curious, we saw e-commerce outpace retail stores for the first time, I think, since '23 in terms of growth. Are you seeing a change in the way the customer is shopping the brand? Or is that reflective of where you were choosing to do kind of the clearance activity?

Meghan Frank: Yes. I would say we saw traffic decline slightly in both stores and e-com. We did see a conversion uptick on e-com. I would say a little bit of consumer behavior. And then also we did see higher markdowns in the quarter. We tend to clear those more through our e-commerce channels, so that would be reflective there.

Operator: That's all the time we have for questions today. Thank you for joining the call, and have a nice day.