

LULU Earnings Call Transcript

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Quarter: 3

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

Howard Tubin: Thank you, and good afternoon. Welcome to lululemon's third 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. 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 third 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. It's good to be here with all of you today. In just a few minutes, Meghan and I will provide an overview of our results for the third quarter, our performance over the Thanksgiving weekend as well as an updated guidance for the fourth quarter and full year. But let me begin with sharing more about the news that after more than 7 amazing years, I will step down from my role as CEO of lululemon on January 31. In my conversations with the Board, we carefully considered what's ahead for the company and for my own journey. Together, we agreed that the timing is right for a change as we near the end of our 5-year plan cycle. I'm incredibly proud of what we have accomplished together over the past 7 years. lululemon is a very different and much stronger company today than when I first joined the organization in August of 2018. I enjoy helping organizations set big, ambitious goals and growth targets and working towards achieving them. Since 2018, lululemon tripled its annual revenue, and we expect to generate \$11 billion this fiscal year. We have broadened our global reach from 18 to over 30 geographies and grown the company's China Mainland business into our second largest market. We expanded the horizon for what's possible for lululemon, quadrupling our international business, growing our men's business as well as our online channel and extending into new categories and activities. And I am proud we are the #1 women's active apparel brand in the United States. We have done this while increasing our profitability. Based on our guidance for 2025, we

will achieve a compound annual growth rate in EPS of approximately 20% from 2018 to 2025. And the company has strong cash flow and a balance sheet with \$1 billion in cash and no debt. So lululemon is in a very good position going forward. But beyond the numbers, there is so much opportunity ahead for the company, which is poised to innovate new products and experiences and welcome more markets and guests. The teams have been addressing opportunities head on and making meaningful progress from product creation and activation to enterprise efficiency. And we've got a leadership team in place that is ready to author the next horizon of what's possible. Together, we built a foundation of innovation, creativity and connection at lululemon that has transformed the athletic apparel industry and will continue to drive it forward. As you've seen in our press release, Marti Morfitt will serve as Executive Chair, Meghan and Andre Maestrini will serve as co-CEOs, supporting all aspects of the business until the next CEO steps into their role. I will continue to serve as an adviser to the company through March of next year to support a smooth transition and assist the leadership team on executing against our business strategies, and I look forward to sharing more about my next chapter. I appreciate the support of our Board of Directors, our management team and everyone at lululemon for their support over the past 7 years. As we step into this transition period, I am confident in the company's senior leaders, and I know that Meghan and Andre will do an extraordinary job. This leadership team will play an important role in creating the future for lululemon. I believe the outstanding product pipeline we have built and the action plan now in place will yield positive results going forward. I cannot wait to see it come to fruition and deliver value to shareholders in the months and years ahead. I've described being CEO of lululemon as my dream job. It truly has lived up to every expectation and given me the opportunity of a lifetime. With that, Meghan and I will now share more about our business results. I'll speak to our Q3 results and then discuss our performance over the Thanksgiving weekend, which was encouraging. Next, I will turn it over to Meghan to build upon the foundation we laid out on our Q2 earnings call regarding the action plan to drive inflection in our U.S. business. And Meghan will then share our detailed Q3 financials and our Q4 outlook before we take your questions. So let's begin with quarter 3. When looking at our U.S. business, our guest metrics remain consistent. We continue to see growth in both total and retained guests, and we are acquiring new guests and retaining existing guests across all age demographics. Where we continue to have opportunity is increasing the frequency of visits and spend with our high-value guests. In the Americas, in Q3, we saw total revenue decline 2% with the U.S. down 3% and Canada negative 1%, in line with our expectations. From a product standpoint, we continue to lead with technical innovations and saw growth in our performance activities led by run and train. Guests also responded well to our outerwear assortment with performance up strong double digit. Shifting to international, where our momentum remains strong, revenue increased 33%, fueled by 46% growth in China Mainland and 47% on a constant currency basis. Our Rest of World segment also saw nice momentum with revenue growing 19% in constant currency. Looking forward, we now expect revenue in China Mainland to be at or better than the high end of our range of 20% to 25% revenue growth for the year, excluding the 53rd week. For Q4, we expect revenue growth to be below the Q3 trend due to calendar shifts, which benefited Q3 and will have a negative impact on Q4. In our Rest of World segment, I would highlight the recent Gangnam store opening in Seoul, South Korea and the strong guest response we've seen in the initial weeks. This store reflects our new design ethos that celebrates our Pacific Northwest heritage while modernizing the in-store experience. And in EMEA, our franchise partner recently opened the third lululemon store in Istanbul, and we have plans to enter several additional markets in 2026. Let me now share some highlights from Thanksgiving. We're pleased with our performance over the Thanksgiving shopping period. I traveled with Carla Anderson, our new GM of North America and other members of our leadership team to several stores over the weekend and saw our educators in action, bringing our brand to life and providing guests with a seamless shopping experience. Our final stop was our new SoHo location. This store offers improved visual merchandising and adjacencies and offers a truly elevated shopping experience. Given the competitive environment, we know guests are looking for value. With the increased traffic over the holiday period, we had the opportunity to clear through some seasonal and end-of-life product, which helps position us well from an inventory standpoint as we exit quarter 4 and enter spring. We also dropped new full-price product, including special edition training gear, which met with good guest response. And relative to last year, we offered our Black Friday product to our members a week earlier

this year. Not only did this help drive traffic to our e-commerce sites, but also fueled a significant number of app downloads and new sign-ups for our membership program. Despite the earlier start, Black Friday was still our biggest volume day ever on our e-commerce sites. I also want to acknowledge we have seen trends slow a bit since Thanksgiving, which we've taken into account in our Q4 guidance. However, despite this, we expect revenue trends in the U.S. in Q4 to be modestly improved relative to Q3. Before I turn it over to Meghan, I want to take a moment to speak to the 3 pillars of the action plan underway to drive an inflection in the business. We are focused on product creation. I've been working with Jonathan Cheung, our Creative Director and our design and innovation teams on our product pipeline. As I've shared, we know that our current merchandising mix, particularly in North America, does not fully reflect the go-forward vision we have for our brand. The team has been in the work, and I believe that we have a strong pipeline of innovation and approach to new style creation. You'll see the impact of this work beginning in spring 2026 and continue to strengthen throughout the year. Product activation, where we are improving the in-store and online experience, engaging our high-value guests in new ways and better aligning our brand and marketing activities with product inflections and drops, and enterprise efficiency, ensuring we are operating as efficiently as possible as we work to inflect the U.S. business, particularly in light of the new tariff environment. We believe these priorities position us well for the near term and will continue to set lululemon up for long-term sustainable growth. Meghan, over to you.

Meghan Frank: Thank you, Calvin. I'm grateful for your leadership over the last 7 years. It has been a privilege to be part of your team during your tenure to see how you immediately made an impact on this organization to go after and deliver against some incredible goals. I appreciate your support as we step into this transition. I'm excited to partner with Andre Maestrini as Interim Co-CEO and to work closely with Marti Morfitt in her expanded role as Executive Chair. In addition, I have full confidence in our entire leadership team as we guide lululemon through this important period. Let's now spend a few minutes on the details of our action plan we have in place to drive improvement in the U.S. As you know, our teams are focused on inflecting our business. On our Q2 earnings call, we laid out actions we have in place. And today, I'd like to share with you a more formal framework for the strategies underway and add some details to our prior discussion. At the highest level, the goals of our plan are simple. We are working to drive acceleration in our U.S. business, maintain momentum in our international regions and protect operating margin in the near term and drive improvement over the long term. We began this work last year as we saw the U.S. business slow, and we expect to see the most significant benefits of our work streams in 2026. As Calvin mentioned, we are executing against 3 pillars, which are product creation, product activation and enterprise efficiency. We believe this plan will enable us to deliver improved differentiated products to our guests, allow our teams to read and react more quickly based on style performance, elevate our in-store and online experience and refine our marketing approach to ensure new and existing guests are aware of the products and innovations coming in 2026. Let's now get into the details beginning with product creation. Our teams have been in the work to reenergize our product engine, bring a new energy into our assortment and increase our speed and agility. So let me give you a few examples. We are increasing the frequency and breadth of new styles and remain on track to bring new style penetration to 35% next spring. The teams have already begun this work with some recent examples being Milemaker, Shake It Out, Tumbled Fleece and Scuba Waffle. In addition, we recently debuted our Team Canada kit for the Milan 2026 Winter Olympic Games. Looking forward and under the direction of our design team, we will be updating several of our key franchises while also maintaining a strong pipeline of new innovations across our performance offering. We'll have a focus on train coming in early 2026, and we'll be bringing newness and novelty across some of our most important franchises, including Swiftly, Daydrift and Steady State. Next, we're increasing our speed to market. Our mainline product development process currently runs 18 to 24 months, and we are working to reduce it to 12 to 14 months. In addition, we've been enhancing our speed lanes. This includes our chase capabilities, which will allow us to get back into select strong performing styles within 6 to 8 weeks and also our fast-track design process. Finally, it's important to keep in mind that the assortments you currently see in stores and online include certain styles that are not representative of our go-forward vision for the brand. There are many elements that we like and our guests are responding well to. However, as we said on our last call, we've let product life cycles run too

long within some of our key franchises. And we have not inspired our high-value guests to purchase as we had in the past. I'm looking forward to 2026 as we will begin to see the excitement our creative team is bringing into our assortments. In addition, given our improved agility, we'll be better able to read, react and adjust our assortments based on guest response to our offering. Shifting now to our second pillar, product activation, where we have several initiatives underway. First, we are elevating the store experience by improving our ability to curate our assortment by store and by market. In May of this year, we began testing an updated approach to the in-store experience and have seen good initial results. Our intention is to use these learnings to enhance our ability to have locally relevant assortments in all stores. The strategy goes beyond assorting stores based on climate differences alone, and we'll be better able to maximize the impact of our assortments through strategic curation, which takes into account local guest taste. We plan to reduce the density of our assortment on a local basis to better highlight styles that are most relevant. This will enable improved visual merchandising for the styles we know are most important to the guests in each local market. And we are working to improve our in-store storytelling by shifting product to adjacencies and category flow to ensure the guest is seeing the versatility and coordination across our assortment. Second, we're improving our digital experience. We recently rolled out a website redesign with enhanced visual merchandising and elevated storytelling, offering an overall more modern guest experience to inspire purchase and increase conversion. Next, we're rolling out new solves to engage our high-value guests. We have several initiatives underway to get at this objective, but there are 2 timely ones I'd highlight for you. These include the updates we've recently rolled out to our membership program and our new partnership with the Amex Platinum Card. Finally, under the product activation pillar, our brand building and marketing activities will continue as we invest in integrated marketing efforts around the world with a planned focus on driving awareness and excitement for both product newness and innovation across all athletic activities as well as lifestyle. We will leverage our ambassadors as well as brand right creators and talent with a sharp focus on engaging guests through social channels and community activations. The final pillar of our action plan is enterprise efficiency. This work stream is not new for us, however, in a world with higher tariffs and the removal of the de minimis provision. And while we work to inflect the U.S. business, we have a heightened focus on ensuring we're operating as efficiently as possible across the enterprise. As we've said, we're taking actions in both the near term and long term to mitigate the increased tariff costs. These include strategic pricing actions, supply chain initiatives, including vendor negotiations and DC network efficiency and enterprise-wide savings initiatives. I will also note that we benefit from strong cash flow generation and a balance sheet with \$1 billion in cash and no debt. This enables us to keep our eye on the long term and prudently invest in our growth initiatives while navigating the near term. Let's now turn to our financials and guidance outlook. Starting with Q3. For Q3, total net revenue rose 7% to \$2.6 billion on both a reported and constant currency basis. Comparable sales increased 2%. Within our regions, results were as follows: Americas revenue decreased 2% on both a reported and constant currency basis with comparable sales down 5%. By country, revenue decreased 3% in the U.S. and was up 1% on a reported basis and flat on a constant currency basis in Canada. China Mainland revenue increased 46% or 47% in constant currency, with comparable sales increasing 25%. Better-than-expected guest response to our merchandise assortment, particularly outerwear, coupled with an earlier start to 11/11 events on our third-party e-commerce platforms contributed to this above-plan performance. And in the Rest of World, revenue grew by 19% on a reported and constant currency basis with comparable sales increasing by 9%. In our store channel, total sales were flat, and we ended the quarter with 796 stores globally. Square footage increased 12% versus last year, driven by the addition of 47 net new lululemon stores since Q3 2024. During the quarter, we opened 12 net new stores and completed 16 optimizations. In our digital channel, revenues increased 13% and contributed \$1.1 billion of top line or 42% of total revenue. By category, men's revenue increased 8% versus last year, women's increased 6% and accessories and other grew 12%. Gross profit for the third quarter was \$1.43 billion or 55.6% of net revenue compared to 58.5% in Q3 2024. The gross profit rate in Q3 decreased 290 basis points and was driven primarily by the following: a 290 basis point decrease in overall product margin driven predominantly by the tariff impact and higher markdowns. Markdowns increased 90 basis points. In addition, foreign exchange had a 10 basis point unfavorable impact. There were several smaller items within gross margin, the net

of which contributed 10 basis points of positive impact. Relative to our guidance for a decline of gross margin of approximately 410 basis points, the upside was driven predominantly by leverage on higher-than-expected top line, lower net tariff impact and prudent management of the fixed expenses within gross margin. 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 \$988 million or 38.5% of net revenue compared to 38% of net revenue for the same period last year. This was favorable to our guidance for deleverage of approximately 150 basis points driven by top line leverage and prudent management of expenses. Operating income for the quarter was \$436 million or 17% of net revenue compared to 20.5% of net revenue in Q3 2024. Tax expense for the quarter was \$135 million or 30.5% of pretax earnings compared to an effective tax rate of 30.2% a year ago. Net income for the quarter was \$307 million or \$2.59 per diluted share compared to \$2.87 for the third quarter of 2024. Capital expenditures were approximately \$167 million for the quarter compared to approximately \$178 million in the third quarter last year. Q3 spend relates primarily to investments to support business growth, including our multiyear distribution center project, store capital for new locations, relocations and renovations and technology investments. Turning to our balance sheet highlights. We ended the quarter with \$1 billion in cash and cash equivalents. Inventory increased 11% and was \$2 billion at the end of Q3. On a unit basis, inventory increased approximately 4%, below our estimate for an increase in the low double digits. Lower-than-expected inventory was driven predominantly by higher-than-planned sales and timing of receipts. 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 million shares at an average price of \$181 during the quarter. Including the recently approved \$1 billion increase to our authorization, we now have approximately \$1.6 billion in capacity to repurchase shares. Let me now share our updated guidance outlook for the full year 2025. We now expect revenue to be in the range of \$10.96 billion to \$11.05 billion. This range represents growth of 4% relative to 2024. Excluding the 53rd week that we had in the fourth quarter of 2024, we expect revenue to grow 5% to 6%. By region, excluding the 53rd week and on a constant currency basis, we continue to expect the U.S. to be within our guidance range of negative 1% to 2%. We continue to expect the Americas to be flat to down 1% and Canada to be flat. We now expect China Mainland to be at or above the high end of our guidance range of 20% to 25%, and we now expect Rest of World to be up in the high teens. When looking at China Mainland, Q3 results were strong and ahead of our expectations. However, let me remind you that there are 2 discrete calendar shifts, which will negatively impact Q4, namely the early start of 11/11 events, which benefited Q3 and a later Chinese New Year relative to last year. As a result, we expect revenue growth in the fourth quarter to be below the Q3 trend. We expect to open approximately 46 net new company-operated stores this year and complete approximately 36 optimizations. We expect overall square footage growth in the low double digits. Our new store openings in 2025 include approximately 15 stores in the Americas, with 9 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. While stores remain an important part of our omni ecosystem, we acknowledge that revenue trends in the U.S. are not where we'd like, and we are closely looking at all potential store openings as we plan for 2026. For the full year, we now expect gross margin to decrease approximately 270 basis points versus 2024. Relative to our prior guidance for a 300 basis point decrease, the improvement is being driven by lower estimated tariff impact. We now expect markdowns to be approximately 70 basis points higher than last year. Turning to SG&A; for the full year. We expect deleverage of approximately 120 basis points versus 2024, above our prior guidance of 80 to 90 basis points. While we continue to manage expenses prudently, we're investing further in marketing in Q4 to help drive traffic and continue to build brand awareness. When looking at operating margin for the full year 2025, we now expect a decrease of approximately 390 basis points versus 2024, in line with our prior guidance. 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 \$12.92 to \$13.02 versus our prior guidance of \$12.77 to \$12.97 and 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 expect capital expenditures to be near the low end of our \$700 million to \$720 million range in 2025. Shifting now to

Q4. Looking at Q4, we expect revenue in the range of \$3.5 billion to \$3.59 billion. This represents a range of negative 3% to negative 1% relative to 2024. Including the 53rd week that we had in the fourth quarter of 2024, we expect revenue to grow 2% to 4%. We expect to open approximately 17 net new company-operated stores and complete 8 optimizations in Q4. We expect gross margin in Q4 to decrease approximately 580 basis points relative to Q4 2024. The decrease will be driven predominantly by the impact of increased tariffs and the removal of the de minimis exemption, deleverage on fixed costs and our ongoing investment in store growth and our multiyear distribution center project. The impact from tariffs and de minimis combined will be approximately 410 basis points. We expect markdowns to be 100 basis points higher than 2024. In Q4, we expect our SG&A; rate to deleverage by approximately 100 basis points relative to Q4 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 Q4, we expect deleverage of approximately 680 basis points with 410 basis points related to tariffs and de minimis. Turning to EPS. We expect earnings per share in the fourth quarter to be in the range of \$4.66 to \$4.76 versus EPS of \$6.14 a year ago. We expect our effective tax rate in Q4 to be approximately 30%. When looking at inventory, we expect units to increase in the high single digits in Q4, with dollar inventories up in the high teens due in large part to the impact of higher tariff rates and foreign exchange. As we look out to next year, we are planning inventory units below sales. Our aim is to increase full price penetration and utilize our chase capabilities to minimize markdown risk. And with that, I will turn it back over to Calvin.

Calvin McDonald: Thank you, Meghan. I want to conclude my remarks for this earnings call by expressing my deep appreciation to the leaders and teams across lululemon. I have so much confidence in what you all will achieve going forward. This has been an extraordinary experience for me over the past 7 years, and I look forward to supporting our leadership team over the coming months as we work to deliver for our shareholders, our guests and for each other in both the near and long term. With that, we'll open it up for questions.

Operator: [Operator Instructions] The first question comes from Matthew Boss with JPMorgan.

Matthew Boss: So in the U.S., could you speak to the cadence of demand that you saw in the third quarter, elaborate on trends quarter-to-date, maybe notably the slowing trend that you cited post Black Friday. And just larger picture, the time line that you see is reasonable for the product assortment to be fully optimized as we look to next year?

Meghan Frank: Thanks, Matt. I would say in terms of U.S. demand, the quarter progressed pretty much as we expected. We did come in line with our Q3 expectation. The best month was August, the softest month was October, but that was planned just based on some activities last year and did come in overall in line with expectation. In terms of quarter-to-date, we're really pleased and saw a strong Thanksgiving period result. We have seen some pullback in demand post Thanksgiving in terms of traffic. We've reflected that in our guidance. And then in terms of the longer picture, we are, as we mentioned, focused on activating the newness that we have in the assortment as we move into Q1. We'll start to see the benefits of that in Q1 in terms of getting our newness penetration up. And then we're also leaning into those activation pieces we mentioned in terms of ensuring we get eyeballs in terms of marketing on that newness in our assortment across all of our channels in terms of stores and e-com.

Matthew Boss: Great. And then, Meghan, just taking all that into account on the product assortment changes, are there any puts and takes for us to consider as we model operating margins relative to this year? Any reinvestments for us to think about maybe as it relates to your comments on experience and activating newness as you outlined as we think about next year?

Meghan Frank: Yes. There will be some puts and takes in terms of margin as we look into '26. And obviously, we'll offer more color as we get into March, see some initial results in response to our assortment. We will have a full year of increased tariffs and the removal of the de minimis provision, offset, obviously, by the actions the team is taking to mitigate those expenses, and we have been making some good progress there. We will need to layer in back some certain expenses we reduced in '25, including incentive comp. And we're going after, I would say, expense savings overall and looking for efficiencies across the business. Bottom line, I would say that the negative factors would outweigh the positives as we move into '26, but the team continues to work on the efficiency side, and we'll give

an update in March there.

Operator: The next question comes from Dana Telsey with Telsey Group.

Dana Telsey: As you think about the segment, how did the segment perform this quarter versus how you performed? And then as you think about the newness that's flowing in, which segments should we be seeing first, what are you thinking about bottoms, about tops, about men's and women's? Any more clarification on that? And what are you looking for in the new CEO? What are you looking for in the new leader as you move forward?

Calvin McDonald: Thanks, Dana. I'll take the first 2 parts of the question. In terms of the flow-through and what we've seen in the overall marketplace, we continue to see sort of pressure in the apparel space. We held share in premium athletic and lost some slight share in the performance apparel as we see guest behavior and trading down. From a newness perspective, I'm pleased with the innovation pipeline and what you've seen and we'll see this quarter in terms of some of the updates to franchises like Scuba, in lounge, BeCalm, Big Cosy, Loungeful are new introductions that are performing well and in performance, the Milemaker as well as Shake It Out. And as you know, as we head into spring, we're moving our new style penetration to 35%. That's going to be a balance of both innovation behind our performance active categories where we continue to see growth through Q3 as well as some other new items and new innovations across lifestyle. And we're going to be kicking off the year with the train campaign followed by some new introductions to some of our core franchises, including Scuba, Swiftly and ABC that the team is excited about.

Meghan Frank: And in terms -- Dana, in terms of the CEO, the search has begun. The Board intends to do a thorough process and really focused on a leader with experience in growth and transformation.

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

Adrienne Yih-Tennant: Yes. Calvin, thank you for all the hard work over the years and all the successful strategies in place going forward. I guess let me start with kind of the new product pipeline and the things that you'll be doing. How much of that new product has been sort of informed from primary research and from the customer directly? And then, Meghan, can you talk about kind of price increases, what you've done season to date and any additional price increases for spring? And you had mentioned kind of maintaining operating margins or supporting them at current levels for next year. Can you give us a little bit more color on what that entails? And best of luck, Calvin.

Calvin McDonald: Thank you, and thank for the best wishes. From a product innovation perspective, our process always begins with research, really focusing on solving for the unmet needs. And I believe the pipeline has a lot of those solutions, both across our activity as we continue to put our performance activity categories initiatives first across run, train, yoga, golf and tennis. You'll see a lot of innovation across all 5 of those activities in the yoga category as well we're kicking off, as I mentioned, train. And we have a new performance fabric that's specifically designed for weight training that we're excited for. And then there's the ongoing updates to our core franchises as we've addressed and looked and using data to really look at our high-value guests into our core franchises and opportunities to bring newness and refresh those swiftly, some updates, our ABC pants for him as well as building on the success of Waffle Scuba seeing opportunities to innovate. So the team definitely focuses and targets using both our own data of our guest behavior as well as research with our ambassadors and collective community as to where the opportunities are.

Meghan Frank: And in terms of pricing, we haven't taken any other further pricing actions relative to what we discussed last quarter. So we took a small amount of the assortment up modestly. We've been pleased with the price elasticity on those actions, I would say, in line with our expectations from a revenue and margin perspective. It's an area we continue to keep our eye on, closely monitoring where the competitive landscape goes, but no imminent plans to go further there. In terms of 2026 operating margin, it is fair to assume that the negatives will outweigh the positives. The margin push though will be a multiyear effort looking at efficiencies. It will be our first full year of tariffs, and we are looking for offsets. The team has been making some progress there. But I would assume we have some pressure next year, and we will be focused on it from a multiyear perspective.

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

Brooke Roach: Calvin, Meghan, I was hoping you could speak to the performance of your largest franchises, both in the performance category and in lounge and social. Are these businesses large

enough that you think that they warrant a reset in order to let the new product innovation shine and the new design language pop out to the consumer in a bigger way in '26 and beyond? And what proof points in the new design language are you currently seeing that gives you confidence that the new styles launching in '26 will change the trend rate that you're seeing in the U.S. today?

Calvin McDonald: Thanks, Brooke. In terms of the overall focus of the team, it's definitely balanced across our activity areas of run, train, yoga, golf and tennis, with some lifestyle. And when we look at the core franchises today, as I've shared, we continue to see growth across our performance activity categories. And we have innovation behind those categories as well as next year as that is definitely our leading strategy. So you'll see innovation in our bottom legging business. You'll see innovation across our top business, all geared towards these key activities and unmet needs of our athletes. And then on the lifestyle side, we continue to see growth in social, both on the back of the newness that we have brought in, Daydrift being a good example. And we have additional innovation next year in our men's bottom business, updating the ABC and bringing that silhouette as well for her that the team is excited about with some new fabric innovation. And then lounge, which has been our core franchises where we've seen the greatest headwind. We can see that updating Scuba with new materials and silhouette changes, we see great response. So the team is leaning and doing more of that as well in China, Mainland China, we activated it and saw great results. So we know even internationally, a lot of these core franchises, although in North America, they have more saturation internationally and globally, they don't yet. So it's a balance to make sure we continue to drive the growth there and then reinvent here in North America. And that really brings us to the overall balance and solution that the consumer is bringing. To your last point, Meghan mentioned, there's a lot of work going on in terms of in-store visual merchandising. We have some small tests going on in L.A., Miami, they are very much focused on exactly what you said, curating the stores, de-assorting, taking product out so that we could put focus on the newness and the guests can see that. And we're seeing very good results, and we're excited and plan to roll that out. That would be a key initiative so that our guests in the physical space can see the newness better than today. And online, with the launch of our new web design, the teams have a lot more levers than they've ever had before through guest navigation and storytelling to put the newness front and center in front of the guests. And there, we're already seeing good results as well in terms of the adoption and the visibility to the newness. We'll continue to play those levers into the next year as the new product comes.

Operator: Our next question comes from Lorraine Hutchinson with Bank of America.

Lorraine Maikis: I was hoping to hear more about the Amex partnership. Can you quantify the impact to sales and margins? And then talk about, if it attracted a new or reengaged guest in line with your expectations?

Calvin McDonald: Great. Thanks, Lorraine. I'll take the first -- or the second part of your question and then hand it over to Meghan. But from an expectation point of view, we've been pleased with it. We went in similar to some of these partnerships and initiatives we do, very much focused on guest acquisition and being able to grow both our men's guests as well as our female guest. And I would say on this partnership, although it's early, we're pleased with the results in the number of new guests that we've seen come through this partnership.

Meghan Frank: Yes. And I would say in terms of the numbers, it's a relatively small part -- exciting part, a small part of our business. We haven't broken out specifics. But I would say we're pleased overall with the profitability of the program. We do have a share in the credits, and that is a reduction to revenue.

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

Michael Binetti: Let me add my congrats, Calvin, to the next step. I think, Calvin, you did mention there are some signs of trade down in third quarter. I was just curious if you had any additional thoughts that you could share there and if that adds anything to your thoughts on using pricing as a lever for the mitigation efforts as we go forward. And then I guess as we look at the next year, I know you guys have been working on some of the multiyear DC projects for a while. I think there's a pretty big one in Canada that you've been working on for a long time that was scheduled to come online next year. There's been some questions about whether maybe that was originally intended to be used for some of the de minimis business. And I wonder if that's something you have to reposition on at this point or how

you're thinking about that distribution center.

Calvin McDonald: Thanks, Michael, and thanks for the best wishes. I'll take the first part. Meghan will take the DC network configuration. And in terms of the -- sorry -- yes, sorry, in terms of trading down, we've seen a bit of that behavior throughout the year. I've talked about the uncertain behavior of the consumer we're seeing. We're seeing a little bit in terms of how they're responding to the promotional activity in the marketplace today, and they're definitely looking for ways in which they can save in value. And it's behavior we've seen throughout the year and continued into Q3.

Meghan Frank: And I would say in terms of pricing, we've been really strategic with the pricing moves we've made. As I mentioned, we're pleased with that -- with the elasticities we've seen and are in line with our expectations from a sales and margin perspective. So I don't see any concern there related to what Calvin just mentioned. And again, we'll take that same stance as we move forward on an item-by-item basis. In terms of the DCs, I would say, given the news on de minimis, the team is deep in the work on evaluating the network. I don't think it means we won't have a presence in Canada, but I do think it means some changes to our DC network, and we will make sure we're as most efficient as possible. I think we can share more as we move into '26 and the team is further along in that work stream.

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

Paul Lejuez: Curious if you could talk a little bit more about the China business, what you saw in e-comm performance versus stores. And also curious how you would characterize the athletic apparel market in China in general? And if there are any big differences by city tiers?

Calvin McDonald: Thanks, Paul. In terms of the performance of our business in China, and obviously, as the results indicate, we continue to see very good momentum, very pleased with the overall results. There were a couple of timing opportunities and shifts to platform activations that helped us in the quarter. But on those, when we activate, we show up as a brand with the least amount of discounting. We actually have a large number of reg sales as a percentage of our business. We were able to use that event to activate Scuba. And as you know, we also have a lower outlet to store ratio, and we use these channels as a means to exit some of our markdown products. So those levers and that mix works well for that market. And obviously, we were really pleased with the overall results. We also saw very good success to our outerwear business, which is a very key important category within that market. And we continue to see guests respond very well to both existing Wunder Puff and styles as well as our new innovation, the Featherweight and other styles and silhouettes that we bring out. Overall, we're definitely gaining share, gaining momentum in that marketplace, and the team there is executing very well. And we're seeing success across all tier cities. And we definitely, as we enter into the Tier 2, Tier 3 deeper, see the business and the brand continue to resonate and perform well.

Operator: The next question comes from Brian Nagel with Oppenheimer.

Brian Nagel: First off, Calvin, best of luck. It's been a pleasure working with you.

Calvin McDonald: Thanks, Brian.

Brian Nagel: So with the leadership change, we've been talking for a while now about product refreshes and particularly a lot of new products set to hit in early '26. So I guess I want a 2-part question. I mean, does the leadership change, change the timing or any aspects of those product launches? And then I guess the follow-up, and I think this may be a bit of a follow-up, but I mean, what are you seeing now as far as consumer reception to the new products you have introduced? Are you -- is there a marked difference in how the consumer is reacting to those products versus some of your legacy items?

Calvin McDonald: Great. Thanks, Brian. In terms of the team and confidence in the work that they've been working on for the past year, there's no change, and this shouldn't be perceived in terms of any lack of excitement and work that, that team has been creating. As I shared, I think, early on, the first season spring when I go back from -- to spring of this year, and we had all our regional teams in, the energy in the room was contagious and exciting. There is enthusiasm for the newness that's coming and shifting that mix to 35%. And there's work the team still has to do as we work and offset the life cycle of some of our core franchises. And that's the work they will continue to be in and have been in as the year progresses from season to season. And relative to the newness, no change. We continue to see newness, what we believe to be future core items drive outsized growth in the U.S. and we're seeing our high-value guests as well as all of our guests respond and react well to those. And we know

as a mix that is increasing next year, and that's just not the existing styles, but it's more styles to come. So overall, the batting average on the newness is very good, and the guest response is very strong, encouraging, pleased with that and encouraged that we have more of that as a composition of our mix moving forward. And the teams are focused on the areas where they're going to continue to offset where we see some of the headwinds.

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

Jay Sole: My question is on the co-CEO structure that exists now. Calvin, given your transition and Celeste transition, who is design reporting to, who is merchandise reporting to, who's ultimately going to make the final decision on what happens in terms of product and what gets made and what goes into the stores?

Calvin McDonald: Thanks, Jay. First of all, it's a very strong leadership team that I have huge confidence in. And in terms of the co-CEO structure, Andre taking on the Chief Commercial Officer role and being able to provide his leadership globally to our markets and to our GMs will really continue in that capacity and excited to have him work with Carla and the North American team and bring new perspective and new insights and sharing from some of the other global markets where we've seen momentum and success. And the other team members will report to Meghan through the search process. So product, both merchandising and design will report into Meghan as well as brand. And we've operated as a team of peers and challenging each other. And I expect and know that, that will continue to be the dynamics and look forward to how they continue to drive the business forward. What I would want to just remind you of is the dates. A lot of the decisions around design, product merchandising, the team has made, in particular, through the first half of next year. The teams are just completing the winter buy for '26. So the work has happened and a lot of that foundation is in place as the search occurs. So I think the team will work and execute the plans to the action plan that Meghan laid out, both on how to activate and leverage a lot of the test and learn initiatives that are underway. But a lot of the solid plans are in place to create the inflection that I know they've been working towards.

Operator: The next question comes from Janine Stichter with BTIG.

Janine Hoffman Stichter: Good luck to you, Calvin. A question for Meghan, just on the puts and takes as we think about margins next year. Can you speak to how you're thinking about markdowns? They came in a little bit higher than expected in Q3. It looks like they step up a bit in Q4. Maybe talk about what you saw there. And then as you talk about aiming to increase full price penetration next year, just speak to your confidence in that? And is that more of something that we would see in the back half? Or could we see that as early as the first half?

Meghan Frank: Thanks, Janine. So this year, as you know, sales haven't met our expectations, and therefore, we have more seasonal inventory that we're clearing through, and that's reflected in our markdown expectations. As we started planning next year, we are taking a more conservative posture on inventory. We will manage inventory units below our sales plans in an effort to mitigate markdown exposure and use those chase capabilities I described to chase the trend on the upside. I would expect and we're planning for that dynamic to start in Q1. That said, we have multiple scenarios if the trend ends up being different than we think. But we are definitely taking, I would say, a more conservative prudent posture in terms of inventory management.

Operator: The next question comes from Mark Altschwager with Baird.

Mark Altschwager: Calvin, best wishes for your next chapter. My question is for Meghan. I just was hoping we could zoom in specifically on the tariff de minimis piece. Last quarter, you gave us some dollar figures for gross and net this year and next year. It sounds like you're making some progress. I guess where are you seeing the progress? And would you be willing to share some updated figures on how you're thinking about the gross net impact both this year and next year?

Meghan Frank: Yes. Thanks, Mark. So we -- our outlook has improved this year in terms of tariffs. So we had 220 basis points of pressure on an annual basis in our last guidance. We've updated that to \$190 million. It's about \$210 million net impact. When we think about next year, we offered a \$320 million number. We're not giving a specific number update there. As I mentioned, we are making progress. I would say some of the areas we're working on still are in the vendor negotiation space as well as our DC network and inventory placement to offset some of those costs as well as just efficiencies across the business. There will be some puts and takes in terms of next year's operating

margin that we went through, and we're really focused on inflecting the business. So we'll give you more of an update there in March in terms of our operating margin perspective for next year.

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