



Tapasya

SEPTEMBER 8, 2024

TAPASYA INVESTMENT FUND I

GLOBAL INVESTMENT REVIEW - IX

INTRODUCTION

Welcome to the **9th edition** of the “**Global Investment Review**”. This document aims to elaborate on the investment thesis of companies in which we have made investments.

The focus of this document will be

- 1) Lululemon (LULU)
- 2) Skills of Stock Picking

In this edition, we will explore our latest addition to the portfolio: Lululemon (LULU), a leading athleisure company that sells athletic apparel, footwear, and accessories.

I believe this company has the potential to be a long-term compounder. It has experienced some significant corrections due to some missteps, making it available at a discount, provided these missteps are not repeated.

Additionally, I use this document to share my thoughts on various aspects of investing with my investors.

Recently, I came across a presentation by [Ian Cassel](#) on “**Skills of Stock Picking**.” It's an excellent presentation that you can find at this [\(link\)](#). I have combined some of the lessons from this presentation with teachings from world-renowned Jiu Jitsu coach John Danaher.

To me, John is like Charlie Munger; he breaks down problems into steps or employs Munger-like mental models. For context, John has a Ph.D. in Philosophy from Columbia University.

I believe John has some great lessons and mental models. I thought of combining the lessons from Ian's presentation and John's teachings, which were initially in the context of fighting but equally applicable to investing, in my view.

LULULEMON (LULU)

Lululemon Athletica Inc., together with its subsidiaries, designs, distributes, and retails athletic apparel, footwear, and accessories under the lululemon brand for women and men. It offers pants, shorts, tops, and jackets for healthy lifestyle, such as yoga, running, training, and other activities. It also provides fitness-inspired accessories. The company sells its products through a chain of company-operated stores; outlets; interactive workout platform; yoga and fitness studios, university campus retailers, and other partners; license and supply arrangements; and temporary locations, as well as through mobile apps and lululemon.com e-commerce website.

It has operations in the United States, Canada, Mainland China, Australia, South Korea, Hong Kong, Japan, New Zealand, Taiwan, Singapore, Malaysia, Macau, Thailand, the Asia Pacific, the United Kingdom, Germany, France, Ireland, Spain, the Netherlands, Sweden, Norway, Switzerland, Europe, the Middle East, and Africa. Lululemon Athletica Inc. was founded in 1998 and is based in Vancouver, Canada.

FINANCIALS

Income Statement TIKR.com	1/31/16	1/29/17	1/28/18	2/3/19	2/2/20	1/31/21	1/30/22	1/29/23	1/28/24	LTM
Revenues ☉	2,060.52	2,344.39	2,649.18	3,288.32	3,979.30	4,401.88	6,256.62	8,110.52	9,619.28	9,827.38
Total Revenues	2,060.52	2,344.39	2,649.18	3,288.32	3,979.30	4,401.88	6,256.62	8,110.52	9,619.28	9,827.38
% Change YoY ☉	14.7%	13.8%	13.0%	24.1%	21.0%	10.6%	42.1%	29.6%	18.6%	
Cost of Goods Sold ☉	(1,063.36)	(1,144.78)	(1,241.69)	(1,472.03)	(1,755.91)	(1,937.89)	(2,648.05)	(3,618.18)	(4,009.87)	(4,093.71)
Gross Profit ☉	997.17	1,199.62	1,407.49	1,816.29	2,223.39	2,463.99	3,608.57	4,492.34	5,609.41	5,733.67
% Change YoY ☉	9.1%	20.3%	17.3%	29.0%	22.4%	10.8%	46.5%	24.5%	24.9%	
% Gross Margins ☉	48.4%	51.2%	53.1%	55.2%	55.9%	56.0%	57.7%	55.4%	58.3%	58.3%

Revenue Growth:

- The company has demonstrated consistent revenue growth over the years.
- The most recent LTM period shows revenues at ~\$9,827, indicating a 16.6% growth year-over-year. Q2' 24 was soft at +7%.
- Earlier periods also saw significant YoY growth, with some periods exceeding 20%.

Gross Profit & Margins:

- Gross profit has also increased alongside revenues.
- LTM gross profit stands at ~\$5,733.

- Gross margins have generally improved over time, reaching 58.3% in the LTM period. This indicates the company is becoming more efficient at managing its cost of goods sold relative to its revenue.

Balance Sheet: Some Key Takeaways

- Strong Financial Position:** Lululemon's balance sheet indicates a healthy and growing company with strong liquidity and solvency.
- Profitable Growth:** Increasing retained earnings and equity demonstrate the company's ability to generate profits and reinvest for future growth.
- Debt Management:** Successful transition to net cash position highlights prudent financial management.
- Shareholder Value:** Decreasing shares outstanding indicates the management's focus on creating shareholder value.

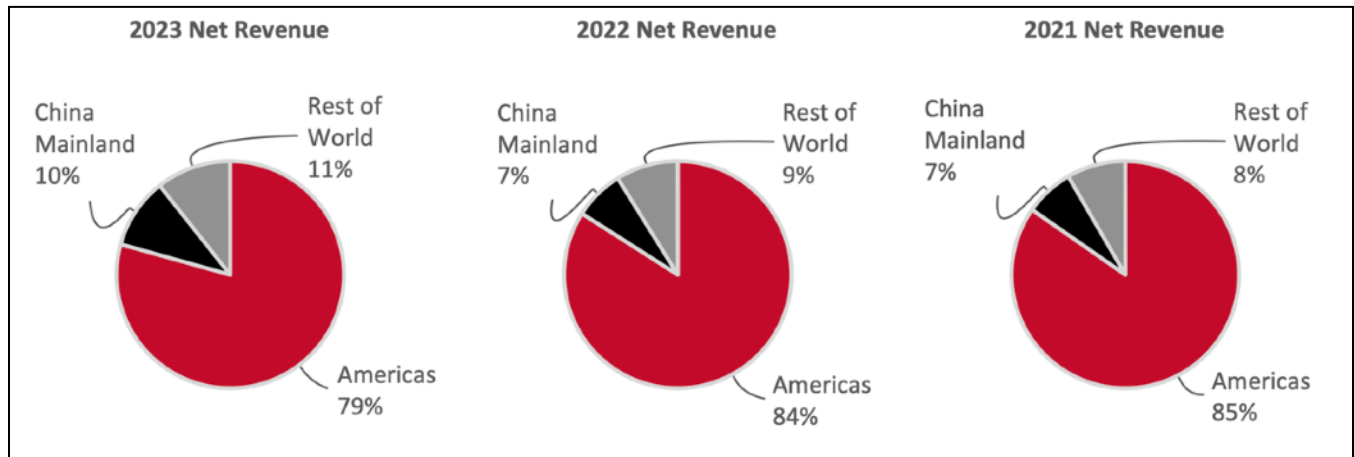
Ratios TIKR.com	1/31/16	1/29/17	1/28/18	2/3/19	2/2/20	1/31/21	1/30/22	1/29/23	1/28/24	LTM
Return Ratios:										
Return on Assets % ⓘ	17.1%	18.1%	17.0%	21.6%	20.7%	13.6%	18.8%	20.5%	21.7%	22.6%
Return on Capital % ⓘ	34.4%	31.4%	31.0%	48.3%	32.5%	23.8%	37.4%	40.4%	39.0%	39.6%
Return On Equity % ⓘ	25.1%	25.4%	17.5%	31.8%	38.0%	26.1%	36.8%	29.0%	42.0%	41.9%
Return on Common Equity % ⓘ	25.1%	25.4%	17.5%	31.8%	38.0%	26.1%	36.8%	29.0%	42.0%	41.9%

- Strong Profitability:** Lululemon has consistently demonstrated robust profitability across all the return ratios.
- Return on Assets (ROA):** The ROA has generally trended upwards, reaching 22.6% in the LTM period. This signifies Lululemon's efficiency in generating profits from its assets.
- Return on Capital (ROC):** Similar to ROA, ROC has also shown an upward trend, with the LTM period at 39.6%. This indicates the company is effectively utilizing its capital to generate earnings.
- Return on Equity (ROE) and Return on Common Equity:** These metrics have also seen growth, with the LTM period at 41.9%. This signifies that Lululemon is generating substantial returns for its shareholders.

They continue to expand in terms of store footprint in USA and also internationally.

Number of company-operated stores by market	January 28, 2024	January 29, 2023
United States	367	350
Canada	71	69
Americas	438	419
China Mainland	127	99
Australia	33	32
South Korea	19	16
Hong Kong SAR	9	9
Japan	8	7
New Zealand	8	8
Taiwan	8	7
Singapore	7	8
Malaysia	3	2
Macau SAR	2	2
Thailand	1	—
APAC	98	91
United Kingdom	20	20
Germany	9	10
France	6	4
Ireland	4	4
Spain	3	3
Netherlands	2	1
Sweden	2	2
Norway	1	1
Switzerland	1	1
EMEA	48	46
Total company-operated stores	711	655

Correspondingly their international revenues represented as China and Rest of World has expanded over the past few years.



Source: 10K 2023

The stores have experienced increased productivity, with sales per square foot consistently improving. In 2021, the sales were \$1443, which rose to \$1609 in 2023.

Despite the growth, the company faced significant share price erosion in 2024. After a sustained period of growth, the share price dropped by approximately 50%.

Several factors contributed to this decline, primarily missteps in assortment. The company encountered customer complaints about the "Breezethrough" assortment, leading to its withdrawal. Additionally, there were issues with "newness" in the women's category, involving seasonal updates related to color, prints, patterns, and silhouettes.

Slower growth rates also played a role, which is likely a reversion to the mean. During the COVID-19 pandemic, the athleisure category experienced significant growth due to work-from-home arrangements and the casualization of office wear.

Despite these challenges, the business continues to grow. With efficient capital deployment, the company has a promising long-term outlook.

Several factors make this company appealing, including its strong brand, international growth potential, and relatively inexpensive valuation. The purchase was made at \$240 levels, resulting in a Free Cash Flow yield of over 5%, comparable to short-term T-Bills with the added benefit of FCF growth in the future.

Confidence in the investment is high, with the expectation of continued business growth and the avoidance of repetitive missteps in assortment. Some missteps are anticipated given the company's operation in the fashion-athleisure category.

Brand recognition is crucial for success in this sector. Any changes or dilution to the brand, such as selling products at mass merchandisers like Walmart or Target, could prompt a sale of the position.

Risks

Retail is a highly competitive business and there are some key risks one needs to consider

- **Competition:** Operating within a challenging retail category, Lululemon must contend not only with established global brands like Nike but also with emerging (unlisted) startups such as ALO and Vuori.
- **Consumer Preference & Trends:** The shift towards casual office attire during the COVID-19 pandemic has benefited athleisure brands like Lululemon. However, any significant changes in consumer preferences and trends could have negative impacts on the company's performance.
- **Assortment Issues:** Given the nature of its business, Lululemon must constantly introduce new products to its assortment. This process inherently involves some risk, as not all new products may resonate with customers, potentially affecting both revenue and margins in specific quarters.
- **International Expansion:** While international expansion represents a significant growth opportunity for Lululemon, the company must focus on building brand awareness and creating the same level of excitement it has achieved in the Americas.

SKILLS OF STOCK PICKING

As mentioned in the introduction, the article combines Ian Cassel's presentation on stock picking skills with John Danaher's hypothetical response to the question of who would win a fight between a gorilla, a lion, and a bear on the Lex Fridman podcast.

John, a renowned Jiu-Jitsu coach and a Charlie Munger-like thinker, employs mental models to analyze problems. He holds a doctorate in psychology from Columbia University.

The article focuses on the hypothetical fight, which is recommended for readers to watch or listen to. John provided a detailed 37-minute answer, demonstrating his preparedness through constant reading. He presented facts about the animals, showcasing his problem-solving skills and mental model.

John emphasizes the importance of skepticism in initial intuitions, as they can be misleading. He highlights the gorilla's strength, bite force, and intelligence, making it the initial favorite among those aware of its attributes.

This discussion leads to Howard Marks' concept of Second Level Thinking, a valuable principle in investing.

John breaks the problem down into smaller, crucial components. He identifies key elements determining ultimate success, including skills, attributes, experience, and elements such as the ability to assess conditions, ambush, surprise attacks, and disengage from unfavorable situations.

I have then made the transitions from animal or human fighting to the realm of investing. I believe that this problem-breaking approach can be applied to understand the key to successful investing.

SKILLS



Skills are abilities that can be developed and improved over time. To become a top investor, regardless of your investing style, you must excel in at least one of the following skills while also possessing proficiency in the others. Any skill deficiency or lack of mastery can significantly hinder your chances of achieving exceptional results.

Identifying: This involves finding actionable investment ideas before others. Research, networking with friends and other investors, and staying informed can all contribute to identifying potential opportunities. The key is not just to blindly copy ideas but to develop conviction in your own decisions.

Valuation: Determining the intrinsic value of a company involves estimating the amount of cash it can generate between now and the future, discounted to its current value (Discounted Cash Flow). While precision is not essential, the valuation should be in the vicinity of what the company is likely to deliver. The market often recognizes intrinsic value over time, despite temporary dislocations.

Buying: This skill revolves around sizing your conviction. It is crucial to find the right balance between conviction and risk. Buying too small a position in a high-conviction, low-risk stock can be as detrimental as buying a large position in a high-risk company. This is because a 1x loss can offset potential 4x-5x gains.

Holding: Patience and constant monitoring are essential for successful investing. You must assess whether the company's performance aligns with your expectations. This is

often where multi-bagger returns are generated. The challenge, particularly for 10x baggers, is resisting the temptation to sell when the stock doubles in value.

Selling: There are valid reasons to sell a stock, such as excessive price appreciation or the discovery of a more promising investment opportunity. Selling may also be considered if the company's performance deviates from your expectations or if there are concerns about management trustworthiness. In cases of suspected fraud, immediate selling is warranted.

Survival: This skill is crucial for long-term success in investing. After years of dealing with market downturns and mistakes, investors may become risk-averse. As Howard Marks observed, there are old investors and bold investors, but there are no old and bold investors. Markets tend to erode boldness over time. The key to survival is to maintain a hunger for success and avoid complacency or slowing down.

ATTRIBUTES OF INVESTING

Unlike skills that can be acquired and developed over time, attributes are largely inherent or shaped by our upbringing during our formative years.

Curiosity

Temperament

Patience

Curiosity: A natural curiosity is necessary to understand not only businesses but also patterns. This ability includes correlating recent developments with historical occurrences within and outside the relevant industry. The capacity to continually ask 'why' and seek the truth is crucial, as we often tend to cling to our existing beliefs. Confirmation bias, a common human tendency, leads us to seek information that reinforces our prior beliefs.

Temperament : The emotional and psychological makeup of an individual plays a vital role in investing. According to Warren Buffett, temperament is even more important than

intelligence. The ideal temperament for investing involves neither deriving excessive pleasure from being with or against the crowd nor treating wins and losses differently. Humans naturally seek comfort in being part of a group, a survival strategy that has ensured our existence for centuries.

Patience : Long-term investing often involves extended periods of waiting (patience) interspersed with bursts of significant action. This attribute is challenging because humans are driven to take action. Inactivity is sometimes perceived as a lack of success, but this is definitely not the case in investing.

EXPERIENCE

Experience is the practical application of one's skills and attributes in the real world. Unlike gorillas, which have impressive strength and lifting abilities, lions and bears are designed for combat. Male lions engage in fights to the death, and the victor eliminates the offspring of the defeated male. The stakes are high.

This is where experience matters. The ability to handle market fluctuations with composure and turn them into an advantage can be a significant differentiator.

Gaining experience requires time and real-life exposure. Reading books can enhance decision-making skills by simulating successful strategies in similar situations, but it cannot replace hands-on experience.

ELEMENTS

Accurately assessing the market's overall state, the available opportunities, and other factors is crucial for successful investing. Although predicting the future is challenging, being able to assess the current state is essential for being a good investor. For example, with current and historical data, investors can determine if the market exhibits euphoria or manic depression, similar to a lion using the elements to create an element of surprise while attacking.

Aggressive buying in years like 2002, 2009, and 2022, or scouting for deals elsewhere, can be strategic moves. Charlie Munger's popularized quote, "Fish where the fish are," accurately reflects investing. Investors should not limit themselves to local markets but expand their horizons globally. Unloved and un-investable ideas, as often projected by the media, may present excellent opportunities if analyzed carefully.

Investing is a continuous journey of learning, primarily involving mental and behavioral aspects, allowing motivated individuals to remain in the arena for an extended period if desired.

CONCLUSION

"I remain open to any feedback you may have on this document and encourage you to contact me via email or phone if you have questions.

It's important to remember that we're all part of this journey together. Our collective focus on the long term, combined with my expertise in capital allocation, will be our greatest asset."

APPENDIX

In writing this document, I have referenced several sources for inspiration. First and foremost, I would like to acknowledge Nick Sleep and Qais Zakaria of Nomad Investment Partnership. Their regular provision of documentation to their investors greatly influenced my investment philosophy and fund management approach. Unfortunately, Nomad closed in early 2014, leaving a void in the industry. However, I would have welcomed the competition had they still been active.

In addition to Nomad, I have utilized various tools and websites. These include videos by Ian Cassel, Lex Fridman, and John Danaher, as well as the analytical tool TIKR for analyzing financial metrics. I have also consulted Value Investor Club's YouTube videos, Gemini, Google, and the LULU Investor Relations website.

Thank you for taking the time to read this document. As always, if you have any questions, please do not hesitate to contact me.

Sincerely,

Pratik Kodial