LUNA INNOVATIONS INC
Form DEF 14A
April 09, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

SCHEDULE 14A
(Rule 14a-101)
INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION
Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934

Filed by the Registrant ý Filed by a Party other than the Registrant ¨
Check the appropriate box:
¨ Preliminary Proxy Statement

¨ Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

ý Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to § 240.14a-12
LUNA INNOVATIONS INCORPORATED
(Name of Registrant as Specified in its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)
Payment of Filing Fee (Check the appropriate box):
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(3) Filing Party:

(4) Date Filed:

301 1st Street SW, Suite 200
Roanoke, Virginia 24011

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD ON MAY 14, 2019

To the Stockholders of Luna Innovations Incorporated:

Notice is hereby given that the Annual Meeting of Stockholders of Luna Innovations Incorporated (the "Company") will be held at The Hotel Roanoke & Conference Center, 110 Shenandoah Avenue, Roanoke, Virginia 24016 on Tuesday, May 14, 2019, at 9:00 a.m. EDT for the following purposes:

1. To elect the board's two nominees named herein to serve as Class I members of the Company's board of directors to hold office until the 2022 annual meeting of stockholders.
2. To approve, on an advisory basis, the compensation of the Company's named executive officers, as disclosed in this proxy statement.
3. To indicate, on an advisory basis, the preferred frequency of stockholder advisory votes on the compensation of the Company's named executive officers.
4. To ratify the appointment, by the Audit Committee of the Company's board of directors, of Grant Thornton LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2019.
5. To transact any other business that is properly brought before the meeting or any adjournment or postponement thereof.

Please refer to the attached proxy statement, which forms a part of this Notice and is incorporated herein by reference, for further information with respect to the business to be transacted at the annual meeting.

Stockholders of record at the close of business on April 1, 2019 (the "Record Date") are entitled to notice of, and to vote at, the annual meeting or any adjournment or postponement thereof. The presence, in person or by proxy, of shares of the Company's common stock representing a majority of shares of the Company's common stock issued and outstanding on the Record Date will be required to establish a quorum at the annual meeting.

Your vote is important. Please sign, date and return the enclosed proxy card as soon as possible, or vote by telephone or on the Internet as instructed in these materials, to make sure that your shares are represented at the annual meeting. If you are a stockholder of record of the Company's common stock, you may cast your vote by proxy or in person at the annual meeting. If your shares are held of record by a brokerage firm, bank or other nominee, you must obtain a proxy issued in your name from that record holder and should instruct the record holder as to how to vote your shares.

By Order of the Board of Directors,

/s/ Scott A. Graeff
Scott A. Graeff
President, Chief Executive Officer, Treasurer and Secretary
Roanoke, Virginia
April 9, 2019

You are cordially invited to attend the annual meeting. Whether or not you plan to attend in person, please complete, sign, date and return the accompanying proxy card in the enclosed envelope, or vote by telephone or on the Internet as instructed in these materials, as promptly as possible in order to ensure your representation at the meeting. Even if you have voted by proxy, you may still vote in person if you attend the meeting.

Important Notice Regarding the Availability of Proxy Materials for the Meeting of Stockholders to be held on May 14, 2019: The Proxy Statement and Annual Report to Stockholders are available at https://materials.proxyvote.com/550351.

LUNA INNOVATIONS INCORPORATED

PROXY STATEMENT
FOR
ANNUAL MEETING OF STOCKHOLDERS
MAY 14, 2019

INFORMATION CONCERNING SOLICITATION AND VOTING

General

This proxy statement is furnished to the stockholders of Luna Innovations Incorporated (the “Company,” “we,” “us,” or “our”) in connection with the solicitation of proxies for use at our annual meeting of stockholders to be held on May 14, 2019 at 9:00 a.m. EDT at The Hotel Roanoke & Conference Center, 110 Shenandoah Avenue, Roanoke, Virginia 24016 for the purposes set forth in the accompanying “Notice of Annual Meeting of Stockholders.” Directions to the annual meeting may be found at http://www.hotelroanoke.com/southwest_va_hotel/directions/. Information on how to vote in person at the annual meeting is discussed below.

A copy of our Annual Report to Stockholders, which includes our annual report on Form 10-K for the year ended December 31, 2018 filed with the Securities and Exchange Commission, together with this proxy statement and accompanying proxy card, is expected to be mailed on or about April 9, 2019 to our stockholders of record as of the close of business on the Record Date. Those materials are also available at https://materials.proxyvote.com/550351.

This solicitation is made on behalf of our board of directors, and we will pay the costs of solicitation. We will reimburse banks, brokerage firms and other custodians, nominees and fiduciaries for reasonable expenses incurred by them in sending our proxy material to our stockholders. Our principal executive offices are located at 301 1st Street SW, Suite 200, Roanoke, Virginia 24011, and our telephone number is (540) 769-8400.

Shares Entitled to Vote and Quorum Requirement

Our outstanding common stock constitutes the only class of securities entitled to vote at the annual meeting. Stockholders of record of our common stock at the close of business on the Record Date are entitled to notice of, and to vote at, our 2019 annual meeting of stockholders. A list of our stockholders will be available for review at our principal executive offices during regular business hours for a period of ten days prior to the annual meeting. As of the close of business on April 1, 2019, 29,378,703 shares of our common stock were issued and 28,125,593 shares of our common stock were outstanding; therefore, the presence at the meeting, in person or by proxy, of at least 14,062,768 shares of common stock will constitute a quorum. Each share of common stock owned as of the Record Date is entitled to one vote. If there is no quorum, holders of a majority of shares present at the meeting in person or represented by proxy may adjourn the meeting to another date.

Voting Procedures

The procedures for voting differ depending on whether you are a stockholder of record (that is, if your shares are registered directly in your own name with the Company’s transfer agent) or you hold your shares in “street name” (that is, your shares are held in an account at a brokerage, bank, dealer or other similar organization rather than in your own name, in which case you are considered to be the “beneficial owner” of those shares).

Stockholders of Record

Stockholders of record may vote by (i) completing and returning the enclosed proxy card prior to the meeting, (ii) voting over the telephone, (iii) voting on the Internet, (iv) voting in person by ballot at the meeting, or (v) submitting a signed proxy card at the meeting.

A proxy card is enclosed for your use. We ask that you carefully review, complete, sign, date and return the proxy card in the accompanying envelope, which is postage prepaid if mailed in the United States.

Instead of submitting your vote in person or by mail, you may vote by telephone or over the Internet. In order to vote by telephone or over the Internet, please have the enclosed proxy card available for reference, and call the number or visit the website listed on the proxy card and follow the instructions. You will be asked to provide the company number and control number from the enclosed proxy card. Your vote must be received by 11:59 p.m., EDT on

Monday, May 13, 2019 to be

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counted. The telephone and Internet voting procedures are designed to authenticate stockholders' identities, to allow stockholders to give their voting instructions and to confirm that stockholders' instructions have been recorded properly.

If you are a stockholder of record and do not vote by completing your proxy card, by telephone, by mail, over the Internet or in person at the annual meeting, your shares will not be voted.

Beneficial Owners

If your shares are held in street name, the organization holding your account is considered to be the stockholder of record for purposes of voting at the annual meeting. If you are a beneficial owner of shares registered in the name of your broker, bank, or other agent, you should have received a voting instruction form with these proxy materials from that organization rather than from the Company. As a beneficial owner, you still have the right to direct your broker or other agent regarding how to vote the shares in your account. Simply complete and mail the voting instruction form to ensure that your vote is counted. Alternatively, you may vote by telephone or over the Internet as instructed by your broker or bank.

You are also invited to attend the annual meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the meeting unless you request and obtain a valid proxy from your broker or other agent. Follow the instructions from your broker or bank included with these proxy materials, or contact your broker or bank to request a proxy form.

If you are a beneficial owner and do not instruct your broker, bank, or other agent how to vote your shares, the question of whether your broker or nominee will still be able to vote your shares depends on whether the New York Stock Exchange ("NYSE"), deems the particular proposal to be a "routine" matter. Even though our common stock is listed on the Nasdaq Capital Market, the NYSE rules apply to brokers who are NYSE members voting on matters being submitted to stockholders at our annual meeting. Brokers and nominees can use their discretion to vote "uninstructed" shares with respect to matters that are considered to be "routine," but not with respect to "non-routine" matters. Under the rules and interpretations of the NYSE, "non-routine" matters are matters that may substantially affect the rights or privileges of stockholders, such as mergers, stockholder proposals, elections of directors (even if not contested), executive compensation and certain corporate governance proposals, even if supported by management. Accordingly, your broker or nominee may not vote your shares on Proposals No. 1, No. 2 or No. 3 without your instructions, but may vote your shares on Proposal No. 4.

We provide Internet proxy voting to allow you to vote your shares online, with procedures designed to ensure the authenticity and correctness of your proxy vote instructions. There is no cost associated with casting your vote online. However, please be aware that you must bear any costs associated with your Internet access, such as usage charges from Internet access providers and telephone companies.

The persons named as attorneys-in-fact to vote the proxies, Scott A. Graeff and Dale E. Messick, were selected by the board of directors and are executive officers of the Company. All properly executed proxies returned in time to be counted at the annual meeting will be voted.

If you return a signed and dated proxy card without marking voting selections, then unless there are different instructions on the proxy card, your shares will be voted at the meeting FOR the election of the two director nominees listed in Proposal No. 1, FOR the advisory approval of executive compensation in Proposal No. 2, for One Year as the preferred frequency of advisory votes to approve executive compensation in Proposal No. 3 and FOR the ratification of the appointment of our independent registered public accounting firm in Proposal No. 4. With respect to any other business that may properly come before the annual meeting and be submitted to a vote of stockholders, proxies will be voted in accordance with the best judgment of the designated proxy holders.

All votes cast at the annual meeting will be tabulated by the person or persons appointed by our board of directors to act as inspectors of election for the meeting. The inspectors of election will separately count, for Proposal No. 1, the election of directors, votes "For," "Withhold" and "broker non-votes," with respect to the proposal regarding frequency of stockholder advisory votes to approve executive compensation, votes for frequencies of one year, two years or three years, abstentions and broker non-votes, and with respect to other proposals, votes "For" and "Against," abstentions and "broker non-votes." Broker non-votes occur when a beneficial owner of shares held in "street name" does not give instructions to the broker or nominee holding the shares as to how to vote on matters deemed "non-routine," in which case the broker or nominee cannot vote the shares, as described above.

Abstentions and broker non-votes will be counted as shares that are present and entitled to vote for purposes of determining the presence of a quorum. Abstentions will be counted towards the vote total for each of Proposals No. 2 and 4 and will have the same effect as "Against" votes. For Proposal No. 3, abstentions will have no effect and will not be counted towards the vote total. Broker non-votes have no effect and are not included in the tabulation of voting results on any proposals.

The director nominees listed in Proposal No. 1 will be elected by a plurality of the votes of the shares present or represented by proxy at the meeting and entitled to vote on the election of directors. The two nominees receiving the most “For” votes will be elected.

Proposal No. 2, advisory approval of the compensation of the Company’s named executive officers, will be considered to be approved if it receives “For” votes from the holders of a majority of shares either present in person or represented by proxy and entitled to vote.

For Proposal No. 3, the advisory vote on the frequency of stockholder advisory votes on executive compensation, the frequency receiving the highest number of votes from the holders of shares present in person or represented by proxy and entitled to vote at the annual meeting will be considered the frequency preferred by the stockholders.

The appointment of our independent registered public accounting firm listed in Proposal No. 4 will be ratified if a majority of shares present or represented by proxy at the meeting and entitled to vote thereon vote “For” such proposal.

Your vote is important. Accordingly, please carefully review, complete, sign, date and return the enclosed proxy card, or vote over the telephone or Internet, whether or not you plan to attend the annual meeting in person.

If you receive more than one set of proxy materials, your shares may be registered in more than one name or in different accounts. Please follow the voting instructions on the proxy cards in the proxy materials to ensure that all of your shares are voted.

Changing Your Vote

If you are a stockholder of record, you may revoke your proxy at any time before it is actually voted at the meeting either by signing and submitting a new proxy card with a later date or by attending the annual meeting and voting in person. You may also grant a subsequent proxy by telephone or over the Internet. Your most recently submitted proxy card or telephone or Internet proxy is the one that will be counted. Merely attending the meeting, however, will not revoke your submitted proxy unless you vote at the meeting, which will have the effect of revoking your proxy. You may also send a timely written notice that you are revoking your proxy to our Corporate Secretary at 301 1st Street SW, Suite 200, Roanoke, Virginia 24011.

If you hold shares through a bank or brokerage firm, you should have received a proxy card and voting instructions with these proxy materials, and you must contact the bank or brokerage firm directly to revoke any prior voting instructions.

Results of Voting

Preliminary voting results will be announced at the annual meeting. In addition, final voting results will be published in a current report on Form 8-K that we expect to file within four business days after the annual meeting. If final voting results are not available to us in time to file a Form 8-K within four business days after the annual meeting, we intend to file a Form 8-K to publish preliminary results and, within four business days after the final results are known to us, file an additional Form 8-K to publish the final results.

PROPOSAL NO. 1
ELECTION OF DIRECTORS
General Information
Our board of directors is divided into three classes (Class I, Class II and Class III) with staggered three-year terms. Each class consists, as nearly as possible, of one-third of the total number of directors. Vacancies on the board of directors may be filled only by persons elected by a majority of the remaining directors. A director elected by the board of directors to fill a vacancy in a class, including vacancies created by an increase in the number of directors, shall serve for the remainder of the full term of that class and until the director's successor is duly elected and qualified.
The board of directors currently has eight members, including two Class I directors, Richard W. Roedel and Gary Spiegel, whose terms expire at the 2019 annual meeting. Mr. Roedel and Mr. Spiegel were both previously elected by our stockholders. The terms of the Class II and Class III directors will expire at the 2020 and 2021 annual meetings of the stockholders, respectively.
Our board of directors has nominated Mr. Roedel and Mr. Spiegel to serve as Class I directors for a three-year term expiring at the 2022 annual meeting of stockholders and until their successors have been duly elected and qualified, or, if sooner, until the director's death, resignation or removal. Mr. Roedel is currently a Class I director, Chairman of the board of directors and chairman of the Nominating and Governance Committee. Mr. Spiegel is currently a Class I director, a member of the Compensation Committee and a member of the Audit Committee. In February 2019, Mr. Spiegel resigned as a Class II director and was immediately reappointed as a Class I director whose term was scheduled to expire at the 2019 annual meeting, in order to switch board classes with John B. Williamson, III, whose term was scheduled to expire at the 2019 annual meeting but had expressed to the board an inability to commit to serving another full three-year term if reelected.
Directors are elected by a plurality of the votes of shares present in person or represented by proxy and entitled to vote on the election of directors. Proxies cannot be voted for more than two nominees. The two nominees receiving the highest number of "For" votes will be elected. Only votes "For" and "Withheld" will affect the outcome. Broker non-votes will have no effect on this proposal. Shares represented by executed proxies will be voted "For" the election of the two nominees recommended by the board of directors unless the proxy is marked in such a manner so as to withhold authority to vote. If any of the nominees is unable or unexpectedly declines to serve as director, the board of directors may designate another nominee to fill the vacancy, and the proxy will be voted for that nominee. Each person nominated for election has agreed to serve if elected, and we have no reason to believe that either nominee will be unable to serve.
The names of the two nominees for director and of our other directors whose terms will continue after the annual meeting, their ages as of April 1, 2019, and certain other information about them are set forth below. There are no family relationships among our directors or executive officers.

Names of Nominees	Age	Position(s)	Director Since
Richard W. Roedel	69	Chairman of the Board of Directors	2005
Gary Spiegel	68	Director	2015
Names of the Incumbent Directors with Terms Continuing After 2019 Annual Meeting	Age	Position(s)	Director Since
John B. Williamson, III	64	Director	2010
Michael W. Wise	68	Director	2011
Warren B. Phelps, III	72	Director	2017
N. Leigh Anderson	69	Director	2017
Donald Pastor	65	Director	2015
Scott A. Graeff	52	Director	2017

Our Nominating and Governance Committee seeks to assemble a board of directors that, as a whole, possesses the appropriate balance of professional and industry knowledge, financial expertise and high-level management experience necessary to oversee and direct our business. To that end, the committee has identified and evaluated nominees in the broader context of the board's overall composition, with the goal of recruiting members who complement and strengthen the skills of other members and who also exhibit integrity, collegiality, sound business judgment and other qualities that the committee views as critical to effective functioning of the board. The biographies below include information, as of the date of this proxy statement, relating to the specific and particular experience, qualifications, attributes or skills of each director or nominee that led the committee to believe that the nominee or director should serve or continue to serve, as applicable, on the board.

However, each of the members of the committee may have a variety of reasons why he believes a particular person would be an appropriate nominee for the board, and these views may differ from the views of other members.

Class I Director Nominees for Election for a Three Year Term Expiring at the 2022 Annual Meeting of Stockholders

Richard W. Roedel has served as a member of our board of directors since 2005 and as Chairman of our board of directors since January 2010. Mr. Roedel also serves as a director of publicly held companies IHS Markit Inc., Six Flags Entertainment Corporation, BrightView Holdings, Inc. and LSB Industries, Inc. Mr. Roedel serves as a Chairman of LSB and Chairman of its audit committee. Mr. Roedel is a member of the audit committee of Six Flags and IHS Markit and Chairman of the Risk Committee of IHS Markit. Mr. Roedel served as a director of Broadview Network Holdings, Inc., a private company with publicly traded debt until 2012. Mr. Roedel was a director of Lorillard, Inc. from 2008 to 2015, when it was acquired by Reynolds American Inc. Mr. Roedel was a director of Sealy Corporation from 2006 to 2013, when Sealy was acquired by Tempur-Pedic International Inc. Mr. Roedel was a director of BrightPoint, Inc. from 2002 until 2012, when BrightPoint was acquired by Ingram Micro. Mr. Roedel served on the Board of Directors of Dade Behring Holdings, Inc. from 2002 until 2007 when Dade was acquired by Siemens AG. Mr. Roedel served in various capacities at Take-Two Interactive Software, Inc. from 2002 until 2005, including chairman and chief executive officer. Mr. Roedel is a member of the National Association of Corporate Directors (NACD) Risk Oversight Advisory Council. Mr. Roedel served a three year term, ending in 2017, on the Standing Advisory Group of the Public Company Accounting Oversight Board (PCAOB). From 1971 through 2000, he was employed by BDO Seidman LLP, becoming an audit partner in 1980, later being promoted in 1990 to managing partner in Chicago and then managing partner in New York in 1994, and finally, in 1999, to chairman and chief executive officer. Mr. Roedel holds a B.S. degree in accounting from The Ohio State University and is a Certified Public Accountant. The Nominating and Governance Committee believes that Mr. Roedel’s public accounting experience and his status as an authority on issues facing audit committees, his extensive service on public company boards and committees and his deep familiarity with our company make him a valuable member of the board of directors.

Gary Spiegel has served as a member of our board of directors since May 2015. He has more than 40 years of experience in the photonics industry. He held various positions, including vice president, sales and marketing, senior vice president, sales and business development, and senior vice president, business development at Newport Corporation from 2002 to 2013. Mr. Spiegel retired from Newport Corporation in 2014 and is currently a business development consultant. He has a Bachelor’s Degree in Industrial Marketing from Baruch College of the City University of New York. He also sits on the board of directors of Telescent Inc., an early stage technology company focused on software defined network cross connect technology and Alio Industries, a small technology company serving a variety of high technology markets. He served as Secretary and Treasurer of the SPIE from 2015 through 2018, where he chaired the Financial Advisory Committee, as well as the Compensation Committee. The Nominating and Governance Committee believes that Mr. Spiegel's extensive experience in the photonics industry enables him to continue to make valuable contributions to the board of directors.

THE BOARD OF DIRECTORS RECOMMENDS YOU VOTE “FOR” EACH NAMED NOMINEE.

Class II Directors Continuing in Office Until the 2020 Annual Meeting of Stockholders

Michael W. Wise has served as a member of our board of directors since May 2011. In May 2015, Mr. Wise retired from his role as the Chief Financial Officer of Corvesta, Inc., an insurance and technology holding company, and Chief Financial Officer of its subsidiary Delta Dental of Virginia. Mr. Wise also served on the boards of directors and as treasurer of additional Corvesta portfolio companies, including Corvesta Life Insurance Company, a life and health insurance company. Prior to joining Delta Dental of Virginia as its Chief Financial Officer in 1996, Mr. Wise owned and managed several small businesses. He currently serves and has in the past served on numerous boards of directors of local non-profit organizations. He received a B.S. degree in Business Administration - Accounting from West Virginia University and was previously a Certified Public Accountant. The Nominating and Governance Committee believes that Mr. Wise's accounting and financial background, his experience in funding and managing technology companies through growth periods, his experience as an entrepreneur and his local and community leadership make him a valuable member of our board of directors. Mr. Wise is also one of our largest stockholders, which the

Nominating and Corporate Governance Committee believes evidences his commitment to the long-term interest of our stockholders.

John B. Williamson, III has served as a member of our board of directors since January 2010. He served as Chief Executive Officer of RGC Resources, Inc., a publicly held energy distribution and services holding company from 1999 to

2014. He continues to serve as Chairman of the Board of RGC Resources, Inc. Mr. Williamson is a member of the boards of directors of Bank of Botetourt, Inc., a publicly held local bank, where he serves as chairman of the nominating and corporate governance committee, Optical Cable Corporation, a publicly held optical fiber manufacturer, where he serves as the chairman of the audit committee and a member of the compensation committee, and Corning Natural Gas Corporation, a publicly held natural gas company, where he serves as chairman of the audit committee and serves on the compensation committee. He was formerly a board member of NTELOS, Inc., a publicly held telecommunications company, where he also served as chairman of the audit committee. Mr. Williamson also formerly served in government executive capacities, including as County Administrator for Botetourt and Nelson Counties in Virginia. He earned a bachelor’s degree in business administration and management from Virginia Commonwealth University and an M.B.A. degree from the College of William and Mary. The Nominating and Governance Committee believes that Mr. Williamson’s public company chief executive officer experience, his experience as audit committee chairman of other public companies and his local and community leadership will enable him to continue to make valuable contributions to the board of directors.

Warren B. Phelps, III has served as a member of our board of directors since May 2017. He has served as Executive Chairman of Empower RF Systems, a developer and manufacturer of high power RF amplifiers for the defense and commercial markets, since January 2013. From 2009 until December 2012, Mr. Phelps served as the Chairman and Chief Executive Officer of Empower. Mr. Phelps serves as Chairman of the Board of Directors and Chairman of the audit committee of U.S. Auto Parts Network, Inc., a public company. From 2000 until his retirement in 2006, Mr. Phelps served in several executive positions for Spirent plc, a leading communications technology company, most recently as President of the Performance Analysis Broadband division. From 1996 to 2000, Mr. Phelps was at Netcom Systems, a provider of network test and measurement equipment, most recently as President and Chief Executive Officer. Prior to that, Mr. Phelps held executive positions, including Chairman and Chief Executive Officer, at MICOM Communications and in various financial management roles at Burroughs/Unisys Corporation. Mr. Phelps current serves on the board of directors of a privately held company and on the Board of Trustees of St. Lawrence University. Mr. Phelps holds a B.S. degree in mathematics from St. Lawrence University in Canton, New York and an M.B.A. from The University of Rochester in Rochester, New York. The Nominating and Governance Committee believes that Mr. Phelps's prior experience as a Chief Executive officer and with the defense and commercial industries enables him to make valuable contributions to the board of directors.

Class III Directors Continuing in Office Until the 2021 Annual Meeting of Stockholders

Scott A. Graeff was appointed as our President, Chief Executive Officer and a member of the Board of Directors in October 2017. Mr. Graeff has served as our Treasurer since 2005, and our Secretary since May 2015. Mr. Graeff previously served as our Chief Strategy Officer from July 2012 to October 2017 and as our Chief Commercialization Officer from 2010 to July 2012. He also served as our interim Chief Financial Officer during the period from 2010 to 2011. He previously served as our Chief Operating Officer from 2009 to 2010, as our Chief Commercialization Officer from 2006 to 2009, and as our Chief Financial Officer and Executive Vice President, Corporate Development, from 2005 to 2006. Mr. Graeff was also a member of our board of directors from 2005 until 2006. From 1999 to 2001, Mr. Graeff served as Chief Financial Officer of Liquidity Link, a software development company. From 2001 to 2002, Mr. Graeff served as President and Chief Financial Officer of Autumn Investments. From 2002 until 2005, Mr. Graeff served as a Managing Director for Gryphon Capital Partners, a venture capital investment group. From 2003 until July 2005, Mr. Graeff also served as the Acting Chief Financial Officer of Luna Technologies, Inc., which we acquired in September 2005. Mr. Graeff holds a B.S. degree in commerce from the University of Virginia. The Nominating and Governance Committee believes that Mr. Graeff's position as our President and Chief Executive Officer and his prior management experience will enable him to continue to make valuable contributions to our board of directors.

Donald Pastor has served as a member of our board of directors since May 2015. Prior to our merger with Advanced Photonix, Inc. ("API"), he served as a director of API from July 2005 to May 2015 and served as the non-executive chairman of the board of directors beginning in October 2012. Mr. Pastor is also the President of DP Business Services, a consulting firm which he founded in January 2012. From 1986 through June 2012, he was employed at Telephonics Corporation. From 2006 through 2012, he served as the president - electronics systems division of

Telephonics Corporation. In addition, Mr. Pastor previously served as the chief executive officer of TLSI, a wholly owned subsidiary of Telephonics Corporation, and as the chief financial officer of Telephonics Corporation. For the past thirty years, Mr. Pastor has held a variety of financial, administrative and operational positions in high technology and defense related industries. Mr. Pastor holds a B.S. degree in marine engineering from the U.S. Merchant Marine Academy and an M.B.A. from Loyola University Maryland. The Nominating and Governance Committee believes that Mr. Pastor's extensive experience in financial, administrative and operational positions in high technology and defense related industries enables him to continue to make valuable contributions to the board of directors.

N. Leigh Anderson has served as a member of our board of directors since May 2017. Dr. Anderson has served as Chief Executive Officer of SISCAPA Assay Technologies, a developer of diagnostic testing technology, of which he was a co-founder, since 2011, and has served as the Chief Executive Officer of the Plasma Proteome Institute, a non-profit biomedical scientific research institute in Washington, D.C., of which he is also a founder, since 2002. From 2001 to 2002, Dr. Anderson served as the Chief Scientific Officer and a member of the board of directors of Large Scale Biology Corporation, a public biotechnology company. Dr. Anderson also served as a member of the board of directors and a member of the audit committee of Dade Behring Holdings, Inc., a publicly held medical diagnostics equipment manufacturer, from 2002 until its acquisition by Siemens AG in 2007. Dr. Anderson earned a B.A. degree in physics from Yale University and a Ph.D. in molecular biology from Cambridge University. The Nominating and Governance Committee believes that Dr. Anderson's scientific background in critical areas and pertinent executive and director experience in the biotechnology and biomedical industries enable him to bring significant value to the board of directors.

Independence of the Board of Directors

As required under the Nasdaq Stock Market (“Nasdaq”) listing standards, a majority of the members of a listed company’s board of directors must qualify as “independent,” as affirmatively determined by the board of directors. Our board of directors consults with legal counsel to ensure that the board’s determinations are consistent with relevant securities and other laws and regulations regarding the definition of “independent,” including those set forth in pertinent Nasdaq listing standards, as in effect from time to time.

Consistent with these considerations, after review of all relevant identified transactions or relationships between each director or director nominee, or any of his family members, and the Company, its senior management and its independent auditors, our board of directors has affirmatively determined that the following seven current directors and director nominee are independent within the meaning of the applicable Nasdaq listing standards: Mr. Wise, Mr. Pastor, Mr. Williamson, Mr. Spiegel, Mr. Roedel, Mr. Phelps, and Dr. Anderson. In making these determinations, the board found that none of these current or former directors had a material or disqualifying relationship with the Company. Mr. Graeff is not independent, as he is currently employed as our President and Chief Executive Officer.

Board Leadership Structure

In January 2010, our board of directors designated an independent non-executive Chairman, Mr. Roedel, who has authority, among other things, to call and preside over board meetings, including meetings of the independent directors, to set meeting agendas and to determine materials to be distributed to the board. Accordingly, the non-executive Chairman has substantial ability to shape the work of the board. We believe that separation of the positions of Chairman and Chief Executive Officer reinforces the independence of the board in its oversight of our business and affairs. In addition, we believe that having an independent non-executive Chairman creates an environment that is more conducive to objective evaluation and oversight of management’s performance, increasing management accountability and improving the ability of the board to monitor whether management’s actions are in the best interests of the Company and our stockholders. As a result, we believe that having an independent non-executive Chairman can enhance the effectiveness of the board as a whole.

Role of the Board in Risk Oversight

One of the board’s key functions is informed oversight of our risk management process. The board does not have a standing risk management committee, but rather administers this oversight function directly through the board as a whole, as well as through its standing committees that address risks inherent in their respective areas of oversight. Our Audit Committee has the responsibility to consider and discuss our major financial risk exposures and the steps our management has taken to monitor and control these exposures, including guidelines and policies to govern the process by which risk assessment and management is undertaken. The Audit Committee also monitors compliance with legal and regulatory requirements. Our Nominating and Governance Committee monitors the effectiveness of our corporate governance policies, including whether they are successful in preventing illegal or improper liability-creating conduct.

Our Compensation Committee assesses and monitors whether any of our compensation policies and programs have the potential to encourage excessive risk-taking.

Information Regarding Certain Committees of the Board of Directors

Our board of directors has established an Audit Committee, a Compensation Committee and a Nominating and Governance Committee. Our board of directors and its committees meet regularly throughout the year and also hold special meetings and act by written consent from time to time as appropriate. Our board of directors has delegated various responsibilities and authority to these committees as generally described below. The committees regularly report on their activities and actions to the full board of directors. Each of these committees of our board of directors has a written charter approved by our board of directors.

The following table provides the membership information for 2018 for each of the Audit, Compensation and Nominating and Governance committees:

Name	Audit		Compensation		Nominating and Governance	
Richard W. Roedel			X		X	*
Donald Pastor			X	*	X	
John B. Williamson, III	X	*			X	
Warren B. Phelps, III	X		X			
Gary Spiegel	X	(1)	X			
Michael W. Wise	X				X	
N. Leigh Anderson	X				X	(2)

* Committee Chairman

(1) Mr. Spiegel was appointed to our Audit Committee in May 2018.

(2) Dr. Anderson was appointed to our Nominating and Governance Committee in May 2018.

Audit Committee

The Audit Committee of our board of directors recommends the appointment of our independent auditors, reviews our internal accounting procedures and financial statements, and consults with and reviews the services provided by our independent auditors, including the results and scope of their audit.

The Audit Committee is currently composed of Messrs. Williamson, Wise, Spiegel and Phelps, and Dr. Anderson. Mr. Williamson is the chairman of the committee. The Audit Committee met four times, including telephonic meetings, during 2018.

The board of directors reviews the Nasdaq listing standards definition of independence for audit committee members on an annual basis and has determined that each member of the Audit Committee is independent within the meaning of the requirements of the Sarbanes-Oxley Act of 2002 and applicable SEC and Nasdaq rules, including Rule 5605(c)(2)(A)(i) and (ii) of the Nasdaq listing rules. The board of directors has also determined that each of Messrs. Williamson, Phelps and Wise qualifies as an audit committee financial expert, as currently defined under applicable SEC rules. In reaching this determination, the board of directors made a qualitative assessment of their level of knowledge and experience based on a number of factors, including their formal education and extensive experience at an executive and audit committee level and, in the case of Mr. Wise, his professional experience as a certified public accountant.

The Audit Committee operates under a written charter adopted by the board of directors, which is available in the "Investor Relations" section of our website at www.lunainc.com.

Compensation Committee

The Compensation Committee of our board of directors reviews and implements changes to the compensation and benefits for our executive officers, administers our stock plans, and establishes and reviews general policies relating to compensation and benefits for certain of our officers.

The Compensation Committee is currently composed of Messrs. Pastor, Phelps, Spiegel and Roedel. Mr. Pastor serves as the chairman of the committee. The Compensation Committee met four times, including telephonic meetings, in 2018.

Each member of the Compensation Committee is independent within the meaning of applicable Nasdaq listing rules.

The Compensation Committee operates under a written charter adopted by the board of directors, which is available in the "Investor Relations" section of our website at www.lunainc.com.

Typically, the Compensation Committee meets at least quarterly and with greater frequency if necessary. The agenda for each meeting is usually developed by the chairman of the Compensation Committee, in consultation with the Chief Executive Officer and Chief Financial Officer. The Compensation Committee meets regularly in executive session. However, from time to time, various members of management and other employees as well as outside advisors or consultants may be invited by the Compensation Committee to make presentations, to provide financial or other background information or advice or to otherwise participate in Compensation Committee meetings. The charter of the Compensation Committee grants the Compensation Committee authority to obtain, at the expense of the Company, advice and assistance from internal and external legal, accounting or other advisors. In particular, the Compensation Committee has the sole authority to retain compensation consultants to assist in its evaluation of executive and director compensation, including the authority to approve the consultant's reasonable fees and other retention terms. As described below in "Compensation Discussion and Analysis," in 2018, the Compensation Committee engaged an independent third-party compensation consultant, Radford, to conduct a competitive peer group analysis regarding our executive compensation program, the results of which were taken into account in our executive compensation program for 2018. Late in 2018, the compensation committee engaged a new independent third-party compensation consultant, Compensation Strategies, Inc., to conduct a competitive peer group analysis and advise on the structure of our 2019 executive compensation program.

Historically, the Compensation Committee has made most of the significant adjustments to annual compensation and determined bonus and equity awards, if any, at one or more meetings held during the first or second quarter of the year. However, the Compensation Committee also considers adoption of annual senior management incentive plans, including new performance objectives, matters related to individual compensation, such as compensation for new executive hires, as well as high-level strategic issues, such as the efficacy of the Company's compensation strategy, potential modifications to that strategy and new trends, plans or approaches to compensation, at various meetings throughout the year. Generally, the Compensation Committee obtains the recommendations and advice of the Chief Executive Officer and Chief Financial Officer regarding the form and amount of compensation for executive officers other than themselves.

The specific determinations of the Compensation Committee with respect to Executive Compensation for the year ended December 31, 2018 are described in greater detail in the "Compensation Discussion and Analysis" section of this proxy statement.

Nominating and Governance Committee

The Nominating and Governance Committee of our board of directors is responsible for reviewing the appropriate size, function and needs of the board of directors, establishing criteria for evaluating and selecting new members of the board, identifying and recommending qualified director nominees to the board for approval and monitoring and making recommendations to the board of directors on matters relating to corporate governance. The Nominating and Governance Committee met four times during 2018.

The Nominating and Governance Committee currently consists of Messrs. Roedel, Pastor, Wise and Williamson, and Dr. Anderson. Mr. Roedel serves as chairman of the committee. All members of the Nominating and Governance Committee are independent within the meaning of applicable Nasdaq listing rules.

The Nominating and Governance Committee operates under a written charter adopted by the board of directors, which is available in the "Investor Relations" section of our website at www.lunainc.com.

Board of Directors and Committee Meeting Attendance

Our board of directors met nine times, including telephonic meetings, during 2018. Each of our directors who served in 2018 attended at least 75% of the aggregate number of meetings held during his tenure by the board of directors and by the committees of the board of directors on which he served.

Independent members of the board of directors regularly meet in executive session without management present.

Annual Meeting Attendance

Our policy is to invite and encourage all directors to attend the annual meeting of stockholders, if possible. All of the members of our board of directors who were serving at the time of our 2018 annual meeting of stockholders attended that meeting.

Director Nomination Process

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Candidates for director nominees are reviewed in the context of the current composition of the board of directors, the operating requirements of the Company and the long-term interests of stockholders. Our Nominating and Governance Committee identifies director nominees by first evaluating the current members of the board of directors willing to continue in service. In the case of incumbent directors whose terms of office are set to expire, the Nominating and Governance Committee reviews these directors' overall service to the Company during their terms, including the number of meetings attended, level of participation, quality of performance and any other relationships and transactions that might impair the directors' independence. Current members with skills and experience that are relevant to our business and who are willing to continue in service are considered for nomination.

If any member of the board of directors does not wish to continue in service, or the committee or board of directors decides not to nominate a member for re-election, the committee identifies the desired skills and experience of a new nominee. In the case of new director candidates, the Nominating and Governance Committee also determines whether the nominee is independent for Nasdaq purposes, which determination is based upon applicable Nasdaq listing standards, applicable SEC rules and regulations and the advice of counsel, if necessary. The Nominating and Governance Committee then uses its network of contacts to compile a list of potential candidates. The Nominating and Governance Committee conducts any appropriate and necessary inquiries into the backgrounds and qualifications of possible candidates after considering the function and needs of the board of directors. Current members of the board of directors and senior management are then polled for their recommendations. To date, the Nominating and Governance Committee has not engaged professional search firms or other third parties to identify or evaluate potential nominees, but the committee may do so in the future.

The Nominating and Governance Committee will also consider nominees recommended by stockholders, and any such recommendations should be forwarded to our Corporate Secretary in writing at our executive offices as identified in this proxy statement. Such recommendations should include the following information:

- the name, age, business address and residence address of the proposed candidate;
- the principal occupation or employment of the proposed candidate and the candidate's business experience for at least the previous five years;
- the class and number of shares of our stock which the proposed candidate beneficially owns;
- a description of all arrangements or understandings between the stockholder making the recommendation and each proposed candidate;
- any information reasonably necessary to determine whether the proposed candidate meets SEC and Nasdaq independence standards; and
- any other information relating to such proposed candidate that is required to be disclosed in solicitations of proxies for elections of directors or is otherwise required pursuant to Regulation 14A under the Exchange Act (including without limitation such proposed candidate's written consent to being named in any proxy statement as a nominee and to serve as a director if elected).

Such recommendations should be provided at least 120 days prior to the anniversary date of the mailing of our proxy statement for the previous annual meeting of stockholders. The committee does not intend to alter the manner in which it evaluates candidates, including the criteria set forth below, based on whether or not the candidate was recommended by a stockholder.

The Nominating and Governance Committee evaluates individual director candidates based upon a number of criteria, including:

- a high degree of personal and professional integrity;
- commitment to promoting the long-term interests of our stockholders;
- broad general business experience and acumen, which may include experience in management, finance, marketing and accounting, with particular emphasis on technology companies or policy-making experience in governmental or non-profit institutions;
- adequate time to devote attention to the affairs of the Company;
- an ability to bring balance to our board of directors in light of the Company's current and anticipated needs and in light of the skills and attributes of the other board members; and
- other attributes relevant to satisfying the requirements imposed by the SEC and Nasdaq.

The Nominating and Governance Committee retains the right to modify these qualifications from time to time.

Our Nominating and Governance Committee does not have a formal policy regarding board diversity. Diversity is one of a number of factors, however, that the committee takes into account in identifying nominees, and the Nominating and Governance Committee believes that it is essential that the board members represent diverse viewpoints.

The Board values diversity, in its broadest sense and, in the director identification and nomination process, the Board seeks a breadth of experience from a variety of industries and from professional disciplines, such as finance, professional services and technology, along with a diversity of gender, ethnicity and geographic location. To accomplish the Board's diversity objectives, the Nominating and Governance Committee may retain an executive search firm to help identify potential directors that meet these objectives. At their February 2019 meetings, our Nominating and Governance Committee and Board confirmed, as a priority, that we are committed to pursuing gender and ethnic diversity on the Board. In furtherance of this commitment, the Board amended our corporate governance guidelines to provide that, in future searches for director candidates, the Nominating and Governance Committee will seek to include female and minority candidates in the initial list of candidates from which the committee selects prospective director candidates, and will require that any search firm that it may engage to assist with a director search do the same.

The Nominating and Governance Committee has identified as one of its top priorities the need to recruit a new director who not only provides a valuable skillset to the Board, but also will contribute to its gender diversity. The Nominating and Governance Committee is committed to nominating a qualified female candidate to the Board and has been pursuing a methodical approach to identify the right director candidate to recommend to the full Board. In recent months, the committee has been engaged in discussions with three female candidates and, based on the status of these discussions, the committee intends to have the process completed, with a recommendation to the full Board for the appointment of a female director, in the second half of 2019. In addition to recruiting this new director, the Nominating and Governance Committee will continue to evaluate the size and composition of our Board on an ongoing basis.

Director Compensation

The following table sets forth certain information concerning cash and non-cash compensation earned by the non-employee members of our board of directors in 2018. The compensation paid to My Graeff, our President and Chief Executive Officer is described below under "Executive Compensation." Mr. Graeff does not receive any additional compensation for his service as a director.

Name	Fees Earned or Paid in Cash (1)(2)($)	Stock Awards (3)($)	Total ($)
John B. Williamson, III	38,000	25,000	63,000
Richard W. Roedel	53,000	50,000	103,000
Michael W. Wise	31,000	25,000	56,000
Donald Pastor	38,000	25,000	63,000
Gary Spiegel	29,500	25,000	54,500
Warren B. Phelps, III	31,000	25,000	56,000
N. Leigh Anderson	29,500	25,000	54,500

(1) Represents the annual cash retainer for board and, as applicable, committee service for 2018. During 2018, the annual cash retainer for board service was $25,000, the annual cash retainer for chairman of the board was $50,000, the annual cash retainer for service as a member of a committee was $3,000, and the annual cash retainer for service as the chairman of a committee was $10,000 (except for the Nominating and Governance Committee, which was $5,000). These retainers are paid prospectively in quarterly installments in advance. Mr. Roedel, who served as chairman of the Nominating and Governance Committee during 2018, elected to forego any compensation for serving in such role.

(2) During 2018, our non-employee directors had the option to receive some or all of their cash retainers for board and committee service in stock units pursuant to our non-employee directors' deferred compensation plan. These stock units are convertible into shares of our common stock on a one-for-one basis upon specified events. Mr. Williamson received an aggregate of 8,317 stock units in lieu of his cash payments for his service on the board of directors with an aggregate grant date fair value of $25,000, as well as an aggregate of 4,325 stock units in lieu of his cash payments for his service as the Chairman of our Audit Committee and as a member of the Nominating and Governance Committee with an aggregate grant date fair value of $13,000. Mr. Phelps received an aggregate of 8,317 stock units in lieu of his cash payments for his service on the board of directors with an aggregate grant date fair value of $25,000, as well as an aggregate of 1,996 stock units in lieu of his cash payments for his service as a member of our Audit Committee and Compensation Committee with an aggregate grant date fair value of $6,000. Mr. Roedel received an aggregate of 16,634 stock units in lieu of his cash payments for his service as chairman of the board of directors with an aggregate

grant date fair value of $50,000, as well as an aggregate of 998 stock units in lieu of his cash payments for his service as a member of our Compensation Committee with an aggregate grant date fair value of $3,000. As of December 31, 2018, our non-employee directors held the following equity compensation awards:

Name	Deferred Stock Units	RSUs	Shares Underlying Stock Options
N. Leigh Anderson	—	8,143	—
John B. Williamson, III	175,817	8,143	294,356
Michael W. Wise	—	8,143	240,000
Donald Pastor	—	8,143	5,341
Richard W. Roedel	224,012	16,287	544,164
Gary Spiegel	—	8,143	—
Warren B. Phelps, III	23,308	8,143	—

(3) Messrs. Pastor, Spiegel, Wise, Phelps and Williamson, and Dr. Anderson received 8,143 restricted stock units, or RSUs, in each case with a grant date fair value of $25,000, for annual director retainer. Mr. Roedel received 16,287 RSUs with a grant date fair value of $50,000 for service as chairman of the board of directors. The grant date fair value was computed in accordance with ASC Topic 718, Compensation-Stock Compensation. For a discussion of valuation assumptions, see Note 10 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

We also reimburse our non-employee directors for all reasonable out-of-pocket expenses incurred in the performance of their duties as directors, which expense reimbursements are not included in the foregoing table.

Compensation

Retainers. Board members receive an annual retainer pursuant to our amended and restated non-employee director compensation policy. In 2018, under this policy, the annual retainer for service as chairman of the board was $50,000, the annual retainer for board service was $25,000, the annual retainer for service as a member of a committee was $3,000, and the annual retainer for service as a chairman of a committee was $10,000 (except for the Nominating and Governance Committee, which was $5,000). In February 2019, our board of directors adopted an amendment to the amended and restated non-employee director compensation policy, effective July 1, 2019, pursuant to which the annual retainer for service as chairman of the board will be $62,500, the annual retainer for board service will be $37,500, the annual retainer for service as a member of a committee will be $4,000, and the annual retainer for service as a chairman of a committee will be $11,000 (except for the Nominating and Governance Committee, which will be $6,000). These board and committee retainers are paid quarterly in advance. These retainers for board and committee service are paid, at the election of the director, in either shares of common stock or stock units issued pursuant to our non-employee directors' deferred compensation plan, as described above.

Equity-Based Compensation. Pursuant to the amended and restated non-employee director compensation policy, non-employee directors are also entitled to receive an annual equity grant in the form of RSUs at the time of annual meeting of stockholders. In 2018, the chairman of our board of directors was entitled to RSUs with a value of $50,000 and other non-employee directors were entitled to RSUs with a value of $25,000. Pursuant to the amendment to our amended and restated non-employee director compensation policy, effective July 1, 2019, the chairman of our board of directors will be entitled to RSUs with a value of $62,500 and other non-employee directors will be entitled to RSUs with a value of $37,500. RSUs granted under the policy will vest on the earlier of the one year anniversary of the grant date or the date of the next annual meeting of stockholders. Our non-employee directors may elect to receive these RSUs in the form of stock units pursuant to our non-employee directors' deferred compensation plan.

Compensation Committee Interlocks and Insider Participation

Our Compensation Committee consists of Mr. Pastor, Mr. Phelps, Mr. Roedel, and Mr. Spiegel. None of the members of our Compensation Committee during 2018 is or was a present or former officer or employee of the Company, nor did such members engage in any transaction or relationship requiring disclosure in this proxy statement under the section titled "Certain Relationships and Related Person Transactions."

No executive officer of the Company served as a director or member of the Compensation Committee (or other board committee performing equivalent functions) of any other entity during the last fiscal year, one of whose executive officers served on our board of directors or Compensation Committee.

Code of Business Conduct and Ethics

We have adopted a Code of Business Conduct and Ethics that applies to all our directors and employees, including our principal executive officer, principal financial officer and principal accounting officer or controller. The full text of our Code of Business Conduct and Ethics is posted on our website at www.lunainc.com in the "Investor Relations" section. If we make any substantive amendments to the Code of Business Conduct and Ethics or grant any waiver from a provision of the Code to any executive officer or director, we will promptly disclose the nature of the amendment or waiver on our website.

Hedging and Pledging Policy

Our insider trading policy prohibits directors, executive officers and other employees from engaging in speculative trading activities, including hedging transactions or other inherently speculative transactions with respect to our securities. The policy also prohibits directors, executive officers and other employees from holding company securities in a margin account or otherwise pledging the company's securities as collateral for a loan.

EXECUTIVE OFFICERS

The following table sets forth certain summary information concerning our executive officers as of April 1, 2019.

Name	Age	Position
Scott A. Graeff	52	President, Chief Executive Officer, Treasurer and Secretary
Dale E. Messick	55	Chief Financial Officer

Information about Mr. Graeff is set forth above under “Class III Directors Continuing in Office Until the 2021 Annual Meeting of Stockholders.”

Dale E. Messick has served as our Chief Financial Officer since August 2006, except during the period from August 2010 to April 2011 when he served as our interim President and Chief Operating Officer. Prior to joining us, Mr. Messick served in various capacities at Worldspan, L.P., a provider of transaction processing and information technology services to the global travel industry, including as Chief Financial Officer from 1997 to 2004 and Senior Vice President - Finance from 2004 to 2005. At Worldspan, Mr. Messick managed a staff of 160 people in the United States, Mexico, and Europe and was responsible for accounting, financial reporting, budgeting, financial planning and analysis, and internal audit operations. Previously, Mr. Messick worked in the audit practice of PricewaterhouseCoopers. Mr. Messick received a B.B.A. degree in accounting from the College of William and Mary and is a Certified Public Accountant.

CERTAIN RELATIONSHIPS AND RELATED PERSON TRANSACTIONS

Policies and Procedures for Transactions with Related Persons

Related person transactions, which we define as all transactions involving an executive officer, director, nominee for director or a holder of more than five percent of our common stock, including any of their immediate family members and any entity owned or controlled by such persons, are reviewed and approved by the Audit Committee of our board of directors and a majority of disinterested directors on our board.

In any transaction involving a related person, our Audit Committee and board of directors consider all of the available material facts and circumstances of the transaction, including:

- the direct and indirect interests of the related persons;
- in the event the related person is a director or director nominee (or immediate family member of a director or director nominee or an entity with which a director or director nominee is affiliated), the impact that the transaction will have on a director’s or director nominee’s independence;
- the risks, costs and benefits of the transaction to us; and
- whether any alternative transactions or sources for comparable services or products are available.

After considering all such facts and circumstances, our Audit Committee and board determine whether approval or ratification of the related person transaction is in our best interests. For example, if our Audit Committee determines that the proposed terms of a related person transaction are reasonable and at least as favorable as could have been obtained from unrelated third parties, it will recommend to our board of directors that such transaction be approved or ratified. Alternatively, if a related person transaction will compromise the independence of one of our directors or director nominees, our Audit Committee may recommend that our board of directors reject the transaction if it could affect our ability to comply with securities laws and regulations or Nasdaq listing requirements.

Each transaction described below was approved or ratified by our Audit Committee or the disinterested members of our board of directors after making a determination that the transaction was on terms no less favorable than those we could have obtained from unrelated third parties.

The policies and procedures described above for reviewing and approving related person transactions are not set forth in writing. The charter for our Audit Committee, however, provides that one of the committee’s responsibilities is to review and approve in advance any proposed related person transactions.

Transactions and Relationships with Directors, Nominees for Director, Executive Officers and Five Percent Stockholders

Other than compensation described in “Executive Compensation” and “Director Compensation” elsewhere in this proxy statement and as described below, we believe that there has not been any other transaction or series of transactions since January 1, 2017 to which we were or are to be a participant in which the amount involved exceeds $120,000 and in which any director, nominee for director, executive officer or holder of more than five percent of our common stock, or members of any such person’s immediate family, had or are expected to have a direct or indirect material interest.

Indemnification Agreements with Officers and Directors

We have entered into indemnity agreements with certain of our officers and directors that provide, among other things, that we will indemnify such officer or director, under the circumstances and to the extent provided for therein, for expenses, damages, judgments, fines and settlements he may be required to pay in actions or proceedings that he is or may be made a party by reason of his position as a director, officer or other agent of the Company, and otherwise to the fullest extent permitted under Delaware law and our bylaws.

PROPOSAL NO. 2
ADVISORY VOTE ON EXECUTIVE COMPENSATION

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), and Section 14A of the Exchange Act, the Company’s stockholders are entitled to vote to approve, on an advisory basis, the compensation of the Company’s named executive officers as disclosed in this proxy statement in accordance with SEC rules.

This vote is not intended to address any specific item of compensation, but rather the overall compensation of the Company’s named executive officers and the philosophy, policies and practices described in this proxy statement. The compensation of the Company’s named executive officers subject to the vote is disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related narrative disclosure contained in this proxy statement. As discussed in those disclosures, the Company believes that its compensation policies and decisions are consistent with current market practices. Compensation of the Company’s named executive officers is designed to enable the Company to attract and retain talented and experienced executives to lead the Company successfully in a competitive environment.

Accordingly, the board of directors is asking the stockholders to indicate their support for the compensation of the Company’s named executive officers as described in this proxy statement by casting a non-binding advisory vote “FOR” the following resolution:

“RESOLVED, that the compensation paid to the Company’s named executive officers, as disclosed pursuant to compensation disclosure rules of the Securities and Exchange Commission, including the Compensation Discussion and Analysis, compensation tables and any related information disclosed in this proxy statement is hereby APPROVED.”

Because the vote is advisory, it is not binding on the board of directors or the Company. Nevertheless, the views expressed by the stockholders, whether through this vote or otherwise, are important to management and the board of directors and, accordingly, the board of directors and the Compensation Committee intend to consider the results of this vote in making determinations in the future regarding executive compensation arrangements.

Advisory approval of this proposal requires the vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the annual meeting.

THE BOARD OF DIRECTORS RECOMMENDS
YOU VOTE "FOR" PROPOSAL NUMBER 2.

PROPOSAL NO. 3

ADVISORY VOTE ON THE FREQUENCY OF SOLICITATION OF
ADVISORY STOCKHOLDER APPROVAL OF EXECUTIVE COMPENSATION

The Dodd-Frank Wall Street Reform and Consumer Protection Act, and Section 14A of the Exchange Act enable the Company's stockholders, at least once every six years, to indicate their preference regarding how frequently the Company should solicit a non-binding advisory vote on the compensation of the Company's named executive officers as disclosed in the Company's proxy statement. Accordingly, the Company is asking stockholders to indicate whether they would prefer an advisory vote every year, every other year or every three years. Alternatively, stockholders may abstain from casting a vote. For the reasons described below, the board of directors recommends that the stockholders select a frequency of one year.

After considering the benefits and consequences of each alternative, the board of directors recommends that the advisory vote on the compensation of the Company's named executive officers be submitted to the stockholders once every year.

The Board has determined that an advisory vote on executive compensation every year is the best approach for the Company. In formulating its recommendation, the Board considered that an annual advisory vote on executive compensation will allow stockholders to provide direct input on the Company's compensation philosophy, policies and practices every year. Additionally, an annual advisory vote on executive compensation is consistent with the Company's policy of seeking input from, and engaging in discussions with, its stockholders on executive compensation and corporate governance matters.

Accordingly, the board of directors is asking stockholders to indicate their preferred voting frequency of soliciting advisory stockholder approval of compensation of the Company's named executive officers once every one, two or three calendar years.

While the board of directors believes that its recommendation is appropriate at this time, the stockholders are not voting to approve or disapprove that recommendation, but are instead asked to indicate their preferences, on an advisory basis, as to whether the non-binding advisory vote on the approval of the Company's executive officer compensation practices should be held every year, every other year or every three years. The option among those choices that receives the highest number of votes from the holders of shares present in person or represented by proxy and entitled to vote at the annual meeting will be deemed to be the frequency preferred by the stockholders.

The board of directors and the Compensation Committee value the opinions of the stockholders in this matter, and the board intends to hold advisory stockholder votes on the compensation of the Company's named executive officers in the future in accordance with the alternative that receives the most stockholder support, even if that alternative does not receive the support of a majority of the shares present and entitled to vote. However, because this vote is advisory and therefore not binding on the board of directors or the Company, the Board may decide that it is in the best interests of the stockholders that the Company hold an advisory vote on executive compensation more or less frequently than the option preferred by the stockholders. The vote will not be construed to create or imply any change or addition to the fiduciary duties of the Company or the board of directors.

THE BOARD OF DIRECTORS RECOMMENDS
A VOTE IN FAVOR OF "ONE YEAR" ON PROPOSAL 3.

PROPOSAL NO. 4
RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Our Audit Committee has appointed Grant Thornton LLP as our independent registered public accounting firm for the year ending December 31, 2019 and has further directed that management submit the selection of our independent registered public accounting firm for ratification by the stockholders at the annual meeting. Grant Thornton LLP has served as our independent audit firm since 2005. A representative of Grant Thornton LLP is expected to be present at our 2019 annual meeting of stockholders and will have an opportunity to make a statement and respond to appropriate questions from stockholders.

Ratification of the appointment of Grant Thornton LLP as our independent registered public accounting firm is not required by our bylaws or other applicable legal requirements. However, our board of directors is submitting the appointment of Grant Thornton LLP to the stockholders for ratification as a matter of good corporate practice. If our stockholders fail to ratify the appointment, the Audit Committee will reconsider whether or not to retain that firm. Even if the appointment is ratified, the Audit Committee at its discretion may direct the appointment of a different independent registered public accounting firm at any time during the year if it determines that such a change would be in our best interests and the best interests of our stockholders.

The affirmative vote of a majority of shares of our common stock present at the 2019 annual meeting of stockholders in person or by proxy and entitled to vote is required to ratify the appointment of Grant Thornton LLP as our independent registered public accounting firm for the year ending December 31, 2019. Abstentions will have the same effect as a vote against this proposal. Broker non-votes are counted towards a quorum but are not counted for any purpose in determining whether this matter has been approved.

Audit and Related Fees for Fiscal Years 2017 and 2018

The following table sets forth a summary of the aggregate fees billed to us by Grant Thornton LLP for professional services for the fiscal years ended December 31, 2017 and 2018, respectively. All of the services described in the following fee table were approved by the Audit Committee.

Name	2017	2018
Audit Fees	$361,725	$332,000
Audit -Related Fees	—	145,500
Total Fees	$361,725	$477,500

The Audit Committee meets regularly with Grant Thornton LLP throughout the year and reviews both audit and, if applicable, other services performed by Grant Thornton LLP as well as fees charged for such services. For 2017, audit fees included $45,725 related to services provided in connection with the disposition of our company's high speed optical receivers business and in connection with preparation for the adoption of new revenue recognition guidelines. For 2018, audit fees included $57,000 related to the sale of our optoelectronics business and the acquisition of Micron Optics, Inc ("MOI"). Audit-related fees in 2018 consisted of the cost of auditing the financial statements of MOI as of and for the year ended December 31, 2017, for inclusion in our Form 8-K/A associated with the closing of the acquisition.

Pre-Approval Policies and Procedures

The Audit Committee has adopted, and the board of directors has approved, a policy that sets forth the procedures and the conditions pursuant to which services proposed to be performed by the independent auditors may be pre-approved. The policy generally pre-approves all audit services and non-audit services by our independent auditors, except in the case of non-audit services where subsequent approval is necessary and permissible. Pursuant to its pre-approval policy, the Audit Committee may delegate pre-approval authority for non-audit services to one or more of its members. The member to whom such authority is delegated must report, for informational purposes only, any pre-approval decisions to the Audit Committee at its next scheduled meeting. During 2017 and 2018, all services provided by Grant Thornton LLP were pre-approved by the Audit Committee in accordance with this policy.

THE BOARD OF DIRECTORS RECOMMENDS YOU VOTE “FOR” PROPOSAL NUMBER 4.

AUDIT COMMITTEE REPORT

As described more fully in its charter, the purpose of the Audit Committee is to assist the board of directors with its oversight responsibilities regarding the integrity of our financial statements, our compliance with legal and regulatory requirements, assessing our independent registered public accounting firm's qualifications and independence and, if applicable, the performance of the persons performing internal audit duties for the Company.

Company management is responsible for preparation, presentation and integrity of our financial statements as well as our financial reporting processes, accounting policies, internal audit function, internal accounting controls and disclosure controls and procedures. Our independent registered public accounting firm is responsible for performing an independent audit of our consolidated financial statements in accordance with generally accepted auditing standards and to issue a report thereon. The Audit Committee's responsibility is to monitor and oversee these processes. The following is the Audit Committee's report submitted to the board of directors for 2018.

The Audit Committee has:

- reviewed and discussed our audited financial statements for the fiscal year ended December 31, 2018 with management and Grant Thornton LLP, our independent registered public accounting firm;
- discussed with Grant Thornton LLP the matters required to be discussed by Auditing Standard No. 1301, Communications with Audit Committees, as adopted by the Public Company Accounting Oversight Board; and
- received from Grant Thornton LLP the disclosures and a letter regarding their independence as required by the applicable requirements of the Public Company Accounting Oversight Board requesting Grant Thornton LLP's communication with the Audit Committee concerning independence and discussed the auditors' independence with them.

In addition, the Audit Committee has met separately with Company management and with Grant Thornton LLP.

Based on the review and discussions referred to above, the Audit Committee recommended to the board of directors that the audited 2018 financial statements be included in our Annual Report on Form 10-K for the year ended December 31, 2018 for filing with the Securities and Exchange Commission.

AUDIT COMMITTEE

John B. Williamson, III, Chairman
Michael W. Wise
N. Leigh Anderson
Warren B. Phelps, III
Gary Spiegel

The foregoing audit committee report is not "soliciting material," shall not be deemed incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof, and shall not otherwise be deemed filed under these acts, except to the extent we specifically incorporate by reference into such filings.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

The following discussion and analysis of our compensation arrangements with our named executive officers should be read together with the compensation tables and related disclosures set forth elsewhere in this proxy statement.

For 2018, our named executive officers were:

- Scott A. Graeff, our President and Chief Executive Officer; and
- Dale E. Messick, our Chief Financial Officer.

Executive Summary

We seek to closely align the interests of our named executive officers with the interests of our stockholders. Our compensation programs are designed to reward our named executive officers for the achievement of short-term and long-term strategic and operational goals and financial performance, without encouraging unnecessary or excessive risk-taking. Our performance-oriented compensation program consists of base salary, annual cash bonuses, long-term equity incentives, such as restricted stock awards and stock option grants, benefits and, for certain senior executive officers, severance and termination protection.

For 2018, our primary corporate goals related to our operating income for the year and our revenue growth compared to 2017. Our executive compensation policies for the year were, therefore, designed to incentivize our executive officers to execute against the most significant financial performance objectives and to focus on creation of value for our stockholders. We sought to incentivize this performance primarily through cash incentives that were based on our financial performance and also through grants of restricted stock.

The highlights of our 2018 executive compensation program were as follows:

- Our named executive officers did not receive salary increases during 2018.
- We established a 2018 senior management incentive plan, which rewarded our named executive officers for our corporate financial performance, specifically whether the Company achieved specified financial performance metrics. The amount of the bonus was based on the amount of consolidated revenue earned in 2018 and consolidated operating income for the twelve months ended December 31, 2018, each adjusted to include the results of discontinued operations, and individual qualitative objectives. We paid bonuses based on our performance as measured against each of the target financial metrics and the accomplishment of the qualitative objectives.
- In May 2018, we granted a total of 190,000 shares of restricted stock to our named executive officers as a part of periodic equity grants to these executives.

Overview of Compensation Philosophy

Our overall compensation philosophy is to provide executive compensation packages that enable us to attract, retain and motivate highly qualified executive officers to achieve our short-term and long-term business goals. Consistent with this philosophy, the following compensation elements provide a framework for our executive compensation program: base salary; a cash bonus program designed to reinforce desired performance goals; and non-cash compensation intended to align the interests of our executives with those of our stockholders.

In January 2019, our Compensation Committee undertook a thorough review of the Company’s executive compensation programs, including salary, cash bonus, and equity-based incentive compensation. Beginning with grants made in 2019, the Compensation Committee intends to provide for annual grants of equity compensation comprising a combination of service-based restricted stock units, which will vest over time, and performance-based restricted stock units that will vest based on our achievement of long-term performance goals.

Role of Compensation Committee and Compensation Consultant

Our executive compensation program is approved and monitored by the Compensation Committee of our board of directors. The Compensation Committee members were Richard W. Roedel, Warren B. Phelps, III and Gary Spiegel with Donald Pastor serving as chairman of the Compensation Committee. All of the members of our Compensation Committee are independent, non-employee directors. Under the terms of its charter, the Compensation Committee is responsible for reviewing and approving compensation granted to our executive officers, including our Chief Executive Officer ("CEO"), and those executive officers who report directly to the CEO and any other officers as determined under Section 16 of the Securities

Exchange Act of 1934, as amended. In particular, the Compensation Committee reviews and approves for the CEO and the other executive officers the following components of compensation:

- annual base salary;
- cash and equity bonuses, including the specific goals and amount;
- other equity compensation, if any;
- employment agreements, severance arrangements, and change in control provisions, as applicable;
- signing bonus or payment of relocation costs, above normal Company policy, if applicable; and
- any other material benefits, other than those provided to all employees.

The Compensation Committee also serves as the administrator for our equity incentive plans. All stock-based awards, including new grants to existing employees and executive officers, as well as grants to new employees, are approved by the Compensation Committee. The Compensation Committee is also responsible for annually evaluating the performance of our executive officers.

We generally attempt to align our overall executive compensation with other publicly-traded peer companies who share similar characteristics. Because of our diversified product and service offerings, we believe our peer group includes a broad range of technology and growth companies with whom we compete for executive talent. Data on compensation practices at such companies has historically been gathered for us by our compensation consultant, Radford (an AON plc subsidiary), through searches of publicly available information, including subscription databases and SEC filings. We use such information primarily to help guide decisions on base salary, target bonuses and equity-based awards.

The Compensation Committee has the authority to retain its own compensation consultant and to obtain advice and assistance from internal or external legal, accounting or other advisors as it sees fit. The Compensation Committee engaged an independent third-party compensation consultant, Radford, in 2018 to conduct a competitive peer group analysis of our current executive compensation program to provide us with insights and market data on executive and director compensation matters, both generally and within our industry. In 2018, Radford compared the salary, target cash incentives, and equity compensation of our executive officers against an identified peer group of publicly traded companies. As a result of its analysis, Radford made recommendations to the Compensation Committee that were intended to bring the compensation elements paid to our executive officers towards the median of the identified peer companies, which are specified in the table below. These peer group companies were selected by the Compensation Committee because they are in the scientific and technical instruments industry and are comparable to our size based on their market and revenue value. As of April 20, 2018, these peer group companies had a median market capitalization of approximately $53.8 million, as compared to our market capitalization of approximately $92.2million and median revenues of approximately $48.3 million, as compared to our revenues of approximately $62.2 million.

Company	Peer Group Industry	Location
Bioanalytical Systems	Life Sciences Tool & Services	West Lafayette, IN
Clearfield	Communications Equipment	Brooklyn Park, MN
CVD Equipment	Semiconductor Equipment	Central Islip, NY
Cyber Optics	Semiconductor Equipment	Minneapolis, MN
Dynasil	Electronic Equipment & Instruments	Newton, MA
Echelon	Electronic Manufacturing Services	San Jose, CA
EMCORE	Communications Equipment	Alhambra, CA
GSI Technology	Semiconductors	Sunnyvale, CA
inTest	Semiconductor Equipment	Mount Laurel, NJ
Intricon	Electronic Components	Arden Hills, MN
LightPath Technologies, Inc.	Other Industrial Goods	Orlando, FL
Optical Cable	Communications Equipment	Roanoke, VA
Perceptron	Electronic Equipment & Instruments	Plymouth, MI
RF Industries	Electronic Manufacturing Services	San Diego, CA
Trio-Tech	Semiconductor	Van Nuys, CA
Wireless Telecom Group	Electronic Equipment & Instruments	Parsippany, NJ

Executive Compensation Program

As described above, our performance-oriented compensation program consists of base salary, annual cash bonuses, long-term equity incentives, such as restricted stock awards and stock option grants, benefits and, for certain senior executive officers, severance and termination protection. We believe that appropriately balancing the total compensation package and ensuring the viability of each component of the package is necessary in order to provide compensation that is competitive and to attract and retain talent. As a small company, we also try to optimize the mix of components to make such compensation programs cost effective for us.

The Compensation Committee intends for our compensation program to provide basic elements that ensure that management is fairly remunerated and has reasonable security so that the management team can perform at its best and take prudent risks. The committee believes that it does not use highly leveraged short-term incentives that drive high risk investments at the expense of our long-term value.

Our Compensation Committee typically evaluates the performance of each executive officer annually, based on the achievement of both corporate goals and individual qualitative performance objectives and makes its compensation decisions accordingly. Total compensation for our executive officers may vary significantly from year to year based on Company, divisional and individual performance. Further, the value of equity-based awards to our executives will vary based on fluctuation in our stock price from time to time.

The following is a more detailed explanation of the primary components of our executive compensation program.

Base Salary

Base salary is generally determined by considering competitive salary data and individual job performance. In determining base salary, we primarily rely on factors such as job performance, skill set, prior experience, past levels of compensation, seniority, pay levels of similarly situated positions internally, alternative opportunities that may be available to executives, retention, and market conditions generally. Base salaries for executive officers are reviewed at least annually. In each case, we take into account the results achieved by the executive, his future potential, the scope of the officer’s responsibilities and the depth of his experience. We do not apply specific formulas to determine annual pay increases, if any, and our Compensation

Committee attempts to make decisions regarding changes in base salary in the context of other short-term and long-term compensation components.

The Compensation Committee approved annual increases in base salaries effective as of October 1, 2017, for the named executive officers. The named executive officers did not receive additional increases during 2018. The following table presents the annual base salaries for each of our named executive officers for the years indicated.

Name	2017 Base Salary*	2018 Base Salary*	% Increase
Scott A. Graeff, President and Chief Executive Officer	$260,234	$325,000(1)	— %
Dale E. Messick, Chief Financial Officer	$255,040	$255,040	— %

* These base salaries represent the salaries in effect following the Compensation Committee's annual salary determinations for the respective year. Because the increase in base salary for 2017 was effective mid-year, the named executive officers' actual salaries for 2017, as reflected in the Summary Compensation Table, are less than the 2017 base salaries reflected above.

(1) Following his appointment to President and Chief Executive Officer in October 2017, Mr. Graeff's annual base salary was increased to $325,000.

Cash Incentive Bonuses

In May 2018, our Compensation Committee adopted a senior management incentive plan for fiscal year 2018. Under the terms of the incentive plan, certain of our employees, including all of our named executive officers were eligible to receive bonus payments based upon a target percentage of their respective salaries for 2018. For our named executive officers, if the threshold operating income target was achieved, the amount of the bonus was to be based upon whether we achieved consolidated revenue exceeding specified amounts, whether we achieved consolidated operating income exceeding specified amounts, and the achievement of specified qualitative objectives. For Mr. Graeff, the target bonus percentage was equal to 50% of his salary for 2018. For Mr. Messick, the target bonus was 40% of his salary for 2018. The Compensation Committee selected these metrics because the committee believed them to be the appropriate indicators of success in the execution of our strategic and operating plans and achievement of key corporate goals and because these factors are critical to increasing the value of our common stock.

If the threshold operating income target was achieved, for both the operating income objective and the revenue objective, minimum, target and maximum levels of achievement were possible. At the minimum level of achievement, the officer would receive a payout of 50% of the target percentage. At the target level of achievement, the officer would receive a payout of 100% of the target percentage. At the maximum level of achievement, the officer would receive a payout of 200% of the target percentage. For financial performance values falling between the minimum and target levels, or between the target and maximum levels, award amounts would be interpolated on a linear basis.

For 2018, our minimum, target, maximum and actual levels of achievement and resulting payout percentages for our named executive officers are reflected in the table below.

Mr. Graeff

Metric	Weighting	Minimum Achievement Level (25% of salary)	Target Achievement Level (50% of salary)	Exceeds Achievement Level (75% of salary)	Maximum Achievement Level (100% of salary)	Actual Performance Level
Consolidated operating income/(loss)	40%	$(0.9) million	$(0.4) million	$0.6 million	$2.0 million	$2.2 million
Consolidated revenue	40%	$42.5 million	$48.4 million	$54.4 million	$59.9 million	$51.3 million
Individual qualitative objectives	20%					75% achieved

Mr. Messick

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Metric	Weighting	Minimum Achievement Level (20% of salary)	Target Achievement Level (40% of salary)	Maximum Achievement Level (60% of salary)	Maximum Achievement Level (80% of salary)	Actual Performance Level
Consolidated operating income/(loss)	40%	$(0.9) million	$(0.4) million	$0.6 million	$2.0 million	$2.2 million
Consolidated revenue	40%	$42.5 million	$48.4 million	$54.4 million	$59.9 million	$51.3 million
Individual qualitative objectives	20%					50% achieved

The financial performance targets established for the 2018 cash incentive bonus plan in February 2018 included the operations of the optoelectronic components business, which was sold to an unrelated third party in July 2018. Accordingly, the Company's actual financial performance for 2018 for purposes of the incentive plan includes the revenue and income of the discontinued operation from January 2018 to July 2018 period. In addition, in October 2018 the Company acquired MOI. Following the acquisition of MOI, the Compensation Committee revised the 2018 plan targets to include the expected impact of MOI on the Company's financial results for the year.

Named Executive Officer	2018 Awarded Bonus	Percentage of 2018 Target Bonus Awarded
Scott A. Graeff, President and Chief Executive Officer	$234,978	145%
Dale E. Messick, Chief Financial Officer	$142,416	140%

Equity Incentives

Consistent with our compensation philosophy, our Compensation Committee believes that equity awards can be a significant motivator in attracting, retaining and rewarding the success of management employees by providing compensation with long-term vesting requirements and linking the ultimate value of those awards to stockholder returns. This component may include both grants of restricted common stock and stock options. Similar to base salary increases, equity instruments may also be granted in connection with promotions or significant changes in responsibility. Although grants of stock-based awards can impact our operating results, we believe that long-term equity-based compensation can be an important element of our overall compensation program because it helps focus our executives on our long-term financial and operational performance and also aligns the interests of our executives with those of our stockholders. The potential financial value offered through such stock awards is also an important retention tool.

As part of its advice to the Compensation Committee in 2018, Radford recommended that we continue making periodic equity grants to our executives as part of moving total compensation toward the median for our peer group provide additional incentives for our executives to increase stockholder value, and that we make the grants in the form of restricted stock in order to help minimize the dilutive impact to our stockholders. In May 2018, the Compensation Committee granted a total of 190,000 shares of restricted stock, which will vest annually over a three-year period, to our named executive officers, as follows:

Name	Shares of Restricted Stock
Scott A. Graeff, President and Chief Executive Officer	140,000
Dale E. Messick, Chief Financial Officer	50,000

In connection with its reevaluation of our executive compensation program for 2019 and future years, our Compensation Committee engaged a new independent third party compensation consulting firm, Compensation

Strategies, Inc. In January 2019, our Compensation Committee undertook, with the assistance of Compensation Strategies, a thorough review of our executive compensation programs, including salary, cash bonus, and equity-based incentive compensation. After completing this review, the Compensation Committee approved equity awards for our executive officers reflecting a revised approach for annual grants of equity compensation (the “2019 Grants”). Beginning with the 2019 Grants, the Compensation Committee intends to provide for annual grants of equity compensation comprising a combination of service-based restricted stock units, which will

vest over time, and performance-based restricted stock units that will vest based on our achievement of long-term performance goals. With respect to the 2019 Grants, the service-based restricted stock units are scheduled to vest in three equal annual installments and the performance-based restricted stock units are scheduled to vest, if at all, based on our levels of 2021 revenue and operating income, in each case subject to the executive officer's continuous service through vesting. The performance-based awards establish threshold, target and maximum vesting amounts based on pre-defined levels of each of 2021 revenue and operating income, subject to the overall achievement of a minimum level of operating income for the year ending December 31, 2021.
Set forth below is a table summarizing the 2019 Grants for each named executive officer:

	Time-Based Restricted Stock Units	Performance-Based Restricted Stock Units		
		Threshold	Target	Maximum
Scott A. Graeff, President and Chief Executive Officer	92,000	11,500	23,000	34,500
Dale E. Messick, Chief Financial Officer	20,000	2,500	5,000	7,500

The Compensation Committee intends to continue to grant a combination of time-based and performance-based equity incentive awards to the named executive officers on an annual basis. It is the Compensation Committee's current expectation that, in future years, performance-based grants will represent an increasing portion of the named executive officers' total annual equity incentive awards.

Timing of Equity Grants
We do not time the granting of our equity awards relative to any favorable or unfavorable news that we release. Restricted stock or stock options for new employees, including executive officers, are generally awarded at the first regular meeting of the Compensation Committee following the employee's hire date, or, in certain limited cases, at the first regular meeting of the Compensation Committee following the prospective employee's written acceptance of an employment offer. The Compensation Committee's regular meeting schedule is established several months in advance of each meeting. Thus, proximity of any equity grant to an earnings announcement or other market events is coincidental.

Change in Control Benefits and Severance
The Compensation Committee believes that change in control and severance benefits play an important role in attracting and retaining valuable executives. The payment of such benefits also ensures a smooth transition in management following a change in control by giving the named executive officer the incentive to remain with the Company through the transition period, and, in the event the officer's employment is terminated as part of the transition, by compensating the officer with a degree of financial and personal security during a period in which he is likely to be unemployed. As a result, we have historically maintained employment agreements with our named executive officers that provide for severance payments and continuation of group benefits if our named executive officers' employment is terminated by us without "cause" or by the named executive officers for "good reason," including in circumstances involving a change in control of the Company. In the event of the termination of employment of a named executive without "cause" or for "good reason" in connection with a change in control, all outstanding stock options and other stock awards are subject to accelerated vesting. Additionally, upon the completion of a change in control, the vesting of the performance-based restricted stock units described above will vest in full as to 100% of the target number of shares.
In connection with a change in control the named executive officers may become subject to certain excise taxes under Section 4999 of the Code with respect to payments that are treated as excess parachute payments under Section 280G. Under the terms of the amended and restated employment agreements we will reimburse each named executive officer for all excise taxes that are imposed under Section 4999 and any income and excise taxes that are payable by such named executive officer as a result of any reimbursements for such excise taxes. In the event, however, it is

determined that the named executive officer is entitled to a reimbursement payment for such excise taxes, but that the change in control payments would not be subject to the excise tax if such payments were reduced by an amount that is less than 10% of the portion of the payments that would be treated as excess parachute payments under Section 280G, then the amounts payable to the named executive officer will be reduced to the maximum amount that could be paid to the named executive officer without giving rise to the excise tax.

Other Benefits

In general, our practice is to provide commensurate benefits to employees at all levels of our organization. Consistent with this practice, the following are the primary benefits provided to our full-time employees, including our named executive officers:

- health, vision and dental insurance including, at the employee’s option, Flexible Spending Accounts and/or a Health Savings Account;
- term life insurance and optional supplemental life insurance;
- optional supplemental health coverage;
- short- and long-term disability benefits;
- 401(k) plan, under which we match 25% of an employee’s contributions up to 10% of the employee’s total cash compensation, which match vests over a period of three years; and
- paid time off and holidays.

We believe that these benefits are consistent with those offered by other companies and specifically with those companies with which we compete for employees.

Compensation Recovery Policy

In February 2019, the Compensation Committee adopted a policy for recoupment of incentive compensation. Under the terms of this policy, if the Company is required to prepare an accounting restatement for any fiscal quarter or year due to the material noncompliance of the Company with any financial reporting requirement, the Company may seek to recover from certain employees, including the named executive officers, during the three fiscal years preceding the date on which the Company was required to prepare such accounting restatement, incentive bonus and equity awards in excess of amounts that would have been awarded based upon the restated financial statements. The Company may seek recoupment from prior incentive compensation payments through the reduction of future incentive compensation payments, the reduction or cancellation of outstanding incentive compensation payments, and direct repayment by the executive.

Future Compensation Strategy

We intend to continue our strategy of paying competitive short-term cash compensation and offering long-term incentives through equity-based compensation programs that align individual compensation with corporate financial performance. We believe that our total compensation package is reasonable in the aggregate. We also believe that, in light of our compensation philosophy, total compensation for our executives should continue to consist of base salary, annual bonus awards (consisting of cash, stock or a combination of both), long-term equity based compensation, and certain other benefits.

We anticipate that the competitive posture of our total direct compensation will vary year to year as a result of our performance, as well as the performance of peer group companies and the market as a whole. Accordingly, the magnitude and weighting of different compensation components will likely evolve over time.

Risk Analysis

The Compensation Committee has reviewed our compensation policies as generally applicable to our employees and believes that our policies do not encourage excessive and unnecessary risk-taking, and that the level of risk that they do encourage is not reasonably likely to have a material adverse effect on us. The design of our compensation policies and programs encourages our employees to remain focused on both our short- and long-term goals.

Tax Considerations

Section 162(m). Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"), disallows a deduction to any publicly held corporation and its affiliates for certain compensation paid to “covered employees” in a taxable year to the extent that compensation to a covered employee exceeds $1 million. Prior to the recent enactment of the Tax Cuts and Jobs Act (TCJA), compensation that qualified as “performance-based compensation” under Section 162(m) of the Code was not subject to this deduction limitation. Pursuant to the TCJA, this exception for “performance-based compensation” under Section 162(m) of the Code was repealed, with respect to taxable years beginning after December 31, 2017, except that certain transition relief is provided by TCJA for remuneration provided pursuant to a written binding contract which was in effect on November 2, 2017 and which was not modified in any material respect on or after such date. As a result, compensation paid to any of our "covered employees" in excess of $1 million per taxable year generally will not be deductible unless among other requirements, it is intended to qualify, and is eligible to qualify, as "performance-based compensation" under Section 162(m) of the Code pursuant to the transition relief provided by the TCJA. Because of certain ambiguities and uncertainties as to the application and interpretation of Section 162(m) of the Code and the regulations issued thereunder, including the uncertain scope of the transition relief provided by the TCJA, no assurance can be given that any compensation paid by the Company will be eligible for such transition relief and, therefore, eligible for the "performance-based compensation" exception under Section 162(m) of the Code. We are in the process of gathering information on our existing compensation arrangements for covered employees as well as assessing the impact of transitional guidance. Prior to the TCJA, the Compensation Committee had not adopted a policy requiring all compensation to be deductible, in order to maintain flexibility in compensating our executive officers in a manner designed to promote our objectives. Going forward, while the Compensation Committee intends to evaluate the effects of the revised compensation limits of Section 162(m) on any compensation it proposes to grant, the Compensation Committee intends to continue to provide future compensation in a manner consistent with our best interests and those of our stockholders, including compensation that is potentially not deductible.

Section 409A. Under Section 409A of the Code, if a named executive officer is entitled to non-qualified deferred compensation benefits that are subject to Section 409A, and such benefits do not comply with Section 409A, the officer would be subject to adverse tax treatment, including accelerated income recognition (in the first year that benefits are no longer subject to a substantial risk of forfeiture) and a 20% penalty tax pursuant to Section 409A. With respect to equity and cash compensation, we generally seek to structure such awards so that they do not constitute "deferred compensation" under Section 409A, thereby avoiding penalties and taxes on such compensation applicable to deferred compensation.

COMPENSATION COMMITTEE REPORT

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis contained in this proxy statement with Company management. Based on the Compensation Committee's review of, and the discussions with management with respect to, the Compensation Discussion and Analysis, the Compensation Committee recommended to the board of directors that the Compensation Discussion and Analysis be included in this proxy statement and incorporated by reference in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018 filed with the Securities and Exchange Commission.

COMPENSATION COMMITTEE

Donald Pastor, Chairman
Richard W. Roedel
Gary Spiegel
Warren B. Phelps, III

The foregoing compensation committee report is not "soliciting material," shall not be deemed incorporated by reference into any filing by us under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof, and shall not otherwise be deemed filed under these acts, except to the extent we specifically incorporate by reference into such filings.

Summary Compensation Table

The following table sets forth the summary information concerning compensation earned during the last three completed fiscal years by our president and chief executive officer and our chief financial officer, who were our only two executive officers during 2018. We refer to these persons as our "named executive officers" elsewhere in this proxy statement. The following table includes all compensation earned by the named executive officers for the respective periods, regardless of whether such amounts were actually paid during the period.

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Non-Equity Incentive Plan Compensation ($)	All Other Compensation ($)	Total ($)
Scott A. Graeff,	2018	325,000	—	429,800 (1)	234,975 (2)	7,470.47 (3)	997,245.47
President and	2017	270,740	—	172,630 (4)	135,371 (5)	7,249 (3)	585,990
Chief Executive Officer	2016	248,975	—	39,675 (6)	152,666 (7)	6,802 (3)	448,118
Dale E. Messick,	2018	255,040	—	153,500 (1)	142,290 (2)	7,373.94 (3)	558,203.94
Chief Financial	2017	249,469	—	53,130 (4)	109,787 (5)	7,240 (3)	419,626
Officer	2016	244,006	—	39,675 (6)	149,620 (7)	7,224 (3)	440,525

(1) In May 2018, the Company granted a total of 190,000 shares of restricted stock to our named executive officers as a part of periodic equity grants to these executives. Mr. Graeff was awarded 140,000 shares, which is equal to $429,800 divided by $3.07, the closing price of our common stock as reported on the Nasdaq Capital Market on May 15, 2018. Mr. Messick was awarded 50,000 shares of restricted stock, which is $153,500 divided by $3.07. The restricted stock awards are subject to a three year vesting schedule. In accordance with SEC rules, this amount is reported in the "Stock Awards" column for 2018 in the table above.

(2) Represents amounts paid to the named executive officer under our 2018 senior management incentive plan upon the deemed achievement of specified financial and qualitative performance objectives.

(3) Represents or includes Company 401(k) plan matching contributions and policy premiums paid for life insurance for the benefit of the named executive officer.

(4) In May 2017, the Company granted a total of 69,000 shares of restricted stock to our named executive officers as a part of periodic equity grants to these executives. Each of Mr. Messick and Mr. Graeff received 34,500 shares, which is equal to $53,130 divided by $1.54 per share, the closing price of our common stock as reported on the Nasdaq Capital Market on May 24, 2017, the date of grant. In December 2017, in connection with his appointment as President and Chief Executive Officer, the Company granted Mr. Graeff an additional 50,000 shares of restricted stock. In accordance with SEC rules, this amount is reported in the "Stock Awards" column for 2017 in the table above.

(5) Represents amounts paid to the named executive officer under our 2017 senior management incentive plan upon the deemed achievement of specified financial and qualitative performance objectives.

(6) In June 2016, the Company granted a total of 69,000 shares of restricted stock to our named executive officers as a part of periodic equity grants to these executives. Each of Mr. Messick, and Mr. Graeff received 34,500 shares, which is equal to $39,675 divided by $1.15 per share, the closing price of our common stock as reported on the Nasdaq Capital Market on June 3, 2016, the date of grant. In accordance with SEC rules, this amount is reported in the "Stock Awards" column for 2016 in the table above.

(7) Represents amounts paid to the named executive officer under our 2016 senior management incentive plan upon achievement of specified financial and qualitative performance objectives.

Grants of Plan-Based Awards for 2018

The following table provides information with regard to potential cash bonuses for 2018 payable under our senior management incentive plan and equity awards made in 2018.

Name	Grant Date	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards (3) Threshold ($)	Target ($)	Maximum ($)	All Other Stock Awards: Number of Securities Underlying (#)	Grant Date Fair Value of Stock and Option Awards ($)(3)
Scott A. Graeff (1)		10,833	162,500	292,500		
	5/15/2018				140,000	$429,800
Dale E. Messick (2)		10,201	102,016	183,629		
	5/15/2018				50,000	$153,500

(1) For Mr. Graeff, the “Threshold” column represents the smallest total bonus that would have been paid for 2018 if we had achieved the threshold operating income and Mr. Graeff achieved one of his individual qualitative goals and we did not achieve any of the other financial or qualitative objectives, which would have resulted in a bonus equal to 3.3% of his 2018 salary. The “Target” column represents the amount that would have been paid to Mr. Graeff if, for 2018, a consolidated operating loss of $0.4 million had been attained, we achieved the target level of consolidated revenue of $48.4 million and Mr. Graeff achieved his qualitative objectives. The “Maximum” column represents the largest total bonus that could have been paid to Mr. Graeff if, for 2018, a consolidated operating income of at least $2.0 million had been attained, we achieved the maximum level of consolidated revenue of $59.9 million, and Mr. Graeff achieved his qualitative objectives. For purposes of the incentive compensation plan, the revenue and operating income values include the operating results of the optoelectronic components business prior to its sale in July 2018.

(2) For Mr. Messick, the “Threshold” column represents the smallest total bonus that would have been paid for 2018 if we had achieved the threshold operating income and Mr. Messick achieved one of his individual qualitative goals and we did not achieve any of the other financial or qualitative objectives, which would have resulted in a bonus equal to 4.0% of his 2018 salary. The “Target” column represents the amount that would have been paid to Mr. Messick if, for 2018, a consolidated operating loss of $0.4 million had been attained and we achieved the target level of consolidated revenue of $48.4 million and he achieved each of his individual qualitative objectives. The “Maximum” column represents the largest total bonus that could have been paid to Mr. Messick if, for 2018, a consolidated operating income of at least $2.0 million was achieved and we recognized consolidated revenues equal to or greater than $59.9 million and he achieved each of his qualitative objectives. For purposes of the incentive compensation plan, the revenue and operating income values include the operating results of the optoelectronic components business prior to its sale in July 2018.

(3) The actual bonuses paid under our senior management incentive plan in respect of 2018 performance were $234,975 for Mr. Graeff and $142,290 for Mr. Messick, respectively. Such amounts are included in "Non-Equity Incentive Plan Compensation" in the Summary Compensation Table above.

(4) Amounts represent the aggregate grant date fair value of stock awards, as calculated in accordance with ASC Topic 718. For a discussion of valuation assumptions, see Note 10 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

Outstanding Equity Awards at December 31, 2018

The following table shows all outstanding unexercised stock options and unvested stock awards held by our named executive officers as of December 31, 2018.

Name	Option Awards: Number of Securities Underlying Unexercised Options (#) Exercisable	Unexercisable	Option Exercise Price ($)	Option Expiration Date	Stock Awards: Number of Shares that have not vested (#)		Market Value of Shares that have not vested ($) (5)
Scott A. Graeff	50,000	—	0.82	5/12/2019			
	34,531	—	1.68	2/28/2022			
					11,500	(1)	38,525
					23,000	(2)	77,050
					33,334	(3)	111,668
					140,000	(4)	469,000
Dale E. Messick	100,000	—	1.70	2/24/2019			
	34,531	—	1.68	2/28/2022			
					11,500	(1)	38,525
					23,000	(2)	77,050
					50,000	(4)	167,500

(1) Represents unvested shares underlying a restricted stock award issued on June 3, 2016, which will vest annually over a three year period.
(2) Represents unvested shares underlying a restricted stock award issued on May 24, 2017, which will vest annually over a three year period.
(3) Represents unvested shares underlying a restricted stock award issued on December 5, 2017, which will vest annually over a three year period.
(4) Represents unvested shares underlying a restricted stock award issued on May 15, 2018, which will vest annually over a three year period.
(5) Based on the closing price of our common stock of $3.35 per share as of December 31, 2018, the last trading day of 2018.

Option Exercises and Stock Vested During 2018

The table below sets forth information concerning the vesting of restricted stock for each named executive officer during 2018.

Name	Stock Awards: Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)
Scott A. Graeff	59,791	200,549
Dale E. Messick	43,125	143,635

Employment Agreements

Employment Agreement with Scott A. Graeff

On December 5, 2017, we entered into an amended and restated employment agreement with Scott A. Graeff as our President and Chief Executive Officer. Under the terms of the amended and restated employment agreement, Mr. Graeff is eligible to participate in an annual cash incentive plan for a discretionary cash bonus plan with a payout at target performance of 50% of his actual salary during such year and a maximum value of 75% of his actual salary during such year, subject to the achievement of individual and corporate performance criteria to be determined by our board of directors or our Compensation Committee and set forth in the incentive plan.

The employment agreement provides that, in the event that his employment is terminated by us “without cause” or by him for “good reason” (each as defined in the employment agreement), subject to his entering into and not revoking a release in a form acceptable to the Company, he will be entitled to receive:

- a severance payment equal to 12 months of his then current annual salary payable in installments on the Company's regular payroll dates plus a lump sum payment equal to his annual cash incentive compensation assuming that the performance objectives were achieved at the target level;
- if he timely elects and remains eligible for continued coverage under COBRA, an amount equal to the health insurance premiums that we were paying on his behalf and on behalf of his covered dependents prior to the date of termination for a period of nine months, or 12 months if the termination occurs within 12 months following a change in control transaction;
- a lump sum payment of any annual cash incentive earned but unpaid with respect to the year preceding the year of termination; and
- a cash payment for any unvested company matching contributions in his account under the Company's 401(k) plan and for any accrued but unpaid vacation.

In addition to the severance and retention payments described above, in the event a change in control occurs due to a sale of the Company's assets or a merger of the Company or an acquisition of the Company via tender offer, the employment agreement also provides that Mr. Graeff will receive the payments described above provided that all such payments will be accelerated and not deferred. In addition, all outstanding equity awards received prior to the change in control shall immediately vest.

In addition, in the event that payments made upon termination constitute parachute payments within the meaning of Section 280G of the Code and are subject to excise tax imposed under Section 4999 of the Code, then the payments may be reduced if such reduction results in Mr. Graeff receiving on an after-tax basis a greater severance amount.

Employment Agreement with Dale E. Messick

In July 2018, we entered into an amended and restated employment agreement with Mr. Messick. Pursuant to the employment agreement, Mr. Messick will be employed by us on an "at-will" basis, meaning either party may terminate the agreement at any time, with or without cause or advanced notice.

Under the terms of the employment agreement, Mr. Messick is eligible to participate in our senior management incentive plan for an annual discretionary cash bonus with a target value of at least 40% of his then current base salary, subject to the achievement of individual and corporate performance criteria to be determined by our board of directors or our Compensation Committee and set forth in the incentive plan.

In the event that Mr. Messick's employment is terminated by us "without cause" or by Mr. Messick for "good reason" (each as defined in his employment agreement), subject to Mr. Messick's entering into and not revoking a separation agreement that includes, among other terms, a general release of claims in our favor, in a form acceptable to us, Mr. Messick will be entitled to receive:

- severance payments equal to his then applicable base salary for a period of 9 months paid in installments on our regular payroll dates;
- an increase in variable store costs of $5.7 million from new corporate-owned stores, outlets, showrooms and other;
- an increase in variable costs such as distribution costs, credit card fees and packaging related to our direct to consumer segment of $6.0 million as a result of increased sales volume;
- an increase in administrative costs related to our direct to consumer segment of $4.4 million associated with the growth in this channel and increased head count to support it;
- an increase in head office employee costs of $5.7 million from increased head count in order to position us for long-term growth, partially offset by decreased stock-based compensation;
- an increase in other head office costs of $5.2 million as a result of the overall growth of our business and investment in strategic initiatives and projects;
- an increase in other costs, including occupancy costs not included in cost of goods sold, of $11.4 million; and
- a decrease in net foreign exchange gains of $10.8 million.

As a percentage of net revenue, selling, general and administrative expenses increased 180 basis points, to 30.0% in fiscal 2014 from 28.2% in fiscal 2013.

We expect selling, general and administrative expenses to increase throughout fiscal 2015 as we add administrative and sales personnel and increase our infrastructure to support the growth in our store base.

Income from Operations

Income from operations decreased $15.3 million, or 4%, to $376.0 million in fiscal 2014 from $391.4 million in fiscal 2013. The decrease was a result of increased selling, general and administrative costs of $89.4 million, partially offset by increased gross profit of $74.1 million. The increase in selling, general and administrative costs was primarily driven by the increase in our business.

On a segment basis, we determine income from operations without taking into account our general corporate expenses. We have reviewed our general corporate expenses and determined some costs previously classified as general corporate are direct segment expenses. Accordingly, all prior year comparable information has been reclassified to conform to the current year classification.

Income from operations before general corporate expenses for fiscal 2014 and fiscal 2013 is summarized below and is expressed in dollar amounts. The percentages are presented as a percentage of net revenue of the respective operating segments.

	Fiscal Year Ended February 1, 2015 and February 2, 2014			
	2014	2013	2014	2013
	(In thousands)		(Percentages)	
Corporate-owned stores	$356,589	$372,267	26.4	30.3
Direct to consumer	132,877	109,999	41.4	41.8
Other	9,499	13,994	7.4	14.1
Income from operations before general corporate expense	498,965	496,260		
General corporate expense	122,932	104,902		
Income from operations	$376,033	$391,358		

Corporate-Owned Stores. Income from operations from our corporate-owned stores segment decreased $15.7 million, or 4%, to $356.6 million for fiscal 2014 from $372.3 million for fiscal 2013 primarily due to an increase in selling, general and administrative expenses related to employee costs as well as operating expenses associated with new stores, partially offset by an increase of $31.2 million in gross profit from increased sales. Income from operations as a percentage of corporate-owned stores net revenue decreased by 390 basis points primarily due to higher selling, general and administrative expenses as a percentage of net revenue as well as lower gross margin resulting from product mix, increased product costs, and increased air freight costs.

Direct to Consumer. Income from operations from our direct to consumer segment increased $22.9 million, or 21%, to $132.9 million in fiscal 2014 from $110.0 million in fiscal 2013. The increase was primarily the result of increased gross profit of $33.1 million primarily due to increased net revenue resulting from increased traffic, partially offset by increased selling, general and administrative expenses related to our long-term strategy for developing this channel. Income from operations as a percentage of direct to consumer net revenue decreased to 41.4% in fiscal 2014 from 41.8% in fiscal 2013.

Other. Income from operations from our other segment decreased $4.5 million, or 32%, to $9.5 million in fiscal 2014 from $14.0 million in fiscal 2013. Income from operations as a percentage of other net revenue decreased by 670 basis points primarily due to an increased number of showrooms in new international markets which have a higher cost structure than North America. We continue to employ our other segment strategy to increase interest in our product in markets we have not otherwise entered with corporate-owned stores.

General Corporate Expense. General corporate expense increased $18.0 million, or 17%, to $122.9 million in fiscal 2014 from $104.9 million in fiscal 2013. This increase was primarily due to a $10.8 million decrease in net foreign exchange gains, primarily from our Canadian operating entity. An increase in expenses related to our head office growth of $7.2 million, which was largely related to additional costs incurred to support the growth of our business, including increased professional fees related to investment in strategic initiatives and projects. General corporate expenses are expected to continue to increase in future years as we grow our overall business and require increased efforts at our head office to support our corporate-owned stores, direct to consumer and other segments.

Other Income (Expense), Net

Other income (expense), net increased $1.3 million, to $7.1 million in fiscal 2014 from $5.8 million in fiscal 2013. The increase was primarily the result of increased interest earned on cash and cash equivalents.

Provision for Income Taxes

Provision for income taxes increased $26.5 million, or 23%, to $144.1 million in fiscal 2014 from $117.6 million in fiscal 2013. In fiscal 2014, our effective tax rate was 37.6% compared to 29.6% in fiscal 2013. The increase in our effective tax rate was a result of a tax expense of $33.7 million recorded during fiscal 2014 to provide for U.S. income and applicable foreign withholding taxes on dividends of $473.7 million which were distributed during fiscal 2014 from foreign subsidiaries to the U.S. parent entity to fund the share repurchase program.

Net Income

Net income decreased $40.5 million, or 15%, to $239.0 million in fiscal 2014 from $279.5 million in fiscal 2013. The decrease in net income in fiscal 2014 was primarily due to an increase of $89.4 million in selling, general and administrative expenses, and an increase of $26.5 million in provision for income taxes, partially offset by a $1.3 million increase in other income (expense), and a $74.1 million increase in gross profit resulting from new stores and the growth of our direct to consumer segment.

Comparison of Fiscal 2013 to Fiscal 2012

Net Revenue

Net revenue increased $220.8 million, or 16%, to $1.591 billion in fiscal 2013 from $1.370 billion in fiscal 2012. Assuming the average exchange rates in fiscal 2013 remained constant with the average exchange rates in fiscal 2012, our net revenue would have increased $247.0 million, or 18%. Total comparable sales, including comparable stores and direct to consumer, and excluding the fifty-third week's sales of fiscal 2012, increased 7% in fiscal 2013, or 9% excluding the effect of foreign currency fluctuations.

The net revenue increase was driven by sales from new stores, the growth of our direct to consumer segment, and increased sales at locations in our comparable stores base. The constant dollar increase in comparable store sales was driven primarily by the strength of our existing product lines, successful introduction of new products and increasing recognition of the lululemon athletica brand name, especially at our U.S. stores, that drove higher transactions per store in the United States.

Our net revenue on a segment basis for fiscal 2013 and fiscal 2012 are expressed in dollar amounts as well as relevant percentages, presented as a percentage of total net revenue below.

	Fiscal Year Ended February 2, 2014 and February 3, 2013			
	2013	2012	2013	2012
	(In thousands)		(Percentages)	
Corporate-owned stores	$1,228,999	$1,090,181	77.3	79.6
Direct to consumer	263,083	197,255	16.5	14.4
Other	99,106	82,922	6.2	6.0
Net revenue	$1,591,188	$1,370,358	100.0	100.0

Corporate-Owned Stores. Net revenue from our corporate-owned stores segment increased $138.8 million, or 13%, to $1.229 billion in fiscal 2013 from $1.090 billion in fiscal 2012. The following contributed to the increase in net revenue from our corporate-owned stores segment:

- Net revenue from corporate-owned stores we opened during fiscal 2013, and during fiscal 2012 prior to sales from such stores becoming part of our comparable stores base, contributed $138.0 million of the increase. New store openings in fiscal 2013 included three stores in Canada, including one ivivva branded store, 36 stores in the United States, including three ivivva branded stores, two stores in Australia, and two stores in New Zealand; and
- Comparable store sales increase of 2% in fiscal 2013 resulted in a $19.5 million increase to net revenue, including the effect of foreign currency fluctuations. Excluding the effect of foreign currency fluctuations, comparable store sales increased 4%, or $37.3 million, in fiscal 2013.

The increase in net revenue was partially offset by $18.7 million of net revenue from the 53rd week of fiscal 2012, which was excluded in the calculation of comparable store sales.

Direct to Consumer. Net revenue from our direct to consumer segment increased $65.8 million, or 33%, to $263.1 million in fiscal 2013 from $197.3 million in fiscal 2012, including $4.2 million of net revenue from the 53rd week of fiscal 2012. Excluding the net revenue from the 53rd week of fiscal 2012, net revenue from our direct to consumer segment increased 36%; excluding the effect of foreign exchange fluctuations, direct to consumer net revenue would have increased 38%. The increase in net revenue from our direct to consumer segment was a result of increasing traffic on our e-commerce websites.

Other. Net revenue from our other segment increased $16.2 million, or 20%, to $99.1 million in fiscal 2013 from $82.9 million in fiscal 2012, including $3.3 million of net revenue from the 53rd week of fiscal 2012. The increase in net revenue from our other segment was primarily due to increased sales from our outlets and showrooms sales channels. We continue to employ our other segment strategy to increase interest in our product in markets where we may not have corporate-owned stores.

Gross Profit

Gross profit increased $77.2 million, or 10%, to $840.1 million in fiscal 2013 from $762.8 million in fiscal 2012. Increased net revenue in all of our operating segments resulted in an increased gross profit. A $17.5 million charge related to the pull-back of black Luon pants was recorded in cost of sales during fiscal 2013.

The increase in gross profit was partially offset by increases in fixed costs, such as occupancy costs and depreciation, as well as increased costs related to our design, merchandising, and production departments.

Gross profit, as a percentage of net revenue, or gross margin, decreased 290 basis points, to 52.8% in fiscal 2013 from 55.7% in fiscal 2012. The decrease in gross margin resulted primarily from:

- a decrease in product margin of 200 basis points due to a lower sales mix of higher margin core items related to the pull-back of black Luon pants, along with higher markdowns and an increase in provision for inventories charged to cost of sales; and
- a non-recurring charge of 110 basis points related to the pull-back of black Luon pants in the first quarter of fiscal 2013.

The decrease in gross margin was partially offset by a decrease in expenses related to our product and supply chain departments, relative to the increase in net revenue, and by leverage on fixed costs, such as depreciation and occupancy costs, which together contributed to an increase in gross margin of 20 basis points.

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Selling, General and Administrative Expenses

Selling, general and administrative expenses increased $62.3 million, or 16%, to $448.7 million in fiscal 2013 from $386.4 million in fiscal 2012. The increase in selling, general and administrative expenses was principally comprised of:

- an increase in employee costs of $25.3 million as we experience growth in labor hours associated with new and existing corporate-owned stores, outlets, showrooms and other, as well as an increase in wages as we invest in our employees;
- an increase in variable store costs of $9.5 million from new and existing corporate-owned stores, outlets, showrooms and other;
- an increase in variable costs such as distribution costs, credit card fees and packaging related to our direct to consumer segment of $7.3 million as a result of increased sales volume;
- an increase in administrative costs related to our direct to consumer segment of $5.3 million associated with the growth in this channel and increased head count to support it;
- an increase in head office employee costs of $5.7 million from increased head count in order to position us for long-term growth, partially offset by decreased management incentive-based compensation and stock-based compensation;
- an increase in other head office costs of $17.5 million as a result of the overall growth of our business and investment in strategic initiatives and projects; and
- an increase in other costs, including occupancy costs and depreciation not included in cost of goods sold, of $9.6 million as a result of the expansion of our business and in order to position us for long-term growth.

The increase in selling, general and administrative expenses was partially offset by a $17.9 million increase in net foreign exchange gains which were primarily from our Canadian operating entity.

As a percentage of net revenue, selling, general and administrative expenses remained unchanged at 28.2% in both fiscal 2013 and fiscal 2012.

Income from Operations

Income from operations increased $14.9 million, or 4%, to $391.4 million in fiscal 2013 from $376.4 million in fiscal 2012. The increase was a result of increased gross profit of $77.2 million, partially offset by increased selling, general and administrative costs of $62.3 million. The increase in selling, general and administrative costs was primarily driven by the increase in our business, as seen in our net revenue increases.

On a segment basis, we determine income from operations without taking into account our general corporate expenses. We have reviewed our general corporate expenses and determined some costs previously classified as general corporate are direct segment expenses. Accordingly, all prior year comparable information has been reclassified to conform to the current year classification.

Income from operations before general corporate expenses for fiscal 2013 and fiscal 2012 are expressed in dollar amounts as well as percentages, presented as a percentage of net revenue of their respective operating segments below.

	Fiscal Year Ended February 2, 2014 and February 3, 2013			
	2013	2012	2013	2012
	(In thousands)		(Percentages)	
Corporate-owned stores	$372,267	$373,607	30.3	34.3
Direct to consumer	109,999	85,128	41.8	43.2
Other	13,994	19,787	14.1	23.9
Income from operations before general corporate expense	496,260	478,522		
General corporate expense	104,902	102,083		
Income from operations	$391,358	$376,439		

Corporate-Owned Stores. Income from operations from our corporate-owned stores segment decreased $1.3 million, or less than 1%, to $372.3 million for fiscal 2013 from $373.6 million for fiscal 2012 primarily due to an increase in selling, general and administrative expenses related to employee costs as well as operating expenses associated with new stores and a $17.5 million charge related to the pull-back of black Luon pants, which was partially offset by an increase of $38.3 million in gross profit. Income from operations as a percentage of corporate-owned stores net revenue decreased by 400 basis points

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primarily from a decrease in gross margin due to a lower mix of higher margin core items related to the pull-back of black Luon pants.

Direct to Consumer. Income from operations from our direct to consumer segment increased $24.9 million, or 29%, to $110.0 million in fiscal 2013 from $85.1 million in fiscal 2012 due to increased sales through our e-commerce websites, with gross profit increasing $36.3 million over fiscal 2012. Income from operations as a percentage of direct to consumer net revenue decreased by 140 basis points in fiscal 2013 compared to fiscal 2012.

Other. Income from operations from our other segment decreased $5.8 million, or 29%, to $14.0 million in fiscal 2013 from $19.8 million in fiscal 2012. We continue to employ our other segment strategy to increase interest in our product in markets we have not otherwise entered with corporate-owned stores.

General Corporate Expense. General corporate expenses increased $2.8 million, or 3%, to $104.9 million in fiscal 2013 from $102.1 million in fiscal 2012. This increase was primarily due to an increase in expenses related to our head office growth of $27.3 million, which was largely related to the growth of our information technology and human resources departments as well as the overall growth of our business, and increased professional fees related to investment in strategic initiatives and projects. Increased depreciation and amortization expense of $3.3 million also contributed to the increase in general corporate expense. The increase in general corporate expense was partially offset by an increase of $17.9 million in net foreign exchange gains which were primarily from our Canadian operating entity as well as decreased management incentive-based compensation of $5.0 million and decreased stock-based compensation expense of $4.9 million.

Other Income (Expense), Net

Other income (expense), net increased $0.8 million, to $5.8 million in fiscal 2013 from $5.0 million in fiscal 2012. The increase was primarily a result of increased interest income earned in fiscal 2013 compared to fiscal 2012 on our increased cash balances.

Provision for Income Taxes

Provision for income taxes increased $7.6 million, or 7%, to $117.6 million in fiscal 2013 from $110.0 million in fiscal 2012. In fiscal 2013, our effective tax rate was 29.6% compared to 28.8% in fiscal 2012.

Net Income

Net income increased $9.0 million, or 3%, to $279.5 million in fiscal 2013 from $270.6 million in fiscal 2012. The increase in net income in fiscal 2013 was primarily due to a $77.2 million increase in gross profit resulting from sales growth at existing and additional corporate-owned stores opened during fiscal 2013 and increasing traffic on our e-commerce websites and the addition of regional websites and a $0.8 million increase in other income (expense), net, partially offset by an increase of $62.3 million in selling, general and administrative expenses, and an increase of $7.6 million in provision for income taxes.

Comparable Sales

We separately track comparable store sales, which reflect net revenue at corporate-owned stores that have been open for at least 12 months. Therefore, net revenue from a store is included in comparable store sales beginning with the first month for which the store has a full month of comparable prior year sales. Non-comparable store sales include sales from new stores that have not been open or otherwise not operated by us for 12 months or from stores which have been significantly remodeled or relocated. Also included in non-comparable stores sales are sales from direct to consumer sales, outlets, wholesale, warehouse sales, showrooms, temporary locations, and sales from corporate-owned stores which we have closed. The 53rd week of fiscal 2012 is excluded from the calculation of comparable store sales.

We began to report total comparable sales in fiscal 2013, which combines comparable store sales and direct to consumer sales, excluding the 53rd week of sales from fiscal 2012. Our direct to consumer segment represents a growing portion of our net revenue as the shopping behavior of our guests evolves. Our approach to our guests supports this as it involves country and region specific websites, mobile/tablet devices in stores, social networks, and product notification emails. We therefore believe that reporting total comparable sales with comparable store sales and direct to consumer sales combined provides a more relevant metric.

By measuring the change in year-over-year net revenue in stores that have been open for 12 months or more as well as direct to consumer sales, total comparable sales allows us to evaluate our performance eliminating the impact of newly opened stores. Various factors affect comparable sales, including:

- the location of new stores relative to existing stores;

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- consumer preferences, buying trends and overall economic trends;
- our ability to anticipate and respond effectively to customer preferences for technical athletic apparel;
- competition;
- changes in our merchandise mix;
- pricing;
- the timing of our releases of new merchandise and promotional events;
- the effectiveness of our grassroots marketing efforts;
- the level of customer service that we provide in our stores and on our websites;
- our ability to source and distribute products efficiently; and
- the number of stores we open, close (including for temporary renovations) and expand in any period.

Opening new stores is an important part of our growth strategy. Accordingly, total comparable sales has limited utility for assessing the success of our growth strategy insofar as comparable sales do not reflect the performance of stores open less than 12 months.

Non-GAAP Financial Measures

Net revenue changes in constant dollars, total comparable sales in constant dollars, comparable store sales in constant dollars, changes in direct to consumer net revenue in constant dollars, the tax rate excluding the tax expense on the repatriation of foreign earnings, and diluted earnings per share excluding the tax expense on the repatriation of foreign earnings are non-GAAP performance measures.

We provide constant dollar changes in net revenue, total comparable sales, comparable store sales, and changes in direct to consumer net revenue because we use these measures to understand the underlying growth rate of net revenue excluding the impact of changes in foreign exchange rates, which are not under management's control. We believe that disclosing these measures on a constant dollar basis is useful to investors because it enables them to better understand the level of growth of our business.

We disclose the tax rate and diluted earnings per share excluding the tax expense on repatriated foreign earnings because of their comparability to our historical information as well as our diluted earnings per share guidance, which we believe is useful to investors.

The presentation of this financial information is not intended to be considered in isolation or as a substitute for, or superior to, the financial information prepared and presented in accordance with GAAP. A reconciliation of the non-GAAP financial measures follows, which includes more detail on the GAAP financial measure that is most directly comparable to each non-GAAP financial measure, and the related reconciliations between these financial measures.

The below performance measures show the dollar and percentage change compared to the corresponding period in the prior year.

Constant dollar changes in net revenue

	Fiscal Year Ended February 1, 2015		Fiscal Year Ended February 2, 2014	
	(In thousands)	(Percentage)	(In thousands)	(Percentage)
Net revenue increase	$206,024	13 %	$220,830	16 %
Adjustments due to foreign exchange rate changes	35,656	2 %	26,153	2 %
Net revenue increase in constant dollars	$241,680	15 %	$246,983	18 %

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Constant dollar total comparable sales

	Fiscal Year Ended February 1, 2015	Fiscal Year Ended February 2, 2014
Total comparable sales	1 %	7 %
Adjustments due to foreign exchange rate changes	2 %	2 %
Total comparable sales in constant dollars	3 %	9 %

Constant dollar comparable store sales

	Fiscal Year Ended February 1, 2015		Fiscal Year Ended February 2, 2014	
	(In thousands)	(Percentage)	(In thousands)	(Percentage)
Comparable store sales	$(42,801)	(3)%	$19,460	2 %
Adjustments due to foreign exchange rate changes	23,712	2 %	17,874	2 %
Comparable store sales in constant dollars	$(19,089)	(1)%	$37,334	4 %

Constant dollar changes in direct to consumer net revenue

	Fiscal Year Ended February 1, 2015	Fiscal Year Ended February 2, 2014
	(Percentage)	
Change in direct to consumer net revenue	22 %	36 %
Adjustments due to foreign exchange rate changes	2 %	2 %
Change in direct to consumer net revenue in constant dollars	24 %	38 %

Tax rate, excluding the tax expense on repatriated foreign earnings

	Fiscal Year Ended February 1, 2015	Fiscal Year Ended February 2, 2014
Tax rate	37.6 %	29.6 %
Tax expense on repatriated foreign earnings	(8.8)%	— %
Tax rate, excluding the tax expense on repatriated foreign earnings	28.8 %	29.6 %

Diluted earnings per share, excluding the tax expense on repatriated foreign earnings

	Fiscal Year Ended February 1, 2015	Fiscal Year Ended February 2, 2014
Diluted earnings per share	$1.66	$1.91
Tax expense on repatriated foreign earnings	0.23	—
Diluted earnings per share, excluding the tax expense on repatriated foreign earnings	$1.89	$1.91

Liquidity and Capital Resources

Our primary sources of liquidity are our current balances of cash and cash equivalents, cash flows from operations and borrowings available under our revolving credit facility. Our primary cash needs are capital expenditures for opening new stores and remodeling existing stores, making information technology system enhancements and funding working capital requirements. Cash and cash equivalents in excess of our needs are held in interest bearing accounts with financial institutions.

As of February 1, 2015, our working capital (excluding cash and cash equivalents) was $126.7 million and our cash and cash equivalents were $664.5 million.

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The following table summarizes our net cash flows provided by and used in operating, investing and financing activities for the periods indicated:

	Fiscal Year Ended		
	February 1, 2015	February 2, 2014	February 3, 2013
	(In thousands)		
Total cash provided by (used in):			
Operating activities	$314,449	$278,339	$280,113
Investing activities	(119,733)	(106,408)	(93,229)
Financing activities	(149,077)	8,907	(5,491)
Effect of exchange rate changes	(79,809)	(72,368)	(651)
(Decrease) increase in cash and cash equivalents	$(34,170)	$108,470	$180,742

Operating Activities

Operating Activities consist primarily of net income adjusted for certain non-cash items, including depreciation and amortization, stock-based compensation expense and the effect of changes in non-cash working capital items, principally accounts payable, inventories, prepaid expenses, income taxes payable, accrued compensation and related expenses, and deferred gift card revenue.

In fiscal 2014, cash provided by operating activities increased $36.1 million, to $314.4 million compared to cash provided by operating activities of $278.3 million in fiscal 2013. The increase was primarily a result of decreased income taxes paid and an increase in accrued compensation and related benefits, partially offset by a decrease in net income. The net increase in items not affecting cash was primarily due to an increase in depreciation related to our increased number of stores.

Investing Activities

Investing Activities relate primarily to capital expenditures.

Cash used in investing activities increased $13.3 million, to $119.7 million in fiscal 2014 from $106.4 million in fiscal 2013. Capital expenditures for our corporate-owned stores segment were $76.9 million in fiscal 2014 which included $38.1 million to open 49 corporate-owned stores and $60.2 million in fiscal 2013 which included $31.3 million to open 45 corporate-owned stores. The remaining capital expenditures for our corporate-owned stores segment in each period were for ongoing store refurbishment. Capital expenditures for our direct to consumer segment were $10.0 million and $6.0 million in fiscal 2014 and fiscal 2013, respectively. Capital expenditures related to corporate activities and administration were $32.9 million and $40.2 million in fiscal 2014 and fiscal 2013, respectively. The capital expenditures in each period for corporate activities and administration were for improvements at our head office and other corporate buildings as well as investments in information technology and business systems.

Capital expenditures are expected to range between $130 million and $135 million in fiscal 2015.

Financing Activities

Financing Activities consist primarily of cash used to repurchase shares of our common stock, cash received on the exercise of stock options, excess tax benefits from stock-based compensation, taxes paid related to the net share settlement of equity awards, and cash paid to acquire the remaining non-controlling interest in Australia in fiscal 2012.

Cash used by financing activities increased $158.0 million, to cash used of $149.1 million in fiscal 2014 from cash provided of $8.9 million in fiscal 2013. The primary cause of this increase is our stock repurchase program which began in the second quarter of fiscal 2014. During fiscal 2014 we repurchased 3.7 million shares for a total cost of $147.4 million.

We believe that our cash and cash equivalent balances, cash generated from operations, and borrowings available to us under our revolving credit facility will be adequate to meet our liquidity needs and capital expenditure requirements for at least the next 12 months. Our cash from operations may be negatively impacted by a decrease in demand for our products as well as the other factors described in "Item 1A. Risk Factors". In addition, we may make discretionary capital improvements with respect to our stores, distribution facilities, headquarters, or other systems, which we would expect to fund through the use of cash, issuance of debt or equity securities or other external financing sources to the extent we were unable to fund such capital expenditures out of our cash and cash equivalents and cash generated from operations.

Revolving Credit Facility

On November 22, 2013, we entered into unsecured demand revolving credit facilities with HSBC Bank Canada and Bank of America, N.A., Canada Branch, which replaced our 2007 credit facility. The credit facilities provide us with available borrowings in a total amount of $15.0 million. Borrowings under the credit facilities must be repaid in full on demand and are available by way of U.S. or Canadian denominated advances, letters of credit or depository bills. Advances denominated in U.S. Dollars bear interest on the outstanding balance at a rate equal to U.S. LIBOR plus 100 basis points or the U.S. prime rate, at our option. Advances denominated in Canadian Dollars bear interest on the outstanding balance at a rate equal to the CDOR Rate plus 100 basis points or the Canadian prime rate, at our option. Borrowings drawn down under standby letters of credit bear a fee of 100 basis points and borrowings drawn down under commercial letters of credit bear the banks' standard pricing. We are also required to pay a quarterly commitment fee of 10 basis points on the unused portion of the facility. Our wholly-owned subsidiary, lululemon usa inc., has provided a guarantee to the bank counter-parties under the facilities. The revolving credit facilities are unsecured, with a negative pledge on assets subject to permitted encumbrances, and no financial covenants. These facilities were renewed for a one year period in November 2014. As of February 1, 2015, aside from letters of credit of $0.6 million, we had no other borrowings outstanding under these credit facilities.

Contractual Obligations and Commitments

Leases. We lease certain store and other retail locations, distribution centers, offices, and equipment under non-cancelable operating leases. Our leases generally have initial terms of between five and 10 years, and generally can be extended only in five-year increments, if at all. Our leases expire at various dates between one and 10 years, excluding extensions at our option. A substantial number of our leases include renewal options and certain of our leases include rent escalation clauses, rent holidays and leasehold rental incentives, none of which are reflected in the table below. Most of our leases for store premises also include contingent rental payments based on sales volume, the impact of which also are not reflected in the table below.

Product purchase obligations. The amounts listed for product purchase obligations in the table below represent agreements (including open purchase orders) to purchase products in the ordinary course of business that are enforceable and legally binding and that specify all significant terms. In some cases, prices are subject to change throughout the production process. The reported amounts exclude product purchase liabilities included in accounts payable and accrued inventory liabilities as of February 1, 2015.

The following table summarizes our contractual arrangements as of February 1, 2015, and the timing and effect that such commitments are expected to have on our liquidity and cash flows in future periods:

	Payments Due by Fiscal Year						
	Total	2015	2016	2017	2018	2019	Thereafter
	(In thousands)						
Operating leases (minimum rent)	$395,483	$82,282	$81,697	$72,660	$57,190	$43,625	$58,029
Product purchase obligations	$189,723	$189,723	$—	$—	$—	$—	$—

Off-Balance Sheet Arrangements

We enter into standby letters of credit to secure certain of our obligations, including leases, taxes and duties. As of February 1, 2015, letters of credit and letters of guarantee totaling $0.6 million have been issued.

Other than our operating leases and these standby letters of credit, we do not have any off-balance sheet arrangements, investments in special purpose entities or undisclosed borrowings or debt. In addition, we have not entered into any derivative contracts or synthetic leases.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions. Predicting future events is inherently an imprecise activity and, as such, requires the use of judgment. Actual results may vary from estimates in amounts that may be material to the financial statements. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact our consolidated financial statements.

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We believe that the following critical accounting policies affect our more significant estimates and judgments used in the preparation of our consolidated financial statements:

Revenue Recognition. Net revenue is recognized net of sales taxes, discounts, and an estimated allowance for sales returns. Sales to customers through corporate-owned stores and other physical locations are recognized at the point of sale, net of an estimated allowance for sales returns. Direct to consumer sales are recognized when goods are shipped and collection is reasonably assured, net of an estimated allowance for sales returns. Other net revenue includes outlet sales, showroom sales, sales to wholesale accounts, warehouse sales, and sales from temporary locations. Revenue is recognized when these sales occur and amounts billed to customers for shipping and handling are recognized at the time of shipment.

Our estimated allowance for sales returns is a subjective critical estimate that has a direct impact on reported net revenue. This allowance is calculated based on a history of actual returns, estimated future returns and any significant future known or anticipated events. Consideration of these factors results in an estimated allowance for sales returns. Our standard terms for retail sales limit returns to approximately 14 days after the sale of the merchandise, however we accept returns after 14 days where the product fails to meet our guests' quality expectations. For our wholesale sales, we allow returns from our wholesale accounts if properly requested and approved. Employee discounts are classified as a reduction of net revenue.

Revenue from our gift cards is recognized when tendered for payment, or upon redemption. Outstanding customer balances are included in "Unredeemed gift card liability" on the consolidated balance sheets. There are no expiration dates on our gift cards, and we do not charge any service fees that cause a decrement to customer balances.

While we will continue to honor all gift cards presented for payment, we may determine the likelihood of redemption to be remote for certain card balances due to, among other things, long periods of inactivity. In these circumstances, to the extent we determine there is no requirement for remitting card balances to government agencies under unclaimed property laws, card balances may be recognized in the consolidated statements of operations in net revenue. The amount to be recognized is an estimate, based on historical customer redemption rates.

Inventory. Inventory is valued at the lower of cost and market. We periodically review our inventories and make provisions as necessary to appropriately value obsolete and damaged goods. The amount of the provision is equal to the difference between the cost of the inventory and its net realizable value based upon assumptions about future demands, selling prices and market conditions. If changes in market conditions result in reductions in the estimated net realizable value of our inventory below our previous estimate, we would increase our reserve in the period in which we made such a determination. In addition, we provide for inventory shrinkage as a percentage of sales, based on historical trends from actual physical inventories. Inventory shrinkage estimates are made to reduce the inventory value for lost or stolen items. We perform physical inventory counts throughout the year and adjust the shrink provision accordingly. In fiscal 2014, we wrote-off $12.4 million of inventory, and in fiscal 2013 we wrote-off $28.1 million of inventory, including $17.5 million related to the pull-back of black Luon pants.

Property and Equipment. Property and equipment are recorded at cost less accumulated depreciation. Buildings are depreciated on a straight-line basis over the expected useful life of the asset, which we estimate to be 20 years. Leasehold improvements are depreciated on a straight-line basis over the lesser of the length of the lease and the estimated useful life of the assets, up to a maximum of five years. All other property and equipment is depreciated using the declining balance method as follows:

Furniture and fixtures	20	%
Computer hardware and software	30	%
Equipment and vehicles	30	%

Changes in circumstances (such as technological advances) can result in differences between the actual and estimated useful lives. In those cases where we determine that the useful life of a long-lived asset should be shortened, we increase depreciation expense over the remaining useful life to depreciate the asset’s net book value to its salvage value.

Long-Lived Assets. Long-lived assets, including intangible assets with finite useful lives are evaluated for impairment when the occurrence of events or changes in circumstances indicates that the carrying value of the assets may not be recoverable as measured by comparing their net book value to the undiscounted estimated future cash flows generated by their use and eventual disposition. Impaired assets are recorded at fair value, determined principally by the present value of the estimated future cash flows expected from their use and eventual disposition.

Income Taxes. Deferred income tax assets are reduced by a valuation allowance, if based on the weight of available positive and negative evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The recognition of a deferred income tax asset is based upon several assumptions and forecasts, including current and proposed tax legislation, current and anticipated taxable income, utilization of previously unrealized non-operating loss carry forwards and regulatory reviews of tax filings. Given the judgments and estimates required and the sensitivity of the results to the significant assumptions used, we believe the accounting estimates used in relation to the recognition of deferred income tax assets are subject to measurement uncertainty and are susceptible to a material change if the underlying assumptions change.

We have not recorded U.S. income tax expense for foreign earnings that we have determined to be indefinitely reinvested outside the United States. We periodically assess the need to utilize these unremitted earnings to finance our foreign operations. This assessment is based on cash flow projections by tax jurisdiction. Such estimates are inherently imprecise since many assumptions utilized in the cash flow projections are subject to revision in the future. The possibility exists that amounts determined to be indefinitely reinvested outside of the United States may ultimately be repatriated. For instance, the cash needs of our U.S. entities may exceed our current expectations, or the actual cash needs of our foreign entities may be less than our current expectations. This would result in additional income tax expense in the year we determined that amounts were no longer indefinitely reinvested.

We file income tax returns in the United States, Canada and various foreign and state jurisdictions. The 2011 to 2013 tax years remain subject to examination by the U.S. federal and state tax authorities. The 2010 tax year is still open for certain state tax authorities. The 2007 to 2013 tax years remain subject to examination by Canadian tax authorities. The 2008 to 2013 tax years remain subject to examination by tax authorities in certain foreign jurisdictions. Our policy is to recognize interest expense and penalties related to income tax matters as a selling, general and administrative expense. At February 1, 2015, we do not have any significant accruals for interest related to unrecognized tax benefits or tax penalties. Our intercompany transfer pricing policies are currently subject to audits by various foreign tax jurisdictions. Although we believe that our intercompany transfer pricing policies and tax positions are reasonable, the final outcomes of tax audits or potential tax disputes may be materially different from that which is reflected in our income tax provisions and accruals.

Goodwill and Intangible Assets. Intangible assets are recorded at cost. Reacquired franchise rights are amortized on a straight-line basis over their estimated useful lives of 10 years. Goodwill represents the excess of the purchase price over the fair market value of identifiable net assets acquired and is not amortized. Goodwill is tested for impairment annually or more frequently when an event or circumstance indicates that goodwill might be impaired. Goodwill impairment testing requires us to estimate the fair value of our reporting units. We generally base our measurement of the fair value on the present value of future cash flows. Our significant estimates in the discounted cash flows model include: the discount rate and long-term rates of growth. We use our best estimates and judgment based on available evidence in conducting the impairment testing.

Stock-Based Compensation. We account for stock-based compensation using the fair value method. The fair value of the awards is estimated at the date of grant and recognized as employee compensation expense on a straight-line basis over the requisite service period. For awards with service and/or performance conditions, the amount of compensation expense recognized is based on the number of awards that are expected to vest.

The estimation of the number stock awards that will ultimately vest requires judgment, and to the extent actual results differ from our estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider several factors when estimating the number of awards which are expected to vest, including, future profit forecasts, types of awards, size of option holder group and anticipated employee retention. Actual results may differ substantially from these estimates.

The calculation of the grant-date fair value of stock options requires us to make certain estimates and assumptions, including, stock price volatility, and the expected life of the options. These assumptions are evaluated and revised, as necessary, to reflect market conditions and the Company's historical experience. The expected term of the options is based upon historical experience of similar awards, giving consideration for expectations of future employee behavior. Expected volatility is based upon the historical volatility of the Company's common stock for the period corresponding with the expected term of the options. In the future, as we gain historical data for volatility in our own stock and the actual term employees hold our options, expected volatility and expected term may change which could

substantially change the grant-date fair value of future awards of stock options and, ultimately, the expense we record.
Contingencies. In the ordinary course of business, we are involved in legal proceedings regarding contractual and employment relationships and a variety of other matters. We record contingent liabilities resulting from claims against us, when a loss is assessed to be probable and the amount of the loss is reasonably estimable. Assessing probability of loss and estimating probable losses requires analysis of multiple factors, including in some cases judgments about the potential actions of third-party claimants and courts.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in interest rates and foreign currency exchange rates. We do not hold or issue financial instruments for trading purposes.

Foreign Currency Exchange Risk. The functional currency of our foreign subsidiaries is generally the applicable local currency. Our consolidated financial statements are presented in U.S. dollars. Therefore, the net revenues, expenses, assets and liabilities of our foreign subsidiaries are translated from their functional currencies into U.S. dollars. Fluctuations in the value of the U.S. Dollar affect the reported amounts of net revenue, expenses, assets and liabilities. Foreign exchange differences which arise on translation of our foreign subsidiaries' balance sheets into U.S. dollars are recorded as a cumulative translation adjustment in accumulated other comprehensive income within stockholders' equity.

We also have exposure to changes in foreign exchange rates associated with transactions which are undertaken by our subsidiaries in currencies other than their functional currency. Such transactions include intercompany transactions and inventory purchases denominated in currencies other than the functional currency of the purchasing entity. As a result, we have been impacted by changes in exchange rates and may be impacted materially for the foreseeable future. The potential impact of currency fluctuation increases as international expansion increases.

We currently generate a significant portion of our net revenue and incur a significant portion of our expenses in Canada. The reporting currency for our consolidated financial statements is the U.S. dollar. The strengthening of the U.S. dollar against the Canadian dollar during fiscal 2014 has resulted in:

- a reduction in our net revenue upon translation of the sales made by our Canadian operations into U.S. dollars for the purposes of consolidation;
- a reduction in our selling, general and administrative expenses incurred by our Canadian operations into U.S. dollars for the purposes of consolidation; and
- foreign exchange gains by our Canadian subsidiaries on U.S. dollar cash and receivables denominated in U.S. dollars.

A 10% depreciation in the relative value of the Canadian dollar against the U.S. dollar compared to the exchange rates in effect for fiscal 2014 would have resulted in lost income from operations of approximately $2.2 million in fiscal 2014. This assumes a consistent 10% depreciation in the Canadian dollar against the U.S. dollar throughout the fiscal year. The timing of changes in the relative value of the Canadian dollar combined with the seasonal nature of our business, can affect the magnitude of the impact that fluctuations in foreign exchange rates have on our income from operations.

We have not historically hedged foreign currency fluctuations. However, in the future, in an effort to mitigate losses associated with these risks, we may at times enter into derivative financial instruments, although we have not historically done so. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

Interest Rate Risk. Our revolving credit facilities provide us with available borrowings in amount up to $15.0 million in the aggregate. Because our revolving credit facilities bear interest at a variable rate, we will be exposed to market risks relating to changes in interest rates, if we have a meaningful outstanding balance. As of February 1, 2015, aside from letters of credit and guarantees, we had no outstanding balances under our revolving facilities. We currently do not engage in any interest rate hedging activity and currently have no intention to do so in the foreseeable future. However, in the future, if we have a meaningful outstanding balance under our revolving facility, in an effort to mitigate losses associated with these risks, we may at times enter into derivative financial instruments, although we have not historically done so. These may take the form of forward contracts, option contracts, or interest rate swaps. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

Inflation

Inflationary factors such as increases in the cost of our product and overhead costs may adversely affect our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of gross margin and selling, general and administrative expenses as a percentage of net revenue if the selling prices of our products do not increase with these increased costs.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
lululemon athletica inc.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Financial Statements:

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Directors of
lululemon athletica inc.

We have audited the accompanying consolidated balance sheets of lululemon athletica inc. and its subsidiaries as of February 1, 2015 and February 2, 2014 and the related consolidated statements of operations and comprehensive income, stockholders' equity and cash flows for the 52, 52, and 53 week periods ended February 1, 2015, February 2, 2014, and February 3, 2013, respectively. In addition, we have audited the financial statement schedule listed in the index appearing under Item 15(a)(2). We also have audited lululemon athletica inc.'s and its subsidiaries' internal control over financial reporting as of February 1, 2015, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management is responsible for these consolidated financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express an opinion on these consolidated financial statements, the financial statement schedule and the company's internal control over financial reporting based on our integrated audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements and the financial statement schedule are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of lululemon athletica inc. and its subsidiaries as of February 1, 2015 and February 2, 2014 and the results of their operations and their cash flows for the 52, 52, and 53 week periods ended February 1, 2015, February 2, 2014, and February 3, 2013, respectively, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also, in our opinion, lululemon athletica inc. and its subsidiaries maintained, in all material respects, effective internal control over financial reporting as of February 1, 2015, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

/s/ PricewaterhouseCoopers LLP
Chartered Accountants
Vancouver, British Columbia
March 25, 2015

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lululemon athletica inc.
CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except per share amounts)

	February 1, 2015	February 2, 2014
ASSETS		
Current assets		
Cash and cash equivalents	$664,479	$698,649
Accounts receivable	13,746	11,903
Inventories	208,116	188,790
Prepaid expenses and other current assets	64,671	46,197
	951,012	945,539
Property and equipment, net	296,008	255,603
Goodwill and intangible assets, net	26,163	28,201
Deferred income tax asset	16,018	18,300
Other non-current assets	7,012	4,745
	$1,296,213	$1,252,388
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$9,339	$12,647
Accrued inventory liabilities	22,296	15,415
Accrued compensation and related expenses	29,932	19,445
Income taxes payable	20,073	769
Unredeemed gift card liability	46,252	38,343
Other accrued liabilities	31,989	29,595
	159,881	116,214
Deferred income tax liability	3,633	3,977
Other non-current liabilities	43,131	35,515
	206,645	155,706
Stockholders' equity		
Undesignated preferred stock, $0.01 par value, 5,000 shares authorized, none issued and outstanding	—	—
Exchangeable stock, no par value, 60,000 shares authorized, issued and outstanding 9,833 and 29,955	—	—
Special voting stock, $0.000005 par value, 60,000 shares authorized, issued and outstanding 9,833 and 29,955	—	—
Common stock, $0.005 par value, 400,000 shares authorized, issued and outstanding 132,112 and 115,342	661	577
Additional paid-in capital	241,695	240,351
Retained earnings	1,020,619	923,822
Accumulated other comprehensive loss	(173,407)	(68,068)
	1,089,568	1,096,682
	$1,296,213	$1,252,388

See accompanying notes to the consolidated financial statements

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lululemon athletica inc.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Amounts in thousands, except per share amounts)

	Fiscal Year Ended		
	February 1, 2015	February 2, 2014	February 3, 2013
Net revenue	$1,797,213	$1,591,188	$1,370,358
Cost of goods sold	883,033	751,112	607,532
Gross profit	914,180	840,076	762,826
Selling, general and administrative expenses	538,147	448,718	386,387
Income from operations	376,033	391,358	376,439
Other income (expense), net	7,102	5,768	4,957
Income before provision for income taxes	383,135	397,126	381,396
Provision for income taxes	144,102	117,579	109,965
Net income	239,033	279,547	271,431
Net income attributable to non-controlling interest	—	—	875
Net income attributable to lululemon athletica inc.	$239,033	$279,547	$270,556
Other comprehensive (loss) income:			
Foreign currency translation adjustment	(105,339)	(89,158)	(459)
Comprehensive income	$133,694	$190,389	$270,097
Basic earnings per share	$1.66	$1.93	$1.88
Diluted earnings per share	$1.66	$1.91	$1.85
Basic weighted-average number of shares outstanding	143,935	144,913	144,000
Diluted weighted-average number of shares outstanding	144,298	146,043	145,806

See accompanying notes to the consolidated financial statements

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lululemon athletica inc.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Amounts in thousands)

	Exchangeable Stock		Special Voting Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total	Non-Controlling Interest	Total
	Shares	Par Value	Shares	Par Value	Shares	Par Value						
Balance at January 29, 2012	33,412	$—	33,412	$—	110,135	$551	$205,557	$373,719	$21,549	$601,376	$4,805	$606,181
Net income attributable to lululemon athletica inc.								270,556		270,556		270,556
Foreign currency translation adjustment									(459)	(459)		(459
Common stock issued upon exchange of exchangeable shares	(1,347)	—	(1,347)	—	1,347	7	(7)			—		—
Stock-based compensation							15,637			15,637		15,637
Excess tax benefit from stock-based compensation							9,901			9,901		9,901
Restricted share issuance					16	—	—			—		—
Stock options exercised					873	4	11,010			11,014		11,014
Registration fees associated with shelf registration statement							(393)			(393)		(393
Non-controlling interest:												
Net income attributable to non-controlling interests											875	875
Purchase of remaining non-controlling interests							(20,333)			(20,333)	(5,680)	(26,013
Balance at February 3, 2013	32,065	$—	32,065	$—	112,371	$562	$221,372	$644,275	$21,090	$887,299	$—	$887,299
								279,547		279,547		279,547

Net income attributable to lululemon athletica inc.										
Foreign currency translation adjustment							(89,158)	(89,158)		(89,158
Common stock issued upon exchange of exchangeable shares	(2,110)	(2,110)	—2,110	11	(11)			—		—
Stock-based compensation					10,087			10,087		10,087
Excess tax benefit from stock-based compensation					6,457			6,457		6,457
Restricted share issuance			58	—	—			—		—
Stock options exercised			686	3	8,168			8,171		8,171
Common stock issued upon settlement of performance-based restricted stock units			208	1	(1)			—		—
Shares withheld related to net share settlement of equity awards			(91)	—	(5,721)			(5,721)		(5,721
Balance at February 2, 2014	29,955	$—29,955	$—115,342	$577	$240,351	$923,822	$(68,068)	$1,096,682	$—	$1,096,68

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	Exchangeable Stock Shares	Exchangeable Stock Par Value	Special Voting Stock Shares	Special Voting Stock Par Value	Common Stock Shares	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total	Non-Controlling Interest	Total
Net income attributable to lululemon athletica inc.								239,033		239,033		239,033
Foreign currency translation adjustment									(105,339)	(105,339)		(105,339
Common stock issued upon exchange of exchangeable shares	(20,122)		(20,122)	—	20,122	101	(101)			—		—
Stock-based compensation							8,269			8,269		8,269
Excess tax benefit from stock-based compensation							413			413		413
Stock options exercised					158	1	2,912			2,913		2,913
Restricted share issuance					34	—	—			—		—
Common stock issued upon settlement of performance-based restricted stock units					217	1	(1)			—		—
Shares withheld related to net share settlement of stock-based compensation					(104)	(1)	(4,971)			(4,972)		(4,972
Repurchase of common stock					(3,657)	(18)	(5,177)	(142,236)		(147,431)		(147,431
Balance at February 1, 2015	9,833	$—	9,833	$—	132,112	$661	$241,695	$1,020,619	$(173,407)	$1,089,568	$—	$1,089,56

See accompanying notes to the consolidated financial statements

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lululemon athletica inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)

	Fiscal Year Ended		
	February 1, 2015	February 2, 2014	February 3, 2013
Cash flows from operating activities			
Net income	$239,033	$279,547	$271,431
Items not affecting cash			
Depreciation and amortization	58,364	49,068	43,000
Stock-based compensation	8,269	10,087	15,637
Derecognition of unredeemed gift card liability	(1,468)	(4,654)	(1,351)
Deferred income taxes	2,087	820	(6,445)
Excess tax benefits from stock-based compensation	(413)	(6,457)	(9,901)
Other, including net changes in other non-cash balances			
Prepaid tax installments	(15,234)	3,067	(7,812)
Other prepaid expenses and other current assets	(8,813)	(14,408)	(10,492)
Inventories	(26,806)	(38,507)	(51,222)
Accounts payable	(2,198)	11,627	(13,481)
Accrued inventory liabilities	8,276	6,985	(1,785)
Other accrued liabilities	3,271	7,837	1,777
Sales tax collected	517	161	(4,232)
Income taxes payable	19,304	(35,075)	30,951
Accrued compensation and related expenses	11,561	(6,282)	4,695
Deferred gift card revenue	11,326	9,306	13,711
Other non-cash balances	7,373	5,217	5,632
Net cash provided by operating activities	314,449	278,339	280,113
Cash flows from investing activities			
Purchase of property and equipment	(119,733)	(106,408)	(93,229)
Net cash used in investing activities	(119,733)	(106,408)	(93,229)
Cash flows from financing activities			
Proceeds from exercise of stock options	2,913	8,171	11,014
Excess tax benefits from stock-based compensation	413	6,457	9,901
Registration fees associated with shelf registration statement	—	—	(393)
Purchase of non-controlling interest	—	—	(26,013)
Taxes paid related to net share settlement of equity awards	(4,972)	(5,721)	—
Repurchase of common stock	(147,431)	—	—
Net cash (used in) provided by financing activities	(149,077)	8,907	(5,491)
Effect of exchange rate changes on cash	(79,809)	(72,368)	(651)
(Decrease) increase in cash and cash equivalents	(34,170)	108,470	180,742
Cash and cash equivalents, beginning of period	$698,649	$590,179	$409,437
Cash and cash equivalents, end of period	$664,479	$698,649	$590,179

See accompanying notes to the consolidated financial statements

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lululemon athletica inc.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share amounts and store count information, unless otherwise indicated)

1 NATURE OF OPERATIONS AND BASIS OF PRESENTATION
Nature of operations
lululemon athletica inc., a Delaware corporation ("lululemon" and, together with its subsidiaries unless the context otherwise requires, the "Company") is engaged in the design, manufacture and distribution of healthy lifestyle inspired athletic apparel, which is sold through a chain of corporate-owned and operated retail stores, direct to consumer through e-commerce, showrooms, a network of wholesale accounts, outlets and warehouse sales. The Company's primary markets are the United States, Canada, Australia, New Zealand, the United Kingdom, and Singapore where 211, 57, 26, five, two, and one corporate-owned store(s), respectively, were in operation as at February 1, 2015. There were 302, 254, and 211 corporate-owned stores in operation as at February 1, 2015, February 2, 2014, and February 3, 2013, respectively.
Basis of presentation
The accompanying consolidated financial statements include the financial position, results of operations and cash flows of the Company during the three-year period ended February 1, 2015. The consolidated financial statements have been presented in U.S. dollars and are prepared in accordance with United States generally accepted accounting principles ("GAAP").
The Company's fiscal year ends on the Sunday closest to January 31 of the following year, typically resulting in a 52 week year, but occasionally giving rise to an additional week, resulting in a 53 week year. Fiscal 2014 and 2013 were 52 week years whereas fiscal 2012 was a 53 week year. Fiscal 2014, 2013 and 2012 ended on February 1, 2015, February 2, 2014, and February 3, 2013, respectively.
The Company's business is affected by the pattern of seasonality common to most retail apparel businesses. Historically, the Company has recognized a significant portion of its operating profit in the fourth fiscal quarter of each year as a result of increased sales during the holiday season.
Certain prior year amounts have been reclassified to conform to fiscal 2014 presentation.
2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
Principles of consolidation
The consolidated financial statements include the accounts of lululemon athletica inc. and its wholly-owned subsidiaries. All inter-company balances and transactions have been eliminated. The results of operations of lululemon athletica australia Pty attributable to the non-controlling interest for fiscal 2012 are presented within equity and net income, and are shown separately from the Company's equity and net income attributable to the Company.
Cash and cash equivalents
Cash and cash equivalents consist of cash on hand, bank balances and short-term deposits with original maturities of less than three months. The Company has not experienced any losses related to these balances, and management believes its credit risk to be minimal.
Accounts receivable
Accounts receivable primarily arise out of sales to wholesale accounts and landlord lease inducements. The allowance for doubtful accounts represents management's best estimate of probable credit losses in accounts receivable. Receivables are written off against the allowance when management believes that the amount receivable will not be recovered. As at February 1, 2015, February 2, 2014 and February 3, 2013 the Company recorded an insignificant allowance for doubtful accounts.
Inventories
Inventories, consisting of finished goods, inventories in transit, and raw materials, are stated at the lower of cost and market value. Cost is determined using weighted-average costs. For finished goods, market is defined as net realizable value,

and for raw materials, market is defined as replacement cost. Cost of inventories includes all costs incurred to deliver inventory to the Company's distribution centers including freight, non-refundable taxes, duty and other landing costs. The Company makes provisions as necessary to appropriately value obsolete or damaged goods. The amount of the provision is equal to the difference between the cost of the inventory and its estimated net realizable value based upon assumptions about future demand, selling prices and market conditions. In addition, the Company provides for inventory shrinkage based on historical trends from actual physical inventory counts. Inventory shrinkage estimates are made to reduce the inventory value for lost or stolen items. The Company performs physical inventory counts and cycle counts throughout the year and adjusts the shrink reserve accordingly.

Property and equipment

Property and equipment are recorded at cost less accumulated depreciation. Direct internal and external costs related to software used for internal purposes which are incurred during the application development stage or for upgrades that add functionality are capitalized. All other costs related to internal use software are expensed as incurred. Depreciation commences when an asset is ready for its intended use. Buildings are depreciated on a straight-line basis over the expected useful life of the asset, which is estimated to be 20 years. Leasehold improvements are depreciated on a straight-line basis over the lesser of the length of the lease and the estimated useful life of the improvement, to a maximum of five years. All other property and equipment are depreciated using the declining balance method as follows:

Furniture and fixtures	20	%
Computer hardware and software	30	%
Equipment and vehicles	30	%

Goodwill and intangible assets

Intangible assets are recorded at cost. Reacquired franchise rights are amortized on a straight-line basis over their estimated useful lives of 10 years.

Goodwill represents the excess of the aggregate of the consideration transferred, the fair value of any non-controlling interest in the acquiree, and the acquisition-date fair value of the Company's previously held equity interest over the net assets acquired and liabilities assumed. Goodwill and intangible assets with indefinite lives are tested annually for impairment or more frequently when an event or circumstance indicates that goodwill or indefinite life intangible assets might be impaired. The Company's operating segment for goodwill is its corporate-owned stores.

Impairment of long-lived assets

Long-lived assets, including intangible assets with finite lives, held for use are evaluated for impairment when the occurrence of events or a change in circumstances indicates that the carrying value of the assets may not be recoverable as measured by comparing their carrying value to the estimated undiscounted future cash flows generated by their use and eventual disposition. Impaired assets are recorded at fair value, determined principally by discounting the future cash flows expected from their use and eventual disposition. Reductions in asset values resulting from impairment valuations are recognized in income in the period that the impairment is determined.

Leased property and equipment

The Company leases stores, distribution centers, and administrative offices. Minimum rental payments, including any fixed escalation of rental payments and rent premiums, are amortized on a straight-line basis over the life of the lease beginning on the possession date. Rental costs incurred during a construction period, prior to store opening, are recognized as rental expense.

Deferred lease inducements, which include leasehold improvements paid for by the landlord and rent free periods, are recorded as liabilities on the consolidated balance sheet and recognized as a reduction of rent expense on a straight-line basis over the term of the lease.

The difference between the recognized rental expense and the total rental payments paid is reflected on the consolidated balance sheet as a deferred lease liability or a prepaid lease asset.

Contingent rental payments based on sales volumes are recorded in the period in which the sales occur.

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The Company recognizes a liability for the fair value of asset retirement obligations ("AROs") when such obligations are incurred. The Company's AROs are primarily associated with leasehold improvements which, at the end of a lease, the Company is contractually obligated to remove in order to comply with the lease agreement. At the inception of a lease with such conditions, the Company records an ARO liability and a corresponding capital asset in an amount equal to the estimated fair value of the obligation. The liability is estimated based on a number of assumptions requiring management's judgment, including store closing costs, cost inflation rates and discount rates, and is accreted to its projected future value over time. The capitalized asset is depreciated using the convention for depreciation of leasehold improvement assets. Upon satisfaction of the ARO conditions, any difference between the recorded ARO liability and the actual retirement costs incurred is recognized as an operating gain or loss in the consolidated statements of operations.

The Company recognizes a liability for a cost associated with a lease exit or disposal activity when such obligation is incurred. A lease exit or disposal liability is measured initially at its fair value in the period in which the liability is incurred. The Company estimates fair value at the cease-use date of its operating leases as the remaining lease rentals, reduced by estimated sublease rentals that could be reasonably obtained for the property, even where the Company does not intend to enter into a sublease. Estimating the cost of certain lease exit costs involves subjective assumptions, including the time it would take to sublease the leased location and the related potential sublease income. The estimated accruals for these costs could be significantly affected if future experience differs from that used in the initial estimate.

Deferred revenue

Receipts from the sale of gift cards are treated as deferred revenue. Amounts received in respect of gift cards are recorded as unredeemed gift card liability. When gift cards are redeemed for apparel, the Company recognizes the related revenue.

Revenue recognition

Net revenue is comprised of corporate-owned store net revenue, direct to consumer sales through www.lululemon.com, www.ivivva.com and other country and region specific websites, and other net revenue, which includes outlet sales, showroom sales, sales to wholesale accounts, warehouse sales, and sales from temporary locations.

Sales to customers through corporate-owned retail stores are recognized at the point of sale, net of discounts and an estimated allowance for sales returns.

Sales of apparel to customers through the Company's retail internet sites are recognized when goods are shipped, and collection is reasonably assured, net of an estimated allowance for sales returns.

Sales of apparel to wholesale accounts are recognized when goods are shipped and collection is reasonably assured.

All revenue is reported net of sales taxes collected for various governmental agencies.

Revenue from the Company's gift cards is recognized when tendered for payment, or upon redemption. Outstanding customer balances are included in "Unredeemed gift card liability" on the consolidated balance sheets. There are no expiration dates on the Company's gift cards, and lululemon does not charge any service fees that cause a decrement to customer balances.

While the Company will continue to honor all gift cards presented for payment, management may determine the likelihood of redemption to be remote for certain card balances due to, among other things, long periods of inactivity. In these circumstances, to the extent management determines there is no requirement for remitting card balances to government agencies under unclaimed property laws, card balances may be recognized in the consolidated statements of operations in net revenue. For the years ended February 1, 2015, February 2, 2014 and February 3, 2013, net revenue recognized on unredeemed gift card balances was $1,468, $4,654, and $1,351, respectively.

Cost of goods sold

Cost of goods sold includes:

- the cost of purchased merchandise, which includes acquisition and production costs including raw material and labor, as applicable;
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the cost incurred to deliver inventory to the Company's distribution centers including in-bound freight, non-refundable taxes, duty and other landing costs;

- the cost of the Company's distribution centers (such as labor, rent and utilities) and the depreciation related to the Company's distribution centers;

- the cost of the Company's production, design, distribution and merchandising departments including salaries, stock-based compensation and benefits, and operating expenses;
- occupancy costs such as minimum rent, contingent rent where applicable, property taxes, utilities and depreciation expense for the Company's corporate-owned store locations;
- hemming; and
- shrink and inventory valuation reserves.

Selling, general and administrative expenses

Selling, general and administrative expenses consist of all operating costs not otherwise included in cost of goods sold. Our selling, general and administrative expenses include the costs of corporate and store-level wages and benefits, costs to transport our products from our distribution facilities to our sales locations and e-commerce guests, professional fees, marketing, information technology, human resources, accounting, corporate facility and occupancy costs, and depreciation and amortization expense other than in cost of goods sold.

For the years ended February 1, 2015, February 2, 2014 and February 3, 2013 the Company incurred transportation costs of $35,901, $31,296, and $23,407 respectively.

Store pre-opening costs

Operating costs incurred prior to the opening of new stores are expensed as incurred.

Income taxes

The Company follows the liability method with respect to accounting for income taxes. Deferred income tax assets and liabilities are determined based on temporary differences between the carrying amounts and the tax basis of assets and liabilities. Deferred income tax assets and liabilities are measured using enacted tax rates that are expected to be in effect when these differences are anticipated to reverse. Deferred income tax assets are reduced by a valuation allowance, if based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The evaluation as to the likelihood of realizing the benefit of a deferred income tax asset is based on the timing of scheduled reversals of deferred tax liabilities, taxable income forecasts, and tax-planning strategies.

The Company provides for taxes at the rate applicable for the appropriate tax jurisdiction. U.S. income taxes on unremitted earnings of foreign subsidiaries which the Company has determined to be indefinitely reinvested have not been recognized. Management periodically assesses the need to utilize these unremitted earnings to finance foreign operations. This assessment is based on cash flow projections that are the result of estimates of future production and operational and fiscal objectives by tax jurisdiction for our operations. Such estimates are inherently imprecise since many assumptions utilized in the cash flow projections are subject to revision in the future.

Currency translation

The functional currency for each entity included in these consolidated financial statements that is domiciled outside of the United States is generally the applicable local currency. Assets and liabilities of each foreign entity are translated into U.S. dollars at the exchange rate in effect on the balance sheet date. Net revenue and expenses are translated at the average rate in effect during the period. Unrealized translation gains and losses are recorded as a cumulative translation adjustment, which is included in other comprehensive income or loss, which is a component of accumulated other comprehensive income or loss included in stockholders' equity.

Foreign currency transactions denominated in a currency other than an entity's functional currency are remeasured into the functional currency with any resulting gains and losses included in income, except for gains and losses arising on intercompany foreign currency transactions that are of a long-term investment nature.

The aggregate foreign exchange gains (losses) included in selling, general and administrative expenses amount to $6,372, $17,314, and $(625) for the years ended February 1, 2015, February 2, 2014, and February 3, 2013, respectively.

Fair value of financial instruments

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, trade accounts payable, accrued liabilities, and other liabilities. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. All foreign exchange gains or losses are

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recorded in the consolidated statements of operations under selling, general and administrative expenses. The fair value of these financial instruments approximates their carrying value, unless otherwise noted.

Concentration of credit risk

The Company is not exposed to significant credit risk on its cash and cash equivalents and accounts receivable. Cash and cash equivalents are held with high quality financial institutions. Accounts receivable are primarily from wholesale accounts and for landlord lease inducements. The Company does not require collateral to support the accounts receivable; however, in certain circumstances, the Company may require parties to provide payment for goods prior to delivery of the goods. The accounts receivable are net of an allowance for doubtful accounts, which is established based on management's assessment of the credit risk of the underlying accounts.

Stock-based compensation

The Company accounts for stock-based compensation using the fair value method. The fair value of awards granted is estimated at the date of grant and recognized as employee compensation expense on a straight-line basis over the requisite service period with the offsetting credit to additional paid-in capital. For awards with service and/or performance conditions, the amount of compensation expense recognized is based on the number of awards expected to vest and is adjusted to reflect those awards that do ultimately vest. For awards with performance conditions, the Company recognizes the compensation expense if and when the Company concludes that it is probable that the performance condition will be achieved. The Company reassesses the probability of achieving the performance condition at each reporting date. The fair value of the restricted shares, performance-based restricted stock units, and restricted stock units is based on the closing price of the Company's common stock on the award date.

Earnings per share

Earnings per share is calculated using the weighted-average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income available to common stockholders for the period by the diluted weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution from common shares issuable through stock options, performance-based restricted stock units that have satisfied their performance factor, and restricted stock units using the treasury stock method.

Contingencies

In the ordinary course of business, we are involved in legal proceedings regarding contractual and employment relationships and a variety of other matters. We record contingent liabilities resulting from claims against us, when a loss is assessed to be probable and the amount of the loss is reasonably estimable.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of net revenue and expenses during the reporting period.

Recently issued accounting standards

In May 2014, the FASB issued ASC Topic 606, Revenue from Contracts with Customers ("ASC 606"), which supersedes the revenue recognition requirements in ASC Topic 605 Revenue Recognition, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. This guidance requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services, and expands the related disclosure requirements. This guidance will be effective for the Company beginning in its first quarter of fiscal 2017. The Company is currently evaluating the impact that this new guidance may have on its consolidated financial statements.

In June 2014, the FASB amended ASC Topic 718, Compensation - Stock Compensation ("ASC 718") for share-based payments in which the terms of the award provide that a performance target can be achieved after the requisite service period. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. This guidance is effective for public companies for years, and interim periods within those years, beginning on or after December 15, 2015, and early application is permitted. This guidance will be effective for the Company beginning in its first quarter of fiscal 2016. The Company is currently evaluating the impact that this new guidance may have on its consolidated financial statements.

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3 INVENTORIES

	February 1, 2015	February 2, 2014
Finished goods	$214,113	$196,292
Provision to reduce inventory to market value	(5,997)	(7,502)
	$208,116	$188,790

4 PROPERTY AND EQUIPMENT

	February 1, 2015	February 2, 2014
Land	$60,548	$67,903
Buildings	29,099	20,407
Leasehold improvements	176,677	140,748
Furniture and fixtures	55,320	41,400
Computer hardware	35,457	29,497
Computer software	84,854	70,537
Equipment and vehicles	11,908	4,108
Accumulated depreciation	(157,855)	(118,997)
	$296,008	$255,603

Included in the cost of computer software are capitalized costs of $2,620 and $1,697 at February 1, 2015 and February 2, 2014, respectively, associated with internally developed software.

Depreciation expense related to property and equipment was $57,450, $48,177 and $41,671 for the years ended February 1, 2015, February 2, 2014, and February 3, 2013, respectively.

5 GOODWILL AND INTANGIBLE ASSETS

	February 1, 2015	February 2, 2014
Goodwill	$25,496	$25,496
Changes in foreign currency exchange rates	(1,083)	(217)
	24,413	25,279
Intangibles—reacquired franchise rights	$10,150	$10,630
Accumulated amortization	(8,264)	(7,830)
Changes in foreign currency exchange rates	(136)	122
	1,750	2,922
Total goodwill and intangibles	$26,163	$28,201

Amortization expense related to intangible assets was $914, $891, and $1,329 for the years ended February 1, 2015, February 2, 2014, and February 3, 2013, respectively. The estimated aggregate future amortization expense is as follows:

Fiscal Year	
2015	$747
2016	677
2017	254
2018	72
Thereafter	—
	$1,750

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The weighted-average remaining useful lives of the reacquired franchise rights was 1.79 years as at February 1, 2015 and 2.49 years as at February 2, 2014.

6 OTHER ACCRUED LIABILITIES

	February 1, 2015	February 2, 2014
Sales tax collected	$8,579	$8,341
Accrued rent	5,567	5,936
Other	17,843	15,318
	$31,989	$29,595

7 OTHER NON-CURRENT LIABILITIES

	February 1, 2015	February 2, 2014
Deferred lease liability	$20,837	$17,994
Tenant inducements	22,294	17,521
	$43,131	$35,515

8 LONG-TERM DEBT AND CREDIT FACILITIES

In November 2013, the Company canceled the uncommitted senior secured demand revolving credit facility with Royal Bank of Canada that it had entered into in April 2007 and entered into unsecured demand revolving credit facilities with HSBC Bank Canada and Bank of America, N.A., Canada Branch for up to $15,000 in the aggregate to support the issuance of letters of credit and to fund the working capital requirements of the Company. Borrowings under the uncommitted credit facilities are made on a when-and-as-needed basis at the discretion of the Company. These facilities were renewed for a one year period in November 2014.

Borrowings under the credit facility can be made either as (i) U.S. Dollar Loans - U.S. Dollar Loans bear interest a rate equal to U.S. LIBOR plus 100 basis points or U.S. prime rate, at the Company's option; (ii) Letters of Credit - Borrowings drawn down under standby letters of credit issued by the banks bear a fee of 100 basis points; and (iii) CDN Dollar Loans - CDN Dollar Loans bear interest at a rate equal to the CDOR Rate plus 100 basis points or the Canadian Prime Rate, at the Company's option.

At February 1, 2015, aside from letters of credit and guarantees, there were no borrowings outstanding under these credit facilities. At February 1, 2015, letters of credit totaling $566 had been issued under these credit facilities.

9 STOCKHOLDERS' EQUITY

Authorized share capital

The holders of the special voting stock are entitled to one vote for each share held. The special voting shares are not entitled to receive dividends or distributions or receive any consideration in the event of a liquidation, dissolution or wind-up. To the extent that exchangeable shares as described below are exchanged for common stock, a corresponding number of special voting shares will be cancelled without consideration.

The holders of the exchangeable shares have dividend and liquidation rights equivalent to those of holders of the common shares of the Company. The exchangeable shares can be converted on a one for one basis by the holder at any time into common shares of the Company plus a cash payment for any accrued and unpaid dividends. Holders of exchangeable shares are entitled to the same or economically equivalent dividend as declared on the common stock of the Company. The exchangeable shares are non-voting. The Company has the right to convert the exchangeable shares into common shares of the Company at any time after the earlier of July 26, 2047, the date on which less than 4,188 exchangeable shares are outstanding or in the event of certain events such as a change in control.

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Purchase of non-controlling interest

In August 2012, the Company purchased the non-controlling interest in lululemon athletica Australia Pty Ltd ("lululemon australia") for $26,013. The Company previously accounted for its 80 percent interest in lululemon australia as a subsidiary with non-controlling interest.

As a result of the transaction, the carrying amount of $5,680 of the non-controlling interest was reduced to $nil. The Company's equity was reduced by $20,333, the excess of the purchase price over the net adjustments, as a charge to additional paid in capital.

10 STOCK-BASED COMPENSATION

Stock-based compensation plans

The Company's employees participate in various stock-based compensation plans which are provided by the Company directly.

In June 2014, the Company's stockholders approved the adoption of the lululemon athletica inc. 2014 Equity Incentive Plan ("2014 Plan"). The 2014 Plan provides for awards in the form of stock options, stock appreciation rights, restricted stock purchase rights, restricted share bonuses, restricted stock units, performance shares, performance-based restricted stock units, cash-based awards, other stock-based awards, and deferred compensation awards to employees (including officers and directors who are also employees), consultants, and directors of the Company.

The awards granted under the 2007 Equity Incentive Plan ("2007 Plan") remain outstanding and continue to vest under their original conditions. No further awards will be granted under the 2007 Plan.

The Company has granted stock options, performance-based restricted stock units, restricted stock units and restricted shares. The majority of stock options granted to date have a four-year vesting period and vest at a rate of 25% each year on the anniversary date of the grant and generally expire seven years from the date of grant. Performance-based restricted stock units issued generally vest three years from the grant date and restricted shares vest one year from the grant date. Restricted stock units granted generally have a three-year vesting period and vest at a certain percentage each year on the anniversary date of the grant. To date, 199 restricted shares have been issued to certain directors of the Company.

The Company's policy is to issue shares from treasury upon the exercise of Company options, vesting of performance-based restricted stock units or restricted stock units, and granting of restricted shares.

Stock-based compensation expense charged to income for the plans was $8,269, $10,087 and $15,637 for the years ended February 1, 2015, February 2, 2014, and February 3, 2013, respectively.

Total unrecognized compensation cost for all stock-based compensation plans was $25,720 as at February 1, 2015, which is expected to be recognized over a weighted-average period of 2.5 years, and was $17,065 as at February 2, 2014 over a weighted-average period of 2.2 years.

Employee stock purchase plan

The Company's board of directors and stockholders approved the Company's Employee Share Purchase Plan ("ESPP") in September 2007. Contributions are made by eligible employees, subject to certain limits as defined in the ESPP, and the Company matches one-third of the contribution. The maximum number of shares available under the ESPP is 6,000 shares. During the year ended February 1, 2015, there were 145 shares purchased under the ESPP in the open market.

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Company stock options, performance-based restricted stock units, restricted shares and restricted stock units

A summary of the Company's stock option, performance-based restricted stock unit, restricted share and restricted stock unit activity as of February 1, 2015, February 2, 2014, and February 3, 2013, and changes during the years then ended is presented below:

	Stock Options		Performance-Based Restricted Stock Units		Restricted Shares		Restricted Stock Units	
	Number	Weighted-Average Exercise Price	Number	Weighted-Average Grant Date Fair Value	Number	Weighted-Average Grant Date Fair Value	Number	Weighted-Average Grant Date Fair Value
Balance at January 29, 2012	2,253	$ 14.77	384	$ 31.90	8	$ 46.10	—	$ —
Granted	84	75.52	156	74.46	16	63.97	—	—
Exercised/vested	874	12.60	—	—	8	46.10	—	—
Forfeited	86	20.43	49	31.81	—	—	—	—
Balance at February 3, 2013	1,377	$ 19.51	491	$ 45.47	16	$ 63.97	—	$ —
Granted	118	64.86	290	52.41	59	52.35	—	—
Exercised/vested	686	11.90	208	21.72	16	63.97	—	—
Forfeited	140	41.33	145	59.03	2	64.30	—	—
Balance at February 2, 2014	669	$ 30.76	428	$ 57.08	57	$ 51.99	—	$ —
Granted	447	48.16	321	49.67	34	39.00	195	45.76
Exercised/vested	158	18.50	217	40.04	29	56.28	—	—
Forfeited	79	59.09	80	61.34	—	—	9	45.92
Balance at February 1, 2015	879	$ 39.25	452	$ 59.27	62	$ 42.86	186	$ 45.75

A total of 15,180 of shares of our common stock have been authorized for future issuance under our 2014 Equity Incentive Plan.

The Company's performance-based restricted stock units are awarded to eligible employees and entitle the grantee to receive a maximum of 1.5 shares of common stock per performance-based restricted stock unit if the Company achieves specified performance goals and the grantee remains employed during the vesting period. The fair value of performance-based restricted stock units is based on the closing price of the Company's common stock on the award date. Expense for performance-based restricted stock units is recognized when it is probable that the performance goal will be achieved.

The fair value of the restricted shares and restricted stock units is based on the closing price of the Company's common stock on the award date.

The following table summarizes information about stock options outstanding and exercisable at February 1, 2015:

	Outstanding			Exercisable		
Range of Exercise Prices	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Life (Years)	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Life (Years)
$0.25 – $14.16	176	$ 7.37	2.6	176	$ 7.37	2.6
$14.29 – $39.56	140	25.96	2.9	132	25.27	2.8
$44.20 – $44.20	224	44.20	6.6	—	—	0.0
$45.75 – $52.59	191	52.02	5.9	13	46.97	3.6
$53.44 – $76.49	148	65.65	5.1	55	66.55	4.6
	879	$ 39.25	4.8	376	$ 23.73	3.0
Intrinsic value	$24,211			$16,220		

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As of February 1, 2015, the unrecognized compensation cost related to these options was $8,172, which is expected to be recognized over a weighted-average period of 3.1 years; and the total aggregate intrinsic value for stock options outstanding and exercisable was $16,220. The weighted-average grant date fair value of options granted during the years ended February 1, 2015, February 2, 2014, and February 3, 2013 was $17.69, $31.96, and $37.20, respectively.
The following table summarizes the intrinsic value of options exercised and full value awards vested during fiscal 2014, 2013, and 2012:

	Intrinsic Value of Options Exercised and Full Value Awards Vested During the Fiscal Year Ended		
	February 1, 2015	February 2, 2014	February 3, 2013
Stock Options	$4,382	$37,591	$53,605
Performance-based restricted stock units	10,242	13,057	—
Restricted shares	1,567	1,070	474
Restricted stock units	—	—	—
	$16,191	$51,718	$54,079

The fair value of each stock option granted is estimated on date of grant using the Black-Scholes model. The assumptions used to calculate the fair value of options granted are evaluated and revised, as necessary, to reflect market conditions and the Company's historical experience. The expected term of the options is based upon historical experience of similar awards, giving consideration for expectations of future employee behavior. Expected volatility is based upon the historical volatility of the Company's common stock for the period corresponding with the expected term of the options. The risk-free interest rate is based on the U.S. Treasury yield curve for the period corresponding with the expected term of the options. The Company began using its own historical data in fiscal 2014 to determine the assumptions; prior to fiscal 2014, the assumptions were based upon a review of a peer group of publicly traded apparel retailers. The following assumptions were used in calculating the fair value of stock options granted in fiscal 2014, 2013, and 2012:

	Stock Options Granted During the Fiscal Year Ended					
	February 1, 2015		February 2, 2014		February 3, 2013	
Expected term	4.00 years		4.06 years		4.06 years	
Expected volatility	45.93	%	64.65	%	64.65	%
Risk-free interest rate	1.04	%	0.72	%	0.72	%
Dividend yield	—	%	—	%	—	%

11 EARNINGS PER SHARE

The details of the computation of basic and diluted earnings per share are as follows:

	Fiscal Year Ended		
	February 1, 2015	February 2, 2014	February 3, 2013
Net income attributable to lululemon athletica inc	$239,033	$279,547	$270,556
Basic weighted-average number of shares outstanding	143,935	144,913	144,000
Effect of stock options assumed exercised	363	1,130	1,806
Diluted weighted-average number of shares outstanding	144,298	146,043	145,806
Basic earnings per share	$1.66	$1.93	$1.88
Diluted earnings per share	$1.66	$1.91	$1.85

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The Company's calculation of weighted-average shares includes the common stock of the Company as well as the exchangeable shares. Exchangeable shares are the equivalent of common shares in all material respects. All classes of stock have in effect the same rights and share equally in undistributed net income. For the fiscal years ended February 1, 2015, February 2, 2014 and February 3, 2013, 296, 57 and 45 stock options, respectively, were anti-dilutive to earnings and therefore have been excluded from the computation of diluted earnings per share.

On June 11, 2014, the Company's board of directors approved a program to repurchase shares of the Company's common stock up to an aggregate value of $450,000. The common stock is to be repurchased in the open market at prevailing market prices, with the timing and actual number of shares to be repurchased depending upon market conditions and other factors. The repurchases will be made up until June 2016. During the fiscal year ended February 1, 2015, 3,657 shares were repurchased under the program at a total cost of $147,431. Subsequent to February 1, 2015, and up to March 23, 2015, no shares were repurchased.

12 COMMITMENTS AND CONTINGENCIES

The Company has obligations under operating leases for its store and other retail locations, distribution centers, offices, and equipment. As of February 1, 2015, the lease terms of the various leases are from two to 10 years. A substantial number of the Company's leases include renewal options and certain of the Company's leases include rent escalation clauses, rent holidays and leasehold rental incentives. Certain of the Company's leases for store premises also include contingent rental payments based on sales volume. The Company is required to make deposits for rental payments pursuant to certain lease agreements, which have been included in other non-current assets. Minimum annual basic rent payments excluding other executory operating costs, pursuant to lease agreements are approximately as laid out in the table below. These amounts include commitment in respect of corporate-owned stores that have not yet opened but for which lease agreements have been executed.

	Payments Due by Fiscal Year						
	Total	2015	2016	2017	2018	2019	Thereafter
Operating leases (minimum rent)	$395,483	$82,282	$81,697	$72,660	$57,190	$43,625	$58,029

Rent expense for the years ended February 1, 2015, February 2, 2014, and February 3, 2013 was $105,989, $95,574, and $82,428, respectively, under operating lease agreements, consisting of minimum rental expense of $68,598, $61,552, and $54,050, respectively, and contingent rental amounts of $37,391, $34,022, and $28,378, respectively.

On January 11, 2015, the Company entered into a license and supply agreement with a license to a partner in the Middle East which grants it the right to operate lululemon athletica branded retail locations in the United Arab Emirates, Kuwait, Qatar, Oman and Bahrain for an initial term of five years. Under this arrangement the Company will be supplying the partner with lululemon products, training and other support. As at February 1, 2015 there were no franchised retail locations in operation.

In addition to the legal matters described below, the Company is, from time to time, involved in routine legal matters incidental to the conduct of its business, including legal matters such as initiation and defense of proceedings to protect intellectual property rights, slip and fall/personal injury claims, product liability claims, and similar matters. The Company believes the ultimate resolution of any such current proceeding will not have a material adverse effect on its continued financial position, results of operations or cash flows.

On October 25, 2013, plaintiff Laborers' District Council Industry Pension Fund filed a books-and-records action in the Delaware Court of Chancery entitled Laborers' District Council Construction Industry Pension Fund v. lululemon athletica inc., C.A. No. 9039-VCP (Del. Ch.) under 8 Del. C. Sec. 220 based on a demand letter it sent to the Company on or around August 8, 2013 to request certain lululemon records relating to the March 2013 sheer Luon issue, the Company's announcement that its then CEO, Christine Day, intended to resign, and certain stock trades executed by the then-Chairman of the Company's board of directors, Mr. Wilson, prior to the Company's announcement regarding its former CEO, Christine Day. The Court held a one-day trial on February 19, 2014, which took the form of an oral argument. On April 2, 2014, the Court rejected the majority of books and records sought by plaintiff and ordered the Company to produce a narrow category of documents relating to one trade made by the Company's former Chairman. On June 11, 2014, the Court consolidated this action with the action captioned Hallandale Beach Police Officers and Firefighters' Personnel Retirement Fund v. lululemon athletica inc., C.A. No.

8522-VCP (Del. Ch.), which is described below. On June 13, 2014, Plaintiffs filed a Motion to Enforce the Court's April 2, 2014 Telephonic Rulings and Compel in Camera Inspection of Withheld and Redacted Documents. The Court held a hearing on the Motion to Enforce on December 1, 2014 and the judgment on the Motion remains pending. The Company believes there is no merit to the Motion.

On August 12, 2013 and August 23, 2013, plaintiffs Thomas Canty and Tammy Federman filed shareholder derivative actions entitled Canty v. Day, et al., No. 13-CV-5629 (S.D.N.Y.) and Federman v. Day, et al., No. 13-CV-5977 (S.D.N.Y.). Plaintiffs allege that they are acting on behalf of the Company and name as defendants current and former directors and certain officers of the Company. On January 17, 2014, plaintiffs filed an amended complaint, operative in both actions. In that amended complaint, plaintiffs challenge certain public disclosures and conduct relating to the March 2013 sheer Luon issue, the June 2013 announcement regarding the resignation of the Company's former CEO, Christine Day, and certain stock trades executed by Mr. Wilson and Ms. Day in the months leading up to that announcement. Plaintiffs allege violations of Section 14(a) of the Securities Exchange Act and breach of fiduciary duty, unjust enrichment, abuse of control, and gross mismanagement. On April 9, 2014, the Court dismissed all of plaintiffs' claims due to plaintiffs' failure to make a pre-suit demand. On May 9, 2014, plaintiff in the Canty action filed a notice of appeal to the United States Court of Appeals for the Second Circuit. The Court of Appeals has scheduled an oral argument on the appeal on March 27, 2015. The Company believes there is no merit to the appeal.

On July 2, 2013, plaintiff Houssam Alkhoury filed a putative shareholder class action entitled Alkhoury v. lululemon athletica inc., et al., No. 13-CV-4596 (S.D.N.Y.) against lululemon, a certain director and a certain officer of the Company (collectively, "Defendants"). On October 1, 2013, the Court appointed Louisiana Sheriffs' Pension & Relief Fund as Lead Plaintiff and on November 1, 2013, Lead Plaintiff filed a consolidated class action complaint on behalf of a proposed class of purchasers of lululemon stock between September 7, 2012 through June 11, 2013 (the "Complaint"). In its Complaint, Lead Plaintiff asserted causes of action under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 against Defendants based on certain public disclosures made by the Company relating to lululemon's product quality and the March 2013 sheer Luon issue. On January 15, 2014, Lead Plaintiff filed a consolidated amended class action complaint (the "Amended Complaint") on behalf of a proposed class of purchasers of lululemon stock between September 7, 2012 through January 10, 2014. In its Amended Complaint, Lead Plaintiff added new claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 based on certain of lululemon's public disclosures related to the Company's ongoing quality control improvements and the impact of those improvements on the Company's financial results. On April 18, 2014, the Court dismissed all of Lead Plaintiff's claims for failure to state a claim. Lead Plaintiff filed a notice of appeal of this decision and filed its appeal brief on August 1, 2014. The Company filed a reply on October 23, 2014, Lead Plaintiff filed a further reply on November 6, 2014, and a hearing has been scheduled for May 8, 2015. The Company believes there is no merit to the appeal.

On May 3, 2013, plaintiff Hallandale Beach Police Officers and Firefighters' Personnel Retirement Fund filed a books-and-records action in the Delaware Court of Chancery entitled Hallandale Beach Police Officers and Firefighters' Personnel Retirement Fund v. lululemon athletica inc., C.A. No. 8522-VCP (Del. Ch.) under 8 Del. C. Sec. 220 based on a demand letter it sent to the Company on April 17, 2013 to request certain lululemon records relating to the March 2013 sheer Luon issue and revisions to the Company's executive bonus plan. The Company moved to dismiss the complaint on May 28, 2013. On June 14, 2013, plaintiff sent a supplemental demand letter that requested additional records from the Company relating to the Company's announcement that Christine Day intended to resign as the Company's Chief Executive Officer, and certain stock trades executed by the Company's then-Chairman, Mr. Wilson, prior to the Company's announcement regarding Ms. Day. On July 1, 2013, plaintiff filed an amended complaint to incorporate allegations relating to the June 14, 2013 supplemental demand letter. The Company moved to dismiss the amended complaint on August 15, 2013, and in response to this filing, plaintiffs served the Company with a new demand letter and then filed a second amended complaint on November 4, 2013. The Company moved to dismiss the second amended complaint on December 4, 2013 and the Court held argument on the motion on February 5, 2014. On April 2, 2014, the Court rejected the majority of books and records sought by plaintiff and ordered the Company to produce a narrow category of documents relating to one trade made by the Company's former Chairman. On June 11, 2014 the Court consolidated this action with the action captioned Laborers' District Council Construction Industry Pension Fund v. lululemon athletica inc., C.A. No. 9039-VCP (Del. Ch.) which is described above. On June 13, 2014 Plaintiffs filed a Motion to Enforce the Court's April 2, 2014 Telephonic Rulings and Compel in Camera Inspection of Withheld and Redacted Documents. The Court held a hearing on the Motion to Enforce on December 1, 2014 and the judgment on the Motion remains pending. The Company believes there is no merit to the Motion.

The Company has indemnification agreements with certain of its current and former officers and directors that may require it, among other things, to indemnify such current or former officers and directors against certain liabilities that may arise by reason of their status or service as directors or officers and to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified.

The Company is unable at this time to predict the amount of its legal expenses associated with these proceedings and any settlement or damages associated with these matters. In the event that the Company is unsuccessful in its defense, or if the Company pursues settlement with regard to any of these actions, the Company could be required to pay significant final settlement amounts and/or judgments that exceed the limits of its insurance policies or the carriers may decline to fund such final settlements and/or judgments, which could have a material adverse effect on the Company's financial condition and liquidity. Regardless of whether any of the claims asserted against the Company in these actions are valid, or whether the Company is ultimately held liable, such litigation may be expensive to defend and may divert resources away from the Company's operations and negatively impact earnings. Further, the Company may not be able to obtain adequate insurance to protect it from these types of litigation matters or extraordinary business losses.

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13 RELATED PARTY BALANCES AND TRANSACTIONS

The Company entered into the following transactions with related parties, all of which were approved by the Company's Audit Committee in accordance with the Company’s related party transaction policy:

	February 1, 2015	February 2, 2014	February 3, 2013
Payments to related parties			
Occupancy costs for one corporate-owned store	$140	$150	$151
Consulting fees	$289	$409	$295

The Company's founder, who was member of the Company's board of directors up until February 2, 2015, owns a retail space that the Company leases for one of its corporate-owned stores. Consulting fees were paid to a relative of the Company's founder.

14 SUPPLEMENTAL CASH FLOW INFORMATION

	February 1, 2015	February 2, 2014	February 3, 2013
Cash paid for income taxes	$146,376	$155,394	$71,342
Interest paid	$14	$117	$206

15 INCOME TAXES

The Company files income tax returns in the U.S., Canada and various foreign, state and provincial jurisdictions. The 2011 to 2013 tax years remain subject to examination by the U.S. federal and state tax authorities. The 2010 tax year is still open for certain state tax authorities. The 2007 to 2013 tax years remain subject to examination by Canadian tax authorities. The 2008 to 2013 tax years remain subject to examination by tax authorities in certain foreign jurisdictions. The Company's policy is to recognize interest expense and penalties related to income tax matters as part of other income (expense), net. At February 1, 2015, the Company does not have any significant accruals for interest related to unrecognized tax benefits or tax penalties.

The Company's intercompany transfer pricing policies are currently subject to audits by the various foreign tax jurisdictions. Although the Company believes that its intercompany transfer pricing policies and tax positions are fully supportable, the final determination of tax audits or potential tax disputes may be different from that which is reflected in the Company's income tax provisions and accruals.

The provision for income taxes consists of the following:

	February 1, 2015	February 2, 2014	February 3, 2013
Federal income tax at statutory rate	35.0 %	35.0 %	35.0 %
Non-deductible compensation expense	0.3	0.5	0.8
U.S. state taxes	1.2	1.2	1.2
Foreign tax rate differential	(6.8)	(7.1)	(7.7)
Tax on repatriated foreign earnings	8.8	—	—
Permanent and other	(0.9)	—	(0.5)
Provision for income taxes	37.6 %	29.6 %	28.8 %

The provision for income taxes in fiscal 2014 includes a tax expense of $33.7 million to provide for U.S. income and applicable foreign withholding taxes on dividends of $473.7 million which were distributed during fiscal 2014 by foreign subsidiaries to the U.S. parent entity to fund the share repurchase program.

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The tax effects of temporary differences that give rise to significant portions of the deferred tax asset and deferred tax liability at February 1, 2015 and February 2, 2014 are presented below:

	February 1, 2015	February 2, 2014
Deferred income tax asset		
Net operating loss carryforward	$8,803	$5,097
Foreign tax credits	—	4,585
Property and equipment	(15,850)	(12,447)
Deferred lease liability	6,977	6,284
Stock-based compensation	4,662	3,758
Inventory	3,058	4,681
Tenant inducements	6,965	5,841
Other	1,403	501
	16,018	18,300
Deferred income tax liability		
Property and equipment	(5,027)	(5,122)
Other	1,394	1,145
	(3,633)	(3,977)
Net deferred income tax asset	$12,385	$14,323

The Company's current and deferred taxes from federal, state and foreign sources were as follows:

	February 1, 2015	February 2, 2014	February 3, 2013
Income before provision for income taxes			
Domestic	$94,234	$81,688	$63,426
Foreign	288,901	315,438	317,970
Income before provision for income taxes	383,135	397,126	381,396
Current taxes			
Federal	$54,172	$27,818	$22,598
State	8,203	4,017	3,795
Foreign	80,461	84,924	90,017
Total current	142,836	116,759	116,410
Deferred taxes			
Federal	$7,763	$266	$(5,667)
State	77	38	(786)
Foreign	(6,574)	516	8
Total deferred	1,266	820	(6,445)
Provision for income taxes	$144,102	$117,579	$109,965

U.S. income and foreign withholding taxes have not been provided on approximately $471,322 of cumulative undistributed earnings of foreign subsidiaries at February 1, 2015. The Company intends to reinvest these earnings for the foreseeable future. U.S. income taxes of approximately $44,148 would be incurred if these earnings were distributed.

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16 SEGMENTED FINANCIAL INFORMATION

The Company applies ASC Topic 280, Segment Reporting ("ASC 280"), in determining reportable segments for its financial statement disclosure. The Company reports segments based on the financial information it uses in managing its business. The Company's reportable segments are comprised of corporate-owned stores and direct to consumer. Direct to consumer represents sales from the Company's e-commerce websites. Outlet sales, showroom sales, sales to wholesale accounts, warehouse sales, and sales from temporary locations have been combined into the other segment. The Company has reviewed the classification of its expenses amongst its reportable segments and has updated the classification of some of these expenses. Accordingly, all prior year comparable information has been reclassified to conform to the current year classification. Information for these segments is detailed in the table below:

	Fiscal Year Ended		
	February 1, 2015	February 2, 2014	February 3, 2013
Net revenue			
Corporate-owned stores	$1,348,225	$1,228,999	$1,090,181
Direct to consumer	321,180	263,083	197,255
Other	127,808	99,106	82,922
	$1,797,213	$1,591,188	$1,370,358
Income from operations before general corporate expense			
Corporate-owned stores	$356,589	$372,267	$373,607
Direct to consumer	132,877	109,999	85,128
Other	9,499	13,994	19,787
	498,965	496,260	478,522
General corporate expense	122,932	104,902	102,083
Income from operations	376,033	391,358	376,439
Other income (expense), net	7,102	5,768	4,957
Income before provision for income taxes	$383,135	$397,126	$381,396
Capital expenditures			
Corporate-owned stores	$76,894	$60,233	$64,863
Direct to consumer	9,952	5,953	4,881
Corporate	32,887	40,222	23,485
	$119,733	$106,408	$93,229
Depreciation and amortization			
Corporate-owned stores	$37,951	$31,349	$28,874
Direct to consumer	6,299	4,599	3,393
Corporate	14,114	13,120	10,733
	$58,364	$49,068	$43,000

Intercompany amounts are excluded from the above table as they are not included in the materials reviewed by the Chief Operating Decision Maker.

The Company operates in five geographic areas—Canada, the United States, Australia and New Zealand, Europe, and Asia. Net revenue from these regions for the years ended February 1, 2015, February 2, 2014, and February 3, 2013 was as follows:

	February 1, 2015	February 2, 2014	February 3, 2013
United States	$1,257,351	$1,052,148	$839,908
Canada	434,328	454,209	461,586
Outside of North America	105,534	84,831	68,864
	$1,797,213	$1,591,188	$1,370,358

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Long-lived assets by geographic area for the years ended February 1, 2015 and February 2, 2014 were as follows:

	February 1, 2015	February 2, 2014
United States	$133,222	$97,288
Canada	144,689	145,416
Outside of North America	18,097	12,899
	$296,008	$255,603

The Company's intangible assets and goodwill relate to the reporting segment consisting of corporate-owned stores.

17 QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following tables present the Company's unaudited quarterly results of operations and comprehensive income for each of the eight fiscal quarters in the periods ended February 1, 2015 and February 2, 2014. The following tables should be read in conjunction with the Company's audited consolidated financial statements and related notes appearing elsewhere in this Form 10-K. The Company has prepared the information below on a basis consistent with its audited consolidated financial statements and has included all adjustments, consisting of normal recurring adjustments, which, in the opinion of the Company's management, are necessary to fairly present its operating results for the quarters presented. The Company's historical unaudited quarterly results of operations are not necessarily indicative of results for any future quarter or for a full year.

	Fiscal 2014				Fiscal 2013			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(Unaudited; Amounts in thousands, except per share amounts)							
Consolidated statements of operations and comprehensive income:								
Net revenue	$602,491	$419,396	$390,708	$384,618	$520,993	$379,900	$344,513	$345,782
Cost of goods sold	292,450	208,308	193,401	188,874	242,203	175,294	158,558	175,057
Gross profit	310,041	211,088	197,307	195,744	278,790	204,606	185,955	170,725
Selling, general and administrative expenses	152,853	129,932	129,419	125,943	124,643	112,270	106,969	104,836
Income from operations	157,188	81,156	67,888	69,801	154,147	92,336	78,986	65,889
Other income (expense), net	1,755	1,814	1,890	1,643	1,519	1,453	1,295	1,501
Income before provision for income taxes	158,943	82,970	69,778	71,444	155,666	93,789	80,281	67,390
Provision for income taxes	48,090	22,519	21,030	52,463	45,974	27,678	23,816	20,111
Net income	$110,853	$60,451	$48,748	$18,981	$109,692	$66,111	$56,465	$47,279
Other comprehensive (loss) income:								
Foreign currency translation adjustment	(92,137)	(29,256)	3,664	12,390	(53,657)	(9,153)	(21,901)	(4,447)
	$18,716	$31,195	$52,412	$31,371	$56,035	$56,958	$34,564	$42,832

Comprehensive income								
Basic earnings per share	$0.78	$0.42	$0.34	$0.13	$0.75	$0.46	$0.39	$0.33
Diluted earnings per share	$0.78	$0.42	$0.33	$0.13	$0.75	$0.45	$0.39	$0.32

The Company's quarterly results of operations have varied in the past and are likely to do so again in the future. As such, the Company believes that comparisons of its quarterly results of operations should not be relied upon as an indication of the Company's future performance.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, as of the end of the period covered by this report, or the Evaluation Date. Based upon the evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the Evaluation Date. Disclosure controls and procedures are controls and procedures designed to reasonably ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this report, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include controls and procedures designed to reasonably ensure that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Inherent Limitations Over Internal Controls

Our internal control over financial reporting is designed to provide reasonable assurances regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements. Management, including our principal executive officer and principal financial officer, does not expect that our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource limitations on all control systems, no evaluation of internal controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Also, any evaluation of the effectiveness of controls in future periods are subject to the risk that those internal controls may become inadequate because of changes in business conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management's Annual Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the criteria set forth in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO. Based on this evaluation, management concluded that we maintained effective internal control over financial reporting as of February 1, 2015. The effectiveness of our internal control over financial reporting as of February 1, 2015 has been audited by PricewaterhouseCoopers LLP our independent registered public accounting firm, as stated in their report in Item 8 of Part II of this Form 10-K.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the fourth quarter of the fiscal year ended February 1, 2015, which were identified in connection with management's evaluation required by Rules 13a-15(d) and 15d-15(d) under the Securities Exchange Act of 1934, as amended, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item concerning our directors, director nominees and Section 16 beneficial ownership reporting compliance is incorporated by reference to our definitive Proxy Statement for our 2015 Annual Meeting of Stockholders under the captions "Election of Directors," "Section 16(a) Beneficial Ownership Reporting Compliance," "Executive Officers" and "Corporate Governance."

We have adopted a written code of business conduct and ethics, which applies to all of our directors, officers and employees, including our principal executive officer and our principal financial and accounting officer. Our Code of Business Conduct and Ethics is available on our website, www.lululemon.com, and can be obtained by writing to Investor Relations, lululemon athletica inc., 1818 Cornwall Avenue, Vancouver, British Columbia, Canada V6J 1C7 or by sending an email to investors@lululemon.com. The information contained on our website is not incorporated by reference into this Annual Report on Form 10-K. Any amendments, other than technical, administrative or other non-substantive amendments, to our Code of Business Conduct and Ethics or waivers from the provisions of the Code of Business Conduct and Ethics for our principal executive officer and our principal financial and accounting officer will be disclosed on our website within four business days following the date of such amendment or waiver.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated by reference to our 2015 Proxy Statement under the captions "Executive Compensation" and "Executive Compensation Tables."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated by reference to our 2015 Proxy Statement under the caption "Principal Stockholders and Stock Ownership by Management."

Equity Compensation Plan Information (as of February 1, 2015)

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights[(1)] (A)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights[(2)] (B)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (A))[(3)] (C)
Equity compensation plans approved by stockholders	1,516,818	$ 39.25	20,458,987
Equity compensation plans not approved by stockholders	—	—	—
Total	1,516,818	$ 39.25	20,458,987

(1) This amount represents the following: (a) 879,282 shares subject to outstanding options, (b) 451,503 shares subject to outstanding performance-based restricted stock units, and (c) 186,033 shares subject to outstanding restricted stock units. The options, performance-based restricted stock units and restricted stock units are all under our 2014 Equity Incentive Plan. Restricted shares outstanding under our 2014 Equity Incentive Plan have already been reflected in our total outstanding common stock balance.

(2) The weighted-average exercise price is calculated solely on the exercise prices of the outstanding options and does not reflect the shares that will be issued upon the vesting of outstanding awards of performance-based restricted stock units and restricted stock units, which have no exercise price.

(3)

This includes (a) 15,180,132 shares of our common stock available for future issuance pursuant to our 2014 Equity Incentive Plan and (b) 5,278,855 shares of our common stock available for future issuance pursuant to our Employee Share Purchase Plan. The number of shares remaining available for future issuance under our 2014 Equity Incentive Plan is reduced by 1.7 shares for each award other than stock options granted and by one share for each stock option award granted. Outstanding awards that expire or are canceled without having been exercised or settled in full are available for issuance again under our 2014 Equity Incentive Plan and shares that are withheld in satisfaction of tax withholding obligations for full value awards are also again available for issuance. No further awards may be issued under the predecessor plan, our 2007 Equity Incentive Plan.

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ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is incorporated by reference to our 2015 Proxy Statement under the captions "Certain Relationships and Related Party Transactions" and "Corporate Governance."

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated by reference to our 2015 Proxy Statement under the caption "Fees for Professional Services."

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULE

(a) Documents filed as part of this report:

1. Financial Statements. The financial statements as set forth under Item 8 of this Annual Report on Form 10-K are incorporated herein.

2. Financial Statement Schedule.

Schedule II

Valuation and Qualifying Accounts

Description	Balance at Beginning of Year (In thousands)	Charged to Costs and Expenses	Write-offs Net of Recoveries	Balance at End of Year
Shrink Provision on Finished Goods				
For the year ended February 3, 2013	$(1,126)	$(2,823)	$2,949	$(1,000)
For the year ended February 2, 2014	(1,000)	(3,462)	3,364	(1,098)
For the year ended February 1, 2015	(1,098)	(3,564)	3,338	(1,324)
Slow Moving and Obsolescence Provision on Finished Goods and Raw Materials				
For the year ended February 3, 2013	$(1,086)	$(6,901)	$2,737	$(5,250)
For the year ended February 2, 2014	(5,250)	(22,449)	22,206	(5,493)
For the year ended February 1, 2015	(5,493)	(2,566)	4,454	(3,605)
Damage Provision on Finished Goods				
For the year ended February 3, 2013	$(283)	$(3,727)	$3,491	$(519)
For the year ended February 2, 2014	(519)	(6,327)	5,935	(911)
For the year ended February 1, 2015	(911)	(8,064)	7,907	(1,068)
Sales Allowances				
For the year ended February 3, 2013	$914	$914	$—	$1,828
For the year ended February 2, 2014	1,828	(173)	—	1,655
For the year ended February 1, 2015	1,655	672	—	2,327
Valuation Allowance on Deferred Income Taxes				
For the year ended February 3, 2013	$(91)	$—	$—	$(91)
For the year ended February 2, 2014	(91)	—	—	(91)
For the year ended February 1, 2015	(91)	—	—	(91)

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3. Exhibits
Exhibit Index

Exhibit No.	Exhibit Title	Filed Herewith	Incorporated by Reference			
			Form	Exhibit No.	File No.	Filing Date
3.1	Amended and Restated Certificate of Incorporation of lululemon athletica inc.		8-K	3.1	001-33608	8/8/2007
3.2	Certificate of Amendment to Amended and Restated Certificate of Incorporation of lululemon athletica inc.		8-K	3.1	001-33608	7/1/2011
3.3	Fourth Amended and Restated Bylaws of lululemon athletica inc.		8-K	3.1	001-33608	9/11/2014
4.1	Form of Specimen Stock Certificate of lululemon athletica inc.		S-1/A	4.1	001-33608	7/9/2007
10.1*	lululemon athletica inc. 2014 Equity Incentive Plan		8-K	10.1	001-33608	6/13/2014
10.2*	Form of Non-Qualified Stock Option Agreement (standard)		8-K	10.1	001-33608	12/11/2014
10.3*	Form of Non-Qualified Stock Option Agreement (for outside directors)		10-Q	10.2	001-33608	12/6/2012
10.4*	Form of Non-Qualified Stock Option Agreement (with clawback provision)		8-K	10.2	001-33608	12/11/2014
10.5*	Form of Non-Qualified Stock Option Agreement (for international employees)		8-K	10.3	001-33608	12/11/2014
10.6*	Form of Notice of Grant of Performance Shares and Performance Shares Agreement (standard)		8-K	10.4	001-33608	12/11/2014
10.7*	Form of Notice of Grant of Performance Shares and Performance Shares Agreement (with clawback provision)		8-K	10.5	001-33608	12/11/2014
10.8*	Form of Notice of Grant of Performance Shares and Performance Shares Agreement (for international employees)		8-K	10.6	001-33608	12/11/2014
10.9*	Form of Notice of Grant of Restricted Stock Units and Restricted Stock Units Agreement (standard)		8-K	10.7	001-33608	12/11/2014

10.10*	Form of Notice of Grant of Restricted Stock Units and Restricted Stock Units Agreement (with clawback provision)	X				
10.11*	Form of Notice of Grant of Restricted Stock Units and Restricted Stock Units Agreement (for international employees)		8-K	10.8	001-33608	12/11/2014
10.12*	Form of Notice of Grant of Restricted Stock Units and Restricted Stock Units Agreement (no tolling of vesting, standard)		8-K	10.9	001-33608	12/11/2014
10.13*	Form of Notice of Grant of Restricted Stock Units and Restricted Stock Units Agreement (no tolling of vesting, with clawback provision)		8-K	10.10	001-33608	12/11/2014
10.14*	Form of Notice of Grant of Restricted Stock Units and Restricted Stock Units Agreement (no tolling of vesting, for international employees)		8-K	10.11	001-33608	12/11/2014
10.15*	Form of Restricted Stock Award Agreement		8-K	10.12	001-33608	12/11/2014

Exhibit No.	Exhibit Title	Filed Herewith	Incorporated by Reference			
			Form	Exhibit No.	File No.	Filing Date
10.16*	Amended and Restated LIPO Investments (USA), Inc. Option Plan and form of Award Agreement		S-1	10.3	333-142477	5/1/2007
10.17	Amended and Restated Registration Rights Agreement dated December 12, 2012 between lululemon athletica inc. and the parties named therein		8-K	10.14	001-33608	12/18/2012
10.18	Exchange Trust Agreement dated July 26, 2007 between lululemon athletica inc., Lulu Canadian Holding, Inc. and Computershare Trust Company of Canada		10-Q	10.5	001-33608	9/10/2007
10.19	Exchangeable Share Support Agreement dated July 26, 2007 between lululemon athletica inc., Lululemon Callco ULC and Lulu Canadian Holding, Inc.		10-Q	10.6	001-33608	9/10/2007
10.20	Amended and Restated Declaration of Trust for Forfeitable Exchangeable Shares dated July 26, 2007, by and among the parties named therein		10-Q	10.7	001-33608	9/10/2007
10.21	Amended and Restated Arrangement Agreement dated as of June 18, 2007, by and among the parties named therein (including Plan of Arrangement and Exchangeable Share Provisions)		S-1/A	10.14	333-142477	7/9/2007
10.22	Form of Indemnification Agreement between lululemon athletica inc. and its directors and certain officers		S-1/A	10.16	333-142477	7/9/2007
10.23	Purchase and Sale Agreement between 2725312 Canada Inc and lululemon athletica inc., dated December 22, 2010		10-K	10.12	001-33608	3/17/2011
10.24*	Outside Director Compensation Plan	X				
10.25*	lululemon athletica inc. Employee Share Purchase Plan		10-Q	10.3	001-33608	11/29/2007
10.26*	Executive Bonus Plan of lululemon athletica inc.		8-K	10.1	001-33608	3/19/2013
10.27*	Executive Employment Agreement, dated effective as of December 1, 2013 between lululemon athletica inc. and Laurent Potdevin		8-K	10.1	001-33608	12/11/2013

10.28*	Amended Executive Employment Agreement, effective as of October 29, 2012 between lululemon athletica canada inc. and John E. Currie		10-K	10.20	001-33608	3/21/2013
10.29*	Executive Employment Agreement with Stuart C. Haselden, dated effective as of January 2, 2015		8-K	10.1	001-33608	1/7/2015
10.30*	Executive Employment Agreement, effective as of October 15, 2013 between lululemon athletica inc. and Tara Poseley		10-Q	10.1	001-33608	12/12/2013
10.31*	Executive Employment Agreement, effective as of March 24, 2010 between lululemon athletica canada inc. and Delaney Schweitzer		10-K	10.23	001-33608	3/25/2010
10.32*	Executive Employment Agreement, effective as of November 24, 2014 between lululemon athletica inc. and Scott (Duke) Stump		10-Q	10.13	001-33608	12/11/2014
21.1	Subsidiaries of lululemon athletica inc.	X				
23.1	Consent of PricewaterhouseCoopers LLP	X				

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31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
32.1**	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					
101	The following financial statements from the Company's 10-K for the fiscal year ended February 1, 2015, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations and Comprehensive Income, (iii) Consolidated Statements of Stockholders' Equity, (iv) Consolidated Statements of Cash Flows (v) Notes to the Consolidated Financial Statements	X				

* Denotes a compensatory plan, contract or arrangement, in which our directors or executive officers may participate.

** Furnished herewith.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LULULEMON ATHLETICA INC.

By: /s/ LAURENT POTDEVIN
Laurent Potdevin
Chief Executive Officer (Principal Executive Officer)

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Laurent Potdevin and Stuart C. Haselden and each of them, with full power of substitution and resubstitution and full power to act without the other, as his or her true and lawful attorney-in-fact and agent to act in his or her name, place and stead and to execute in the name and on behalf of each person, individually and in each capacity stated below, and to file, any and all documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing, ratifying and confirming all that said attorneys-in-fact and agents or any of them or their and his or her substitute or substitutes, may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ LAURENT POTDEVIN Laurent Potdevin	Director and Chief Executive Officer (Principal Executive Officer)	March 25, 2015
/s/ STUART C. HASELDEN Stuart C. Haselden	Chief Financial Officer (Principal Financial and Accounting Officer)	March 25, 2015
/s/ MICHAEL CASEY Michael Casey	Director, Co-Chairman of the Board	March 25, 2015
/s/ DAVID M. MUSSAFER David M. Mussafer	Director, Co-Chairman of the Board	March 25, 2015
Robert Bensoussan	Director	
/s/ STEVEN J. COLLINS Steven J. Collins	Director	March 25, 2015
/s/ ROANN COSTIN RoAnn Costin	Director	March 25, 2015
/s/ WILLIAM H. GLENN William H. Glenn	Director	March 25, 2015
/s/ MARTHA A.M. MORFITT Martha A.M. Morfitt	Director	March 25, 2015

/s/ RHODA M. PITCHER Rhoda M. Pitcher	Director	March 25, 2015
/s/ THOMAS G. STEMBERG Thomas G. Stemberg	Director	March 25, 2015
/s/ EMILY WHITE Emily White	Director	March 25, 2015

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* Denotes a compensatory plan, contract or arrangement, in which our directors or executive officers may participate.

** Furnished herewith.