

Fitbit Inc. (FIT): Short @ \$11.00

Short Thesis: Low Purchase Intent for Wearable Devices in 2016, No Wide Moat, Claims of “Highly Inaccurate” Fitbit Heart Rate Trackers and Looming Competitive Threats from Under Armour (UA), Apple and Samsung.

TABLE 1: Fitbit 1Q16 Results

1Q16 Results			2Q16 Guidance			1Q16 Results			2Q16 Guidance		
EPS	Cons.	Result	EPS	Cons.	Result	Total Rev.	Cons.	Result	Total Rev.	Cons.	Result
0.10	0.03	beat	0.10	0.26	miss	505.4M	443.24M	beat	575M	532.79M	beat

Source: Fitbit Inc. and Yahoo Finance

Fitbit's 1Q16 results easily beat analyst estimates (see Table 1), however we believe investors are focused on how saturated the market for wearable devices has become as well as slowing revenue growth and declining earnings. There are also concerns over Fitbit's product portfolio steadily moving upmarket to the smartwatch space where stronger competitors with deeper pockets like Apple and Samsung are already established. Furthermore, recent negative headline risks regarding the reliability of Fitbit's heart rate monitors have yet to be fully addressed by the company. We believe this “reliability risk” will serve as a negative overhang limiting any upside for the stock price and worse, may cause irreparable damage to the company's brand which may result in a sales slowdown of new products this year.

I. Low Purchase Intent for Smartwatches and Wearable Devices in 2016

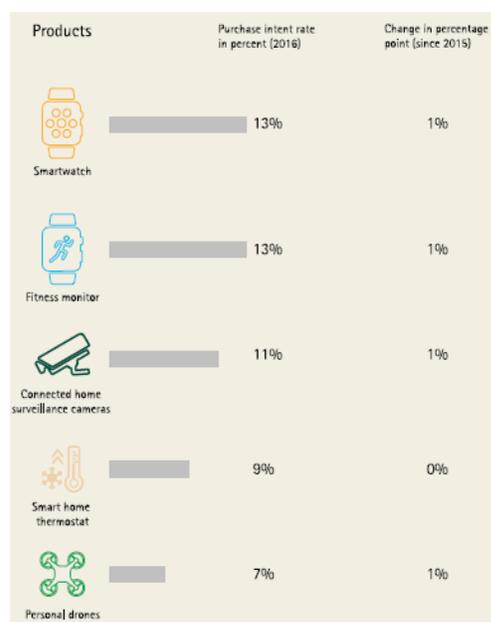


FIGURE 1: Purchase Intent for New Electronic Devices in 2016

A recent survey by *Accenture* showed that consumers are increasingly growing bored with new technology and less people are planning on buying new devices this year. Of the 28,000 consumers surveyed, only 48% said they were planning on purchasing a new smartphone this year, down 9% from last year. Laptops, TVs and tablets also showed a purchase intent of ~30%, a respective decrease of 6%, 8% and 9% from last year.

However, for Fitbit, the biggest concern is that only 13% of consumers surveyed showed they were likely to purchase new types of gadgets and wearable devices like smartwatches and fitness monitors this year, an increase of only 1% from last year (see Figure 1).

Source: Accenture, Igniting Growth in Consumer Technology, 2016

II. No Wide Moat: FIT's Market Share Eroding Despite 1Q16 Record Shipments

Table 2 shows the top 5 vendors (by unit shipments) in the wearables market for 1Q16. Fitbit is the top vendor shipping 4.8M units (+25.4% y/y) most notably their new *Alta* and *Blaze* models while Xiaomi came in second with 3.7M units shipped (+41.8% y/y). In smart watch sales, Apple managed to gain nearly 50% of market share while Samsung and Motorola took the second and third places. Also noteworthy is that Apple and Fitbit sell for a far higher average selling price than Xiaomi (the price of *Xiaomi Mi Band* is less than the price of the watch strap for the *Apple Watch* and for most Fitbit models). This results in far higher revenue for the current leaders in fitness wearables and smart watch segments.

TABLE 2: Global Wearables Market in 1Q16 – Top 5 Vendors (Million Units Shipped)

Vendor	1Q16 Unit Shipments	1Q16 Mkt. Share	1Q15 Unit Shipments	1Q15 Mkt. Share	Y/Y Growth
1 Fitbit	4.8	24.5%	3.8	32.6%	25.4%
2 Xiaomi	3.7	19.0%	2.6	22.4%	41.8%
3 Apple	1.5	7.5%	n/a	0.0%	n/a
4 Garmin	0.9	4.6%	0.7	6.1%	27.8%
5 Samsung	0.7	3.6%	0.7	5.8%	4.5%
5 BBK	0.7	3.6%	n/a	0.0%	n/a
Others	7.3	37.2%	3.9	33.1%	87.9%
Total	19.7	100.0%	11.8	100.0%	67.2%

Source: IDC Worldwide Quarterly Wearables Tracker, May 16, 2016

Despite the record 1Q16 quarter, FIT's market share has been consistently eroding, dropping from 43.9% in 4Q14 to 29.5% in 4Q15 and more recently to 24.5% in 1Q16, a decrease of 19.4 percentage points. The loss of market share despite record unit shipments shows that Fitbit's smartwatch and fitness tracking devices offer no unique differentiable advantage relative to its closest competitors.

There have also been complaints that Fitbit's optical rate sensors have not been performing well in terms of measuring heart rate and miscounting steps. These complaints are troubling since the company is targeting the corporate wellness market to grow its revenues and has said in its most recent earnings call that it is dedicating resources to the digital health and fitness area.

III. Mixed Reviews of Blaze and Competitive Threat from Under Armour

The wearable device market is a niche market with no barriers to entry. Competition is fluid and market players typically cut prices in order to gain market share. To maintain current pricing levels and protect their margins, device makers need a unique product feature to differentiate themselves from the competition. The *Apple Watch* has the "coolness" factor and its design is often described as sleek with a unique user interface. Moreover, it also performs the same basic fitness tracking tasks (step counting, resting heart rate monitor, customized workout routines, etc.). The *Apple Watch* is priced at \$349 and upwards putting it on the high end of the market. In contrast, *Xiaomi's Mi Band* is priced at \$27 and also performs the same basic fitness tracking tasks of the *Apple Watch* and the Fitbit *Blaze*.

Fitbit's new smartwatch called *Blaze* was released in 1Q16 with a price point of \$200. So far, product reviews have been mixed – with the design as not being attractive enough and the heart rate sensor as not that accurate and the step counter miscounting steps.

Our big red flag for Fitbit in 2016 is the entry of Under Armour (UA) in the fitness tracking space. We believe UA has the ability to take market share from both Apple and Fitbit. First, UA manufactures sportswear apparel and has a very large and loyal user base, rivaling that of Nike's sportswear apparel user base. Secondly, UA is integrating its fitness trackers into its sports apparel. For example, its heart rate monitor is strapped to the athlete's chest where in theory, it is closer to the heart and can therefore give more accurate heart rate measurements, both at rest and in the middle of a high-intensity workout. This is a problem for Fitbit since complaints are that it does not provide accurate heart rate measurements during high-intensity workouts.

Thirdly, UA's fitness trackers come as a suite of 3 products – a band (\$180) to track steps and distance, a scale (\$180) to track body weight and measure body fat percentage and a heart rate monitor (\$80). The whole suite can be purchased for \$400 or individually at price points that are similar to Fitbit's fitness tracker price points.

We believe Under Armour presents a credible threat to Fitbit's market share this year. It has the "coolness" factor of the *Apple Watch* and a large loyal sportswear user base that can be upsold to its fitness tracker products. With the credible threat from UA, it could likely be that Fitbit may have to reduce its price points to maintain sales momentum. This, in turn would jeopardize margins in the short term. We are therefore cautious on the name for the near term.

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Analyst Certification

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