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Fitbit Inc. (FIT): Hold @ $6.50

Hold Thesis: We are maintaining our Hold with a PT of $6.50. We believe FIT is currently at fair value (~$6.00-6.50) with all the negative news and investor sentiment priced into the stock. Any sign of a reversal in the downward sales momentum – like the launch of a new smartwatch in 2H17 – will likely cause valuation multiples to expand and shift investor sentiment. Currently, the wearable tech space is very crowded and competition is highly fluid. We believe it could take several quarters for management to execute their diversification strategy. Even if successful, there is still the risk that other larger, more well-capitalized competitors (i.e., Apple or Samsung) could also enter the same Enterprise Healthcare space that Fitbit is targeting and take share away from Fitbit. We believe Fitbit could be an attractive acquisition target where its Brand can still command a premium value.

TABLE 1: Fitbit 1Q17 Results

1Q17 Results			2Q17 Guidance			1Q17 Results			2Q17 Guidance		
EPS	Cons.	Result	EPS	Cons.	Result	Total Rev.	Cons.	Result	Total Rev.	Cons.	Result
-0.15	-0.18	beat	(0.14)-(0.17)	-0.11	miss	298.94M	277.48	beat	330-350M	340.38M	in-line

Source: Fitbit Inc. and Estimize.com

I. *Loses Top Spot in Wearable Tech Space in 1Q17*

According to *Strategy Analytics,* global wearables shipments reached 22.0M units in 1Q17, up 21% y/y from 18.2M in 1Q16 driven by stronger demand for new smartwatch models in North America, Western Europe and Asia (see Table 2).

TABLE 2: Top 4 Wearables Vendors (1Q17) – Shipments (Million Units), Market Share, Y/Y Growth

		1Q17		1Q16		Y/Y
		Unit Shipments	Market Share	Unit Shipments	Market Share	Growth
1	Apple	3.5	15.9%	2.2	12.1%	59.1%
2	Xiaomi	3.4	15.5%	3.8	20.9%	-10.5%
3	Fitbit	2.9	13.2%	4.5	24.7%	-35.6%
4	Others	12.2	55.5%	7.7	42.3%	58.4%
	Total:	22.0		18.2		

Source: Strategy Analytics

Apple shipped 3.5M wearables worldwide in 1Q17, rising 59% y/y from 2.2M units in 1Q16. Apple captured 16% global market share, overtaking Fitbit to become the world's largest wearables vendor.

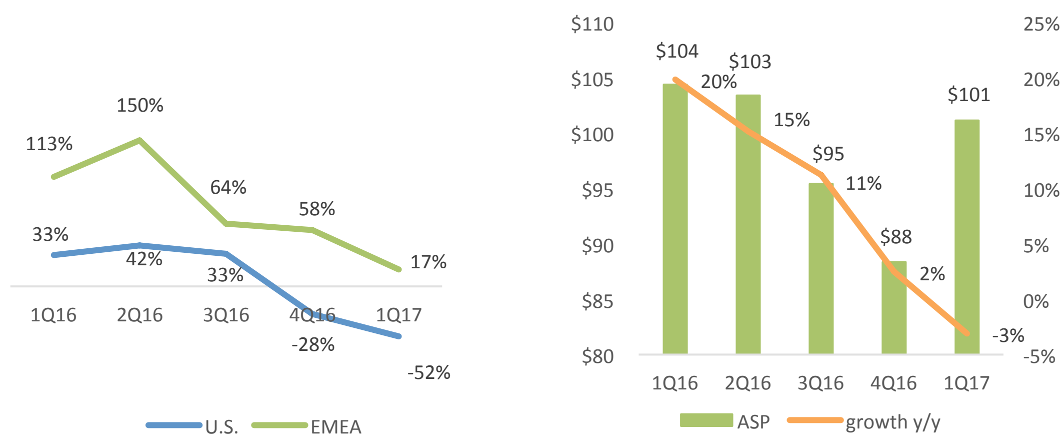
According to *Strategy Analytics,* the new *Apple Watch Series 2* is selling relatively well in the U.S. and UK due to enhanced styling, intensive marketing and a good retail presence. Xiaomi also shipped 3.4M wearables for 15% market share worldwide in 1Q17. Demand for its popular *Mi Band* fitness series was mostly flat across its core Asian markets.

Fitbit shipped 2.9M wearables worldwide in 1Q17 falling 36% y/y from 4.5M in 1Q16 (see Table 2). Fitbit lost its wearables leadership to Apple, due to slowing demand for its fitness bands and a late entry to the emerging smartwatch market.

II. Sales are Falling but ASP is Holding Up – Indicating Brand Still Has Value

We believe consumer appeal for fitness trackers started to wane in 2H16 when U.S. sales (57% of total revenue) of FIT's wristbands in 2Q16 dropped from 42% y/y to negative 28% y/y in 4Q16. In addition, sales growth in EMEA (29% of total revenue) fell dramatically from 150% y/y in 2Q16 to 58% y/y in 4Q16 (see Figure 1, left chart). In 1Q17, Fitbit lost is leadership position in the wearables space as sales plummeted further to negative 52% y/y in the U.S. and to just 17% y/y in EMEA.

FIGURE 1: U.S. (57% of TR) + EMEA (29% of TR) = 86% of Total Sales (left) and ASP (US$, Y/Y %) (right)



Source: Fitbit Inc.

Fitbit CEO James Park has been trying to change Fitbit to more than just a maker of trendy gadgets by splitting the company into two groups: 1) Consumer Health and Fitness and 2) Enterprise Health. The Consumer Health segment will remain focused on selling Fitbit wearables and high-end smartwatches to consumers while the Enterprise Health segment will be positioned as a big data health care solutions provider. Enterprise Health will offer corporate wellness offerings to health care insurance providers (i.e., United Healthcare) and medical device manufacturers (i.e., Medtronic) urging them to purchase Fitbit's tracker bands and distribute them to their clients/patients.

<u>We believe this strategy, while it accomplishes the goal of diversifying FIT's revenue stream – from being too reliant on a fickle and trend-conscious consumer to a more stable, consistent purchase patterns of the enterprise sector – will take years to execute. Moreover, this strategy does not insulate Fitbit from the likes of Apple and Samsung, who also have fitness wearable offerings, from entering the same enterprise health space and taking share from Fitbit.</u>

On a positive note, Fitbit's average ASP has held up well at $101 in 1Q17 indicating that the Fitbit brand still has value (see Figure 1, right chart). In their 1Q17 earnings call, management stated that FIT's products range from $59 to $300 and that price range would hold even as the company switched from trackers to smartwatches.

We remain cautiously optimistic that Fitbit's new smartwatch product will have unique features that differentiate it from both Apple and Samsung smartwatches, making it a compelling upgrade for Fitbit's 50M registered users in the short term. However, the wearable tech space is extremely crowded at this time and competition is very fluid, making it difficult for any one company to remain in the top rankings for very long.

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Analyst Certification

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