Siena Market Line
3rd week of March 2016

Fitbit, Inc.

NYSE: FIT

Analyst: Joseph Gonyeau
Sector: Technology

BUY

Price Target: $25.01

Key Statistics as of 3/11/2016

Market Price:	$14.51
Industry:	Scientific & Technical Instruments
Market Cap:	$3,134.3M
52-Week Range:	$11.91-$51.90
Beta:	1.63

Thesis Points:

- The fitness tracking industry is growing rapidly and Fitbit is the undisputed market leader.
- Health insurance discounts will make Fitbit a necessity for governments, employers, and insurers.
- Q4 Earnings triggered a market overreaction, dropping the price by 26.5%, making now a perfect time to buy.

Company Description:

Fitbit, Inc. (FIT) merged the health and fitness markets in 2007 and have since established themselves as a leading global health and fitness brand by providing wearable health and fitness tracking devices. The Fitbit platform combines connected health and fitness devices with software and services, including an online dashboard and mobile apps, data analytics, motivational and social tools, personalized insights, and virtual coaching through customized fitness plans and interactive workouts. Their platform helps people increase their physical activity, eat healthier, sleep better, and actively manage their weight. They achieve this through their family of eight wearable connected health and fitness trackers. These wrist-based and "clippable" devices automatically track users' daily steps, distance traveled, calories burned, and their quality of sleep and display real-time feedback to encourage them to become more active in their daily lives. Since its June 2015 IPO, Fitbit has established itself as the market leader in fitness trackers, commanding a 26.9% market share in 2015, 11% greater than their next biggest competitor, Xiaomi. Fitbit's stock price has dropped by about half since the beginning of 2016; however, this was due in large part to a market overreaction to 2016 forward guidance, making now a perfect time to buy a very bullish stock.

Thesis

Fitbit, Inc. (FIT) is the undisputed market leader in the market for fitness trackers, and is well on its way to establishing its name as a generalized trademark for all fitness trackers. Over the last few years, they have been an attractive prospect for investors, growing revenues at well over 100% on a year over year basis, from 175% YoY growth in 2014, to 149.3% YoY growth in 2015. On top of this, FIT has managed to keep gross margins strong, with full year numbers at a steady 48% for the last two years. They have been financially solid on the core financial statements, maintaining strong cash flows, with YoY EBITDA growth of 104% in 2015. This is paired with an impressive balance sheet that boasts no debt and a cash balance of $535.8 million. Although they have strong financials, poor forward guidance for Q1 2016 regarding a shrinking operating margin due to both increased SG&A expenses, as well as anticipated additional manufacturing costs, triggered a massive sell-off. This sell-off ultimately caused their stock price to drop from $16.52 before earnings to $12.15 four days later, a drop of 26.5%. This was an overreaction by the market, as their Earnings Per Share and revenue growth blew away estimates for 2015, and their year-long guidance predicts a year with revenue growth comfortably above 30%. They were also able to easily explain that these anticipated increased costs are the direct result of their plan to make a global launch of new products Fitbit Blaze and Alta. Ultimately, FIT wants to maximize production and perform a global launch, which are the dominant reasons for their negative guidance. The major sell-off was an overreaction by the market, as FIT is simply investing more money to make more money, lowering profits in the short-term before seeing revenues in the long-term. This sell-off has provided us with the perfect opportunity to buy an undervalued stock with no debt and a large cash balance.

Industry Outlook

As obesity rates rise, and technology makes gathering and synthesizing information easier, the market for fitness trackers is booming, with Fitbit at the forefront. The Fitbit ecosystem allows Fitbit devices to interact with dozens of different apps, web sites and has seen unparalleled success catering to the fitness and health audience. Not only is the market for individual sales booming, but Fitbit is on the verge of tapping into a new market, that could enable Fitbit to establish itself as a dominant force worldwide. James Park, the CEO of Fitbit, has been seeking ties with health and life insurance companies, who would use Fitbit products to encourage their customers to live healthier lives, to save the insurers money on healthcare costs. As society becomes more health-conscious, there has been a global shift from reactive sick-care to preventative healthcare, and the Fitbit ecosystem is vital to the expansion of this global trend, as it is on the cusp of becoming a necessity for employers, insurers, and even governments seeking to save money on healthcare. Fitbit has already established a relationship with John Hancock Life Insurance, who gives their employees free Fitbits and reduced premiums in exchange for uploading data on their lifestyle. In the U.S., it is typically employers who help pay for the insurance and healthcare costs of their employees. Corporations are starting to learn that signing up for this system can save them money on insurance premiums and healthcare costs, with over 70 of the Fortune 500 companies already subscribing to the Fitbit ecosystem. To compound this, healthier employees are more productive, boosting bottom-line productivity. As corporations begin to see the cost savings associated with the Fitbit ecosystem, governments undoubtedly will as well. Outside of the U.S., it is generally the government that faces healthcare costs, and Fitbit has already established a trial relationship with the Australian government. In 2016, one million Australian citizens will trial the new Australian e-health system, which included various Fitbit products, to analyze their health data. If the system is shown to decrease the costs of healthcare claims as is expected, Fitbit may be able to establish itself as a market leader in a massive new revenue generating service.

Business Model

Fitbit's business model revolves around the sale of their eight core health and fitness devices, which currently account for almost all of their revenues, with a small portion of their revenue derived from their subscription based services. They target a large, mainstream health and fitness market by offering products and systems that help their customers track steps, sleep patterns, diet, and calories burned, to name a few. Aside from their hardware, they also offer online dashboards and mobile apps that synthesize the information gathered from the Fitbit devices, to give users a more meaningful collection of data to track their fitness. With their open API, the enable third-party developers to create health and fitness apps that interact with their platform. This open platform and their large community of connected users, has enabled them to establish a large ecosystem of apps, and motivational and fitness videos to increase the Fitbit experience.

People

Fitbit is led by their youthful CEO James Park and CTO Eric Friedman, the company's original co-founders. Park was named among Fortune magazine's "40 Under 40" in 2015, an annual ranking of the most influential young people in business. Park serves as a tenacious leader for the Fitbit shareholders, navigating the company through its turbulent beginnings as a $400,000 startup. Eric Friedman is the other co-founder of Fitbit, with previous experience co-founding Wind-Up Labs, Inc., in 2002. During his time at Wind-Up Labs, he oversaw the creation of HeyPix, one of the forerunners in P2P photo sharing applications. Both Park and Friedman have extensive experience in software engineering, which is commonly mentioned as a driving force behind the ease of navigating the Fitbit dashboard. Their past has proven them both to be pioneers in the advancement of technology, which is very useful for Fitbit, as its advancement relies on the continuous innovation of hardware.

Competitive Advantage

There is currently a lot of competition in the fitness tracker market, including brands such as Jawbone, Xiaomi, and Apple; however, Fitbit has the competitive advantages to ensure that it holds its rank as the market powerhouse. First, Fitbit has established itself as a global brand. The Fitbit name has essentially become synonymous with the connected fitness market, and is well on its way to establishing itself as a brand such as "Band Aid." In the first Quarter of 2015, Fitbit's products were 85% of the total dollars spent on fitness trackers, up from around 60% in 2013, and 70% in 2014. Fitbit's next competitive advantage is the broad range of connected devices that it offers, with varying price ranges. Many companies offer numerous variations of a certain product, but Fitbit offers multiple different products, and different variations within each group. It also offers multiple levels of functionality and price, ranging from sleep monitoring to advanced GPS capabilities. One of their other biggest competitive advantages is that not only do they provide the hardware devices, but also the software platform to track the data that is gathered by the device. The software helps the consumer utilize the information in a relevant way. The hardware and software work together towards the specific goal of monitoring ones fitness. Products such as the Apple watch offer fitness tracking as just one small feature among many, whereas Fitbit focuses and excels at it. The final major competitive advantage that Fitbit has over its competitors is that its devices are compatible with many platforms, from the Nike+ app to Under Armour's fitness app. This allows people to track their fitness along with their friends who may be using different devices, and could open the door for future sales growth as those software users become Fitbit hardware users.

Financials

Since Fitbit is a young hardware maker, operating margins are razor thin, as new competitors are continuously entering the market. Regardless, Fitbit has seen impressive YoY revenue growth over the past few years, from 175% in 2014, to 149% in 2015, and a more stable anticipated growth of 33% in 2016. Operating Costs to revenue have also decreased from around 100%, to a much more stable 81% since 2013, with a slight anticipated spike in operating costs to occur in 2016. Operating Costs to revenue can be expected to increase to about 83% as Fitbit begins its global marketing campaign and international expansion. However, after a year operating costs will most likely stabilize to around 80% before tapering off to an industry average of around 76%. As negative guidance anticipates operating margins to decrease in Q1 2016, a result of this expansion, a major sell-off occurred in the market, causing Fitbit's price to drop by 26%. This was unwarranted, as Fitbit is simply investing in itself now, to increase revenues and bolster its margins in the future. Growth so far has been completely contained in the United States; for Q4, the U.S. accounted for over $500m in revenues, while no other regions broke $100m in sales. Full year revenues were 74% domestically, but the ability to expand internationally and reach a 50% split in revenue by geographic regions provides tremendous upside. This expansion is intended to capitalize on the growing popularity of fitness trackers, as the amount of active Fitbit users is up 16.9 million (152%) at the end of 2015, as they sold 32.3 million devices over the last two years. Fitbit is also very financially flexible, with more than $535 million in their cash balances. Based on a 1 year estimated beta for Fitbit relative to the S&P 500 over the same year, Fitbit had an impressive ROIC of around 44% in 2015 with a WACC of 23%, significantly greater than the industry average of 13% in the Technology and Hardware industry, signifying that this is a value creating company. ROIC is anticipated to be a more stable 32% for 2016, showing that even through a global expansion, they can be expected to create value. Aside from the negative guidance for Q1, Fitbit smashed Q4 estimates due to a very strong holiday season, and is trading at around 12x Earnings Per Share. EPS in Q4 came in at $0.35, beating estimates by $.10, as revenues also beat estimates by $63.8 million. With revenues growing at 100% on a YoY basis, gross margins have been kept quite strong, at a steady 48% for the last two years. FIT also has strong cash flows, with YoY EBITDA growth of 104% in 2015. The negative guidance for Q1 has caused the price of FIT to drop drastically, providing an opportune time to engage in a long position. Full year guidance for 2016 has been kept in line with consensus, with anticipated revenues of around $2.5 billion, EBITDA between $400m and $800m, and EPS around $1.15. Based on UFCF, I have an intrinsic value at $18.55, with a 1-year target at $25.14, slightly above analyst estimates, making now the perfect time to buy.

Conclusion

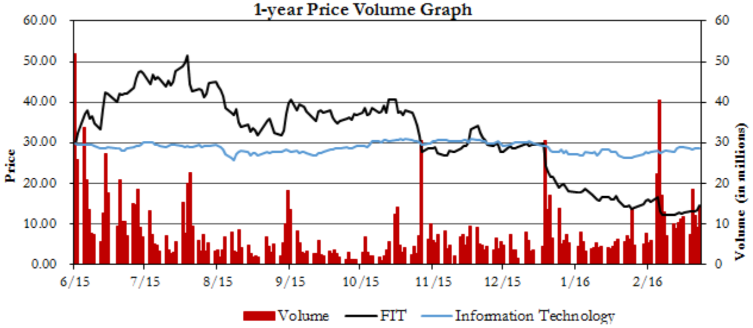
Fitbit is the dominant market leader in a booming market capitalizing on increased awareness of physical activity. Shortly after its June IPO, Fitbit was trading in the low $50s as investors were impressed by its massive growth; however, after peaking in August the stock has been in a steady decline. Like Fitbit, many of the high P/E and tech growth stocks were also hit significantly harder than the overall market, signifying more of a macroeconomic issue than anything wrong with Fitbit. A more recent selloff occurred in January, after Q4 negative guidance regarding the upcoming year. This dropped Fitbit's price by 26%, which is based off of anticipated decreases in margins caused by increased SG&A expenses and R&D expenses. However, this is only for Q1, and Fitbit's forward guidance for 2016 as a whole is still very positive, with revenue growth expected to be above 30%. I feel that the market brought Fitbit to a more realistic price in December, and that the January price decline was unwarranted. This is a value creating company that has the dominant share in a growing market and is on the cusp of tapping into an untapped market that could provide unheard of returns. This recent sell off has given us the chance to buy a very bullish stock at a significant discount.

Siena Market Line
3rd week of March 2016

Fitbit Inc. (FIT) — CENTER FOR GLOBAL FINANCIAL STUDIES — BULLISH

Analysis by Joseph Gonyeau	Current Price: $14.51	Intrinsic Value $18.55	Target 1 year Return: 73.25%
3/13/2016	Divident Yield: 0.0%	Target Price $25.14	Probability of Price Increase: 99.8%

1-year Price Volume Graph



Description

Fitbit, Inc. provides wearable health and fitness tracking devices.

General Information

Sector	Information Technology
Industry	Electronic Equipment, Instruments and Components
Last Guidance	November 3, 2015
Next earnings date	NM
Estimated Country Risk Premium	12.42%
Effective Tax rate	36%
Effective Operating Tax rate	46%

Market Data

Market Capitalization	$2,922.57
Daily volume (mil)	14.18
Shares outstanding (mil)	216.01
Diluted shares outstanding (mil)	164.21
% shares held by institutions	97%
% shares held by investments Managers	22%
% shares held by hedge funds	5%
% shares held by insiders	24.52%
Short interest	18.60%
Days to cover short interest	4.81
52 week high	$51.90
52-week low	$11.91
Levered Beta	
Volatility	0.00%

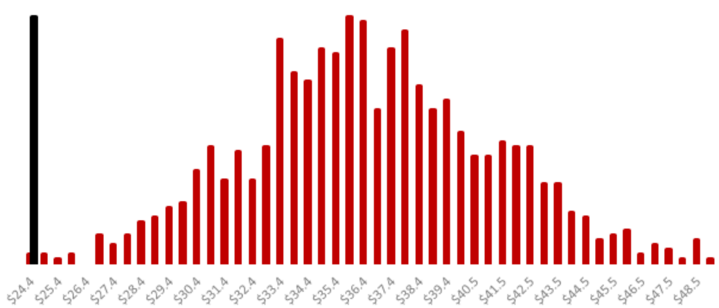
Past Earning Surprises

Quarter ending	Revenue	EBITDA
12/31/2014	N/A	N/A
3/31/2015	N/A	N/A
6/30/2015	25.53%	112.31%
9/30/2015	13.73%	65.85%
12/31/2015	9.81%	18.36%
Mean	16.36%	65.50%
Standard error	4.7%	27.1%

Peers

GoPro, Inc.
Garmin Ltd.
Apple Inc.

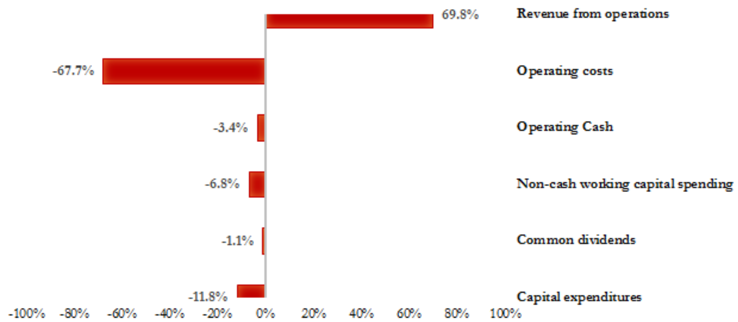
Target Price Distribution--Prob(Price Increase)= 100%



Management	Position	Total compensations growth	Total return to shareholders
Park, James	Co-Founder, Chairman, Chief	N/M	0% per annum over 0y
Friedman, Eric	Co-Founder, Chief Technology	N/M	0% per annum over 0y
Zerella, William	Chief Financial Officer	N/M	0% per annum over 0y
Hartmann, Hansgregory	Chief Operations Officer	N/M	N/M
Missan, Andrew	Executive Vice President and	N/M	N/M
Rosa, Tim	Vice President of Global Mar	N/M	N/M

Profitability	FIT (LTM)	FIT (3 years historical average)	Industry (LTM)
ROIC	44.8%	-408.12%	9.24%
NOPAT Margin	9%	#DIV/0!	11.8%
Revenue/Invested Capital	4.98	#DIV/0!	0.78
ROE	#VALUE!	#VALUE!	10.35%
Adjusted net margin	9%	#DIV/0!	10.7%
Revenue/Adjusted Book Value	#VALUE!	#VALUE!	0.97
Invested Funds	**FIT (LTM)**	**FIT (3 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	61.5%	70.8%	22%
Estimated Operating Cash/Total Capital	43.7%	54.8%	N/A
Non-cash working Capital/Total Capital	16.9%	11.9%	15%
Invested Capital/Total Capital	89.9%	101.9%	75%
Capital Structure	**FIT (LTM)**	**FIT (3 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.02	0.00	0.16
Cost of Existing Debt	0.78%	17.97%	3.52%
Estimated Cost of new Borrowing	1.25%	0.50%	3.52%
CGFS Risk Rating	0.78%	#DIV/0!	CCC
Unlevered Beta (LTM)	0.00%		1.02
WACC	0.78%	23.02%	15.02%

Sensitivity Analysis



Porter's 5 forces (scores are out of 100)

Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	149.3%	9.0%	1.95
12/31/2016	33.0%	12.4%	1.37