



Is It Time to Give Up on FitBit's Stock?

Description

Fitbit (NYSE: FIT) is facing serious issues. The latest chapter in this drama is that due to its new Versa Lite fitness smartwatch collecting dust on retail store shelves, the company has made a \$150 million reduction in 2019 expected full-year revenue. The stock seems like a bargain, priced at less than two times its cash and investible assets, but it's cheap for good reason. The core device business is suffering and efforts to pivot haven't gained traction.

Let's look at where this fitness tracking device manufacturer is today and whether investors can bet on this underdog to beat the odds.

Pricing power and margins have degraded

Investors love companies with pricing power like **Walt Disney** that can raise prices every year at its theme parks but still draw record crowds. Fitbit, on the other hand, seems to have lost that ability (if it ever had it at all). Stuck between [low-priced competitors](#) like **Huami** and the popular premium-priced **Apple** watch, CEO James Park says that it can succeed with products "in the \$50 to \$300 price range that are easy to use and feature-rich." But the track record of its average sales prices (ASP) shows its customers are less willing to pay up for its higher-priced products. In Q1 2018, ASPs peaked with the introduction of its first smartwatch, but have degraded to \$86 in the most recent quarter and may not ever recover back to its highs.

Metric	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019
Smartwatch % of revenue	30%	56%	49%	43%	43%	39%
Average selling price	\$112	\$106	\$108	\$100	\$91	\$86
Gross margin	46%	39.8%	39%	38%	32.9%	34.5%

Source: Fitbit earnings announcements, table by author.

[Gross margins](#) have also suffered from the expansion into smartwatches. This was not unexpected, but the low 30% gross margins in the first half of 2019 are a far cry from the tracker-only gross margins

like the 47.8% the company posted as recently as Q3 2016. This margin compression leaves less money for marketing and research and development, which have put hobbled the company's cash flow and profits.

With the tracker business struggling, investors may be pinning hopes on alternative revenue streams.

Revenue beyond the device is still small

At the end of 2016, I wrote about Fitbit's efforts to [bring in non-device revenue](#) including its personal training app, corporate wellness programs, and its digital health initiatives. Over two years later, those efforts (now called Fitbit Health Solutions) are still only a small part of the company.

This business is on track to achieve revenues of \$100 million in 2019, growing 24% from last year. This number sounds impressive but accounts for less than 7% of the midpoint in full-year revenue guidance. But wait, there's more to this nine-figure revenue number that investors should understand. On the [most recent earnings call](#), Chief Financial Officer Ron Kisling explained that "Fitbit Health Solutions' revenue remains skewed toward hardware." Like it or not, Fitbit is still predominantly a hardware company, mainly due to opportunities it's missed to pivot.

Too little to show for too many opportunities

There were 29.2 million devices sold in 2017 and 2018, but the number of active users only increased by 4.4 million over that period. It's pretty disappointing that only 15% of devices sold have resulted in new active users. It's even more disheartening to note that the active user metric is a really low bar. Customers only have to log 100 steps in the previous 90 days to be counted as "active". It's tough to grow a brand when its products aren't being used. Creating more engaged users is probably Fitbit's biggest missed opportunity.

Two years ago, the company was selected by the U.S. Food and Drug Administration (FDA) as one of only nine companies to participate in its Digital Health Software Precertification Pilot Program. This program was intended to drive software as a medical device innovation and streamline the path for approvals. CEO James Park said recently that "we're continuing to work with the FDA on a variety of initiatives, including around sleep apnea. I just can't give you a time frame right now." No tangible results makes this big missed opportunity number two.

Management's latest idea is bundling its new premium software offering with its devices for the upcoming holiday season. Park even suggested giving "away certain hardware devices for free and then having a recurring revenue stream on the services side with that user for a longer period of time." This might work, but I wouldn't blame investors who are saying "show me the money!"

Will Fitbit survive?

Fitbit is facing a wall of challenges and management may realize they can't succeed without help. Reports indicate that this tracker-manufacturer is considering options [with potential acquirers](#). The company is certainly not dead yet. With plenty of cash and a loyal following, it is likely doomed to the fate of [other consumer-facing tech companies](#): the king of a small niche market. Even with a longshot

chance of a buyout-stock-pop, investors would do well to put their money elsewhere.

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