**Stitch Fix (SFIX) Equity Report**

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**BASIC INFORMATION**

Stitch Fix, coinciding with the ticker symbol “SFIX”, is a publicly traded firm within the Russell 2000. Stitch Fix is therefore one of the 2,000 smallest-cap firms within the Russell 3000 Index. Stitch Fix conducts its retail business wholly online. It is a part of the online retail B2C segment of the E-commerce industry. We argue that the Stitch Fix stock is currently underpriced and the SMIF should invest in said stock. Stitch Fix is currently trading at $23.23, as of December 5th, 2019. Stitch Fix currently has a market capitalization of $2.171 billion. According to CNN Business, analysts predict a median target stock price of $28, a high estimate of $38, and a low estimate of $16.

**INVESTMENT SUMMARY**

Stitch Fix is a personal styling service that sends individually picked clothing and accessory items for a one-time styling fee. Customers fill out a questionnaire online about their style preferences. A stylist employed by the company, of the 5,100+ total, picks five items to send to the customer. The Stitch Fix stock price since November is up almost $4 sending a good sign to investors. Also, the 11-analyst-offering 12 month's forecast of Stitch Fix’s stock price have a median of $28 with a high of $38. Stitch Fix recently just came out with their 2019 report, and their revenue was up 29%. Stitch Fix has also beat its last four EPS estimates. We believe this stock is underpriced because of the analyst stock price is above the current stock price along with Stitch Fix’s continual revenue and customer growth.

**BUSINESS DESCRIPTION**

Stitch Fix is an online clothing subscription service. Stitch Fix has no receivables because of the subscription plans. One of the key drivers in Stitch Fix’s revenue is the monthly subscription plan; this subscription-base also ensures a reliable amount of income year-round, A $20 styling fee for every order helps cover costs, such as the human stylists as well as shipping costs. A large amount of Stitch Fix’s revenue is lost in cost of goods sold. Stitch Fix purchases clothing from other brands and repackages it to meet the customer's specific needs. A large expense that continuously weighs on Stitch Fix is the cost of data management. Being a completely online company, costs are associated with the over 125 full-time data scientists working at Stitch Fix, including the cost of maintaining such data.

**MANAGEMENT AND GOVERNANCE**

After taking a 4-month maternity leave twice as CEO, Katrina Lake made 4-month maternity leave an option for other women throughout the company.

Executive Compensation (Fiscal Year 2018)

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| --- | --- | --- |
| Katrina Lake | Chief Executive Officer | $601,571 |
| Paul Yee | Chief Financial Officer | $440,000 |
| Michael Smith | Chief Operating Officer | $511,288 |
| Scott Darling | Chief Legal Officer and Corporate Secretary | $325,000 |

The Compensation Committee of the Board of Directors actively reviews the Chief Executive Officer’s performance in areas including achieving performance goals, planning and carrying out the company's long-term strategic plan, and developing a corporate culture that has the highest amount of integrity and ethical standards. These conditions determine the compensation for the Chief Executive Officer.

**INDUSTRY OVERVIEW & COMPETITIVE POSITIONING**

Stitch Fix is part of an industry that is growing very fast. Stitch Fix is part of the E-commerce retail industry. In 2018, the sale of E-commerce retail was 2.3 trillion and by 2021 it is forecasted to reach 4.5 trillion. Stitch Fix has the advantage of conducting business within a culture in need of instant access and desire for convenient shopping, along with the decline of shopping in brick and mortar. Stich Fix has created a disruptive company that can deliver clothes that match clients’ taste. Stitch Fix has a competitive advantage in their use of data analytics; Stitch Fix utilizes machine learning tools and continues to innovate to make the shopping experience as easy and accurate as possible. Stitch Fix is a company with immense opportunities. The company has the potential to expand and grab more market share over the next few years. They also have the option of expanding their price range to include both more expensive articles of clothes and cheaper ones as well. The few competitors that the company has are either private companies, which are a subsidiary of other companies (trunk club or amazon prime wardrobe), or are too small to adequately compete with Stitch Fix. While Stitch Fix has a lot of opportunities, we also must acknowledge that it exists within an industry that is very competitive. Dealing with fashion means that Stitch Fix must deal with the ever-changing trends which can be very time consuming and expensive. Being a clothes delivery firm, the company faces the ever-present problem of logistical issues. While it is very convenient to have your clothes delivered right to your house, it's also very inconvenient to have to return it and wait a much longer time to get your order again. This is one of the reasons Stitch Fix strives for continuous improvement, especially in their data science and machine learning applications, so problems like these don’t happen.

**GROWTH OPPORTUNITIES**

Stitch Fix is currently experiencing and will continue to experience growth in three main dimensions: active customers, revenue, and international expansion.

 In 2014, Stitch Fix recorded a total number of active customers at 261,000. The number of active clients grew to 3,236,000 by 2019; that is an overall growth rate of 1140% within that six-year period. Although the rate of growth has slowed, Stitch Fix continues to entice additional clients every year. The company experienced a growth in current customers of 18% within the last year (2018-2019).

Stitch Fix has also experienced extensive growth in revenue within the last six years, showing a similar trend as customer growth. Stitch Fix revenue has grown from $73,200 in 2014 to $1,577,558 in 2019; revenue has grown by 2055%. The revenue growth rate has also diminished as time continues, but Stitch Fix still illustrates an impressive recent growth rate of 28.62% within the last year (2018-2019).

Stitch Fix is positioned to undergo immense international growth as well due to their recent expansion into the UK market. Stitch Fix launched their services into the UK in May of 2019. Stitch Fix expects the expansion to be highly successful because the personalization capabilities that their service provides will resonate with the UK culture. Stitch Fix also expects great success due to their partnering with international brands to appeal to the new UK client base. Stitch Fix does expect reduced profitability in the short-term due to the expected $12 million of expenses relating to the expansion.

**COMPETITIVE ADVANTAGE**

Stitch Fix holds a relatively immense competitive advantage over its competitors due to the abundance of data that Stitch Fix encompasses and collects. It is incredibly advantageous that Stitch Fix’s data is primary data that is provided directly from the client, whereas competitors rely on secondary data from external sources. Over 85% of their shipments have received direct client feedback. Stitch Fix has estimated that they receive over 90 meaningful data points provided by each customer throughout the entire subscription process. They also utilize a game called “Style Shuffle”, where clients can flip through clothing items and respond whether they like or dislike it; over 2.25 million clients have used this game. Stitch Fix also gathers data in their initial questionnaire that each new client receives; this initial form is to gather a basis on the clients’ preferences. The initial questionnaire includes data on basics, item measurements, personalized preferences, and nuanced descriptions. Basics include categories such as brand, size, color, fit, material, and pattern. Item measurements include categories such as length, width, distance from the collar to the first button, collar circumference, etc. Personalized preferences would include price preference, which body part one prefers to cover up, which body part one prefers to show off, etc. Lastly, nuanced descriptions would include information on how often one dresses for certain occasions and what events certain clothing items are appropriate for. Stitch Fix employs 125 data scientists who analyze this abundance of data and over 5,100 employee stylists who put together ideal outfits relating to preferences.

**VALUATION**



**FINANCIAL ANALYSIS**

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| **SFIX Revenue** |
| Total Revenue | $0.073 Million | $0.342 Million | $0.730 Million | $0.977 Million | $1.226Million | $1.578 Million | $2.099 Million | $2.279Million | $2.894Million |
| % Growth | NA | 368% | 113% | 33.8% | 25.5% | 28.6% | 33%  | 30% | 27% |
| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |

Stitch Fix was founded in 2011 and has been making a profit ever since. Stitch Fix has experienced growth of 2055% from just 2014 to 2019. The amount of growth has decreased throughout the years, but the revenue that Stitch Fix collects has continued to increase. We believe that Stitch Fix’s revenue growth will continue this positive trajectory. We project the growth rate to increase to 33% in 2020 due to additional revenue expected from the recent UK expansion. The growth rate will likely go back to diminishing slightly throughout the years; we project growth to decelerate at about 3% per year.

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| **Market Value** | **Return** | **Efficiency** | **Liquidity** | **Leverage** | **Profitability** |
| PE Ratio | ROE | Inventory Turnover Ratio | Days Sales in Inventory | Current Ratio | Quick Ratio | Total Debt Ratio | Debt / Equity Ratio | Net Profit Margin | Gross Profit Margin |
| 63.56 | 12.1% | 11.45 | 31.88 days | 2.64 | 1.72 | 0.357 | 0.556 | 2.34% | 44.57% |

Stitch Fix exhibits a PE ratio of 63.56. This PE ratio does appear to be high, and we believe that it is high because Stitch Fix is a growth firm. Growth firms typically have high PE ratios, whereas value firms have low PE ratios. The three reasons for Stitch Fix’s growth were previously discussed. The Stitch Fix PE ratio is actually lower than the PE ratio of the online retail industry, which is at 76.38. Stitch Fix’s PE ratio therefor is not as concerning as it initially appears.

Stitch Fix’s ROE, of 12.1%, can be analyzed by comparing it to the ROEs of peer firms. Peers’ ROEs are as follows: Blue Apron (-59.2%), Chewy.com (76.6%), Wayfair (205.0), 1-800-Flowers (10.1%), and Shutterfly (1.15%). SFIX has a concerningly low ROE compared to Wayfair and Chewy, but dissecting the dupont equation shows that Stitch Fix is better-off than these two competitors. The dupont equation can break ROE down into profitability, efficiency, and leverage. This further analysis uncovers that Wayfair and Chewy both have negative profitability (from negative net income) as well as negative leverage (from negative equity). Stitch Fix has positive profitability and leverage, illustrating that it is in a much better position than its peers.

Stitch Fix exhibits efficiency in their well-managed inventory, compared to its peers. Stitch Fix has an inventory turnover ratio of 11.45, whereas 1-800-Flowers and Blue Apron have lower ratios, at 7.98 and 5.11 respectively. This means that Stitch Fix is more efficient at selling goods quickly and experience higher demand for their goods. Stitch Fix has a lower days sales in inventory value, at 31.88 days, than 1-800-Flowers and Blue Apron; 1-800-Flowers is at 45.77 days and Blue Apron is at 71.41 days. This means that Stitch Fix, on average, only holds an item of inventory for 31.88 days, whereas the other two companies hold their inventory for over 1.5x as long.

Stitch Fix appears to be adequately liquid through its short-term solvency ratios. Stitch Fix has a current ratio of 2.64; this means that Stitch Fix has over 2.5x the amount of current assets as it does current liabilities. Stitch Fix has a quick ratio of 1.72; a quick ratio of greater-than 1 means that the firm is sufficiently able to meet its short-term liabilities. Both ratios depict that Stitch Fix is in a healthy position in relation to liquidity.

Stitch Fix is in a low-risk leverage position, as shown by its long-term solvency ratios. Stitch Fix’s total debt ratio of 0.357 means that a larger portion of its assets are funded by equity, rather than debt. A total debt ratio that is less than 1 shows that a firm is in a good, low-risk position. Stitch Fix’s debt/equity ratio of 0.556 shows that Stitch Fix is adequately able to cover its outstanding debt through equity in the event of a business downturn. A good D/E ratio should be around 1 to 1.5 and should never be above 2; Stitch Fix’s ratio of nearly 0.5 is very good.

Stitch Fix’s profitability ratios are concerning, but management predicted low profitability in the latter half of 2019 due to expenses relating to the UK expansion. An estimated $12 million will go toward selling, general, and administrative expenses that are dedicated to the expansion. Stitch Fix has a net profit margin of 2.34% and a gross profit margin of 44.57%. The net profit margin is much lower than the gross profit margin because Stitch Fix reinvests a lot of profit back into its company. A lot of profit has to be allocated to pay for the abundance of data collection that the firm conducts; there are around 125 data scientists and over 5,100 employed stylists whom require pay. There are also plenty of technological expenses relating to the physical collection of the data.

**INVESTMENT RISKS**

The investment risks associated with Stitch Fix are low, but they still exist. Stitch Fix has had problems with other companies establishing their own alternative to brick-and-mortar shopping, and this could lead to a decrease in revenue and stifle the company growth. Stitch Fix will have to find a way to stay competitive while at the same time finding a cost-effective way to acquire new clients and engage with existing clients.