

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended February 1, 2020

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: 001-38291

STITCH FIX, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	27-5026540 (I.R.S. Employer Identification No.)
1 Montgomery Street San Francisco (Address of Principal Executive Offices)	Suite 1500 California 94104 (Zip Code)
(415) 882-7765 Registrant's telephone number, including area code	

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol	Name of Each Exchange on Which Registered
Class A common stock, par value \$0.00002 per share	SFIX	Nasdaq Global Select Market

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

As of March 4, 2020, the number of outstanding shares of the registrant's Class A common stock, par value \$0.00002 per share, was 56,522,096, and the number of outstanding shares of the registrant's Class B common stock, par value \$0.00002 per share, was 45,954,513.

STITCH FIX, INC.
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In this Quarterly Report on Form 10-Q, "we," "our," "us," "Stitch Fix," and "the Company" refer to Stitch Fix, Inc. The Stitch Fix logo and other trade names, trademarks or service marks of Stitch Fix are the property of Stitch Fix, Inc. This Quarterly Report on Form 10-Q contains references to our trademarks and to trademarks belonging to other entities. Trade names, trademarks and service marks of other companies appearing in this Quarterly Report on Form 10-Q are the property of their respective holders. We do not intend our use or display of other companies' trade names or trademarks to imply a relationship with, or endorsement or sponsorship of us by, any other companies.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Stitch Fix, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)
(In thousands, except share and per share amounts)

	February 1, 2020	August 3, 2019
Assets		
Current assets:		
Cash and cash equivalents	\$ 165,989	\$ 170,932
Short-term investments	134,592	143,276
Inventory, net	147,236	118,216
Prepaid expenses and other current assets	38,513	49,980
Total current assets	486,330	482,404
Long-term investments	96,657	53,372
Property and equipment, net	63,158	54,888
Operating lease right-of-use assets	123,490	—
Deferred tax assets	27,047	22,175
Other long-term assets	3,046	3,227
Total assets	\$ 799,728	\$ 616,066
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 86,092	\$ 90,883
Operating lease liabilities	23,475	—
Accrued liabilities	84,904	69,734
Gift card liability	10,393	7,233
Deferred revenue	11,273	11,997
Other current liabilities	3,934	2,784
Total current liabilities	220,071	182,631
Operating lease liabilities, net of current portion	125,925	—
Deferred rent, net of current portion	—	24,439
Other long-term liabilities	14,822	12,996
Total liabilities	360,818	220,066
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Class A common stock, \$0.00002 par value – 2,000,000,000 shares authorized as of February 1, 2020, and August 3, 2019; 56,362,550 and 54,551,240 shares issued and outstanding as of February 1, 2020, and August 3, 2019, respectively	1	1
Class B common stock, \$0.00002 par value – 100,000,000 shares authorized as of February 1, 2020, and August 3, 2019; 46,081,625 and 46,846,240 shares issued and outstanding as of February 1, 2020, and August 3, 2019, respectively	1	1
Additional paid-in capital	308,687	279,511
Accumulated other comprehensive income (loss)	2,294	(187)
Retained earnings	127,927	116,674
Total stockholders' equity	438,910	396,000
Total liabilities and stockholders' equity	\$ 799,728	\$ 616,066

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Stitch Fix, Inc.
Condensed Consolidated Statements of Operations and Comprehensive Income
(Unaudited)
(In thousands, except share and per share amounts)

	For the Three Months Ended		For the Six Months Ended	
	February 1, 2020	January 26, 2019	February 1, 2020	January 26, 2019
Revenue, net	\$ 451,784	\$ 370,280	\$ 896,599	\$ 736,516
Cost of goods sold	249,597	207,131	493,110	408,199
Gross profit	202,187	163,149	403,489	328,317
Selling, general, and administrative expenses	193,689	147,738	394,831	302,009
Operating income	8,498	15,411	8,658	26,308
Interest (income) expense	(1,477)	(1,170)	(3,130)	(2,569)
Other (income) expense, net	28	(453)	862	(573)
Income before income taxes	9,947	17,034	10,926	29,450
Provision (benefit) for income taxes	(1,484)	5,058	(327)	6,796
Net income (loss)	\$ 11,431	\$ 11,976	\$ 11,253	\$ 22,654
Other comprehensive income (loss):				
Change in unrealized gain (loss) on available-for-sale securities, net of tax	247	104	75	22
Foreign currency translation	651	93	2,406	119
Total other comprehensive income (loss), net of tax	898	197	2,481	141
Comprehensive income	\$ 12,329	\$ 12,173	\$ 13,734	\$ 22,795
Net income (loss) attributable to common stockholders:				
Basic	\$ 11,431	\$ 11,968	\$ 11,253	\$ 22,632
Diluted	\$ 11,431	\$ 11,968	\$ 11,253	\$ 22,633
Earnings (loss) per share attributable to common stockholders:				
Basic	\$ 0.11	\$ 0.12	\$ 0.11	\$ 0.23
Diluted	\$ 0.11	\$ 0.12	\$ 0.11	\$ 0.22
Weighted-average shares used to compute earnings (loss) per share attributable to common stockholders:				
Basic	102,045,087	99,590,187	101,801,666	99,278,599
Diluted	104,637,548	102,817,838	104,018,782	103,597,316

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Stitch Fix, Inc.
Condensed Consolidated Statements of Stockholders' Equity
(Unaudited)
(In thousands, except share amounts)

	For the Three Months Ended January 26, 2019					
	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount				
Balance as of October 27, 2018	99,434,225	\$ 2	\$ 243,086	\$ (56)	\$ 90,471	\$ 333,503
Issuance of common stock upon exercise of stock options	390,308	—	(69)	—	—	(69)
Issuance of restricted stock units, net of tax withholdings	84,268	—	(918)	—	—	(918)
Vesting of early exercised options	—	—	88	—	—	88
Stock-based compensation	—	—	8,512	—	—	8,512
Net income (loss)	—	—	—	—	11,976	11,976
Other comprehensive income (loss), net of tax	—	—	—	197	—	197
Balance as of January 26, 2019	<u>99,908,801</u>	<u>\$ 2</u>	<u>\$ 250,699</u>	<u>\$ 141</u>	<u>\$ 102,447</u>	<u>\$ 353,289</u>

	For the Three Months Ended February 1, 2020					
	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount				
Balance as of November 2, 2019	101,708,646	\$ 2	\$ 290,720	\$ 1,396	\$ 116,496	\$ 408,614
Issuance of common stock upon exercise of stock options	503,891	—	5,140	—	—	5,140
Issuance of common stock upon settlement of restricted stock units, net of tax withholdings	231,638	—	(3,044)	—	—	(3,044)
Stock-based compensation	—	—	15,871	—	—	15,871
Net income (loss)	—	—	—	—	11,431	11,431
Other comprehensive income (loss), net of tax	—	—	—	898	—	898
Balance as of February 1, 2020	<u>102,444,175</u>	<u>\$ 2</u>	<u>\$ 308,687</u>	<u>\$ 2,294</u>	<u>\$ 127,927</u>	<u>\$ 438,910</u>

For the Six Months Ended January 26, 2019

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount				
Balance as of July 28, 2018	98,799,861	\$ 2	\$ 235,312	\$ —	\$ 79,758	\$ 315,072
Cumulative effect of adopting accounting standards ⁽¹⁾	—	—	—	—	35	35
Issuance of common stock upon exercise of stock options	968,415	—	1,931	—	—	1,931
Issuance of restricted stock units, net of tax withholdings	140,525	—	(2,281)	—	—	(2,281)
Vesting of early exercised options	—	—	178	—	—	178
Stock-based compensation	—	—	15,559	—	—	15,559
Net income (loss)	—	—	—	—	22,654	22,654
Other comprehensive income (loss), net of tax	—	—	—	141	—	141
Balance as of January 26, 2019	<u>99,908,801</u>	<u>\$ 2</u>	<u>\$ 250,699</u>	<u>\$ 141</u>	<u>\$ 102,447</u>	<u>\$ 353,289</u>

For the Six Months Ended February 1, 2020

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount				
Balance as of August 3, 2019	101,397,480	2	279,511	(187)	116,674	\$ 396,000
Issuance of common stock upon exercise of stock options	626,559	—	5,658	—	—	5,658
Issuance of common stock upon settlement of restricted stock units, net of tax withholdings	420,136	—	(5,256)	—	—	(5,256)
Stock-based compensation	—	—	28,774	—	—	28,774
Net income (loss)	—	—	—	—	11,253	11,253
Other comprehensive income (loss), net of tax	—	—	—	2,481	—	2,481
Balance as of February 1, 2020	<u>102,444,175</u>	<u>\$ 2</u>	<u>\$ 308,687</u>	<u>\$ 2,294</u>	<u>\$ 127,927</u>	<u>\$ 438,910</u>

⁽¹⁾ See Note 2, Summary of Significant Accounting Policies, of the Notes to the Condensed Consolidated Financial Statements for more details on the cumulative effect of adopting accounting standards.

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Stitch Fix, Inc.
Condensed Consolidated Statements of Cash Flow
(Unaudited)
(In thousands)

	For the Six Months Ended	
	February 1, 2020	January 26, 2019
Cash Flows from Operating Activities		
Net income (loss)	\$ 11,253	\$ 22,654
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Deferred income taxes	(4,865)	(2,288)
Inventory reserves	2,831	4,853
Stock-based compensation expense	27,881	14,747
Depreciation, amortization, and accretion	10,347	6,456
Other	71	—
Change in operating assets and liabilities:		
Inventory	(31,586)	(22,928)
Prepaid expenses and other assets	5,167	1,546
Operating lease right-of-use assets and liabilities	141	—
Accounts payable	(4,870)	7,012
Accrued liabilities	15,254	17,689
Deferred revenue	(729)	3,822
Gift card liability	3,160	3,512
Other liabilities	4,187	592
Net cash provided by operating activities	38,242	57,667
Cash Flows from Investing Activities		
Purchases of property and equipment	(11,446)	(11,903)
Purchases of securities available-for-sale	(129,925)	(185,994)
Sales of securities available-for-sale	14,095	1,163
Maturities of securities available-for-sale	81,675	9,500
Net cash used in investing activities	(45,601)	(187,234)
Cash Flows from Financing Activities		
Proceeds from the exercise of stock options, net	5,658	1,931
Payments for tax withholding related to vesting of restricted stock units	(5,256)	(2,281)
Net cash provided by (used in) financing activities	402	(350)
Net increase (decrease) in cash, cash equivalents, and restricted cash	(6,957)	(129,917)
Effect of exchange rate changes on cash	2,014	(103)
Cash, cash equivalents, and restricted cash at beginning of period	170,932	310,366
Cash, cash equivalents, and restricted cash at end of period	\$ 165,989	\$ 180,346
Components of Cash, Cash Equivalents, and Restricted Cash		
Cash and cash equivalents	\$ 165,989	\$ 167,496
Restricted cash – current portion	—	250
Restricted cash – long-term portion	—	12,600
Total cash, cash equivalents, and restricted cash	\$ 165,989	\$ 180,346
Supplemental Disclosure		
Cash paid for income taxes	\$ 90	\$ 191
Supplemental Disclosure of Non-Cash Investing and Financing Activities:		
Purchases of property and equipment included in accounts payable and accrued liabilities	\$ 4,474	\$ 4,741
Capitalized stock-based compensation	\$ 893	\$ 812
Vesting of early exercised options	\$ —	\$ 178
Leasehold improvements paid by landlord	\$ 7,406	\$ —

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Stitch Fix, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Description of Business

Stitch Fix, Inc. (“we,” “our,” “us” or “the Company”) delivers one-to-one personalization to our clients through the combination of data science and human judgment. Our stylists hand select items from a broad range of merchandise. Stylists pair their own judgment with our analysis of client and merchandise data to provide a personalized shipment of apparel, shoes, and accessories suited to each client’s needs. We call each of these unique shipments a Fix. After receiving a Fix, our clients purchase the items they want to keep and return the other items. We also offer a direct-buy functionality that allows clients the flexibility of purchasing items outside of a Fix. Through direct buy, clients are offered previously purchased items in different colors, sizes, or prints, as well as a personalized set of algorithmically generated items based on items they have already bought from us. No styling fee is charged for direct purchases. We are incorporated in Delaware and have operations in the United States and the United Kingdom.

Initial Public Offering

On November 16, 2017, we completed an initial public offering (“IPO”). In connection with the IPO, we authorized two new classes of common stock: Class A common stock and Class B common stock. The rights of the holders of Class A and Class B common stock are identical, except with respect to voting, conversion, and transfer rights. Each share of Class A common stock is entitled to one vote per share and each share of Class B common stock is entitled to ten votes per share. Each share of Class B common stock is convertible at any time at the option of the stockholder into one share of Class A common stock and has no expiration date. The Class B common stock automatically converts to Class A common stock upon transfers or any sale. In our IPO, we issued and sold 8,000,000 shares of our Class A common stock at a public offering price of \$15.00 per share. We received \$110.4 million in net proceeds after deducting \$6.2 million of underwriting discounts and \$3.4 million in offering costs. Upon the closing of the IPO, all of the then outstanding shares of common stock were reclassified into Class B common stock, all of the outstanding shares of convertible preferred stock automatically converted into 59,511,055 shares of Class B common stock, and all of the outstanding preferred stock warrants were automatically exercised into 1,066,225 shares of Class B common stock. Subsequent to the closing of the IPO, there were no shares of preferred stock or preferred stock warrants outstanding.

In December 2017, we issued an additional 1,175,557 shares of Class A common stock at a price of \$15.00 per share following the underwriters’ exercise of their option to purchase additional shares and received \$16.7 million in net proceeds after deducting underwriting discounts and expenses.

2. Summary of Significant Accounting Policies

Basis of Presentation

Our fiscal year is a 52-week or 53-week period ending on the Saturday closest to July 31. The fiscal years ending August 1, 2020 (“2020”), and August 3, 2019 (“2019”), consist of 52 weeks and 53 weeks, respectively.

The unaudited condensed consolidated financial statements include the accounts of Stitch Fix, Inc. and our wholly owned subsidiaries, and have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) and the requirements of the U.S. Securities and Exchange Commission (“SEC”) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted. These financial statements have been prepared on the same basis as our annual consolidated financial statements and, in the opinion of management, reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for the fair statement of our financial information. These interim results are not necessarily indicative of the results to be expected for the fiscal year ending August 1, 2020, or for any other interim period or for any other future year. All intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the related notes thereto for the fiscal year ended August 3, 2019, included in the Company’s Annual Report on Form 10-K filed with the SEC on October 2, 2019 (“2019 Annual Report”).

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in our condensed consolidated financial statements and accompanying footnotes.

Significant estimates and assumptions are used for inventory, stock-based compensation expense, income taxes, leases, and revenue recognition. Actual results could differ from those estimates and such differences may be material to the condensed consolidated financial statements.

Restricted Cash

Restricted cash represented cash balances held in segregated accounts collateralizing letters of credit for our leased properties at January 26, 2019.

Short-Term and Long-Term Investments

The Company's short-term and long-term investments have been classified and accounted for as available-for-sale securities. We determine the appropriate classification of our investments at the time of purchase and reevaluate the classification at each balance sheet date. Available-for-sale securities with maturities of 12 months or less are classified as short-term and available-for-sale securities with maturities greater than 12 months are classified as long-term. The Company's available-for-sale securities are carried at fair value, with unrealized gains and losses, net of taxes, reported within accumulated other comprehensive income (loss) ("AOCI") in stockholders' equity, with the exception of unrealized losses believed to be other-than-temporary, which are reported in earnings in the current period, if applicable. The cost of securities sold is based upon the specific identification method.

Foreign Currency

The functional currency of our international subsidiary is the local currency. For that subsidiary, we translate assets and liabilities to U.S. dollars using period-end exchange rates, and average monthly exchange rates for revenues, costs, and expenses. We record translation gains and losses in AOCI as a component of stockholders' equity. Net foreign exchange transaction gains and losses resulting from the conversion of the transaction currency to functional currency are recorded in other income, net in the condensed consolidated statements of operations and comprehensive income.

Revenue Recognition

We generate revenue primarily from the sale of merchandise in a Fix and, to a lesser extent, from direct purchases. Clients create an online account on our website or mobile app, complete a style profile, and order a Fix to be delivered on a specified date.

Each Fix represents an offer made by us to the client to purchase merchandise. The client is charged a nonrefundable upfront styling fee before the Fix is shipped. As an alternative to the styling fee, we offer select clients the option to purchase a Style Pass. Style Pass clients pay a nonrefundable annual fee for unlimited Fixes that is credited towards merchandise purchases. If the offer to purchase merchandise is accepted, we charge the client the order amount for the accepted merchandise, net of the upfront styling fee or Style Pass annual fee. For each Fix, acceptance occurs when the client checks out the merchandise on our website or mobile app. We offer a discount to clients who purchase all of the items in the Fix.

We recognize revenue through the following steps: (1) identification of the contract, or contracts, with the customer; (2) identification of the performance obligations in the contract; (3) determination of the transaction price; (4) allocation of the transaction price to the performance obligations in the contract; and (5) recognition of revenue when, or as, we satisfy a performance obligation.

Both our styling fee and Style Pass arrangements consist of one performance obligation, which is the option to purchase merchandise. The upfront styling fee is not a performance obligation as the styling activity is not distinct within the context of the contract. Similarly, the right to receive multiple options under Style Pass does not provide the customer with material stand-alone value and therefore does not give rise to a separate performance obligation. Both the upfront styling fee and Style Pass annual fee are included in deferred revenue until the performance obligation is satisfied when the client exercises his or her option to purchase merchandise (i.e., upon checkout of a Fix) or when the option(s) to purchase merchandise expire(s).

Revenue is recognized when control of the promised goods is transferred to the client. For a Fix, control is transferred when the client accepts or rejects the offer to purchase merchandise. Upon acceptance by purchasing one or more items within the Fix at checkout, the total amount of the order, including the upfront styling fee, is recognized as revenue. If none of the items within the Fix are accepted at checkout, the upfront styling fee is recognized as revenue at that time. The Style Pass annual fee is recognized at the earlier of (i) the time at which a client accepts and applies the Style Pass fee to an offer to purchase merchandise or (ii) upon expiry of the annual period. Under Style Pass arrangements, if a client does not accept any items within the Fix, the annual fee will continue to be deferred until it is applied to a future purchase or upon expiry of the annual period. If a client would like to exchange an item, we recognize revenue at the time the exchanged item is shipped, which coincides with the transfer of control to the customer. For a direct purchase, control is transferred when the item is shipped to the client.

We deduct discounts, sales tax, and estimated refunds to arrive at net revenue. Sales tax collected from clients is not considered revenue and is included in accrued liabilities until remitted to the taxing authorities. All shipping and handling costs are accounted for as fulfillment costs in cost of goods sold and as selling, general, and administrative expense (“SG&A”), respectively, and are therefore not evaluated as a separate performance obligation. Discounts are recorded as a reduction to revenue when the order is accepted. We record a refund reserve based on our historical refund patterns. Our refund reserve, which is included in accrued liabilities in the condensed consolidated balance sheets, was \$2.4 million and \$3.1 million as of February 1, 2020, and August 3, 2019, respectively.

The Company has four types of contractual liabilities: (i) cash collections of upfront styling fees, which are included in deferred revenue and are recognized as revenue upon the earlier of application to a merchandise purchase or expiry of the offer, (ii) cash collections of Style Pass annual fees, which are included in deferred revenue and are recognized upon the earlier of application to a merchandise purchase or expiry of the Style Pass annual period, (iii) unredeemed gift cards, which are included in gift card liability and recognized as revenue upon usage or inclusion in gift card breakage estimates, and (iv) referral credits, which are included in other current liabilities and are recognized as revenue when used.

We sell gift cards to clients and establish a liability based upon the face value of such gift cards. We reduce the liability and recognize revenue upon usage of the gift card. If a gift card is not used, we will recognize estimated gift card breakage revenue proportionately to customer usage of gift cards over the expected gift card usage period, subject to requirements to remit balances to governmental agencies. All commissions paid to third parties upon issuance of gift cards are recognized in SG&A as incurred, as on average, gift cards are used within a one-year period. Similarly, referral credits that are considered incremental costs of obtaining a contract with a customer are recognized in SG&A when issued, as on average, referral credits are used within a one-year period.

Contractual liabilities included in deferred revenue, gift card liability, and other current liabilities were \$11.3 million, \$10.4 million, and \$2.6 million, respectively, at February 1, 2020, and \$12.0 million, \$7.2 million, and \$1.6 million, respectively, at August 3, 2019. During the three months ended February 1, 2020, the Company recognized \$0.2 million, \$0.7 million, and \$0.1 million of revenue included in deferred revenue, gift card liability, and other current liabilities, respectively, at August 3, 2019. During the six months ended February 1, 2020, the Company recognized \$11.1 million, \$2.1 million, and \$0.6 million of revenue included in deferred revenue, gift card liability, and other current liabilities, respectively, at August 3, 2019.

Deferred revenue related to upfront styling fees totaled \$7.9 million as of February 1, 2020, and \$9.6 million as of August 3, 2019. Deferred revenue related to Style Pass annual fees totaled \$3.3 million as of February 1, 2020, and \$2.3 million as of August 3, 2019.

The Company expects deferred revenue for upfront styling fees and Style Pass annual fees to be recognized within one year. On average, gift card liability and other current liabilities are also recognized within one year.

Concentration of Credit Risks

We are subject to concentrations of credit risk principally from cash and cash equivalents and investment securities. The majority of our cash is held by three financial institutions within the United States. Our cash balances held by these institutions may exceed federally insured limits. The associated risk of concentration for cash is mitigated by banking with credit-worthy institutions. The associated risk of concentration for cash equivalents and investments is mitigated by maintaining a diversified portfolio of highly rated instruments.

No client accounted for greater than 10% of total revenue, net for the three and six months ended February 1, 2020, and January 26, 2019, respectively.

Recently Issued Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The standard requires entities to use a financial instrument impairment model based on expected losses, known as the current expected credit loss model, rather than incurred losses. Under the new guidance, an entity recognizes an allowance for estimated credit losses upon recognition of the financial instrument. We expect to adopt this standard in our first fiscal quarter of 2021. We are currently evaluating the impact that this standard will have on our consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles—Goodwill and Other—Internal-use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract*. The amendment aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. This standard is effective beginning in our first fiscal quarter of 2021 on a prospective or retrospective basis, with early adoption permitted. We are currently evaluating the impact that this standard will have on our consolidated financial statements.

In December 2019, the FASB issued ASU No. 2019-12, *Income Taxes (Topic 740) – Simplifying the Accounting for Income Taxes*. This update amends and simplifies the accounting for income taxes by eliminating certain exceptions in existing guidance related to performing intraperiod tax allocation, calculating interim period taxes, and recognizing deferred taxes for investments. The update also provides new guidance to reduce complexity in certain areas. This standard is effective beginning in our first fiscal quarter of 2022 with early adoption permitted. We are currently evaluating the impact that this standard will have on our consolidated financial statements.

Recently Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (“ASU 2016-02”), which requires lessees to record most leases on their balance sheets but recognize the expenses on their income statements in a manner similar to Accounting Standards Codification (“ASC”) 840. ASU 2016-02 states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. Presentation of leases within the consolidated statements of operations and comprehensive income and consolidated statements of cash flow is generally consistent with prior periods presented under ASC 840. However, this standard resulted in a substantial increase in our long-term assets and liabilities on our consolidated balance sheet.

We adopted this standard on August 4, 2019, on a modified retrospective basis through a cumulative-effect adjustment of zero to opening retained earnings. We also elected the package of practical expedients to leases that commenced before the effective date whereby we elected to not reassess the following:

- (i) whether any expired or existing contracts contain leases;
- (ii) the lease classification for any expired or existing leases; and
- (iii) initial direct costs for any existing leases.

Upon adoption of ASU 2016-02, we did not record right-of-use assets or lease liabilities for leases with an initial term of 12 months or less. Payments on those leases will be recognized on a straight-line basis through the consolidated statements of operations and comprehensive income over the lease term. We also elected to combine lease and non-lease components on new or modified leases after adoption. Upon adoption on August 4, 2019, we recorded \$133.0 million in right-of-use assets, net of \$25.7 million previously recorded as deferred rent on our consolidated balance sheets. We also recorded \$22.0 million in current operating lease liabilities and \$136.7 million in operating lease liabilities, net of current portion.

In June 2018, the FASB issued ASU No. 2018-07, *Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting* (“ASU 2018-07”). Under ASU 2018-07, the accounting for awards issued to nonemployees will be similar to the accounting for employee awards. This includes allowing for the measurement of awards at the grant date and recognition of awards with performance conditions when those conditions are probable, both of which are earlier than under current guidance for nonemployee awards. We adopted this standard in the first quarter of fiscal year 2020. The standard did not have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* (“ASU 2014-09”), which amended the existing FASB Accounting Standards Codification. ASU 2014-09 establishes a principle for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services and also provides guidance on the recognition of costs related to obtaining and fulfilling customer contracts. The new guidance may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption (“modified retrospective method”).

We adopted the standard in the first quarter of 2019 under the modified retrospective approach. Under the new standard, we recognize estimated gift card breakage revenue proportionately to customer gift card usage over the expected gift card usage period rather than waiting until the likelihood of redemption becomes remote. Further, we recognize revenue related to exchanges upon shipment by us, rather than upon receipt by the customer. In the first quarter of 2019, the Company recorded a cumulative catch-up adjustment resulting in an increase to opening retained earnings, net of tax, of \$0.4 million, comprised of the impact of \$0.3 million from the change in revenue recognition related to gift cards and \$0.1 million from the recognition of exchanges upon shipment.

In October 2016, the FASB issued ASU No. 2016-16, *Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory (Topic 740)*, which amends existing guidance on the recognition of current and deferred income tax impacts for intra-entity asset transfers other than inventory. We adopted the standard in the first quarter of 2019 under the modified retrospective approach. As a result, a cumulative adjustment of \$0.4 million, net of tax, was recorded to reduce opening retained earnings in connection with adoption of this standard.

3. Fair Value Measurements

We disclose and recognize the fair value of our assets and liabilities using a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. The guidance establishes three levels of the fair value hierarchy as follows:

Level 1: Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date;

Level 2: Inputs are observable, unadjusted quoted prices in active markets for similar assets or liabilities, unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the related assets or liabilities; and

Level 3: Unobservable inputs that are significant to the measurement of the fair value of the assets or liabilities that are supported by little or no market data.

Our financial instruments consist of cash and cash equivalents, short-term and long-term investments, accounts payable, and accrued liabilities. At February 1, 2020, and August 3, 2019, the carrying values of cash and cash equivalents, accounts payable, and accrued liabilities approximated fair value due to their short-term maturities.

The following table sets forth the amortized cost, gross unrealized gains, gross unrealized losses and fair values of our short-term and long-term investments accounted for as available-for-sale securities as of February 1, 2020, and August 3, 2019:

(in thousands)	February 1, 2020				August 3, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Financial Assets:								
Investments:								
U.S. Treasury securities	\$ 68,970	\$ 150	\$ —	\$ 69,120	\$ 49,807	\$ 100	\$ —	\$ 49,907
Commercial paper	34,828	—	—	34,828	29,761	—	—	29,761
Asset-backed securities	44,566	176	—	44,742	42,587	145	—	42,732
Corporate bonds	82,287	272	—	82,559	73,969	279	—	74,248
Total	\$ 230,651	\$ 598	\$ —	\$ 231,249	\$ 196,124	\$ 524	\$ —	\$ 196,648

The following table sets forth the fair value of available-for-sale securities by contractual maturity as of February 1, 2020, and August 3, 2019:

(in thousands)	February 1, 2020				August 3, 2019			
	One Year or Less	Over One Year Through Five Years	Over Five Years	Total	One Year or Less	Over One Year Through Five Years	Over Five Years	Total
Financial Assets:								
Investments:								
U.S. Treasury securities	\$ 47,774	\$ 21,346	\$ —	\$ 69,120	\$ 44,772	\$ 5,135	\$ —	\$ 49,907
Commercial paper	34,828	—	—	34,828	29,761	—	—	29,761
Asset-backed securities	3,806	40,936	—	44,742	5,412	37,320	—	42,732
Corporate bonds	48,184	34,375	—	82,559	63,331	10,917	—	74,248
Total	\$ 134,592	\$ 96,657	\$ —	\$ 231,249	\$ 143,276	\$ 53,372	\$ —	\$ 196,648

The following table sets forth our cash equivalents, and short-term and long-term investments accounted for as available-for-sale securities that were measured at fair value on a recurring basis based on the fair value hierarchy as of February 1, 2020, and August 3, 2019:

(in thousands)	February 1, 2020				August 3, 2019			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial Assets:								
Cash equivalents:								
Money market funds	\$ 5,998	\$ —	\$ —	\$ 5,998	\$ 6,427	\$ —	\$ —	\$ 6,427
Commercial paper	—	—	—	—	—	11,970	—	11,970
Investments:								
U.S. Treasury securities	69,120	—	—	69,120	49,907	—	—	49,907
Commercial paper	—	34,828	—	34,828	—	29,761	—	29,761
Asset-backed securities	—	44,742	—	44,742	—	42,732	—	42,732
Corporate bonds	—	82,559	—	82,559	—	74,248	—	74,248
Total	\$ 75,118	\$ 162,129	\$ —	\$ 237,247	\$ 56,334	\$ 158,711	\$ —	\$ 215,045

There were no transfers of financial assets or liabilities into or out of Level 1, Level 2, or Level 3 for the three and six months ended February 1, 2020, and January 26, 2019.

4. Leases

On August 4, 2019, we adopted ASU 2016-02. Upon adoption, we recognized operating lease right-of-use assets and operating lease liabilities of \$133.0 million and \$158.7 million, respectively. As part of this adoption, we elected to not record operating lease right-of-use assets or operating lease liabilities for leases with an initial term of 12 months or less. We also elected to combine lease and non-lease components on all new or modified leases into a single lease component.

Our leasing portfolio includes various lease arrangements for our corporate offices and fulfillment centers. Such leases generally have original lease terms between five and eight years, and often include one or more options to renew. We include options to extend in the lease term if they are reasonably certain of being exercised. We do not currently consider our renewal options to be reasonably certain to be exercised. We do not have residual value guarantees associated with our leases. Short-term lease payments were not material for the three and six months ended February 1, 2020.

The following table includes the components of our rent expense recorded in selling, general, and administrative expense:

(in thousands)	For the Three Months Ended	For the Six Months Ended
	February 1, 2020	February 1, 2020
Operating lease cost	\$ 7,268	\$ 14,482
Variable lease costs	1,438	2,947
Sublease income	(492)	(866)
Total	\$ 8,214	\$ 16,563

Certain leases contain variable payments, which are expensed as incurred and not included in our operating lease right-of-use assets and operating lease liabilities. These amounts primarily include payments for maintenance, utilities, taxes, and insurance on our office and fulfillment center leases. Operating lease right-of-use assets and operating lease liabilities are recognized based on the present value of future minimum lease payments at lease commencement. The Company calculates the present value of its leases using an estimated incremental borrowing rate, which requires judgment. Our incremental borrowing rate is determined for each lease using a peer group of companies with similar credit profiles, adjusted for the impact of collateralization and lease term.

The following is a schedule by year of the maturities of operating lease liabilities with original terms in excess of one year, as of February 1, 2020:

(in thousands)	February 1, 2020	
Remainder of 2020	\$	14,623
2021		29,684
2022		27,416
2023		25,143
2024		20,953
2025		16,362
Thereafter		40,326
Total undiscounted future minimum lease payments		174,507
Less imputed interest		(25,107)
Total discounted future minimum lease payments	\$	149,400

A schedule of the future minimum rental commitments under our non-cancelable operating lease agreements with an initial or remaining term in excess of one year as of August 3, 2019, in accordance with ASC 840 were as follows:

(in thousands)	August 3, 2019	
2020	\$	27,018
2021		27,680
2022		25,451
2023		23,258
2024		19,696
Thereafter		56,687
Total	\$	179,790

The weighted average remaining term for our leases as of February 1, 2020 was 6.5 years. The weighted average discount rate for our leases as of February 1, 2020 was 4.5%.

Supplemental cash flow information related to our leases is as follows:

(in thousands)	For the Six Months Ended February 1, 2020	
Cash paid for amounts included in the measurement of operating lease liabilities	\$	15,621
Operating lease right-of-use assets obtained in exchange for operating lease liabilities		133,091

In January 2020, we entered into an agreement to lease approximately 700,000 square feet of space to be used as a fulfillment center in Plainfield, Indiana. We expect to classify this lease as an operating lease, with a commencement date before the end of fiscal year 2020. The lease expires in 2030 and we expect to record operating lease costs of approximately \$28.6 million over the life of the lease.

5. Accrued Liabilities

Accrued liabilities consisted of the following:

(in thousands)	February 1, 2020		August 3, 2019	
Compensation and related benefits	\$	10,967	\$	9,494
Advertising		18,297		12,922
Sales taxes		8,189		6,956
Shipping and freight		9,849		7,045
Accrued accounts payable		7,921		7,550
Inventory purchases		19,046		15,703
Other		10,635		10,064
Total accrued liabilities	\$	84,904	\$	69,734

6. Commitments and Contingencies

Commitments

In November 2019, the Company executed an agreement for cloud computing services. The agreement was effective as of November 1, 2019, and continues through October 30, 2022. The Company has a total minimum commitment of \$23.5 million with annual commitments ranging from \$7.5 million to \$8.0 million.

Refer to “Note 4 - Leases” for information regarding lease commitments.

Contingencies

We record a loss contingency when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We also disclose material contingencies when we believe a loss is not probable but reasonably possible. Accounting for contingencies requires us to use judgment related to both the likelihood of a loss and the estimate of the amount or range of loss. Although we cannot predict with assurance the outcome of any litigation or tax matters, we do not believe there are currently any such actions that, if resolved unfavorably, would have a material impact on our operating results, financial position, and cash flows.

On October 11, 2018, October 26, 2018, November 16, 2018, and December 10, 2018, four putative class action lawsuits alleging violations of the federal securities laws were filed in the U.S. District Court for the Northern District of California, naming as defendants us and certain of our officers. The four lawsuits each make the same allegations of violations of the Securities Exchange Act of 1934, as amended, by us and our officers for allegedly making materially false and misleading statements regarding our active client growth and strategy with respect to television advertising between June 2018 and October 2018. The plaintiffs seek unspecified monetary damages and other relief. The four lawsuits have been consolidated and a lead plaintiff has been appointed. On September 18, 2019, the lead plaintiff in the consolidated class action lawsuits filed a consolidated complaint for violation of the federal securities laws. On October 28, 2019, we and other defendants filed a motion to dismiss the consolidated complaint. The lead plaintiff filed an opposition to the motion to dismiss on December 9, 2019, and we and the other defendants filed our reply in support of our motion to dismiss on December 30, 2019. The court has taken the motion under submission.

On December 12, 2018, a derivative action was filed against our directors in the same court, alleging the same violations of securities laws as alleged in the four putative class action cases described above and breach of fiduciary duties. The derivative action has been stayed pending the outcome of the motion to dismiss in the related class action lawsuits. On December 12, 2019, a second derivative action was filed against our directors in the same court, alleging the same violations of securities laws and breach of fiduciary duties as the other derivative action. The second derivative action has also been stayed pending the outcome of the motion to dismiss in the related class action lawsuits.

There have been no other material changes to our commitments and contingencies as disclosed in our 2019 Annual Report.

Indemnifications

In the ordinary course of business, we may provide indemnifications of varying scope and terms to vendors, directors, officers and other parties with respect to certain matters. We have not incurred any material costs as a result of such indemnifications and have not accrued any liabilities related to such obligations in our condensed consolidated financial statements.

7. Accumulated Other Comprehensive Income (Loss)

The tables below present the changes in AOCI by component and, if applicable, the reclassifications out of AOCI:

(in thousands)	Changes in Accumulated Other Comprehensive Income (Loss)		
	Available-for-sale Securities	Foreign Currency Translation	Total
Balance at October 27, 2018	\$ (82)	\$ 26	\$ (56)
Other comprehensive income (loss) before reclassifications ⁽¹⁾	104	93	197
Net change in AOCI	104	93	197
Balance at January 26, 2019	\$ 22	\$ 119	\$ 141

(in thousands)	Changes in Accumulated Other Comprehensive Income (Loss)		
	Available-for-sale Securities	Foreign Currency Translation	Total
Balance at November 2, 2019	\$ 219	\$ 1,177	\$ 1,396
Other comprehensive income (loss) before reclassifications ⁽¹⁾	249	651	900
Amounts reclassified from AOCI	(2)	—	(2)
Net change in AOCI	247	651	898
Balance at February 1, 2020	\$ 466	\$ 1,828	\$ 2,294

(in thousands)	Changes in Accumulated Other Comprehensive Income (Loss)		
	Available-for-sale Securities	Foreign Currency Translation	Total
Balance at July 28, 2018	\$ —	\$ —	\$ —
Other comprehensive income (loss) before reclassifications ⁽¹⁾	22	119	141
Net change in AOCI	22	119	141
Balance at January 26, 2019	\$ 22	\$ 119	\$ 141

(in thousands)	Changes in Accumulated Other Comprehensive Income (Loss)		
	Available-for-sale Securities	Foreign Currency Translation	Total
Balance at August 3, 2019	\$ 391	\$ (578)	\$ (187)
Other comprehensive income (loss) before reclassifications ⁽¹⁾	77	2,406	2,483
Amounts reclassified from AOCI	(2)	—	(2)
Net change in AOCI	75	2,406	2,481
Balance at February 1, 2020	\$ 466	\$ 1,828	\$ 2,294

⁽¹⁾The associated income tax effects for gains / losses on available-for-sale securities were \$79 and \$267 for the three months ended January 26, 2019, and February 1, 2020, respectively, and \$12 and \$142 for the six months ended January 26, 2019, and February 1, 2020, respectively.

8. Stock-Based Compensation

2011 Equity Incentive Plan

In 2011, we adopted the 2011 Equity Incentive Plan (the "2011 Plan"). The 2011 Plan provided for the grant of stock-based awards to employees, directors, and nonemployees under terms and provisions established by the board of directors.

The 2011 Plan allowed for the grant of incentive stock options or nonqualified stock options as well as restricted stock units, restricted stock, and stock appreciation rights. Only incentive and nonqualified stock options were granted under the 2011 Plan. Employee stock option grants generally vest 25% on the first anniversary of the grant date with the remaining options vesting

ratably over the next three years. Options generally expire after 10 years. Effective upon our IPO, the 2011 Plan was replaced by the 2017 Incentive Plan.

2017 Incentive Plan

In November 2017, our board of directors and stockholders adopted our 2017 Incentive Plan (the “2017 Plan”). The remaining shares available for issuance under the 2011 Plan became reserved for issuance under the 2017 Plan. Our 2017 Plan provides for the grant of Class A incentive stock options to employees, including employees of any parent or subsidiary, and for the grant of nonqualified stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, performance stock awards, performance cash awards, and other forms of stock awards to employees, directors, and consultants, including employees and consultants of our subsidiaries. The number of shares authorized for issuance under the 2017 Plan was 22,207,698 as of February 1, 2020, of which 4,647,010 were available for grant.

2019 Inducement Plan

In October 2019, our board of directors adopted our 2019 Inducement Plan (the “2019 Plan”). Our 2019 Plan provides for the grant of Class A nonqualified stock options and restricted stock unit awards to individuals who satisfy the standards for inducement grants under the relevant Nasdaq Stock Market rules. The number of shares authorized for issuance under the 2019 Plan was 1,750,000 as of February 1, 2020, of which 236,596 were available for grant.

Stock option activity under the 2011 Plan, 2017 Plan, and 2019 Plan is as follows:

	Options Outstanding			
	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in Years)	Aggregate Intrinsic Value (in thousands)
Balance – August 3, 2019	7,070,125	\$ 14.48	7.72	\$ 73,861
Granted	1,514,077	\$ 23.91		
Exercised	(626,559)	\$ 9.03		
Cancelled	(355,712)	\$ 21.12		
Balance – February 1, 2020	<u>7,601,931</u>	\$ 16.74	7.79	\$ 52,311

The aggregate intrinsic value is the difference between the current fair value of the underlying common stock and the exercise price for in-the-money stock options.

The following table summarizes the restricted stock unit (“RSU”) award activity under the 2017 Plan and 2019 Plan:

	Unvested RSUs	
	Class A Common Stock	Weighted-Average Grant Date Fair Value
Unvested at August 3, 2019	4,428,845	\$ 27.30
Granted	2,456,130	\$ 22.21
Vested	(420,136)	\$ 27.16
Forfeited	(544,969)	\$ 26.34
Unvested at February 1, 2020	<u>5,919,870</u>	\$ 25.29

Stock-Based Compensation Expense

Stock-based compensation expense for employees was \$15.8 million and \$27.9 million for the three and six months ended February 1, 2020, respectively, and \$8.1 million and \$14.7 million for the three and six months ended January 26, 2019, respectively. Stock-based compensation expense is included in selling, general, and administrative expenses in our condensed consolidated statements of operations and comprehensive income.

The weighted-average grant date fair value of options granted during the six months ended February 1, 2020, was \$11.59 per share. The weighted-average grant date fair value of options granted during the six months ended January 26, 2019, was \$11.03 per share. As of February 1, 2020, the total unrecognized compensation expense related to unvested options and RSUs, net of estimated forfeitures, was \$179.4 million, which we expect to recognize over an estimated weighted average period of 2.9 years.

We record stock-based compensation of stock options granted to employees by estimating the fair value of stock-based awards using the Black-Scholes option pricing model and amortizing the fair value of the stock-based awards granted over the applicable vesting period of the awards on a straight-line basis. The fair value of stock options granted to employees was estimated at the grant date using the Black-Scholes option-pricing model with the following assumptions:

	For the Three Months Ended		For the Six Months Ended	
	February 1, 2020	January 26, 2019	February 1, 2020	January 26, 2019
Expected term (in years)	5.5 - 6.1	5.5 - 6.5	5.5 - 6.2	5.1 - 6.5
Volatility	50.1 %	42.1% - 42.1%	50.1% - 51.2%	41.7% - 42.1%
Risk free interest rate	1.6 %	2.9% - 3.0%	1.6% - 1.7%	2.8% - 3.0%
Dividend yield	— %	— %	— %	— %

9. Income Taxes

The following table summarizes our effective tax rate from income for the periods presented:

(in thousands)	For the Three Months Ended		For the Six Months Ended	
	February 1, 2020	January 26, 2019	February 1, 2020	January 26, 2019
Income before income taxes	\$ 9,947	\$ 17,034	\$ 10,926	\$ 29,450
Provision for income taxes	(1,484)	5,058	(327)	6,796
Effective tax rate	(14.9)%	29.7 %	(3.0)%	23.1 %

Our effective tax rate for the three and six months ended February 1, 2020, differs from the federal statutory income tax rate primarily due to certain nondeductible expenses and state taxes which are offset by the benefits of allowable credits and excess tax benefits from stock-based compensation.

Our effective tax rate for the three and six months ended January 26, 2019, differed from the federal statutory income tax rate primarily due to lower tax rates in foreign jurisdictions where international expansion expenses are incurred, and certain nondeductible expenses and state taxes, partially offset by the benefits of stock-based compensation deductions and allowable credits.

10. Earnings (Loss) Per Share Attributable to Common Stockholders

Basic and diluted earnings (loss) per share attributable to common stockholders is presented in conformity with the two-class method required for participating securities. We consider convertible preferred stock and early exercised share options to be participating securities. In connection with our IPO, we established two classes of authorized common stock: Class A common stock and Class B common stock. As a result, all then-outstanding shares of common stock were converted into shares of Class B common stock upon effectiveness of our IPO. The rights of the holders of Class A and Class B common stock are identical, except with respect to voting, conversion, and transfer rights. Each share of Class A common stock is entitled to one vote per share and each share of Class B common stock is entitled to ten votes per share. Each share of Class B common stock is convertible at any time at the option of the stockholder into one share of Class A common stock.

Undistributed earnings allocated to participating securities are subtracted from net income (loss) in determining net income (loss) attributable to common stockholders. Basic net income (loss) per share attributable to common stockholders is computed by dividing the net income (loss) attributable to common stockholders by the weighted-average number of common shares outstanding during the period. All participating securities are excluded from basic weighted-average common shares outstanding.

For the calculation of diluted earnings (loss) per share ("EPS"), net income (loss) attributable to common stockholders for basic EPS is adjusted by the effect of dilutive securities. Diluted net income (loss) per share attributable to common stockholders is computed by dividing the net income (loss) attributable to common stockholders by the weighted-average number of common shares outstanding, including all potentially dilutive common shares. The undistributed earnings are allocated based on the contractual participation rights of the Class A and Class B common shares as if the earnings for the year have been distributed. As the liquidation and dividend rights are identical, the undistributed earnings are allocated on a proportionate basis. The computation of the diluted net income (loss) per share of Class A common stock assumes the conversion of Class B common stock, while diluted net income (loss) per share of Class B common stock does not assume the conversion of Class A common stock as Class A common stock is not convertible into Class B common stock.

A reconciliation of the numerator and denominator used in the calculation of basic and diluted EPS attributable to common stockholders is as follows:

(in thousands, except share and per share amounts)	For the Three Months Ended			
	February 1, 2020		January 26, 2019	
	Class A	Class B	Class A	Class B
Numerator:				
Net income (loss)	\$ 6,243	\$ 5,188	\$ 5,166	\$ 6,810
Less: undistributed earnings to participating securities	—	—	(4)	(4)
Net income (loss) attributable to common stockholders - basic	6,243	5,188	5,162	6,806
Reallocation of undistributed earnings (loss) as a result of conversion of Class B to Class A shares	5,188	—	6,806	—
Reallocation of undistributed earnings (loss) to Class B shares	—	64	—	103
Net income (loss) attributable to common stockholders - diluted	<u>\$ 11,431</u>	<u>\$ 5,252</u>	<u>\$ 11,968</u>	<u>\$ 6,909</u>
Denominator:				
Weighted-average shares of common stock - basic	55,733,232	46,311,855	42,956,285	56,633,902
Conversion of Class B to Class A common shares outstanding	46,311,855	—	56,633,902	—
Effect of dilutive stock options and restricted stock units	2,592,461	1,760,938	3,227,651	2,721,015
Weighted-average shares of common stock - diluted	<u>104,637,548</u>	<u>48,072,793</u>	<u>102,817,838</u>	<u>59,354,917</u>
Earnings (loss) per share attributable to common stockholders:				
Basic	<u>\$ 0.11</u>	<u>\$ 0.11</u>	<u>\$ 0.12</u>	<u>\$ 0.12</u>
Diluted	<u>\$ 0.11</u>	<u>\$ 0.11</u>	<u>\$ 0.12</u>	<u>\$ 0.12</u>

(in thousands, except share and per share amounts)	For the Six Months Ended			
	February 1, 2020		January 26, 2019	
	Class A	Class B	Class A	Class B
Numerator:				
Net income (loss)	\$ 6,113	\$ 5,140	\$ 9,220	\$ 13,434
Less: undistributed earnings to participating securities	—	—	(9)	(13)
Net income (loss) attributable to common stockholders - basic	6,113	5,140	9,211	13,421
Add: adjustments to undistributed earnings to participating securities	—	—	1	1
Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares	5,140	—	13,421	—
Reallocation of undistributed earnings to Class B shares	—	78	—	182
Net income (loss) attributable to common stockholders - diluted	\$ 11,253	\$ 5,218	\$ 22,633	\$ 13,604
Denominator:				
Weighted-average shares of common stock - basic	55,300,571	46,501,095	40,404,333	58,874,266
Conversion of Class B to Class A common shares outstanding	46,501,095	—	58,874,266	—
Effect of dilutive stock options and restricted stock units	2,217,116	1,736,121	4,318,717	3,393,581
Weighted-average shares of common stock - diluted	104,018,782	48,237,216	103,597,316	62,267,847
Earnings (loss) per share attributable to common stockholders:				
Basic	\$ 0.11	\$ 0.11	\$ 0.23	\$ 0.23
Diluted	\$ 0.11	\$ 0.11	\$ 0.22	\$ 0.22

The following common stock equivalents were excluded from the computation of diluted earnings (loss) per share for the periods presented because including them would have been antidilutive:

	For the Three Months Ended		For the Six Months Ended	
	February 1, 2020	January 26, 2019	February 1, 2020	January 26, 2019
Restricted stock units	2,347,736	1,821,371	4,022,303	1,601,328
Stock options to purchase Class A common stock	2,969,625	1,659,061	2,969,625	1,214,086
Stock options to purchase Class B common stock	1,336,984	3,335,064	2,083,118	389,158
Total	6,654,345	6,815,496	9,075,046	3,204,572

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis of our financial condition and results of operations together with our unaudited condensed consolidated financial statements and related notes thereto included in Part I, Item 1 of this report and with our audited consolidated financial statements and related notes and our Annual Report on Form 10-K for the year ended August 3, 2019, filed with the Securities and Exchange Commission on October 2, 2019. We use a 52- or 53-week fiscal year, with our fiscal year ending on the Saturday that is closest to July 31 of that year. Each fiscal year typically consists of four 13-week fiscal quarters. The fiscal year ended August 3, 2019, and the fiscal year ending August 1, 2020, include 53 and 52 weeks of operations, respectively. Throughout this Quarterly Report on Form 10-Q (this "Quarterly Report"), all references to quarters and years are to our fiscal quarters and fiscal years unless otherwise noted.

Special Note Regarding Forward-Looking Statements

This Quarterly Report contains forward-looking statements that involve risks, uncertainties, and assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report that are not purely historical, including without limitation statements in the following discussion and analysis of financial condition and results of operations regarding our projected financial position and results, business strategy, plans, and objectives of our management for future operations, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the Private Securities Litigation Reform Act of 1995. Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "might," "plan," "project," "seek," "should," "target," "will," "would," and similar expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management, which are in turn based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties, and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled "Risk Factors" included under Part II, Item 1A below. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

Since our founding in 2011, we have helped millions of men, women, and kids discover and buy what they love through personalized shipments of apparel, shoes, and accessories, hand-selected by Stitch Fix stylists and delivered to our clients' homes. We call each of these shipments a Fix. Clients can choose to schedule automatic shipments or order a Fix on demand after they fill out a style profile on our website or mobile app. For each Fix, we charge clients a styling fee that is credited toward items they purchase. Alternatively, select U.S. clients may purchase an annual Style Pass, which offers unlimited styling for the year for a \$49 fee that is also credited towards items they purchase. After receiving a Fix, our clients purchase the items they want to keep and return the other items, if any, at no additional charge. In addition, our Extras feature allows clients to select items such as socks, bras, underwear, and other intimates that are then added to the items their stylist selects for their Fix.

In May 2019, we launched our service in the UK. In June 2019, we launched direct-buy functionality to allow clients the flexibility of purchasing items outside of a Fix. The first offering of this direct-buy functionality is Shop New Colors, which is available for Men's and Women's clients in the United States and allows clients to order previously purchased items in different colors, sizes, or prints. In February 2020, we launched Shop Your Looks, which presents clients a personalized set of algorithmically generated items for direct purchase based on items they have already bought from us. No styling fee is charged for direct purchases.

We believe our success in serving clients has resulted in our rapid and profitable growth. We have achieved positive cash flows from operations on an annual basis since 2014, while continuing to make meaningful investments to drive growth. For the three and six months ended February 1, 2020, we reported \$451.8 million and \$896.6 million in net revenue, respectively, representing year-over-year growth of 22.0% and 21.7% from the three and six months ended January 26, 2019, respectively. As of February 1, 2020, and January 26, 2019, we had 3,465,000 and 2,961,000 active clients, respectively, representing year-over-year growth of 17.0%.

Net income for the three and six months ended February 1, 2020, was \$11.4 million and \$11.3 million, respectively, a decrease of \$0.5 million and \$11.4 million, respectively, compared to the three and six months ended January 26, 2019.

Key Financial and Operating Metrics

Non-GAAP Financial Measures

We report our financial results in accordance with generally accepted accounting principles in the United States (“GAAP”). However, management believes that certain non-GAAP financial measures provide users of our financial information with additional useful information in evaluating our performance. We believe that adjusted EBITDA is frequently used by investors and securities analysts in their evaluations of companies, and that this supplemental measure facilitates comparisons between companies. We also provide adjusted EBITDA excluding the impact of stock-based compensation expense (“ex. SBC”), which management believes provides useful information to investors and others in understanding our operating performance and facilitates comparisons between companies. We believe free cash flow is an important metric because it represents a measure of how much cash from operations we have available for discretionary and non-discretionary items after the deduction of capital expenditures. These non-GAAP financial measures may be different than similarly titled measures used by other companies.

Our non-GAAP financial measures should not be considered in isolation from, or as substitutes for, financial information prepared in accordance with GAAP. There are several limitations related to the use of our non-GAAP financial measures as compared to the closest comparable GAAP measures. Some of these limitations include:

- adjusted EBITDA ex. SBC excludes the non-cash expense of stock-based compensation, which has been, and will continue to be for the foreseeable future, an important part of how we attract and retain our employees and a significant recurring expense in our business;
- adjusted EBITDA and adjusted EBITDA ex. SBC exclude the recurring, non-cash expenses of depreciation and amortization of property and equipment and, although these are non-cash expenses, the assets being depreciated and amortized may have to be replaced in the future;
- adjusted EBITDA and adjusted EBITDA ex. SBC do not reflect our tax provision, which reduces cash available to us;
- adjusted EBITDA and adjusted EBITDA ex. SBC exclude interest (income) expense and other (income) expense, net, as these items are not components of our core business; and
- free cash flow does not represent the total residual cash flow available for discretionary purposes and does not reflect our future contractual commitments.

Adjusted EBITDA and Adjusted EBITDA ex. SBC

We define adjusted EBITDA as net income (loss) excluding interest (income) expense, provision (benefit) for income taxes, other (income) expense, net, and depreciation and amortization. We define adjusted EBITDA ex. SBC as adjusted EBITDA excluding stock-based compensation expense. The following table presents a reconciliation of net income (loss), the most comparable GAAP financial measure, to adjusted EBITDA and adjusted EBITDA ex. SBC for each of the periods presented:

(in thousands)	For the Three Months Ended		For the Six Months Ended	
	February 1, 2020	January 26, 2019	February 1, 2020	January 26, 2019
Adjusted EBITDA ex. SBC reconciliation:				
Net income (loss)	\$ 11,431	\$ 11,976	\$ 11,253	\$ 22,654
Add (deduct):				
Interest (income) expense	(1,477)	(1,170)	(3,130)	(2,569)
Provision (benefit) for income taxes	(1,484)	5,058	(327)	6,796
Other (income) expense, net	28	(453)	862	(573)
Depreciation and amortization	5,804	3,790	10,770	7,184
Adjusted EBITDA	14,302	19,201	19,428	33,492
Add (deduct):				
Stock-based compensation expense	15,755	8,110	27,881	14,747
Adjusted EBITDA ex. SBC	\$ 30,057	\$ 27,311	\$ 47,309	\$ 48,239

Free Cash Flow

We define free cash flow as cash flows provided by operating activities reduced by purchases of property and equipment that are included in cash flows used in investing activities. The following table presents a reconciliation of cash flows provided by operating activities, the most comparable GAAP financial measure, to free cash flow for each of the periods presented:

(in thousands)	For the Six Months Ended	
	February 1, 2020	January 26, 2019
Free cash flow reconciliation:		
Cash flows provided by operating activities	\$ 38,242	\$ 57,667
Deduct:		
Purchases of property and equipment	(11,446)	(11,903)
Free cash flow	\$ 26,796	\$ 45,764
Cash flows used in investing activities	\$ (45,601)	\$ (187,234)
Cash flows provided by financing activities	\$ 402	\$ (350)

Operating Metrics

	February 1, 2020	November 2, 2019	August 3, 2019	April 27, 2019	January 26, 2019
Active clients (in thousands)	3,465	3,416	3,236	3,133	2,961
Net revenue per active client ⁽¹⁾	\$ 501	\$ 485	\$ 488	\$ 467	\$ 463

⁽¹⁾ Fiscal year 2019 was a 53-week year, with the extra week occurring in the quarter ended August 3, 2019. Net revenue per active client calculations including the fourth quarter of fiscal year 2019 include 53 weeks of revenue.

Active Clients

We believe that the number of active clients is a key indicator of our growth and the overall health of our business. We define an active client as a client who checked out a Fix or was shipped an item using our direct-buy functionality in the preceding 52 weeks, measured as of the last day of that period. A client checks out a Fix when she indicates what items she is keeping through our mobile application or on our website. We consider each Men's, Women's, or Kids account as a client, even if they share the same household. We had 3,465,000 and 2,961,000 active clients as of February 1, 2020, and January 26, 2019, respectively, representing year-over-year growth of 17.0%.

Net Revenue per Active Client

We believe that net revenue per active client is an indicator of client engagement and satisfaction. We calculate net revenue per active client based on net revenue over the preceding four fiscal quarters divided by the number of active clients, measured as of the last day of the period. Net revenue per active client was \$501 and \$463 as of February 1, 2020, and January 26, 2019, respectively, representing year-over-year growth of 8.3%.

Factors Affecting Our Performance

Client Acquisition and Engagement

To grow our business, we must continue to acquire clients and successfully engage them. We believe that implementing broad-based marketing strategies that increase our brand awareness has the potential to strengthen Stitch Fix as a national consumer brand, help us acquire new clients, and drive revenue growth. As our business has achieved a greater scale and we are able to support a large and growing client base, we have increased our investments in marketing to take advantage of more marketing channels to efficiently acquire clients. For example, we continued to increase our advertising spend, from \$23.9 million and \$62.8 million for the three and six months ended January 26, 2019, to \$35.6 million and \$86.3 million for the three and six months ended February 1, 2020, to support the growth of our business. While we expect to continue to make significant marketing investments to grow our business in the long run, our marketing expenses may vary from period to period. For example, we now plan to spend less on marketing in the second half of fiscal year 2020 than we previously anticipated. We currently utilize both digital and offline channels to attract new visitors to our website or mobile app and subsequently convert them into clients. Our current marketing efforts include client referrals, affiliate programs, partnerships, display advertising, television, print, radio, video, content, direct mail, social media, email, mobile "push" communications, search engine optimization, and keyword search campaigns.

To successfully acquire clients and increase engagement, we must also continue to improve the diversity of our offering. These efforts may include broadening our brand partnerships and expanding into new categories, product types, price points, and geographies. For example, in July 2018 we launched Stitch Fix Kids, expanding our client and vendor base, and in May 2019, we launched our services in the UK, expanding our geographic scope. In June 2019, we introduced a direct-buy functionality with Shop New Colors, allowing clients in the United States to buy previously purchased items in new colors, prints, and sizes, and in February 2020, we launched Shop Your Looks, which presents clients a personalized set of algorithmically generated items for direct purchase based on items they have already bought from us.

Investment in our Operations and Infrastructure

To grow our client base and enhance our offering, we will incur additional expenses. We intend to leverage our data science and deep understanding of our clients' needs to inform investments in operations and infrastructure. We anticipate that our expenses will increase as we continue to hire additional personnel and further advance our technological and data science capabilities. Moreover, we intend to make capital investments in our inventory, fulfillment centers, and office space and logistics infrastructure as we launch new categories, expand internationally, and drive operating efficiencies. For example, we plan to invest a total of \$25-35 million in fiscal year 2020 in UK merchandise, styling, and operations. We expect to increase our spending on these investments in the future and cannot be certain that these efforts will grow our client base or be cost-effective. However, we believe these strategies will yield positive returns in the long term.

Inventory Management

We leverage our data science to buy and manage our inventory, including merchandise assortment and fulfillment center optimization. To ensure sufficient availability of merchandise, we generally enter into purchase orders well in advance and frequently before apparel trends are confirmed by client purchases. As a result, we are vulnerable to demand and pricing shifts and availability of merchandise at time of purchase. We incur inventory write-offs and changes in inventory reserves that impact our gross margins. Because our merchandise assortment directly correlates to client success, we may at times optimize our inventory to prioritize long-term client success over short-term gross margin impact. Moreover, our inventory investments will fluctuate with the needs of our business. For example, entering new locations such as the UK, new categories such as Stitch Fix Kids, or adding new fulfillment centers will all require additional investments in inventory.

Merchandise Mix

We offer apparel, shoes, and accessories across categories, brands, product types, and price points. We currently serve our clients in the following categories: Women's, Petite, Maternity, Men's, Plus, and Kids. We carry a mix of third-party branded merchandise, including premium brands, and our own Exclusive Brands. We also offer a wide variety of product types, including denim, dresses, blouses, skirts, shoes, jewelry, and handbags. We sell merchandise across a broad range of price points and may further broaden our price point offerings in the future. These new offerings may impact revenue differently. For example, as we expand our assortment of lower price point products, our average order values may decrease.

While changes in our merchandise mix have not caused significant fluctuations in our gross margin to date, categories, brands, product types, and price points do have a range of margin profiles. For example, our Exclusive Brands have generally contributed higher margin, shoes have generally contributed lower margin, and new categories, such as Kids, tend to initially have lower margins. Shifts in merchandise mix driven by client demand may result in fluctuations in our gross margin from period to period.

Components of Results of Operations

Revenue

We generate revenue from the sale of merchandise. We charge a nonrefundable upfront fee, referred to as a "styling fee," that is credited towards any merchandise purchased in the Fix. We deduct discounts, sales tax, and estimated refunds to arrive at net revenue, which we refer to as revenue throughout the report. We offer Style Pass to provide select U.S. clients with an alternative to paying a styling fee per Fix. Style Pass clients pay a nonrefundable annual fee for unlimited styling that is credited towards merchandise purchases. To a lesser extent, we also recognize revenue resulting from direct purchases and estimated breakage income on gift cards. We expect our revenue to increase in absolute dollars as we grow our business, although our revenue growth rate may slow in future periods.

Cost of Goods Sold

Cost of goods sold consists of the costs of merchandise, expenses for shipping to and from clients and inbound freight, inventory write-offs and changes in our inventory reserve, payment processing fees, and packaging materials costs, offset by the recoverable cost of merchandise estimated to be returned. We expect our cost of goods sold to fluctuate as a percentage of revenue primarily due to how we manage our inventory and merchandise mix. Our classification of cost of goods sold may vary from other companies in our industry and may not be comparable.

Selling, General, and Administrative Expenses

Selling, general, and administrative expenses consist primarily of compensation and benefits costs, including stock-based compensation expense for our employees including our stylists, fulfillment center operations, data analytics, merchandising, engineering, marketing, client experience, and corporate personnel. Selling, general, and administrative expenses also include marketing and advertising costs, third-party logistics costs, facility costs for our fulfillment centers and offices, professional service fees, information technology costs, and depreciation and amortization expense. We expect our selling, general, and administrative expenses to increase in absolute dollars and to fluctuate as a percentage of revenue due to the anticipated growth of our business, increased marketing investments, and additional costs associated with being a public company. Our classification of selling, general, and administrative expenses may vary from other companies in our industry and may not be comparable.

Interest Income

Interest income is generated from our cash equivalents and investments in available-for-sale securities.

Provision for Income Taxes

Our provision for income taxes consists of an estimate of federal, state, and international income taxes based on enacted federal, state, and international tax rates, as adjusted for allowable credits, deductions, and uncertain tax positions.

Results of Operations

Comparison of the Three and Six Months Ended February 1, 2020, and January 26, 2019

The following table sets forth our results of operations for the periods indicated:

(in thousands)	For the Three Months Ended		% Change	For the Six Months Ended		% Change
	February 1, 2020	January 26, 2019		February 1, 2020	January 26, 2019	
Revenue, net	\$ 451,784	\$ 370,280	22.0 %	\$ 896,599	\$ 736,516	21.7 %
Cost of goods sold	249,597	207,131	20.5 %	493,110	408,199	20.8 %
Gross profit	202,187	163,149	23.9 %	403,489	328,317	22.9 %
Selling, general, and administrative expenses	193,689	147,738	31.1 %	394,831	302,009	30.7 %
Operating income (loss)	8,498	15,411	(44.9) %	8,658	26,308	(67.1) %
Interest (income) expense	(1,477)	(1,170)	26.2 %	(3,130)	(2,569)	21.8 %
Other (income) expense, net	28	(453)	(106.2) %	862	(573)	(250.4) %
Income before income taxes	9,947	17,034	(41.6) %	10,926	29,450	(62.9) %
Provision (benefit) for income taxes	(1,484)	5,058	(129.3) %	(327)	6,796	(104.8) %
Net income (loss)	\$ 11,431	\$ 11,976	(4.6) %	\$ 11,253	\$ 22,654	(50.3) %

The following table sets forth the components of our results of operations as a percentage of revenue:

	For the Three Months Ended		For the Six Months Ended	
	February 1, 2020	January 26, 2019	February 1, 2020	January 26, 2019
Revenue, net	100.0 %	100.0 %	100.0 %	100.0 %
Cost of goods sold	55.2 %	55.9 %	55.0 %	55.4 %
Gross margin	44.8 %	44.1 %	45.0 %	44.6 %
Selling, general, and administrative expenses	42.9 %	39.9 %	44.0 %	41.0 %
Operating income (loss)	1.9 %	4.2 %	1.0 %	3.6 %
Interest (income) expense	(0.3) %	(0.3) %	(0.3) %	(0.3) %
Other (income) expense, net	— %	(0.1) %	0.1 %	(0.1) %
Income before income taxes	2.2 %	4.6 %	1.2 %	4.0 %
Provision for income taxes	(0.3) %	1.4 %	— %	0.9 %
Net income (loss)	2.5 %	3.2 %	1.2 %	3.1 %

Revenue and Gross Margin

Revenue increased by \$81.5 million and \$160.1 million, or 22.0% and 21.7%, respectively, during the three and six months ended February 1, 2020, compared with the same periods last year. The increase in revenue was due to increased sales of merchandise, primarily attributable to a 17.0% increase in active clients and an 8.3% increase in net revenue per active client from January 26, 2019, to February 1, 2020. The 53rd week of fiscal 2019 contributed approximately 2.0% of the increase to revenue per active client as of February 1, 2020.

Gross margin for the three and six months ended February 1, 2020, increased by 70 basis points and 40 basis points, respectively, compared with the same periods last year. The increase for both periods was primarily driven by improvements in merchandise costs and operational efficiencies, partially offset by an increase in shipping costs.

Selling, General, and Administrative Expenses

Selling, general, and administrative expenses increased by \$46.0 million and \$92.8 million for the three and six months ended February 1, 2020, respectively, compared with the same periods last year. As a percentage of revenue, selling, general, and administrative expenses increased to 42.9% for the three months ended February 1, 2020, compared with 39.9% for the three months ended January 26, 2019, and increased to 44.0% for the six months ended February 1, 2020, compared with 41.0% for the six months ended January 26, 2019.

The increase for the three and six months ended February 1, 2020, compared with the same period last year, was primarily related to higher compensation and benefits expense and stock-based compensation due to increased headcount as we continued to invest in talent and higher advertising spend year over year to support the growth of our business.

Provision for Income Taxes

The following table summarizes our effective tax rate from income for the periods presented:

(in thousands)	For the Three Months Ended		For the Six Months Ended	
	February 1, 2020	January 26, 2019	February 1, 2020	January 26, 2019
Income before income taxes	\$ 9,947	\$ 17,034	\$ 10,926	\$ 29,450
Provision (benefit) for income taxes	(1,484)	5,058	(327)	6,796
Effective tax rate	(14.9)%	29.7%	(3.0)%	23.1%

Our effective tax rate for the three and six months ended February 1, 2020, differs from the federal statutory income tax rate primarily due to certain nondeductible expenses and state taxes which are offset by the benefits of allowable credits and excess tax benefits from stock-based compensation.

Our effective tax rate for the three and six months ended January 26, 2019, differed from the federal statutory income tax rate primarily due to lower tax rates in foreign jurisdictions where international expansion expenses are incurred, and certain nondeductible expenses and state taxes, partially offset by the benefits of stock-based compensation deductions and allowable credits.

Liquidity and Capital Resources

Sources of Liquidity

Our principal sources of liquidity since inception have been our cash flows from operations, as well as the net proceeds we received through private sales of equity securities and our IPO. We have had positive and growing cash flows from operations since 2014. As of February 1, 2020, we had raised an aggregate of \$169.6 million of equity capital including proceeds from our IPO. We had \$166.0 million of cash and cash equivalents and investments of \$231.2 million as of February 1, 2020. Our investment balance includes \$134.6 million of short-term investments with contractual maturities of 12 months or less as of February 1, 2020.

Our primary use of cash includes operating costs such as merchandise purchases, compensation and benefits, marketing, and other expenditures necessary to support our business growth. We have been able to fund these costs through our cash flows from operations since 2014 and expect to continue to do so. We believe our existing cash balances and cash flows from operations will be sufficient to meet our working capital and capital expenditure needs for at least the next 12 months.

Cash Flows

The following table summarizes our cash flows for the periods indicated below:

(in thousands)	For the Six Months Ended	
	February 1, 2020	January 26, 2019
Net cash provided by operating activities	\$ 38,242	\$ 57,667
Net cash used in investing activities	(45,601)	(187,234)
Net cash provided by (used in) financing activities	402	(350)
Net increase (decrease) in cash, cash equivalents, and restricted cash	<u>\$ (6,957)</u>	<u>\$ (129,917)</u>

Cash provided by operating activities

During the six months ended February 1, 2020, cash provided by operating activities was \$38.2 million, which consisted of net income of \$11.3 million, adjusted by non-cash charges of \$36.2 million, and a change of \$9.3 million in our net operating assets and liabilities. The non-cash charges were largely driven by \$27.9 million of stock-based compensation expense and \$10.3 million of depreciation, amortization, and accretion. The change in our net operating assets and liabilities was primarily due to an increase of \$31.6 million in our inventory balance due to increased inventory purchases to support our growth, partially offset by a change of \$15.3 million in accrued liabilities and a change of \$5.2 million in prepaid expenses and other assets related to increased business activity and timing of payments.

During the six months ended January 26, 2019, cash provided by operating activities was \$57.7 million, which consisted of net income of \$22.7 million, adjusted by non-cash charges of \$23.8 million and a change of \$11.2 million in our net operating assets and liabilities. The non-cash charges were largely driven by \$14.7 million of stock-based compensation expense, \$6.5 million of depreciation and amortization, and \$4.9 million of inventory obsolescence reserves. The change in our net operating assets and liabilities was primarily due to an increase of \$24.7 million in accounts payable and accrued liabilities related to increased business activity and timing of payments, substantially offset by an increase of \$22.9 million in our inventory balance due to increased inventory purchases to support our growth.

Cash used in investing activities

During the six months ended February 1, 2020, and January 26, 2019, cash used in investing activities was \$45.6 million and \$187.2 million, respectively. During the six months ended February 1, 2020, cash used in investing activities was primarily related to our investment of \$129.9 million in highly rated available-for-sale securities and \$11.4 million in purchases of property and equipment, partially offset by maturities of available-for-sale securities of \$81.7 million. During the six months ended January 26, 2019, cash used in investing activities was primarily related to our investment of \$186.0 million in highly rated available-for-sale securities and \$11.9 million in purchases of property and equipment.

Cash provided by (used in) financing activities

During the six months ended February 1, 2020, cash provided by financing activities was \$0.4 million, which was primarily due to proceeds from the exercise of stock options, partially offset by payments for tax withholding related to vesting of restricted stock units.

During the six months ended January 26, 2019, cash used in financing activities was \$0.4 million, primarily due to payments for tax withholding related to vesting of restricted stock units.

Contractual Obligations and Other Commitments

There have been no material changes to our contractual obligations and other commitments as disclosed in our Annual Report on Form 10-K for the fiscal year ended August 3, 2019 ("2019 Annual Report").

Refer to "Note 4 - Leases" and "Note 6 - Commitments and Contingencies" in the Notes to the Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q for commitments entered into during the six months ended February 1, 2020.

Off-Balance Sheet Arrangements

We have not entered into any off-balance sheet arrangements and do not have any holdings in variable interest entities.

Critical Accounting Policies and Estimates

Our unaudited condensed consolidated financial statements have been prepared in accordance with GAAP. The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses and the related disclosures. We base our estimates on historical

experience and on other assumptions that we believe to be reasonable under the circumstances. These estimates and assumptions form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Except for changes resulting from the adoption of new accounting standards during the period, there have been no significant changes to our critical accounting policies and estimates as discussed in our 2019 Annual Report.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

We are primarily exposed to market risks through interest rate risk on our investments. As of February 1, 2020, we had \$231.2 million in highly rated investments accounted for as available-for-sale securities, which are presented on our balance sheet at their fair market value. These interest-earning instruments carry a degree of interest rate risk; however, a hypothetical 10% change in interest rates during the three and six months ended February 1, 2020, would not have had a material impact on our condensed consolidated financial statements.

Foreign Currency Risk

As of February 1, 2020, our revenue was earned in U.S. dollars and British pound sterling. Our expansion into the UK exposes us to fluctuations in foreign currency exchange rates. Fluctuations in foreign currency exchange rates may also result in transaction gains or losses on transactions in currencies other than the U.S. Dollar or British pound sterling. For the three and six months ended February 1, 2020, a hypothetical 10% increase or decrease in current exchange rates would not have had a material impact on our condensed consolidated financial results.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended), as of the end of the period covered by this Quarterly Report. Based on the evaluation of our disclosure controls and procedures as of February 1, 2020, our Chief Executive Officer and Chief Financial Officer concluded that, as a result of the material weaknesses in our internal control, our disclosure controls and procedures were not effective as of February 1, 2020.

Material Weakness in Internal Control Over Financial Reporting

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements would not be prevented or detected on a timely basis.

As previously disclosed, throughout fiscal year 2019 we implemented processes and procedures designed to remediate the material weakness identified in connection with the audit of our Consolidated Financial Statements for the year ended July 28, 2018. We have continued to review, confirm, and test these initiatives and, in connection with those efforts, as of August 3, 2019, we identified a material weakness in our internal control over financial reporting associated with certain outsourced IT service providers and related material weaknesses in our COSO components as described below.

Outsourced IT Service Providers

We rely upon a variety of outsourced IT service providers for key elements of the technology infrastructure impacting our financial reporting process. Certain of these outsourced IT service providers could not provide System and Organization Controls (SOC) reports or, if they did, they were for periods that did not closely align with our fiscal year end. As such, we did not have controls designed to assess the design and operation of internal controls pertaining to these outsourced IT service providers over our period of reliance. Given that management did not effectively assess the design and operation of certain outsourced IT service providers' internal controls, certain of our controls over IT systems and business processes were also ineffective, to the extent that they rely upon information that was subject to the outsourced IT service providers' control environment. These deficiencies impact substantially all financial statement account balances and disclosures, and when aggregated represent a material weakness in internal control over financial reporting.

Control Activities and Monitoring

Given the outsourced IT service providers material weakness, we identified related COSO material weaknesses, including: (1) deficiencies in the principles associated with the control activities component of the COSO framework relating to: (i) selecting

and developing control activities and information technology that contribute to the mitigation of risks and support achievement of objectives, and (ii) selecting and developing general control activities over technology to support the achievement of objectives; and (2) deficiencies in the principles associated with the monitoring component of the COSO framework relating to selecting, developing, and performing ongoing evaluation to ascertain whether the components of internal control are present and functioning.

Notwithstanding the identified outsourced IT service providers and related COSO material weaknesses, management has concluded that the Consolidated Financial Statements included in this Quarterly Report present fairly, in all material respects, the Company's financial position, results of operations and cash flows for the periods disclosed in conformity with U.S. GAAP.

Management's Planned Remediation Activities

Our management has been actively engaged in developing and implementing remediation plans to address the outsourced IT service providers and related COSO material weaknesses described above. These remediation efforts are ongoing and include or are expected to include the following:

- Expanding controls and/or applying other appropriate procedures to address the design and operation of internal controls relating to certain outsourced IT service providers.
- Enhancing procedures for the identification of control activities and monitoring of control performance to ensure that the components of internal control relating to certain outsourced IT service providers are present and functioning.

As we continue to evaluate and work to improve our internal control over financial reporting, we may decide to take additional measures to address control deficiencies or modify the remediation plans described above. The outsourced IT service providers and related COSO material weaknesses will not be considered remediated until the applicable controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively. During the remainder of fiscal year 2020, we intend to continue executing these plans to remediate the outsourced IT service providers and related COSO material weaknesses. However, we cannot be certain that the measures we have taken or may take in the future will ensure that we establish and maintain adequate controls over our financial processes and reporting in the future.

Changes in Internal Control over Financial Reporting

Other than the remediation efforts underway, there were no changes during the quarter ended February 1, 2020 in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

An effective internal control system, no matter how well designed, has inherent limitations, including the possibility of human error or overriding of controls, and therefore can provide only reasonable assurance with respect to reliable financial reporting. Because of its inherent limitations, our internal control over financial reporting may not prevent or detect all misstatements, including the possibility of human error, the circumvention or overriding of controls, or fraud. Effective internal controls can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On October 11, 2018, October 26, 2018, November 16, 2018, and December 10, 2018, four putative class action lawsuits alleging violations of the federal securities laws were filed in the U.S. District Court for the Northern District of California, naming as defendants us and certain of our officers. The four lawsuits each make the same allegations of violations of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), by us and our officers for allegedly making materially false and misleading statements regarding our active client growth and strategy with respect to television advertising between June 2018 and October 2018. The plaintiffs seek unspecified monetary damages and other relief. The four lawsuits have been consolidated and a lead plaintiff has been appointed. On September 18, 2019, the lead plaintiff in the consolidated class action lawsuits filed a consolidated complaint for violation of the federal securities laws. On October 28, 2019, we and other defendants filed a motion to dismiss the consolidated complaint. The lead plaintiff filed an opposition to the motion to dismiss on December 9, 2019, and we and the other defendants filed our reply in support of our motion to dismiss on December 30, 2019. The court has taken the motion under submission. We believe these claims are without merit and intend to vigorously defend against them.

On December 12, 2018, a derivative action was filed against our directors in the same court, alleging the same violations of securities laws as alleged in the four putative class action cases described above and breach of fiduciary duties. The derivative action has been stayed pending the outcome of the motion to dismiss in the related class action lawsuits. On December 12, 2019, a second derivative action was filed against our directors in the same court, alleging the same violations of securities laws and breach of fiduciary duties as the other derivative action. The second derivative action has also been stayed pending the outcome of the motion to dismiss in the related class action lawsuits.

On December 29, 2017, a lawsuit was filed by a holder of shares of our Class A common stock in the Court of Chancery of the State of Delaware, naming as defendants us and certain of our directors, as well as two other public companies and certain of their directors. The lawsuit sought a court determination that Article VI, Section E of our amended and restated certificate of incorporation, purporting to limit to federal court the forum in which a stockholder could bring a claim under the Securities Act of 1933, as amended (the “Securities Act”), and similar provisions in our co-defendants’ certificates of incorporation, were invalid. On December 19, 2018, the Chancery Court of the State of Delaware issued an opinion in *Sciabacucchi v. Salzberg*, invalidating our federal exclusive forum provision. We have appealed this decision to the Delaware Supreme Court.

In addition, we are subject to legal proceedings that arise in the ordinary course of business. We have in the past and may in the future become involved in private actions, collective actions, investigations and various other legal proceedings by clients, employees, suppliers, competitors, government agencies, stockholders or others. We evaluate any claims and lawsuits with respect to their potential merits, our potential defenses and counter claims, and the expected effect on us of defending the claims and a potential adverse result. However, the results of any litigation, investigations and other legal proceedings are inherently unpredictable and expensive. Any claims against us, whether meritorious or not, could be time consuming, result in costly litigation, damage our reputation, require significant amounts of management time and divert significant resources. If any legal proceedings were to be determined adversely to us, or we were to enter into a settlement arrangement, we could be exposed to monetary damages or limits on our ability to operate our business, which could have an adverse effect on our business, financial condition and operating results.

ITEM 1A. RISK FACTORS

Investing in our common stock involves a high degree of risk. You should consider and read carefully all of the risks and uncertainties described below, as well as other information included in this Quarterly Report on Form 10-Q (this “Quarterly Report”), and in our other public filings. The risks described below are not the only ones facing us. The occurrence of any of the following risks or additional risks and uncertainties not presently known to us or that we currently believe to be immaterial could materially and adversely affect our business, financial condition, or results of operations. In such case, the trading price of our common stock could decline, and you may lose all or part of your investment. This Quarterly Report also contains forward-looking statements and estimates that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of specific factors, including the risks and uncertainties described below.

Risks Related to Our Business

We have a short operating history in an evolving industry and, as a result, our past results may not be indicative of future operating performance.

We have a short operating history in a rapidly evolving industry that may not develop in a manner favorable to our business. Our relatively short operating history makes it difficult to assess our future performance. You should consider our business and prospects in light of the risks and difficulties we may encounter.

Our future success will depend in large part upon our ability to, among other things:

- cost-effectively acquire new clients and engage with existing clients;
- increase consumer awareness of our brand and maintain our reputation;
- anticipate and respond to macroeconomic changes;
- successfully expand our offering and geographic reach;
- anticipate and respond to changing style trends and consumer preferences;
- manage our inventory effectively;
- compete effectively;
- avoid interruptions in our business from information technology downtime, cybersecurity breaches, or labor stoppages;
- effectively manage our growth;
- continue to enhance our personalization capabilities;
- hire, integrate, and retain talented people at all levels of our organization;
- maintain the quality of our technology infrastructure;
- develop new features to enhance the client experience; and
- retain our existing merchandise vendors and attract new vendors.

If we fail to address the risks and difficulties that we face, including those associated with the challenges listed above as well as those described elsewhere in this “Risk Factors” section, our business and our operating results will be adversely affected.

If we fail to effectively manage our growth, our business, financial condition, and operating results could be harmed.

To effectively manage our growth, we must continue to implement our operational plans and strategies, improve and expand our infrastructure of people and information systems, and expand, train, and manage our employee base. Since our inception, we have rapidly increased our employee headcount to support the growth of our business. We added a significant number of employees during 2019 and expect to continue growing in 2020. We have expanded across all areas of our business. To support continued growth, we must effectively integrate, develop, and motivate a large number of new employees while maintaining our corporate culture. The risks associated with a rapidly growing workforce will be particularly acute as we expand internationally, as we are less familiar with the labor markets outside of the United States, and if we choose to expand into new merchandise categories.

We are also required to manage numerous relationships with various vendors and other third parties. Further growth of our operations, vendor base, fulfillment centers, information technology systems, or internal controls and procedures may not be adequate to support our operations. For example, in May 2019, we launched our service in the UK, which involves working with international vendors, establishing offices and fulfillment centers in the UK, and complying with UK and European Union (“EU”) laws and regulations. Our launch of Stitch Fix Kids in July 2018 also required us to increase our vendor base, expand our fulfillment center operations, and evaluate compliance with additional regulatory requirements, among other things. If we are unable to manage the growth of our organization effectively, our business, financial condition, and operating results may be adversely affected.

Our continued growth depends on attracting new clients.

Our success depends on our ability to attract new clients in a cost-effective manner. To expand our client base, we must appeal to and acquire clients who have historically used other means to purchase apparel, shoes, and accessories, such as traditional brick-and-mortar apparel retailers or the websites of our competitors. We also face competition for clients from other retailers who offer or plan to offer similar services as ours. We reach new clients through paid marketing, referral programs, organic word of mouth, and other methods of discovery, such as mentions in the press or internet search engine results. Starting in calendar 2017, we began to increase our paid marketing expenses by investing more in digital marketing and launching our first television advertising campaigns. Although we plan to pull back modestly on marketing spend in the near term, we expect to increase our spending on these and other paid marketing channels in the future and cannot be certain that these efforts will yield more clients, continue to achieve meaningful payback on our investments, or be as cost effective. For example, in recent periods, we have seen higher costs in some key digital marketing channels. Although we expect to increase marketing spend over time, our marketing activity and spend may vary from period to period, which may result in faster or slower rates of active client growth in any given period. Moreover, new clients may not purchase from us as frequently or spend as much with us as existing clients, and the revenue generated from new clients may not be as high as the revenue generated from our existing clients. These factors may harm our growth prospects and our business could be adversely affected.

We rely on consumer discretionary spending and may be adversely affected by economic downturns and other macroeconomic conditions or trends.

Our business and operating results are subject to global economic conditions and their impact on consumer discretionary spending. Some of the factors that may negatively influence consumer spending include high levels of unemployment; higher consumer debt levels; reductions in net worth, declines in asset values, and related market uncertainty; home foreclosures and reductions in home values; fluctuating interest rates and credit availability; fluctuating fuel and other energy costs; fluctuating commodity prices; and general uncertainty regarding the overall future political and economic environment. Economic conditions in certain regions may also be affected by natural disasters, such as hurricanes, tropical storms, earthquakes, and wildfires; public health crises, such as the novel coronavirus; and other major unforeseen events. Consumer purchases of discretionary items, including the merchandise that we offer, generally decline during recessionary periods or periods of economic uncertainty, when disposable income is reduced or when there is a reduction in consumer confidence.

Adverse economic changes could reduce consumer confidence, and could thereby negatively affect our operating results. In challenging and uncertain economic environments, we cannot predict when macroeconomic uncertainty may arise, whether or when such circumstances may improve or worsen or what impact such circumstances could have on our business.

We expect to increase our paid marketing to help grow our business, but these efforts may not be successful or cost effective.

Promoting awareness of our service is important to our ability to grow our business, drive client engagement, and attract new clients. We believe that much of the growth in our client base during our first five years originated from referrals, organic word of mouth, and other methods of discovery, as our marketing efforts and expenditures were relatively limited. In recent years, we increased our paid marketing initiatives and intend to continue to do so. Our marketing efforts currently include client referrals, affiliate programs, partnerships, display advertising, television, print, radio, video, content, direct mail, social media, email, mobile “push” communications, search engine optimization, and keyword search campaigns. In February 2019, we launched our first integrated brand marketing campaign. We have limited or no experience marketing our services using some of these methods and our efforts may be unsuccessful. Our marketing initiatives may become increasingly expensive and generating a meaningful return on those initiatives may be difficult, such as the increased costs we have seen in certain digital marketing channels. We may also adjust our marketing activity from period to period as we launch new initiatives or offerings, such as direct buy, run tests, or make decisions on marketing investments in response to anticipated rates of return, such as when we identify favorable cost per acquisition trends. For example, we tend to reduce our advertising during the holiday season, when many other retailers compete for marketing opportunities. Even if we successfully increase revenue as a result of our paid marketing efforts, it may not offset the additional marketing expenses we incur.

We currently obtain a significant number of visits to our websites via organic search engine results. Search engines frequently change the algorithms that determine the ranking and display of results of a user’s search, which could reduce the number of organic visits to our websites, in turn reducing new client acquisition and adversely affecting our operating results.

Social networks are important as a source of new clients and as a means by which to connect with current clients, and their importance may be increasing. We may be unable to effectively maintain a presence within these networks, which could lead to lower than anticipated brand affinity and awareness, and in turn could adversely affect our operating results.

With respect to our email marketing efforts, if we are unable to successfully deliver emails to our clients or if clients do not engage with our emails, whether out of choice, because those emails are marked as low priority or spam, or for other reasons, our business could be adversely affected.

We may be unable to maintain a high level of engagement with our clients and increase their spending with us, which could harm our business, financial condition, or operating results.

A high proportion of our revenue comes from repeat purchases by existing clients, especially those existing clients who are highly engaged and purchase a significant amount of merchandise from us. If existing clients no longer find our service and merchandise appealing or appropriately priced, they may make fewer purchases and may stop using our service. Even if our existing clients continue to find our service and merchandise appealing, they may decide to receive fewer Fixes and purchase less merchandise over time as their demand for new apparel declines. In addition, as we expand our assortment to include more lower price point products, the amount clients spend with us may decrease. If clients who receive Fixes most frequently and purchase a significant amount of merchandise from us were to make fewer or lower priced purchases or stop using our service, our financial results could be negatively affected. In addition, we seek to attract high-quality clients who will remain clients for the long term, but our efforts may not be successful or produce the results we anticipate. A decrease in the number of clients, a decrease in client spending on the merchandise we offer, or our inability to attract high-quality clients could negatively impact our operating results. Further, we believe that our future success will depend in part on our ability to increase sales to our existing clients over time and, if we are unable to do so, our business may suffer.

Compromises of our data security could cause us to incur unexpected expenses and may materially harm our reputation and operating results.

In the ordinary course of our business, we and our vendors collect, process, and store certain personal information and other data relating to individuals, such as our clients and employees, including client payment card information. We rely substantially on commercially available systems, software, tools, and monitoring to provide security for our processing, transmission, and storage of personal information and other confidential information. There can be no assurance, however, that we or our vendors will not suffer a data compromise, that hackers or other unauthorized parties will not gain access to personal information or other data, including payment card data or confidential business information, or that any such data compromise or unauthorized access will be discovered in a timely fashion. The techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not identified until they are launched against a target, and we and our vendors may be unable to anticipate these techniques or to implement adequate preventative measures. In addition, our employees, contractors, vendors, or other third parties with whom we do business may attempt to circumvent security measures in order to misappropriate such personal information, confidential information, or other data, or may inadvertently release or compromise such data.

Compromise of our data security or of third parties with whom we do business, failure to prevent or mitigate the loss of personal or business information, and delays in detecting or providing prompt notice of any such compromise or loss could disrupt our operations, damage our reputation, and subject us to litigation, government action, or other additional costs and liabilities that could adversely affect our business, financial condition, and operating results.

Our industry is highly competitive and if we do not compete effectively our operating results could be adversely affected.

The retail apparel industry is highly competitive. We compete with eCommerce companies that market the same or similar merchandise and services that we offer; local, national, and global department stores; specialty retailers; discount chains; independent retail stores; and the online offerings of these traditional retail competitors. Additionally, we experience competition for consumer discretionary spending from other product and experiential categories. We believe our ability to compete depends on many factors within and beyond our control, including:

- effectively differentiating our service and value proposition from those of our competitors;
- attracting new clients and engaging with existing clients;
- our direct relationships with our clients and their willingness to share personal information with us;
- further developing our data science capabilities;
- maintaining favorable brand recognition and effectively marketing our services to clients;
- delivering merchandise that each client perceives as personalized to him or her;
- the amount, diversity, and quality of brands and merchandise that we or our competitors offer;
- our ability to expand and maintain appealing Exclusive Brands and exclusive-to-Stitch Fix merchandise;
- the price at which we are able to offer our merchandise;
- the speed and cost at which we can deliver merchandise to our clients and the ease with which they can use our services to return merchandise; and
- anticipating and quickly responding to changing apparel trends and consumer shopping preferences.

Many of our current competitors have, and potential competitors may have, longer operating histories; larger fulfillment infrastructures; greater technical capabilities; faster shipping times; lower-cost shipping; larger databases; more purchasing power; higher profiles; greater financial, marketing, institutional, and other resources; and larger customer bases than we do. These factors may allow our competitors to derive greater revenue and profits from their existing customer bases; acquire customers at lower costs; or respond more quickly than we can to new or emerging technologies, changes in apparel trends and consumer shopping behavior, and changes in supply conditions. These competitors may engage in more extensive research and development efforts, enter or expand their presence in the personalized retail market, undertake more far-reaching marketing campaigns, and adopt more aggressive pricing policies, which may allow them to build larger customer bases or generate revenue from their existing customer bases more effectively than we do. If we fail to execute on any of the above better than our competitors, our operating results may be adversely affected.

If we are unable to develop and introduce new merchandise offerings or expand into new markets in a timely and cost-effective manner, our business, financial condition, and operating results could be negatively impacted.

The largest portion of our revenue today comes from the sale of Women's apparel. From 2015 to 2018, we expanded our merchandise offering into categories including Petite, Maternity, Men's, Plus, Premium Brands, and Kids; began offering different product types including, accessories, and Extras; and expanded the number of brands we offer. In May 2019, we

launched our service in the UK market. In June 2019, we introduced a direct-buy functionality with Shop New Colors, allowing clients in the United States to buy previously purchased items in new colors, prints, and sizes. We continue to explore additional offerings to serve our existing clients, attract new clients, and expand our geographic scope. For example, in February 2020, we expanded Shop Your Looks, which allows clients to discover and shop personalized outfits with new items that complement their prior purchases, to all U.S. Women's and Men's clients.

New offerings may not have the same success, or gain traction as quickly, as our current offerings. If the merchandise we offer is not accepted by our clients or does not attract new clients, or if we are not able to attract clients in new markets such as the UK, our sales may fall short of expectations, our brand and reputation could be adversely affected, and we may incur expenses that are not offset by sales. If the launch of a new category or offering or in a new geography requires investments greater than we expect, our operating results could be negatively impacted. Also, our business may be adversely affected if we are unable to attract brands and other merchandise vendors that produce sufficient high-quality, appropriately priced, and on-trend merchandise. For example, vendors in the UK may not be familiar with our company or brand, which may make it difficult for us to obtain the merchandise we seek or be able to purchase products at an appropriate price.

Our current merchandise offerings have a range of margin profiles and we believe new offerings will also have a broad range of margin profiles that will affect our operating results. New businesses generally contribute lower margins and imported merchandise may be subject to tariffs or duties that lower margins. Additionally, as we enter into new categories and markets, we may not have as high purchasing power as we do in our current offerings, which could increase our costs of goods sold and further reduce our margins. Expansion of our merchandise offerings and geographic scope may also strain our management and operational resources, specifically the need to hire and manage additional merchandise buyers to source new merchandise and to allocate new categories across our distribution network. We may also face greater competition in specific categories or regions from companies that are more focused on these areas. For example, now that we have launched in the UK, we compete with existing businesses that have been providing similar services in the region and may be more familiar with trends and customer preferences in that market. Also, our entry into the Kids category means we now compete with a number of additional companies that have been in the Kids category for a longer period of time and may have more experience in children's clothing. If any of the above were to occur, it could damage our reputation, limit our growth, and have an adverse effect on our operating results.

Expansion of our operations internationally requires management attention and resources, involves additional risks, and may be unsuccessful.

In May 2019, we launched our service in the UK market, and we may choose to expand to other international markets in the future. Prior to launching in the UK, we had no experience operating internationally or selling our merchandise outside of the United States, and if we continue to expand internationally, we will need to adapt to different local cultures, standards, laws, and policies. The business model we employ may not appeal to consumers outside of the United States. Furthermore, to succeed with clients in international locations, such as the UK, we will need to locate fulfillment centers in foreign markets and hire local employees, and we will have to invest in these facilities and employees before proving we can successfully run foreign operations. We may not be successful in expanding into additional international markets or in generating revenue from foreign operations for a variety of reasons, including:

- the need to localize our merchandise offerings, including translation into foreign languages and adaptation for local practices;
- different consumer demand dynamics, which may make our model and the merchandise we offer less successful compared to the United States;
- competition from local incumbents that understand the local market and may operate more effectively;
- regulatory requirements, taxes, trade laws, trade sanctions and economic embargoes, tariffs, export quotas, custom duties, or other trade restrictions, or any unexpected changes thereto such as Brexit (as defined below);
- laws and regulations regarding anti-bribery and anti-corruption compliance;
- differing labor regulations where labor laws may be more advantageous to employees as compared to the United States and result in increased labor costs;
- more stringent regulations relating to privacy and data security and access to, or use of, commercial and personal information, particularly in Europe and the United States;
- differing payment requirements and customer behavior relating to payments and fraud;
- changes in a specific country's or region's political or economic conditions; and
- risks resulting from changes in currency exchange rates.

For example, clients in the UK are accustomed to more return shipping options than are typically offered in the United States, which required us to increase the number of shipping vendors we use in that market, increasing our costs. If we continue to invest substantial time and resources to establish and expand our operations internationally and are unable to do so successfully and in a timely manner, our operating results would suffer.

We may not be able to sustain our revenue growth rate and we may not be profitable in the future.

Our recent revenue growth and past profitability should not be considered indicative of our future performance. Our rate of revenue growth has varied in recent periods. Specifically, our revenue increased by 21.7% in the first half of 2020 compared to the first half of 2019, 28.6% in 2019 compared to 2018, 25.5% in 2018 compared to 2017, and 33.8% in 2017 compared to 2016. As we grow our business, our revenue growth rates may slow in future periods due to a number of reasons, which may include slowing demand for our merchandise and service, increasing competition, a decrease in the growth rate of our overall market, and our failure to capitalize on growth opportunities, as well as the maturation of our business.

Moreover, our expenses have increased in recent periods, and we expect expenses to increase substantially in the near term, particularly as we make significant investments in our marketing initiatives; expand our geographic markets, operations, and infrastructure; develop and introduce new merchandise offerings; and hire additional personnel. We may not always pursue short-term profits but are often focused on long-term growth, which may impact our financial results. In addition, in connection with operating as a public company, we are incurring significant additional legal, accounting, and other expenses that we did not incur as a private company. If our revenue does not increase to offset increases in our operating expenses, we may not be profitable in future periods.

We must successfully gauge apparel trends and changing consumer preferences.

Our success is, in large part, dependent upon our ability to identify apparel trends, predict and gauge the tastes of our clients, and provide a service that satisfies client demand in a timely manner. However, lead times for many of our purchasing decisions may make it difficult for us to respond rapidly to new or changing apparel trends or client acceptance of merchandise chosen by our merchandising buyers. We generally enter into purchase contracts significantly in advance of anticipated sales and frequently before apparel trends are confirmed by client purchases. In the past, we have not always predicted our clients' preferences and acceptance levels of our merchandise with accuracy. Further, we use our data science to predict our clients' preferences and gauge demand for our merchandise, and there is no guarantee that our data science and algorithms will accurately anticipate client demand and tastes. Our entry into the UK also requires us to become familiar with different apparel trends and customer preferences. In addition, consumer shopping behavior may continue to evolve and we may need to adapt our service to such changes, which could be further complicated by any future expansion into additional geographic markets. To the extent we misjudge the market for the service we offer or fail to execute on trends and deliver attractive merchandise to clients, our sales will decline and our operating results will be adversely affected.

If we are unable to manage our inventory effectively, our operating results could be adversely affected.

To ensure timely delivery of merchandise, we generally enter into purchase contracts well in advance of a particular season and often before apparel trends are confirmed by client purchases. As a result, we are vulnerable to demand and pricing shifts and to suboptimal selection and timing of merchandise purchases. In the past, we have not always predicted our clients' preferences and acceptance levels of our trend items with accuracy, which has resulted in significant inventory write offs and lower gross margins. Furthermore, we do not use the same liquidation methods as traditional retailers, such as markdowns. We rely on our merchandising team to order styles and products that our clients will purchase and we rely on our data science to inform the levels of inventory we purchase, including when to reorder items that are selling well and when to write off items that are not selling well. If our merchandise team does not predict client demand and tastes well or if our algorithms do not help us reorder the right products or write off the right products timely, we may not effectively manage our inventory and our operating results could be adversely affected.

Our business depends on a strong brand and we may not be able to maintain our brand and reputation.

We believe that maintaining the Stitch Fix brand and reputation is critical to driving client engagement and attracting clients and merchandise vendors. Building our brand will depend largely on our ability to continue to provide our clients with an engaging and personalized client experience, including valued personal styling services, high-quality merchandise, and appropriate price points, which we may not do successfully. Client complaints or negative publicity about our styling services, merchandise, delivery times, or client support, especially on social media platforms, could harm our reputation and diminish client use of our services, the trust that our clients place in Stitch Fix, and vendor confidence in us.

Our brand depends in part on effective client support, which requires significant personnel expense. Failure to manage or train our client support representatives properly or inability to handle client complaints effectively could negatively affect our brand, reputation, and operating results.

If we fail to cost-effectively promote and maintain the Stitch Fix brand, our business, financial condition, and operating results may be adversely affected.

If we fail to attract and retain key personnel, effectively manage succession, or hire, develop, and motivate our employees, our business, financial condition, and operating results could be adversely affected.

Our success, including our ability to anticipate and effectively respond to changing style trends and deliver a personalized styling experience, depends in part on our ability to attract and retain key personnel on our executive team and in our merchandising, algorithms, engineering, marketing, styling, and other organizations.

We do not have long-term employment or non-competition agreements with any of our personnel. Senior employees have left Stitch Fix in the past and others may in the future, which we cannot necessarily anticipate and whom we may not be able to promptly replace. For example, in December 2019, our Chief Financial Officer and our Chief Marketing Officer left the company. The loss of one or more of our key personnel or the inability to promptly identify a suitable successor to a key role could have an adverse effect on our business. In particular, our Founder and Chief Executive Officer has unique and valuable experience leading our company from its inception through today. If she were to depart or otherwise reduce her focus on Stitch Fix, our business may be disrupted. We do not currently maintain key-person life insurance policies on any member of our senior management team or other key employees.

We also face significant competition for personnel, particularly in the San Francisco Bay Area where our headquarters are located. To attract top talent, we have had to offer, and believe we will need to continue to offer, competitive compensation and benefits packages before we can validate the productivity of those employees. We may also need to increase our employee compensation levels in response to competition. We cannot be sure that we will be able to attract, retain, and motivate a sufficient number of qualified personnel in the future, or that the compensation costs of doing so will not adversely affect our operating results. Additionally, we may not be able to hire new employees quickly enough to meet our needs. If we fail to effectively manage our hiring needs or successfully integrate new hires, our efficiency, ability to meet forecasts, and employee morale, productivity, and retention could suffer, which may have an adverse effect on our business, financial condition, and operating results.

If we fail to effectively manage our stylists, our business, financial condition and operating results could be adversely affected.

More than 5,100 of our employees are stylists, most of whom work remotely and on a part-time basis for us and are paid hourly. They track and report the time they spend working for us. These employees are classified as nonexempt under federal and state law. If we fail to effectively manage our stylists, including by ensuring accurate tracking and reporting of their hours worked and proper processing of their hourly wages, then we may face claims alleging violations of wage and hour employment laws, including, without limitation, claims of back wages, unpaid overtime pay, and missed meal and rest periods. Any such employee litigation could be attempted on a class or representative basis. Such litigation can be expensive and time-consuming regardless of whether the claims against us are valid or whether we are ultimately determined to be liable, and could divert management's attention from our business. We could also be adversely affected by negative publicity, litigation costs resulting from the defense of these claims, and the diversion of time and resources from our operations.

Our business, including our costs and supply chain, is subject to risks associated with sourcing, manufacturing, and warehousing.

We currently source nearly all of the merchandise we offer from third-party vendors, many of whom use manufacturers in the same geographic region, and as a result we may be subject to price fluctuations, including from tariffs, or demand disruptions. Our operating results would be negatively impacted by increases in the cost of our merchandise, and we have no guarantees that costs will not rise. In addition, as we expand into new categories, product types, and geographies, we expect that we may not have strong purchasing power in these new areas, which could lead to higher costs than we have historically seen in our current categories. We may not be able to pass increased costs on to clients, which could adversely affect our operating results.

The fabrics used by our vendors are made of raw materials including petroleum-based products and cotton. Significant price fluctuations or shortages in petroleum, cotton, or other raw materials could significantly increase our cost of goods sold. Moreover, in the event of a significant disruption in the supply of the fabrics or raw materials used in the manufacture of the merchandise we offer, our vendors might not be able to locate alternative suppliers of materials of comparable quality at an acceptable price. For example, natural disasters have in the past increased raw material costs, impacting pricing with certain of our vendors, and caused shipping delays for certain of our merchandise. Similarly, the occurrence of a contagious disease or illness could cause delays or increase costs in the manufacture of certain merchandise. For example, the novel coronavirus has caused delays in some shipments from our suppliers. In addition, the labor costs to produce our products may fluctuate. Any delays, interruption, damage to, or increased costs in the manufacture of the merchandise we offer could result in higher prices to acquire the merchandise, or non-delivery of merchandise altogether, and could adversely affect our operating results.

In addition, we cannot guarantee that merchandise we receive from vendors will be of sufficient quality or free from damage, or that such merchandise will not be damaged during shipping, while stored in one of our fulfillment centers, or when returned by customers. While we take measures to ensure merchandise quality and avoid damage, including evaluating vendor product samples, conducting inventory inspections, and inspecting returned product, we cannot control merchandise while it is out of our possession or prevent all damage while in our fulfillment centers. We may incur additional expenses and our reputation could be harmed if clients and potential clients believe that our merchandise is not of high quality or may be damaged.

If we are unable to acquire new merchandise vendors or retain existing merchandise vendors, our operating results may be harmed.

We offer merchandise from hundreds of established and emerging brands. In order to continue to attract and retain quality merchandise brands, we must help merchandise vendors increase their sales and offer them a high-quality, cost-effective fulfillment process.

If we do not continue to acquire new merchandise vendors or retain our existing merchandise vendors on acceptable commercial terms, we may not be able to maintain a broad selection of products for our clients, and our operating results may suffer.

In addition, our Exclusive Brands are sourced from third-party vendors and contract manufacturers. The loss of one of our Exclusive Brand vendors, or our inability to source any additional vendors needed for our Exclusive Brands, could require us to source Exclusive Brand merchandise from another vendor or manufacturer, which could cause inventory delays, impact our clients' experiences, and otherwise harm our operating results.

Any failure by us or our vendors to comply with product safety, labor, or other laws, or our standard vendor terms and conditions, or to provide safe factory conditions for our or their workers, may damage our reputation and brand, and harm our business.

The merchandise we sell to our clients is subject to regulation by the Federal Consumer Product Safety Commission, the Federal Trade Commission, and similar state and international regulatory authorities. As a result, such merchandise could in the future be subject to recalls and other remedial actions. Product safety, labeling, and licensing concerns may result in us voluntarily removing selected merchandise from our inventory. Such recalls or voluntary removal of merchandise can result in, among other things, lost sales, diverted resources, potential harm to our reputation, and increased client service costs and legal expenses, which could have a material adverse effect on our operating results.

Some of the merchandise we sell, including the children's merchandise sold through Stitch Fix Kids, may expose us to product liability claims and litigation or regulatory action relating to personal injury or environmental or property damage. Although we maintain liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms or at all. In addition, some of our agreements with our vendors may not indemnify us from product liability for a particular vendor's merchandise or our vendors may not have sufficient resources or insurance to satisfy their indemnity and defense obligations.

We purchase our merchandise from numerous domestic and international vendors. Our standard vendor terms and conditions require vendors to comply with applicable laws. We have hired independent firms that conduct audits of the working conditions at the factories producing our Exclusive Brand products. If an audit reveals potential problems, we require that the vendor institute corrective action plans to bring the factory into compliance with our standards, or we may discontinue our relationship with the vendor. The loss of an Exclusive Brand vendor due to failure to comply with our standards could cause inventory delays, impact our clients' experiences, and otherwise harm our operating results. In addition, failure of our vendors to comply with applicable laws and regulations and contractual requirements could lead to litigation against us, resulting in increased legal expenses and costs. Furthermore, the failure of any such vendors to provide safe and humane factory conditions and oversight at their facilities could damage our reputation with clients or result in legal claims against us.

We may incur significant losses from fraud.

We have in the past incurred and may in the future incur losses from various types of fraud, including stolen credit card numbers, claims that a client did not authorize a purchase, merchant fraud, and clients who have closed bank accounts or have insufficient funds in open bank accounts to satisfy payments. In addition to the direct costs of such losses, if the fraud is related to credit card transactions and becomes excessive, it could result in us paying higher fees or losing the right to accept credit cards for payment. In addition, under current credit card practices, we are typically liable for fraudulent credit card transactions. Our failure to adequately prevent fraudulent transactions could damage our reputation, result in litigation or regulatory action, and lead to expenses that could substantially impact our operating results.

We are subject to payment-related risks.

We accept payments online via credit and debit cards and online payment systems such as PayPal, which subjects us to certain regulations and fraud. We may in the future offer new payment options to clients that would be subject to additional regulations

and risks. We pay interchange and other fees in connection with credit card payments, which may increase over time and adversely affect our operating results. While we use a third party to process payments, we are subject to payment card association operating rules and certification requirements, including the Payment Card Industry Data Security Standard and rules governing electronic funds transfers. If we fail to comply with applicable rules and regulations, we may be subject to fines or higher transaction fees and may lose our ability to accept online payments or other payment card transactions. If any of these events were to occur, our business, financial condition, and operating results could be adversely affected.

System interruptions that impair client access to our website or other performance failures in our technology infrastructure could damage our business.

The satisfactory performance, reliability, and availability of our website, mobile application, internal applications, and technology infrastructure are critical to our business. We rely on our website and mobile application to engage with our clients and sell them merchandise. We also rely on a host of internal custom-built applications to run critical business functions, such as styling, merchandise purchasing, warehouse operations, and order fulfillment. In addition, we rely on a variety of third-party, cloud-based solution vendors for key elements of our technology infrastructure. These systems are vulnerable to damage or interruption and we have experienced interruptions in the past. For example, in February 2017, as a result of an outage with Amazon Web Services, where much of our technology infrastructure is hosted, we experienced disruptions in applications that support our warehouse operations and order fulfillment that caused a temporary slowdown in the number of Fix shipments we were able to make. Interruptions may be caused by a variety of incidents, including human error, our failure to update or improve our proprietary systems, cyber attacks, fire, flood, earthquake, power loss, or telecommunications failures. Any failure or interruption of our website, mobile application, internal business applications, or our technology infrastructure could harm our ability to serve our clients, which would adversely affect our business and operating results.

Our use of personal information and other data subjects us to privacy laws and obligations, and our failure to comply with such obligations could harm our business.

We collect and maintain significant amounts of personal information and other data relating to our clients and employees. Numerous laws, rules, and regulations in the United States and internationally, including the EU's General Data Protection Regulation ("GDPR"), govern privacy and the collection, use, and protection of personal information. These laws, rules, and regulations evolve frequently and may be inconsistent from one jurisdiction to another or may be interpreted to conflict with our practices. Any failure or perceived failure by us or any third parties with which we do business to comply with these laws, rules, and regulations, or with other obligations to which we may be or become subject, may result in actions against us by governmental entities, private claims and litigation, fines, penalties, or other liabilities. Any such action would be expensive to defend, damage our reputation, and adversely affect our business and operating results. For example, the GDPR imposes more stringent data protection requirements and provides greater penalties for noncompliance than previous data protection laws. Further, the UK government withdrew from the EU on January 31, 2020, subject to a transition period that is set to end on December 31, 2020 ("Brexit"). Brexit has created uncertainty with regard to the regulation of data protection in the UK. In particular, it is uncertain whether the UK will enact data protection laws or regulations designed to be consistent with the GDPR and how data transfers to and from the UK will be regulated. Similarly, the State of California legislature passed the California Consumer Privacy Act of 2018 ("CCPA"), which became effective on January 1, 2020. The CCPA requires us to make new disclosures to consumers about our data collection, use, and sharing practices. The CCPA also allows consumers to opt out of certain data sharing with third parties, and provides a new cause of action for data breaches with the possibility of significant statutory damage awards. Additionally, the Federal Trade Commission and many state attorneys general are interpreting federal and state consumer protection laws as imposing standards for the online collection, use, dissemination, and security of data.

Unfavorable changes or failure by us to comply with evolving internet and eCommerce regulations could substantially harm our business and operating results.

We are subject to general business regulations and laws as well as regulations and laws specifically governing the internet and eCommerce. These regulations and laws may involve taxes, privacy and data security, consumer protection, the ability to collect and/or share necessary information that allows us to conduct business on the internet, marketing communications and advertising, content protection, electronic contracts, or gift cards. Furthermore, the regulatory landscape impacting internet and eCommerce businesses is constantly evolving. For example, California's Automatic Renewal Law requires companies to adhere to enhanced disclosure requirements when entering into automatically renewing contracts with consumers. As a result, a wave of consumer class action lawsuits was brought against companies that offer online products and services on a subscription or recurring basis. Any failure, or perceived failure, by us to comply with any of these laws or regulations could result in damage to our reputation, lost business, and proceedings or actions against us by governmental entities or others, which could impact our operating results.

If the use of “cookie” tracking technologies is further restricted, regulated, or blocked, or if changes in technology cause cookies to become less reliable or acceptable as a means of tracking consumer behavior, the amount or accuracy of internet user information we collect would decrease, which could harm our business and operating results.

Cookies are small data files that are sent by websites and stored locally on an internet user's computer or mobile device. We, and third parties who work on our behalf, collect data via cookies that is used to track the behavior of visitors to our sites, to provide a more personal and interactive experience, and to increase the effectiveness of our marketing. However, internet users can easily disable, delete, and block cookies directly through browser settings or through other software, browser extensions, or hardware platforms that physically block cookies from being created and stored.

Privacy regulations restrict how we deploy our cookies and this could potentially increase the number of internet users that choose to proactively disable cookies on their systems. In the EU, the Directive on Privacy and Electronic Communications requires users to give their consent before cookie data can be stored on their local computer or mobile device. Users can decide to opt out of nearly all cookie data creation, which could negatively impact our operating results. We may have to develop alternative systems to determine our clients' behavior, customize their online experience, or efficiently market to them if clients block cookies or regulations introduce additional barriers to collecting cookie data.

Material weaknesses in our internal control over financial reporting may cause us to fail to timely and accurately report our financial results or result in a material misstatement of our financial statements.

As of August 3, 2019, we had material weaknesses in our internal control over financial reporting, as defined in the standards established by the Sarbanes-Oxley Act of 2002, (the “Sarbanes-Oxley Act”). A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our financial statements would not be prevented or detected on a timely basis.

As of August 3, 2019, we identified a material weakness in our internal control over financial reporting associated with certain outsourced IT service providers and related material weaknesses in components of the internal control framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Specifically, we rely on a variety of outsourced IT service providers for key elements of the technology infrastructure impacting our financial reporting process. Certain of these outsourced IT service providers could not provide System and Organization Controls reports or, if they did, they were for periods that did not closely align with our fiscal year end. As such, we did not have controls designed to assess the design and operation of internal controls pertaining to these outsourced IT service providers over our period of reliance. Given that management did not effectively assess the design and operation of certain outsourced IT service providers' internal controls, certain of our controls over IT systems and business processes were also ineffective, to the extent that they rely upon information that was subject to the outsourced IT service providers' control environment. These deficiencies impact substantially all financial statement account balances and disclosures, and when aggregated represent a material weakness in internal control over financial reporting. Given the outsourced IT service providers material weakness, we identified related COSO material weaknesses, including (a) deficiencies in the principles associated with the control activities component of the COSO framework relating to: (i) selecting and developing control activities and information technology that contribute to the mitigation of risks and support achievement of objectives, and (ii) selecting and developing general control activities over technology to support the achievement of objectives; and (b) deficiencies in the principles associated with the monitoring component of the COSO framework relating to selecting, developing, and performing ongoing evaluation to ascertain whether the components of internal control are present and functioning.

We have initiated and will continue to implement remediation plans to address the outsourced IT service providers and related COSO material weaknesses including, but not limited to, expanding controls and/or applying other appropriate procedures to address the design and operation of internal controls relating to certain outsourced IT service providers and enhancing procedures for the identification of control activities and monitoring of control performance to ensure that the components of internal control relating to certain outsourced IT service providers are present and functioning.

In the remainder of fiscal year 2020, we intend to continue executing these plans to remediate the material weaknesses. However, we cannot be certain that the measures we have taken or may take in the future will ensure that we establish and maintain adequate controls over our financial processes and reporting in the future.

If we identify future material weaknesses in our internal controls over financial reporting or fail to meet the demands placed upon us as a public company, including the requirements of the Sarbanes-Oxley Act, we may be unable to accurately report our financial results or report them within the timeframes required by law or stock exchange regulations. Failure to comply with Section 404 of the Sarbanes-Oxley Act could also potentially subject us to sanctions or investigations by the SEC or other regulatory authorities. If additional material weaknesses exist or are discovered in the future, and we are unable to remediate any such material weakness, our reputation, financial condition, and operating results could suffer.

Shipping is a critical part of our business and any changes in our shipping arrangements or any interruptions in shipping could adversely affect our operating results.

We currently rely on two major vendors for our shipping. If we are not able to negotiate acceptable pricing and other terms with these entities or they experience performance problems or other difficulties, it could negatively impact our operating results and our clients' experience. In addition, our ability to receive inbound inventory efficiently and ship merchandise to clients may be negatively affected by inclement weather, fire, flood, power loss, earthquakes, labor disputes, acts of war or terrorism, and similar factors. For example, in the past, strikes at major international shipping ports have impacted our supply of inventory from our vendors. In addition, as a result of Hurricane Harvey in September 2017, one of our shipping vendors was unable to deliver Fixes to certain affected areas for several weeks, resulting in delivery delays and Fix cancellations. We are also subject to risks of damage or loss during delivery by our shipping vendors. If our merchandise is not delivered in a timely fashion or is damaged or lost during the delivery process, our clients could become dissatisfied and cease using our services, which would adversely affect our business and operating results.

Our operating results could be adversely affected by natural disasters, public health crises, political crises, or other catastrophic events.

Our principal offices and one of our fulfillment centers are located in the San Francisco Bay Area, which has a history of earthquakes, and are thus vulnerable to damage. We also operate offices and fulfillment centers in other regions. Natural disasters, such as earthquakes, hurricanes, tornadoes, floods, fires, and other adverse weather and climate conditions; unforeseen public health crises, such as the novel coronavirus or other pandemics and epidemics; political crises, such as terrorist attacks, war, and other political instability; or other catastrophic events, whether occurring in the United States or internationally, could disrupt our operations in or cause us to close one or more of our offices and fulfillment centers or could disrupt, delay, or otherwise negatively impact the operations of one or more of our third-party providers or vendors. For example, several companies are recommending or requiring that employees work from home. We are continuing to monitor the situation and may require employees to work from home, which may negatively impact productivity. Furthermore, these types of events could impact our merchandise supply chain, including our ability to ship merchandise to clients from or to the impacted region, and could impact our ability or the ability of third parties to operate our sites and ship merchandise. In addition, these types of events could negatively impact consumer spending in the impacted regions. To the extent any of these events occur, our business and operating results could be adversely affected.

If we cannot successfully protect our intellectual property, our business would suffer.

We rely on trademark, copyright, trade secrets, patents, confidentiality agreements, and other practices to protect our brands, proprietary information, technologies, and processes. Our principal trademark assets include the registered trademarks "Stitch Fix" and "Fix," multiple private label clothing and accessory brand names, and our logos and taglines. Our trademarks are valuable assets that support our brand and consumers' perception of our services and merchandise. We also hold the rights to the "stitchfix.com" internet domain name and various other related domain names, which are subject to internet regulatory bodies and trademark and other related laws of each applicable jurisdiction. If we are unable to protect our trademarks or domain names in the United States, the UK, or in other jurisdictions in which we may ultimately operate, our brand recognition and reputation would suffer, we would incur significant expense establishing new brands and our operating results would be adversely impacted.

We currently have three patents issued and a number of additional patent applications pending in the United States. We have also filed patent applications in the People's Republic of China. The patents we own and those that may be issued in the future may not provide us with any competitive advantages or may be challenged by third parties, and our patent applications may never be granted. Even if issued, there can be no assurance that these patents will adequately protect our intellectual property or survive a legal challenge, as the legal standards relating to the validity, enforceability, and scope of protection of patent and other intellectual property rights are uncertain. Our limited patent protection may restrict our ability to protect our technologies and processes from competition. We primarily rely on trade secret laws to protect our technologies and processes, including the algorithms we use throughout our business. Others may independently develop the same or similar technologies and processes, or may improperly acquire and use information about our technologies and processes, which may allow them to provide a service similar to ours, which could harm our competitive position.

We may be required to spend significant resources to monitor and protect our intellectual property rights, and the efforts we take to protect our proprietary rights may not be sufficient.

We may be accused of infringing intellectual property rights of third parties.

We are also at risk of claims by others that we have infringed their copyrights, trademarks, or patents, or improperly used or disclosed their trade secrets. The costs of supporting any litigation or disputes related to these claims can be considerable, and we cannot assure you that we will achieve a favorable outcome of any such claim. If any such claims are valid, we may be compelled to cease our use of such intellectual property and pay damages, which could adversely affect our business. Even if such claims are not valid, defending them could be expensive and distracting, adversely affecting our operating results.

Changes in U.S. tax or tariff policy regarding apparel produced in other countries could adversely affect our business.

A predominant portion of the apparel we sell is originally manufactured in countries other than the United States. International trade disputes that result in tariffs and other protectionist measures could adversely affect our business, including disruption and cost increases in our established patterns for sourcing our merchandise and increased uncertainties in planning our sourcing strategies and forecasting our margins. For example, the U.S. government recently imposed significant new tariffs on China related to the importation of certain product categories, including apparel, footwear, and other goods. A substantial portion of our products are manufactured in China. As a result of these tariffs, we expect our cost of goods imported from China to increase, which may negatively impact our sales or profitability. Although we are actively reviewing options to mitigate our exposure to current or potential tariffs, there can be no assurance that we will be able to offset any increased costs. Other changes in U.S. tariffs, quotas, trade relationships, or tax provisions could also reduce the supply of goods available to us or increase our cost of goods. Although such changes would have implications across the entire industry, we may fail to effectively adapt to and manage the adjustments in strategy that would be necessary in response to those changes. In addition to the general uncertainty and overall risk from potential changes in U.S. laws and policies, as we make business decisions in the face of such uncertainty, we may incorrectly anticipate the outcomes, miss out on business opportunities, or fail to effectively adapt our business strategies and manage the adjustments that are necessary in response to those changes. These risks could adversely affect our revenues, reduce our profitability, and negatively impact our business.

We could be required to collect additional sales taxes or be subject to other tax liabilities that may increase the costs our clients would have to pay for our offering and adversely affect our operating results.

In general, we have not historically collected state or local sales, use, or other similar taxes in any jurisdictions in which we do not have a tax nexus, in reliance on court decisions or applicable exemptions that restrict or preclude the imposition of obligations to collect such taxes with respect to online sales of our products. In addition, we have not historically collected state or local sales, use, or other similar taxes in certain jurisdictions in which we do have a physical presence, in reliance on applicable exemptions. On June 21, 2018, the U.S. Supreme Court decided, in *South Dakota v. Wayfair, Inc.*, that state and local jurisdictions may, at least in certain circumstances, enforce a sales and use tax collection obligation on remote vendors that have no physical presence in such jurisdiction. A number of states have already begun, or have positioned themselves to begin, requiring sales and use tax collection by remote vendors and/or by online marketplaces. The details and effective dates of these collection requirements vary from state to state. While we now collect, remit, and report sales tax in all states that impose a sales tax, it is still possible that one or more jurisdictions may assert that we have liability for previous periods for which we did not collect sales, use, or other similar taxes, and if such an assertion or assertions were successful it could result in substantial tax liabilities, including for past sales taxes and penalties and interest, which could materially adversely affect our business, financial condition, and operating results.

Federal income tax reform could have unforeseen effects on our financial condition and results of operations.

The Tax Cuts and Jobs Act (the "Tax Act") was enacted on December 22, 2017, and contains many significant changes to U.S. federal tax laws. The Tax Act requires complex computations that were not previously provided for under U.S. tax law. We provided for an estimated effect of the Tax Act in our financial statements for the period ended July 28, 2018. The Tax Act requires significant judgments to be made in the interpretation of the law and significant estimates in the calculation of the provision for income taxes. However, additional guidance may be issued by the Internal Revenue Service ("IRS"), the Department of the Treasury, or other governing body that may significantly differ from our interpretation of the law, which may result in a material adverse effect on our business, cash flow, results of operations, or financial conditions.

We may be subject to additional tax liabilities, which could adversely affect our operating results.

We are subject to income- and non-income-based taxes in the United States under federal, state, and local jurisdictions and in the UK. The governing tax laws and applicable tax rates vary by jurisdiction and are subject to interpretation. Various tax authorities may disagree with tax positions we take and if any such tax authorities were to successfully challenge one or more of our tax positions, the results could have a material effect on our operating results. Further, the ultimate amount of tax payable in a given financial statement period may be materially impacted by sudden or unforeseen changes in tax laws, changes in the mix and level of earnings by taxing jurisdictions, or changes to existing accounting rules or regulations. The determination of our overall provision for income and other taxes is inherently uncertain as it requires significant judgment around complex transactions and calculations. As a result, fluctuations in our ultimate tax obligations may differ materially from amounts recorded in our financial statements and could adversely affect our business, financial condition, and operating results in the periods for which such determination is made.

We may require additional capital to support business growth, and this capital might not be available or may be available only by diluting existing stockholders.

We intend to continue making investments to support our business growth and may require additional funds to support this growth and respond to business challenges, including the need to develop our services, expand our inventory, enhance our operating infrastructure, expand the markets in which we operate, and potentially acquire complementary businesses and technologies. Accordingly, we may need to engage in equity or debt financings to secure additional funds. If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences, and privileges superior to those of holders of our Class A common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to our capital-raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities. In addition, we may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly limited, and our business and prospects could fail or be adversely affected.

Our failure to adequately and effectively staff our fulfillment centers, through third parties or with our own employees, could adversely affect our client experience and operating results.

We currently receive and distribute merchandise at six fulfillment centers in the United States, one of which is operated by a third party. We also have a seventh fulfillment center in the UK, which is operated by the same third party that we use in the United States. If we or our third-party partner are unable to adequately staff our fulfillment centers to meet demand or if the cost of such staffing is higher than historical or projected costs due to mandated wage increases, regulatory changes, international expansion, or other factors, our operating results could be harmed. In addition, operating fulfillment centers comes with potential risks, such as workplace safety issues and employment claims for the failure or alleged failure to comply with labor laws or laws respecting union organizing activities. Furthermore, if we fail to comply with wage and hour laws for our nonexempt employees, many of whom work in our fulfillment centers, we could be subject to legal risk, including claims for back wages, unpaid overtime pay, and missed meal and rest periods, which could be on a class or representative basis. Any such issues may result in delays in shipping times, reduced packing quality, or costly litigation, and our reputation and operating results may be harmed.

By using a third-party operator for some of our fulfillment centers, we also face additional risks associated with not having complete control over operations at those fulfillment centers. Any deterioration in the financial condition or operations of that third party, or the loss of the relationship with that third party, would have significant impact on our operations.

Some of our software and systems contain open source software, which may pose particular risks to our proprietary applications.

We use open source software in the applications we have developed to operate our business and will use open source software in the future. We may face claims from third parties demanding the release or license of the open source software or derivative works that we developed from such software (which could include our proprietary source code) or otherwise seeking to enforce the terms of the applicable open source license. These claims could result in litigation and could require us to purchase a costly license, publicly release the affected portions of our source code, or cease offering the implicated solutions unless and until we can re-engineer them to avoid infringement. In addition, our use of open source software may present additional security risks because the source code for open source software is publicly available, which may make it easier for hackers and other third parties to determine how to breach our website and systems that rely on open source software. Any of these risks could be difficult to eliminate or manage and, if not addressed, could have an adverse effect on our business and operating results.

Adverse litigation judgments or settlements resulting from legal proceedings in which we are or may be involved could expose us to monetary damages or limit our ability to operate our business.

Currently, we are involved in various legal proceedings, including the securities litigation and other matters described elsewhere in this Quarterly Report. We have in the past and may in the future become involved in other private actions, collective actions, investigations, and various other legal proceedings by clients, employees, suppliers, competitors, government agencies, stockholders, or others. The results of any such litigation, investigations, and other legal proceedings are inherently unpredictable and expensive. Any claims against us, whether meritorious or not, could be time consuming, result in costly litigation, damage our reputation, require significant amounts of management time, and divert significant resources. If any of these legal proceedings were to be determined adversely to us, or we were to enter into a settlement arrangement, we could be exposed to monetary damages or limits on our ability to operate our business, which could have an adverse effect on our business, financial condition, and operating results.

If we are unable to make acquisitions and investments, or successfully integrate them into our business, our business could be harmed.

As part of our business strategy, we may acquire other companies or businesses. However, we may not be able to find suitable acquisition candidates, and we may not be able to complete acquisitions on favorable terms, if at all. Acquisitions involve numerous risks, any of which could harm our business and negatively affect our operating results, including:

- difficulties in integrating the technologies, operations, existing contracts, and personnel of an acquired company;
- difficulties in supporting and transitioning clients and suppliers, if any, of an acquired company;
- diversion of financial and management resources from existing operations or alternative acquisition opportunities;
- failure to realize the anticipated benefits or synergies of a transaction;
- failure to identify all of the problems, liabilities, or other shortcomings or challenges of an acquired company or technology, including issues related to intellectual property, regulatory compliance practices, revenue recognition or other accounting practices, or employee or client issues;
- risks of entering new markets in which we have limited or no experience;
- potential loss of key employees, clients, vendors, and suppliers from either our current business or an acquired company's business;
- inability to generate sufficient revenue to offset acquisition costs;
- additional costs or equity dilution associated with funding the acquisition; and
- possible write-offs or impairment charges relating to acquired businesses.

Risks Relating to Ownership of Our Class A Common Stock

The market price of our Class A common stock may continue to be volatile or may decline steeply or suddenly regardless of our operating performance and we may not be able to meet investor or analyst expectations. You may lose all or part of your investment.

The market price of our Class A common stock may fluctuate or decline significantly in response to numerous factors, many of which are beyond our control, including:

- actual or anticipated fluctuations in our client base, the level of client engagement and client acquisition, revenue, or other operating results;
- variations between our actual operating results and the expectations of securities analysts, investors, and the financial community;
- any forward-looking financial or operating information we may provide to the public or securities analysts, any changes in this information, or our failure to meet expectations based on this information;
- actions of securities analysts who initiate or maintain coverage of us, changes in financial estimates by any securities analysts who follow our company, or our failure to meet these estimates or the expectations of investors;
- whether investors or securities analysts view our stock structure unfavorably, particularly our dual-class structure and the significant voting control of our executive officers, directors, and their affiliates;
- additional shares of our Class A common stock being sold into the market by us or our existing stockholders, or the anticipation of such sales;

- announcements by us or our competitors of significant products or features, technical innovations, acquisitions, strategic partnerships, joint ventures, or capital commitments;
- changes in operating performance and stock market valuations of companies in our industry, including our vendors and competitors;
- price and volume fluctuations in the overall stock market, including as a result of trends in the economy as a whole;
- lawsuits threatened or filed against us;
- developments in new legislation and pending lawsuits or regulatory actions, including interim or final rulings by judicial or regulatory bodies; and
- other events or factors, including those resulting from war or incidents of terrorism, or responses to these events.

In addition, extreme price and volume fluctuations in the stock markets have affected and continue to affect many eCommerce and other technology companies' stock prices. Often, their stock prices have fluctuated in ways unrelated or disproportionate to the companies' operating performance. In the past, stockholders have filed securities class action litigation following periods of market volatility. For example, beginning in October 2018, we and certain of our directors and officers were sued in putative class action and derivative lawsuits alleging violations of the federal securities laws for allegedly making materially false and misleading statements. We may be the target of additional litigation of this type in the future as well. Such securities litigation could subject us to substantial costs, divert resources and the attention of management from our business, and seriously harm our business.

Moreover, because of these fluctuations, comparing our operating results on a period-to-period basis may not be meaningful. You should not rely on our past results as an indication of our future performance. This variability and unpredictability could also result in our failing to meet the expectations of industry or financial analysts or investors for any period. If our revenue or operating results fall below the expectations of analysts or investors or below any forecasts we may provide to the market, or if the forecasts we provide to the market are below the expectations of analysts or investors, the price of our Class A common stock could decline substantially. Such a stock price decline could occur even when we have met any previously publicly stated revenue or earnings forecasts that we may provide.

An active trading market for our Class A common stock may not be sustained.

Our Class A common stock is currently listed on the Nasdaq Global Select Market ("Nasdaq") under the symbol "SFIX" and trades on that market and others. We cannot assure you that an active trading market for our Class A common stock will be sustained. Accordingly, we cannot assure you of the liquidity of any trading market, your ability to sell your shares of our Class A common stock when desired or the prices that you may obtain for your shares.

Future sales of shares by existing stockholders could cause our stock price to decline.

If our existing stockholders sell or indicate an intention to sell, substantial amounts of our Class A common stock in the public market, the trading price of our Class A common stock could decline. In addition, shares underlying any outstanding options and restricted stock units will become eligible for sale if exercised or settled, as applicable, and to the extent permitted by the provisions of various vesting agreements and Rule 144 of the Securities Act. All the shares of Class A and Class B common stock subject to stock options and restricted stock units outstanding and reserved for issuance under our 2011 Equity Incentive Plan, as amended, our 2017 Incentive Plan, and our 2019 Inducement Plan have been registered on Form S-8 under the Securities Act and such shares are eligible for sale in the public markets, subject to Rule 144 limitations applicable to affiliates. If these additional shares are sold, or if it is perceived that they will be sold in the public market, the trading price of our Class A common stock could decline.

The dual class structure of our common stock concentrates voting control with our executive officers, directors and their affiliates, and may depress the trading price of our Class A common stock.

Our Class B common stock has ten votes per share and our Class A common stock has one vote per share. As a result, the holders of our Class B common stock, including our directors, executive officers, and their affiliates, are able to exercise considerable influence over matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger or other sale of our company or our assets, even if their stock holdings represent less than 50% of the outstanding shares of our capital stock. As of March 4, 2020, 46,688,808 of our 102,476,609 shares outstanding were held by our directors, executive officers, and their affiliates, and 45,838,734 of such shares held by our directors, executive officers, and their affiliates were shares of Class B common stock. This concentration of ownership will limit the ability of other stockholders to influence corporate matters and may cause us to make strategic decisions that could involve risks to you or that may not be aligned with your interests. This control may adversely affect the market price of our Class A common stock.

In addition, in July 2017, FTSE Russell and Standard & Poor's announced that they would cease to allow most newly public companies utilizing dual or multi-class capital structures to be included in their indices. Affected indices include the S&P 500, S&P MidCap 400, and S&P SmallCap 600, which together make up the S&P Composite 1500. Under the announced policies, our dual class capital structure currently makes us ineligible for inclusion in Standard & Poor's indices and, as a result, mutual funds, exchange-traded funds, and other investment vehicles that attempt to passively track the S&P indices will not be investing in our stock. These policies are new and it is unclear what effect, if any, they will have on the valuations of publicly traded companies excluded from the indices, but it is possible that they may depress these valuations compared to those of other similar companies that are included.

If securities or industry analysts either do not publish research about us or publish inaccurate or unfavorable research about us, our business, or our market, or if they change their recommendations regarding our common stock adversely, the trading price or trading volume of our Class A common stock could decline.

The trading market for our Class A common stock is influenced in part by the research and reports that securities or industry analysts may publish about us, our business, our market, or our competitors. If one or more of the analysts initiate research with an unfavorable rating or downgrade our Class A common stock, provide a more favorable recommendation about our competitors, or publish inaccurate or unfavorable research about our business, our Class A common stock price would likely decline. If any analyst who may cover us were to cease coverage of us or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause the trading price or trading volume of our Class A common stock to decline.

We do not currently intend to pay dividends on our Class A common stock and, consequently, your ability to achieve a return on your investment will depend on appreciation of the value of our Class A common stock.

We have never declared or paid cash dividends on our capital stock. We currently intend to retain any future earnings to finance the operation and expansion of our business, and we do not expect to pay any cash dividends on our Class A common stock in the foreseeable future. As a result, any investment return our Class A common stock will depend upon increases in the value for our Class A common stock, which is not certain.

Future securities sales and issuances could result in significant dilution to our stockholders and impair the market price of our Class A common stock.

We may issue additional equity securities in the future. We also issue common stock to our employees and others under our incentive plans. Future issuances of shares of our Class A common stock or the conversion of a substantial number of shares of our Class B common stock, or the perception that these sales or conversions may occur, could depress the market price of our Class A common stock and result in dilution to existing holders of our Class A common stock. Also, to the extent outstanding options to purchase our shares of our Class A or Class B common stock are exercised or options or other stock-based awards are issued or become vested, there will be further dilution. The amount of dilution could be substantial depending upon the size of the issuances or exercises. Furthermore, we may issue additional equity securities that could have rights senior to those of our Class A common stock. As a result, holders of our Class A common stock bear the risk that future issuances of debt or equity securities may reduce the value of our Class A common stock and further dilute their ownership interest.

The requirements of being a public company may strain our resources, result in more litigation, and divert management's attention.

As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act, the listing requirements of the Nasdaq, and other applicable securities rules and regulations. Complying with these rules and regulations has increased and will continue to increase our legal and financial compliance costs, make some activities more difficult, time consuming, or costly, and increase demand on our systems and resources. To address these challenges, we have expanded our finance and accounting teams. The Exchange Act requires, among other things, that we file annual, quarterly, and current reports with respect to our business and operating results. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. We are required to disclose changes made in our internal control and procedures on a quarterly basis. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight may be required. As a result, management's attention may be diverted from other business concerns, which could adversely affect our business and operating results. We may need to hire additional employees or engage outside consultants to comply with these requirements, which will increase our costs and expenses.

In addition, changing laws, regulations, and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time consuming. These laws, regulations, and standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and

governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We intend to invest resources to comply with evolving laws, regulations, and standards, and this investment may result in increased general and administrative expenses and a diversion of management's time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations, and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to their application and practice, regulatory authorities may initiate legal proceedings against us and our business may be adversely affected.

These new rules and regulations may make it more expensive for us to obtain director and officer liability insurance and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These factors could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee and compensation committee, and qualified executive officers.

By disclosing information in filings required of a public company, our business and financial condition are more visible, which we believe may result in threatened or actual litigation, including by competitors and other third parties. If those claims are successful, our business could be seriously harmed. Even if the claims do not result in litigation or are resolved in our favor, the time and resources needed to resolve them could divert our management's resources and seriously harm our business.

Delaware law and provisions in our amended and restated certificate of incorporation and amended and restated bylaws could make a merger, tender offer, or proxy contest difficult, thereby depressing the trading price of our Class A common stock.

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that could depress the trading price of our Class A common stock by acting to discourage, delay, or prevent a change of control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions include the following:

- establish a classified board of directors so that not all members of our board of directors are elected at one time;
- permit the board of directors to establish the number of directors and fill any vacancies and newly created directorships;
- provide that directors may only be removed for cause;
- require super-majority voting to amend some provisions in our certificate of incorporation and bylaws;
- authorize the issuance of "blank check" preferred stock that our board of directors could use to implement a stockholder rights plan;
- eliminate the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the board of directors is expressly authorized to make, alter, or repeal our bylaws;
- restrict the forum for certain litigation against us to Delaware;
- reflect the dual class structure of our common stock; and
- establish advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted upon by stockholders at annual stockholder meetings.

Any provision of our amended and restated certificate of incorporation or amended and restated bylaws that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our Class A common stock.

Our amended and restated certificate of incorporation provides that the Court of Chancery of the State of Delaware and, to the extent enforceable, the federal district courts of the United States are the exclusive forums for substantially all disputes between us and our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers, or employees.

Our amended and restated certificate of incorporation provides that the Court of Chancery of the State of Delaware is the exclusive forum for the following types of actions or proceedings under Delaware statutory or common law:

- any derivative action or proceeding brought on our behalf;
- any action asserting a breach of fiduciary duty;

- any action asserting a claim against us arising under the Delaware General Corporation Law, our amended and restated certificate of incorporation, or our amended and restated bylaws; and
- any action asserting a claim against us that is governed by the internal affairs doctrine.

This provision does not apply to suits brought to enforce a duty or liability created by the Exchange Act or any other claim for which the U.S. federal courts have exclusive jurisdiction. Our amended and restated certificate of incorporation further provides that the federal district courts of the United States will be the exclusive forum for resolving any complaint asserting a cause of action arising under the Securities Act, subject to and contingent upon a final adjudication in the State of Delaware of the enforceability of such exclusive forum provision.

These exclusive forum provisions may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers, or other employees, which may discourage lawsuits against us and our directors, officers, and other employees. We are currently subject to a stockholder derivative action regarding the validity of the federal exclusive forum provision. In December 2018, the Court of Chancery of the State of Delaware issued an opinion holding that the provision stating that U.S. federal district courts are the exclusive forum for resolving any complaint asserting a cause of action arising under the Securities Act is not enforceable. We have appealed this decision to the Delaware Supreme Court. If the Delaware Supreme Court ultimately affirms the Court of Chancery's decision, we may be required to pay the plaintiffs' attorneys fees and future stockholder disputes arising under the Securities Act may be more costly for us to resolve.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number	Description	Incorporation By Reference				Filed or Furnished Herewith
		Form	SEC File No.	Exhibit	Filing Date	
3.1	Amended and Restated Certificate of Incorporation of Stitch Fix, Inc.	8-K	001-38291	3.1	11/21/2017	
3.2	Amended and Restated Bylaws of Stitch Fix, Inc.	8-K	001-38291	3.2	11/21/2017	
10.1+	Offer Letter, by and between Stitch Fix, Inc. and Elizabeth Spaulding, dated November 7, 2019.	10-Q	001-38291	10.4	12/10/2019	
10.2+	Separation Agreement, by and between Stitch Fix, Inc. and Paul Yee, dated December 9, 2019.	10-Q	001-38291	10.5	12/10/2019	
31.1	Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.2	Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.1*	Certification of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
101.INS	Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document).					X
101.SCH	Inline XBRL Taxonomy Extension Schema Document					X
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document					X
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document					X
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document					X
104	Cover Page Interactive Data File (the cover page interactive data file does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document).					

* The certification attached as Exhibit 32.1 accompanying this Quarterly Report on Form 10-Q is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Stitch Fix, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

+ Indicates management contract or compensatory plan.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

Date: March 10, 2020

Stitch Fix, Inc.

By: /s/ Michael Smith

Michael Smith

President, Chief Operating Officer, and Interim Chief
Financial Officer

(Principal Financial and Accounting Officer)

CERTIFICATION

I, Katrina Lake, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Stitch Fix, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 10, 2020

/s/ Katrina Lake

Katrina Lake

Founder, Chief Executive Officer and Director
(Principal Executive Officer)

CERTIFICATION

I, Michael Smith, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Stitch Fix, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 10, 2020

/s/ Michael Smith

Michael Smith

President, Chief Operating Officer, and Interim Chief
Financial Officer

(Principal Financial and Accounting Officer)

CERTIFICATION

In connection with the Quarterly Report of Stitch Fix, Inc. (the “Company”) on Form 10-Q for the period ended February 1, 2020, as filed with the Securities and Exchange Commission (the “Periodic Report”), we, Katrina Lake, Chief Executive Officer of the Company, and Michael Smith, Chief Financial Officer of the Company, each certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of our knowledge:

1. The Periodic Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Exchange Act; and
2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 10, 2020

/s/ Katrina Lake

Katrina Lake
Founder, Chief Executive Officer and Director
(Principal Executive Officer)

/s/ Michael Smith

Michael Smith
President, Chief Operating Officer, and Interim Chief Financial
Officer
(Principal Financial and Accounting Officer)