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 October 3, 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: 001-37444

FITBIT, INC.
(Exact name of registrant as specified in its charter)

Delaware	**20-8920744**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
199 Fremont Street, 14th Floor San Francisco, California	**94105**
(Address of principal executive offices)	*(Zip Code)*

(415) 513-1000
(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, $0.0001 par value	**FIT**	**The New York Stock Exchange**

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, 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	☑	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

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 Exchange Act).

Yes ☐ No ☑

As of October 28, 2020, there were 244,867,751 shares of the registrant's Class A common stock outstanding and 27,600,601 shares of the registrant's Class B common stock outstanding.

TABLE OF CONTENTS

NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which involve risks and uncertainties. All statements contained in this Quarterly Report on Form 10-Q other than statements of historical fact, including statements regarding our future results of operations and financial position, our business strategy and plans, and our objectives for future operations, are forward-looking statements. The words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," "forecast," and similar expressions are intended to identify forward-looking statements. Forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements about:

- *the expected timing and anticipated closing of our pending acquisition by Google LLC;*
- *the impact of the COVID-19 pandemic on our business and our response to it;*
- *our future revenue, cost of revenue, gross margin, operating expenses, including personnel costs, research and development expense, sales and marketing expense, and general and administrative expense;*
- *continued investments in research and development, sales and marketing, and international expansion, and the impact of those investments;*
- *competitors and competition in our markets;*
- *our ability to anticipate and satisfy consumer preferences;*
- *our smartwatches and their market acceptance and future potential;*
- *our ability to develop and introduce new products and services, including recurring consumer services revenue offerings, and improve our existing products and services;*
- *our ability to grow and engage our user base;*
- *our expectations to derive the substantial majority of our revenue from sales of devices;*
- *trends in our quarterly operating results and other operating metrics;*
- *the impact of tariffs or other restrictions placed on our products imported into the United States from other countries, including China;*
- *the impact of changes in tax laws on our operating results;*
- *the impact of tax relief or other government benefits enacted in response to the COVID-19 pandemic;*
- *the impact of our adoption of accounting pronouncements;*
- *our ability to forecast demand and manage inventory;*
- *our ability to maintain and promote our brand and expand brand awareness;*
- *our ability to detect, prevent, or fix defects;*
- *our ability to obtain products and services from third-party suppliers, contract manufacturers, and logistics providers;*
- *our ability to adequately assess and mitigate credit and other risks in our sales channels;*
- *legal proceedings and the impact of such proceedings;*
- *the effect of seasonality on our results of operations;*
- *our ability to attract and retain highly skilled employees;*
- *the impact of our acquisitions in enhancing the features and functionality of our devices;*
- *the impact of foreign currency exchange rates;*
- *the sufficiency of our existing cash and cash equivalent balances and cash flow from operations to meet our working capital and capital expenditure needs through the anticipated closing of the Merger transaction with Google; and*
- *general market, political, economic and business conditions, including as may be impacted by the COVID-19 pandemic, and our ability to anticipate and respond to these conditions*.

We caution you that the foregoing list does not contain all of the forward-looking statements made in this Quarterly Report on Form 10-Q.

You should not rely upon forward-looking statements as predictions of future events. We have based the forward-looking statements contained in this Quarterly Report on Form 10-Q primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition, operating results, and prospects. The outcome of the events described in these forward-looking statements is subject to risks, uncertainties, and other factors described in the section titled "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible for us to predict all risks and uncertainties that could have an impact on the forward-looking statements contained in this Quarterly Report on Form 10-Q. We cannot assure you that the results, events, and circumstances reflected in the forward-looking statements will be achieved or occur, and actual results, events, or circumstances could differ materially from those described in the forward-looking statements.

The forward-looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statements made in this Quarterly Report on Form 10-Q to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect new information or the occurrence of unanticipated events, except as required by law. We may not actually achieve the plans, intentions, or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures, or investments we may make.

PART I. FINANCIAL INFORMATION
Item 1. Condensed Consolidated Financial Statements

FITBIT, INC.
Condensed Consolidated Balance Sheets
(in thousands)
(unaudited)

	October 3, 2020	December 31, 2019
Assets		
Current assets:		
Cash and cash equivalents	$ 373,384	$ 334,479
Marketable securities	43,051	184,023
Accounts receivable, net	358,451	435,269
Inventories	98,996	136,752
Income tax receivable	40,252	573
Prepaid expenses and other current assets	35,013	28,656
Total current assets	949,147	1,119,752
Property and equipment, net	74,684	82,756
Operating lease right-of-use assets	62,144	70,225
Goodwill	64,812	64,812
Intangible assets, net	8,395	16,746
Deferred tax assets	15,330	4,111
Other assets	12,334	9,684
Total assets	$ 1,186,846	$ 1,368,086
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$ 174,603	$ 194,626
Accrued liabilities	431,215	513,530
Operating lease liabilities	22,390	23,511
Deferred revenue	49,317	32,307
Income taxes payable	2,439	636
Total current liabilities	679,964	764,610
Long-term deferred revenue	5,327	8,535
Long-term operating lease liabilities	56,703	67,902
Other liabilities	55,960	39,776
Total liabilities	797,954	880,823
Commitments and contingencies (Note 6)		
Stockholders’ equity:		
Class A and Class B common stock	27	26
Additional paid-in capital	1,166,720	1,126,827
Accumulated other comprehensive income	178	188
Accumulated deficit	(778,033)	(639,778)
Total stockholders’ equity	388,892	487,263
Total liabilities and stockholders’ equity	$ 1,186,846	$ 1,368,086

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

FITBIT, INC.
Condensed Consolidated Statements of Operations
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
Revenue	$ 363,932	$ 347,200	$ 813,362	$ 932,646
Cost of revenue	228,120	239,248	529,586	627,027
Gross profit	135,812	107,952	283,776	305,619
Operating expenses:				
Research and development	90,771	65,693	256,093	213,651
Sales and marketing	60,726	71,296	183,157	222,972
General and administrative	35,493	23,083	112,583	74,640
Total operating expenses	186,990	160,072	551,833	511,263
Operating loss	(51,178)	(52,120)	(268,057)	(205,644)
Interest income (expense), net	(268)	2,388	1,038	8,476
Other income (expense), net	965	(492)	3,198	1,242
Loss before income taxes	(50,481)	(50,224)	(263,821)	(195,926)
Income tax expense (benefit)	3,971	1,669	(125,566)	3,950
Net loss	$ (54,452)	$ (51,893)	$ (138,255)	$ (199,876)
Net loss per share:				
Basic	$ (0.20)	$ (0.20)	$ (0.52)	$ (0.78)
Diluted	$ (0.20)	$ (0.20)	$ (0.52)	$ (0.78)
Shares used to compute net loss per share:				
Basic	270,443	258,753	267,958	256,046
Diluted	270,443	258,753	267,958	256,046

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

FITBIT, INC.
Condensed Consolidated Statements of Comprehensive Loss
(in thousands)
(unaudited)

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
Net loss	(54,452)	(51,893)	$ (138,255)	$ (199,876)
Other comprehensive loss				
Cash flow hedges:				
Change in unrealized loss on cash flow hedges, net of $0 tax benefit	—	(66)	—	(66)
Net change, net of tax	—	(66)	—	(66)
Available-for-sale investments:				
Change in unrealized gain (loss) on investments	(172)	35	(10)	364
Net change, net of tax	(172)	35	(10)	364
Comprehensive loss	$ (54,624)	$ (51,924)	$ (138,265)	$ (199,578)

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

FITBIT, INC.
Condensed Consolidated Statements of Stockholders' Equity
(in thousands, except share amounts)
(unaudited)

	Three Months Ended October 3, 2020					
	Class A and Class B Common Stock					
	Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders' Equity
Balance at July 4, 2020	269,584,380	$ 27	$ 1,153,520	$ 350	$ (723,581)	$ 430,316
Issuance of common stock	2,646,154	—	1,988	—	—	1,988
Stock-based compensation expense	—	—	17,799	—	—	17,799
Taxes related to net share settlement of restricted stock units	—	—	(6,587)	—	—	(6,587)
Net loss	—	—	—	—	(54,452)	(54,452)
Other comprehensive income	—	—	—	(172)	—	(172)
Balance at October 3, 2020	272,230,534	$ 27	$ 1,166,720	$ 178	$ (778,033)	$ 388,892

	Three Months Ended September 28, 2019					
	Class A and Class B Common Stock					
	Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity
Balance at June 29, 2019	258,139,452	$ 25	$ 1,092,306	$ 263	$ (467,050)	$ 625,544
Issuance of common stock	1,746,274	1	232	—	—	233
Stock-based compensation expense	—	—	17,971	—	—	17,971
Taxes related to net share settlement of restricted stock units	—	—	(2,850)	—	—	(2,850)
Net loss	—	—	—	—	(51,893)	(51,893)
Other comprehensive income	—	—	—	(31)	—	(31)
Balance at September 28, 2019	259,885,726	$ 26	$ 1,107,659	$ 232	$ (518,943)	$ 588,974

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

FITBIT, INC.
Condensed Consolidated Statements of Stockholders' Equity (Continued)
(in thousands, except share amounts)
(unaudited)

	Nine Months Ended October 3, 2020					
	Class A and Class B Common Stock					
	Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders' Equity
Balance at December 31, 2019	264,883,426	$ 26	$ 1,126,827	$ 188	$ (639,778)	$ 487,263
Issuance of common stock	7,347,108	1	2,990	—	—	2,991
Stock-based compensation expense	—	—	55,719	—	—	55,719
Taxes related to net share settlement of restricted stock units	—	—	(18,816)	—	—	(18,816)
Net loss	—	—	—	—	(138,255)	(138,255)
Other comprehensive income	—	—	—	(10)	—	(10)
Balance at October 3, 2020	272,230,534	$ 27	$ 1,166,720	$ 178	$ (778,033)	$ 388,892

	Nine Months Ended September 28, 2019					
	Class A and Class B Common Stock					
	Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity
Balance at December 31, 2018	252,362,841	$ 25	$ 1,055,046	$ (66)	$ (319,067)	$ 735,938
Issuance of common stock	7,522,885	1	7,044	—	—	7,045
Stock-based compensation expense	—	—	59,064	—	—	59,064
Taxes related to net share settlement of restricted stock units	—	—	(13,495)	—	—	(13,495)
Net loss	—	—	—	—	(199,876)	(199,876)
Other comprehensive income	—	—	—	298	—	298
Balance at September 28, 2019	259,885,726	$ 26	$ 1,107,659	$ 232	$ (518,943)	$ 588,974

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

FITBIT, INC.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Nine Months Ended	
	October 3, 2020	**September 28, 2019**
Cash Flows from Operating Activities		
Net loss	$ (138,255)	$ (199,876)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provision for doubtful accounts	461	29
Provision for excess and obsolete inventory	14,189	5,163
Depreciation	33,332	43,215
Non-cash lease expense	11,082	17,961
Accelerated depreciation of property and equipment	726	169
Amortization of intangible assets	8,351	6,100
Stock-based compensation	57,877	59,175
Deferred income taxes	(11,289)	618
Other	585	(50)
Changes in operating assets and liabilities, net of acquisition:		
Accounts receivable	76,356	68,617
Inventories	21,410	(125,500)
Prepaid expenses and other assets	(9,136)	5,880
Income taxes receivable	(39,679)	5,992
Accounts payable	(23,028)	11,826
Accrued liabilities and other liabilities	(66,763)	(60,763)
Lease liabilities	(14,432)	(20,975)
Deferred revenue	13,802	(2,586)
Income taxes payable	1,803	(107)
Net cash used in operating activities	(62,608)	(185,112)
Cash Flows from Investing Activities		
Purchase of property and equipment	(22,419)	(26,277)
Purchases of marketable securities	(59,735)	(287,969)
Sales of marketable securities	—	2,016
Maturities of marketable securities	200,877	322,132
Acquisition, net of cash acquired	—	(2,625)
Net cash provided by investing activities	118,723	7,277
Cash Flows from Financing Activities		
Payment of financing lease liability	(1,384)	(2,239)
Proceeds from issuance of common stock	2,990	7,044
Taxes paid related to net share settlement of restricted stock units	(18,816)	(13,495)
Net cash used in financing activities	(17,210)	(8,690)
Net increase (decrease) in cash and cash equivalents	38,905	(186,525)
Cash and cash equivalents at beginning of period	334,479	473,956
Cash and cash equivalents at end of period	$ 373,384	$ 287,431

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

FITBIT, INC.
Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation and Summary of Significant Accounting Policies

The accompanying condensed consolidated financial statements of Fitbit, Inc. (the "Company") are unaudited. The condensed consolidated balance sheet at December 31, 2019 has been derived from the audited financial statements of the Company. The accompanying condensed financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") for interim financial information, and in management's opinion, includes all adjustments, consisting of only normal recurring adjustments, necessary for the fair statement of the Company's financial position, its results of operations, and cash flows for the interim periods presented. The results of operations for the three and nine months ended October 3, 2020 are not necessarily indicative of the results to be expected for the full fiscal year or any other period.

The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the fiscal year ended
December 31, 2019, filed with the Securities and Exchange Commission ("SEC") on February 27, 2020.

The Company's fiscal year ends on December 31 of each year. The Company is on a 4-4-5 week quarterly calendar. There were 91 days in each of the three months ended October 3, 2020 and September 28, 2019.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated.

Use of Estimates

The preparation of condensed consolidated financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported and disclosed in the condensed consolidated financial statements and accompanying notes. The primary estimates and assumptions made by management are related to revenue recognition, reserves for sales returns and incentives, reserves for warranty, valuation of stock-based awards, fair value of derivative assets and liabilities, allowance for credit losses, inventory valuation, fair value of goodwill and acquired tangible and intangible assets and liabilities assumed during acquisitions, the recoverability of intangible assets and their useful lives, contingencies, and income taxes. Actual results could differ from those estimates, and such differences may be material to the condensed consolidated financial statements.

Google Acquisition

On November 1, 2019, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Google LLC, a Delaware limited liability company ("Google"), and Magnoliophyta Inc., a Delaware corporation and wholly owned subsidiary of Google (the "Merger Sub"). Pursuant to the terms of, and subject to the conditions specified in, the Merger Agreement, the Merger Sub will merge with and into the Company, and the Company will become a wholly owned subsidiary of Google (the "Merger"). If the Merger is completed, Google will acquire all the shares of the Company's Class A common stock and Class B common stock (together, the "Shares") for $7.35 per share in cash, without interest (the "Merger Consideration"). All Shares underlying vested stock options and vested stock-based awards will be converted into the right to receive the Merger Consideration (or, in the case of stock options, the difference between the Merger Consideration and the applicable per share exercise price), less any applicable tax withholdings. Unvested stock options and stock-based awards will generally be converted into cash-based awards with an equivalent value based on the Merger Consideration and vesting schedule. Completion of the Merger is subject to customary closing conditions, including approval by the expiration or termination of any waiting periods or receipt of any requisite consents under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, approval under the antitrust laws of the European Union and other jurisdictions agreed by the parties, and satisfaction of other closing conditions. On August 4, 2020, the European Commission announced it had initiated a Phase II review of the transaction. On October 16, 2020, the European Commission extended the deadline for its Phase II investigation to January 8, 2021. The duration of a Phase II review cannot be foreseen with certainty. While the Company still expects to secure the necessary regulatory approvals and to close the transaction in 2020, the time frame may extend beyond that. The Merger was approved by the Company's stockholders on January 3, 2020.

Risks and Uncertainties for COVID-19

The outbreak of the novel coronavirus COVID-19, which was declared a global pandemic by the World Health Organization in March 2020, adversely impacted the Company's business in the first three quarters of 2020. The pandemic and associated containment measures have caused disruptions in the development, manufacture, shipment, and sales of the Company's products. The Company's operating results were negatively impacted by decreased retail activity and retail store closures due to COVID-19, primarily during the first half of 2020. Operating results were also impacted by additional reserves for product returns, rebates and promotions, and price protection on certain products, primarily as a result of declining demand due to COVID-19.

The current circumstances are dynamic and unprecedented, and the impacts of the COVID-19 pandemic on the Company's business operations, including the duration and severity of the effect on overall consumer demand, are highly uncertain and cannot be predicted. However, these impacts have had, and the Company expects will continue to have, a significant adverse effect on the Company's operations, revenue, liquidity, financial conditions, and financial results. For further information regarding the impact of COVID-19 on the Company, see Part I, Item 2, Management's Discussion and Analysis, and Part II, Item 1A, Risk Factors in this Quarterly Report on Form 10-Q.

Significant Accounting Policies

There have been no significant changes in the Company's accounting policies from those disclosed in its Annual Report on Form 10-K filed with the SEC on February 27, 2020.

Recent Accounting Pronouncements

Accounting Pronouncements Not Yet Adopted

In December 2019, the Financial Accounting Standards Board (the "FASB") issued ASU 2019-12, Simplifying the Accounting for Income Taxes. This guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2020, with early adoption permitted. The Company is currently evaluating the impact this guidance may have on its consolidated financial statements and related disclosures.

Accounting Pronouncements Recently Adopted

In June 2016, the FASB issued ASU 2016-13, Financial Instruments–Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 provides for a new impairment model which requires measurement and recognition of expected credit losses for most financial assets and certain other instruments, including but not limited to accounts receivable and available-for-sale debt securities. In April 2019, the FASB issued ASU No. 2019-04, Codification Improvements to Topic 326, Financial Instruments–Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments. This ASU clarifies and corrects guidance related to Topic 326, Topic 815, and Topic 825. In May 2019, the FASB issued ASU 2019-05, Financial Instruments-Credit Losses (Topic 326): Targeted Transition Relief. This ASU provides an option to irrevocably elect to measure certain individual financial assets at fair value instead of amortized cost. The Company adopted Topic 326 utilizing the modified retrospective method. Prior periods were not retrospectively adjusted. The cumulative effect upon adoption on the opening accumulated deficit balance was zero.

In January 2017, the FASB issued ASU 2017-04, Intangibles–Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. ASU 2017-04 simplifies the subsequent measurement of goodwill by eliminating the second step of the goodwill impairment test. The second step measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Under ASU 2017-04, a company will record an impairment charge based on the excess of a reporting unit's carrying amount over its fair value. ASU 2017-04 became effective for the Company on January 1, 2020. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework–Changes to the Disclosure Requirements for Fair Value Measurement. ASU 2018-13 modifies the disclosure requirements on fair value measurements and became effective for the Company on January 1, 2020. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In August 2018, the FASB issued ASU 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. ASU 2018-15 clarifies the accounting for implementation costs in cloud computing arrangements and became effective for the Company on January 1, 2020. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

2. Fair Value Measurements

The carrying values of the Company's accounts receivable, accounts payable, and accrued liabilities approximated their fair values due to the short period of time to maturity or repayment.

The following tables set forth the Company's financial instruments that were measured at fair value on a recurring basis by level within the fair value hierarchy (in thousands):

	October 3, 2020			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds	$ 189,887	$ —	$ —	$ 189,887
U.S. government agencies	—	36,337	—	36,337
Corporate debt securities	—	61,980	—	61,980
Total	$ 189,887	$ 98,317	$ —	$ 288,204
Liabilities:				
Contingent consideration	$ —	$ —	$ 1,523	$ 1,523
Total	$ —	$ —	$ 1,523	$ 1,523

	December 31, 2019			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds	$ 107,708	$ —	$ —	$ 107,708
U.S. government agencies	—	77,364	—	77,364
Corporate debt securities	—	207,137	—	207,137
Total	$ 107,708	$ 284,501	$ —	$ 392,209
Liabilities:				
Contingent consideration	$ —	$ —	$ 1,889	$ 1,889
Derivative liabilities	—	748	—	748
Total	$ —	$ 748	$ 1,889	$ 2,637

The fair value of the Company's Level 1 financial instruments is based on quoted market prices in active markets for identical instruments. The fair value of the Company's Level 2 financial instruments is based on observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data.

In addition, Level 2 assets and liabilities include derivative financial instruments associated with hedging activity, which are further discussed in Note 3. Derivative financial instruments are initially measured at fair value on the contract date and are subsequently remeasured to fair value at each reporting date using inputs such as spot rates, forward rates, and discount rates. There is not an active market for each hedge contract, but the inputs used to calculate the value of the instruments are tied to active markets.

There were no Level 3 assets as of October 3, 2020 and December 31, 2019. The Company's Level 3 liabilities measured and recorded on a recurring basis as of October 3, 2020 and December 31, 2019 consist of contingent consideration related to an acquisition. Subsequent changes in the fair value of this obligation will be recorded within the Company's consolidated statements of operations. The Company estimated the fair value of the acquisition-related contingent consideration using a probability-weighted discounted cash flow model. As the fair value measure is based on significant inputs that are not observable in the market, they are categorized as Level 3. There were no transfers between fair value measurement levels during the three and nine months ended October 3, 2020 and September 28, 2019.

3. Financial Instruments

Cash, Cash Equivalents and Marketable Securities

The Company's marketable securities are classified as available-for-sale as of the balance sheet date and are reported at fair value with unrealized gains and losses reported, net of tax, as a separate component of accumulated other comprehensive income (loss) in stockholders' equity. Because the Company views marketable securities as available to support current operations as needed, it has classified all available-for-sale securities as current assets. Realized gains on available-for-sale securities are reported in other income (expense), net, as incurred.

For debt securities in an unrealized loss position, the Company determines whether a credit loss exists. The estimate of credit loss is determined by considering available information relevant to the collectability of the security and information about past events, current conditions, and reasonable and supportable forecasts. The allowance for credit loss is recorded as a charge to other income (expense), net, not to exceed the amount of the unrealized loss. Any excess unrealized loss greater than the credit loss at a security level is recognized in accumulated other comprehensive income (loss). During the three and nine months ended October 3, 2020, no allowance for credit losses on marketable securities was recorded.

The following table sets forth cash, cash equivalents, and marketable securities as of October 3, 2020 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cash and Cash Equivalents	Marketable Securities
Cash	$ 128,230	$ —	$ —	$ 128,230	$ 128,230	$ —
Money market funds	189,887	—	—	189,887	189,887	—
U.S. government agencies	36,320	17	—	36,337	27,312	9,025
Corporate debt securities	61,885	96	—	61,981	27,955	34,026
Total	$ 416,322	$ 113	$ —	$ 416,435	$ 373,384	$ 43,051

The following table sets forth cash, cash equivalents and marketable securities as of December 31, 2019 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cash and Cash Equivalents	Marketable Securities
Cash	$ 126,293	$ —	$ —	$ 126,293	$ 126,293	$ —
Money market funds	107,708	—	—	107,708	107,708	—
U.S. government agencies	77,316	48	—	77,364	30,375	46,989
Corporate debt securities	207,063	85	(11)	207,137	70,103	137,034
Total	$ 518,380	$ 133	$ (11)	$ 518,502	$ 334,479	$ 184,023

The gross unrealized gains or losses on marketable securities as of October 3, 2020 and December 31, 2019 were not material. There were no available-for-sale investments as of October 3, 2020 and December 31, 2019 that have been in a continuous unrealized loss position for greater than 12 months on a material basis.

The following table classifies marketable securities by contractual maturities (in thousands):

	October 3, 2020	December 31, 2019
Due in one year	$ 43,051	$ 173,827
Due in one to two years	—	10,196
Total	$ 43,051	$ 184,023

Derivative Financial Instruments

The Company operates in foreign countries, which exposes it to market risk associated with foreign currency exchange rate fluctuations between the U.S. dollar and various foreign currencies. In order to manage this risk, the Company may hedge a portion of its foreign currency exposures related to outstanding monetary assets and liabilities as well as forecasted revenues and expenses, using foreign currency exchange forward or option contracts. In general, the market risk related to these contracts is offset by corresponding gains and losses on the hedged transactions. The Company does not enter into derivative contracts for trading or speculative purposes.

Balance Sheet Hedges

The Company may enter into foreign exchange contracts to hedge certain monetary assets and liabilities that are denominated in currencies other than the functional currency of its subsidiaries. These foreign exchange contracts are carried at fair value, do not qualify for hedge accounting treatment, and are not designated as hedging instruments. Changes in the value of the foreign exchange contracts are recognized in other income (expense), net, and offset the foreign currency gain or loss on the underlying net monetary assets or liabilities.

The Company had no outstanding balance sheet hedges as of October 3, 2020, and outstanding balance sheet hedges with a total notional amount of $83.4 million as of December 31, 2019.

Fair Value of Foreign Currency Derivatives

The foreign currency derivative contracts that were not settled at the end of the period are recorded at fair value, on a gross basis, in the condensed consolidated balance sheets. The following table presents the fair value of the Company's foreign currency derivative contracts as of the periods presented (in thousands):

		October 3, 2020		December 31, 2019	
	Balance Sheet Location	**Fair Value Derivative Assets**	**Fair Value Derivative Liabilities**	**Fair Value Derivative Assets**	**Fair Value Derivative Liabilities**
Hedges not designated	Accrued liabilities	—	—	—	748
Total fair value of derivative instruments		$ —	$ —	$ —	$ 748

Financial Statement Effect of Foreign Currency Derivative Contracts

The following table presents the pre-tax impact of the Company's foreign currency derivative contracts on the condensed consolidated statements of operations for the periods presented (in thousands):

		Three Months Ended		Nine Months Ended	
	Income Statement Location	**October 3, 2020**	**September 28, 2019**	**October 3, 2020**	**September 28, 2019**
Foreign exchange balance sheet hedges:					
Gain (loss) recognized in income	Other income, net	$ —	$ 2,041	$ 3,077	$ 1,567

As of October 3, 2020, there were no net derivative gains related to the Company's cash flow hedges to be reclassified from other comprehensive income ("OCI") into revenue within the next 12 months.

Offsetting of Foreign Currency Derivative Contracts

The Company presents its derivative assets and derivative liabilities at gross fair values in the condensed consolidated balance sheets. The Company generally enters into master netting arrangements, which mitigate credit risk by permitting net settlement of transactions with the same counterparty. The Company is not required to pledge, and is not entitled to receive, cash collateral related to these derivative instruments.

The following tables set forth the available offsetting of net derivative assets under the master netting arrangements as of December 31, 2019 (in thousands):

	December 31, 2019					
	Gross Amounts Offset in the Condensed Consolidated Balance Sheets			Gross Amounts Not Offset in Condensed Consolidated Balance Sheets		
	Gross Amounts Recognized	Gross Amounts Offset	Net Amounts Presented	Financial Instruments	Cash Collateral Received	Net Amount
Foreign exchange contracts liabilities	748	—	748	—	—	748

There were no net derivative assets as of October 3, 2020.

4. Balance Sheet Components

Deferred Revenue

Deferred revenue relates to performance obligations for which payments have been received by the customer prior to revenue recognition. Deferred revenue primarily consists of deferred software, or amounts allocated to mobile dashboard and on-line apps and unspecified upgrade rights. Deferred revenue also includes deferred subscription-based services. The deferred software and deferred subscription-based service performance obligations are anticipated to be recognized over the useful life or service periods of one to eighteen months.

Changes in the total short-term and long-term deferred revenue balances were as follows (in thousands):

	Three Months Ended October 3, 2020	Nine Months Ended October 3, 2020
Beginning balances	$ 37,215	$ 40,842
Deferral of revenue	37,708	61,972
Recognition of deferred revenue	(20,279)	(48,170)
Ending balances	$ 54,644	$ 54,644

Revenue Returns Reserve

Revenue returns reserve activities were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
Beginning balances	$ 81,851	$ 75,044	$ 101,326	$ 104,001
Increases (1)	37,422	41,945	103,127	119,070
Returns taken	(25,976)	(42,845)	(111,156)	(148,927)
Ending balances	$ 93,297	$ 74,144	$ 93,297	$ 74,144

(1) Increases in the revenue returns reserve include provisions for open box returns and stock rotations.

Inventories

Inventories consisted of the following (in thousands)

	October 3, 2020	December 31, 2019
Components	$ 471	$ 5,397
Finished goods	98,525	131,355
Total inventories	$ 98,996	$ 136,752

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consisted of the following (in thousands):

	October 3, 2020	December 31, 2019
Prepaid expenses	$ 18,910	$ 11,219
Prepaid marketing	2,937	3,347
Tariff receivable	2,730	—
Other	10,436	14,090
Total prepaid expenses and other current assets	$ 35,013	$ 28,656

Property and Equipment, Net

Property and equipment, net, consisted of the following (in thousands):

	October 3, 2020	December 31, 2019
Tooling and manufacturing equipment	$ 120,895	$ 103,177
Furniture and office equipment	20,511	19,922
Purchased and internally-developed software	30,528	27,424
Leasehold improvements	60,941	59,926
Total property and equipment	232,875	210,449
Less: Accumulated depreciation and amortization	(158,191)	(127,693)
Property and equipment, net	$ 74,684	$ 82,756

Total depreciation expense related to property and equipment, net was $12.3 million and $13.1 million for the three months ended October 3, 2020 and September 28, 2019, respectively, and $33.3 million and $43.2 million for the nine months ended October 3, 2020 and September 28, 2019, respectively.

Goodwill and Intangible Assets, Net

The carrying amount of goodwill was $64.8 million as of October 3, 2020 and December 31, 2019.

The carrying amounts of the intangible assets as of October 3, 2020 and December 31, 2019 were as follows (in thousands):

	October 3, 2020			December 31, 2019		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Developed technology	$ 37,813	$ (29,418)	$ 8,395	$ 37,813	$ (23,910)	$ 13,903
Customer relationships	3,918	(3,918)	—	3,790	(991)	2,799
Trademarks and other	1,150	(1,150)	—	1,278	(1,234)	44
Total intangible assets, net	$ 42,881	$ (34,486)	$ 8,395	$ 42,881	$ (26,135)	$ 16,746

Total amortization expense related to intangible assets was $1.3 million and $2.0 million for the three months ended October 3, 2020 and September 28, 2019, respectively, and $8.4 million and $6.1 million for the nine months ended October 3, 2020 and September 28, 2019, respectively.

The estimated future amortization expense of acquired finite-lived intangible assets to be charged to cost of revenue and operating expenses after October 3, 2020 is as follows (in thousands):

	Cost of Revenue	Operating Expenses	Total
Remaining 2020	$ 1,259	$ 14	$ 1,273
2021	5,037	206	5,243
2022	1,488	131	1,619
2023	—	56	56
2024	—	56	56
Thereafter	—	148	148
Total finite-lived intangible assets, net	$ 7,784	$ 611	$ 8,395

Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

	October 3, 2020	December 31, 2019
Sales returns reserve	$ 93,297	$ 101,326
Accrued sales incentives	82,740	156,839
Employee-related liabilities	73,272	37,355
Product warranty	39,023	52,403
Inventory received but not billed	30,940	1,669
Accrued manufacturing expense and freight	23,313	35,112
Accrued co-op advertising and marketing development funds	22,888	40,689
Accrued research and development	20,832	19,232
Accrued sales and marketing	14,186	26,781
Sales taxes and VAT payable	10,364	19,603
Accrued legal settlements and fees	8,725	8,854
Finance lease liabilities	2,338	1,384
Derivative liabilities	—	748
Other accrued liabilities	9,297	11,535
Accrued liabilities	$ 431,215	$ 513,530

Product warranty reserve activities were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
Beginning balances	$ 44,934	$ 45,260	$ 52,403	$ 45,605
Charged to cost of revenue	10,521	11,019	24,851	28,247
Changes related to pre-existing warranties	(4,801)	2,201	(5,555)	4,874
Settlement of claims	(11,631)	(13,576)	(32,676)	(33,822)
Ending balances	$ 39,023	$ 44,904	$ 39,023	$ 44,904

5. Leases

The Company leases its principal facilities located in San Francisco, California. The Company also leases office space in various locations. Both the Company's principal facilities and leases in various locations have expiration dates between 2020 and 2024. The lease agreements often include leasehold improvement incentives, escalating lease payments, renewal provisions and other provisions which require the Company to pay taxes, insurance, maintenance costs or defined rent increases. The Company's leases are primarily accounted for as operating leases. Operating lease ROU assets and short-term and long-term operating lease liabilities are included on the face of the condensed consolidated balance sheet. Finance lease ROU assets are presented within other assets, and finance lease liabilities are presented within accrued liabilities. The Company has no leases that have not yet commenced as of October 3, 2020.

Total lease cost consists of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	October 3, 2020	**September 28, 2019**	**October 3, 2020**	**September 28, 2019**
Finance lease costs:				
Amortization of ROU assets	$ 390	$ 989	$ 668	$ 2,640
Interest on lease liabilities	—	—	—	—
Operating lease costs[1]	6,031	5,850	19,179	16,834
Variable lease costs	3,110	1,463	5,766	4,108
Sublease income	(146)	(479)	(1,113)	(4,110)
Total lease costs	$ 9,385	$ 7,823	$ 24,500	$ 19,472

[1] includes short-term leases, which are immaterial.

Supplemental cash flow information related to leases was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 3, 2020	**September 28, 2019**	**October 3, 2020**	**September 28, 2019**
Cash paid for amounts included in the measurement of lease liabilities:				
Financing cash flows from finance leases	$ —	$ 1,302	$ 1,384	$ 2,239
Operating cash flows from finance leases	—	—	—	—
Operating cash flows from operating leases	6,168	6,737	19,097	20,775
ROU assets obtained in exchange for lease obligations:				
Finance lease liabilities	$ 2,338	$ —	$ 3,722	$ —
Operating lease liabilities	—	—	4,497	288

Supplemental balance sheet information related to leases was as follows (in thousands):

	October 3, 2020	December 31, 2019
Finance leases:		
Other assets	$ 1,948	$ 1,384
Accrued liabilities	$ 2,338	$ 1,384
Operating leases:		
Operating lease ROU assets	$ 62,144	$ 70,225
Operating lease liabilities	$ 22,390	$ 23,511
Long-term operating lease liabilities	56,703	67,902
Total operating lease liabilities	$ 79,093	$ 91,413

Weighted-average lease terms and discount rates are as follows:

	October 3, 2020	December 31, 2019
Weighted-average remaining lease terms (in years):		
Finance leases	1.3	0.5
Operating leases	3.6	4.2
Weighted-average discount rates:		
Finance leases	— %	— %
Operating leases	5.5 %	5.5 %

Maturities of lease liabilities as of October 3, 2020 were as follow (in thousands):

	Finance Leases	Operating Leases
Remaining 2020	$ 2,338	$ 24,956
2021	—	25,106
2022	—	23,385
2023	—	17,970
2024	—	405
Thereafter	—	—
Total minimum lease payments	$ 2,338	$ 91,822
Less: amount representing interest	—	(12,729)
Total lease liabilities	$ 2,338	$ 79,093

6. Commitments and Contingencies

Purchase Commitments

The aggregate amount of open purchase orders as of October 3, 2020 was approximately $430.5 million. Of the aggregate amount, $156.9 million related to the Company's migration to a third-party hosting provider, of which $17.3 million was accrued for as of October 3, 2020. The Company cannot determine the aggregate amount of such purchase orders that represent contractual obligations because purchase orders may represent authorizations to purchase rather than binding agreements. The Company's purchase orders are based on its current needs and are fulfilled by its suppliers, contract manufacturers, and logistics providers within short periods of time.

During the normal course of business, the Company and its contract manufacturers procure components based upon a forecasted production plan. If the Company cancels all or part of the orders, or materially reduces forecasted orders, it may be liable to its suppliers and contract manufacturers for the cost of the excess components purchased by its contract manufacturers. As of October 3, 2020, $7.9 million was accrued for such liabilities to contract manufacturers.

Letters of Credit

As of October 3, 2020 and December 31, 2019, the Company had outstanding letters of credit of $24.8 million and $24.6 million, respectively, issued to cover the security deposit on the lease of its office headquarters in San Francisco, California, and other facility leases.

Legal Proceedings

Jawbone. Aliphcom, Inc. d/b/a Jawbone ("Jawbone") and the Company each initiated civil lawsuits against each other in 2015. These included a complaint filed by Jawbone in California state court alleging the misappropriation of certain trade secrets by six former Jawbone employees who had joined Fitbit and who were also named as defendants. On December 8, 2017, the parties announced the global settlement of all of the outstanding civil litigation on confidential terms, and all of the cases were dismissed with prejudice.

In February 2017 and February 2018, the Company received subpoenas from the U.S. Attorney's Office for the Northern District of California requesting documents regarding certain of the Company's confidential business information that appeared to be related to Jawbone's allegations of trade secret misappropriation, and the Company produced documents in response. On June 14, 2018, the six former Jawbone employees who were named as individual defendants in the state trade secret case were charged in a federal indictment with being in possession of certain Jawbone trade secrets. Charges were dismissed against one individual in December 2019. On February 3, 2020, a jury returned a not-guilty verdict on all counts in favor of the first individual to be tried. On February 14, 2020, the government dropped all charges against the remaining individuals.

Sleep Tracking. On May 8, 2015, a purported class action lawsuit was filed against the Company in the U.S. District Court for the Northern District of California, alleging that the sleep tracking function available in certain trackers does not perform as advertised. Plaintiffs sought class certification, restitution, unspecified compensatory and punitive damages, and reasonable costs and expenses including attorneys' fees. On January 31, 2017, plaintiffs filed a motion for class certification. Plaintiffs' motion for class certification was granted on November 20, 2017. On April 20, 2017, the Company filed a motion for summary judgment, which the court denied on December 8, 2017.

The parties subsequently agreed to a settlement, and on August 1, 2018, the plaintiffs filed a motion for preliminary approval of the class action settlement. At the hearing on September 13, 2018, the court denied preliminary settlement approval without prejudice and ordered revised settlement papers be filed. On November 29, 2018, the court granted preliminary settlement approval and the final approval hearing was scheduled for August 1, 2019. On May 10, 2019, the plaintiffs filed a request for attorneys' fees and expenses. The Company opposed that request. At the hearing on August 1, 2019, the court asked the parties to submit a re-notice plan in order to achieve a higher claims rate. On the fee request, the court offered the plaintiffs alternative conditions, and on August 18, 2019, the plaintiffs filed their fee election, opting for a 90% reduction of challenged fees and expenses. The re-notice plan was approved on October 16, 2019, and the re-notice resulted in approximately 80,000 more claims, for a total of approximately 141,000 claims. The court granted final approval of the settlement on February 6, 2020, in an amount that is not material to the Company.

On March 20, 2020, the court ruled on plaintiffs' request for attorneys' fees and costs and awarded $6.9 million in attorneys' fees and $0.2 million in costs. On April 20, 2020, the Company filed a notice of appeal. On August 14, 2020, the parties agreed to settle the attorneys' fees issue for $5.6 million and on August 24, 2020, the appeal was dismissed.

Securities Litigation I. In 2016, putative class actions were filed in federal and California state court against the Company and other defendants alleging violations of the federal securities laws based on alleged materially false and misleading statements about the Company's PurePulse® heart rate tracking technology. The parties agreed to settle the lawsuits for $33.3 million, which the Company accrued for as of December 31, 2017. Following court approval of the settlement, the federal and state class action cases were dismissed with prejudice in May 2018.

During 2016 and 2017, seven derivative lawsuits were filed in various federal courts and in the Delaware Court of Chancery naming the Company as nominal plaintiff and certain of the Company's officers and directors as defendants. The federal cases are all stayed. The three cases filed in the Delaware Court of Chancery were consolidated and a second amended complaint was filed in which plaintiffs allege breach of fiduciary duty and insider trading against certain defendants who sold shares in the Company's initial public offering and/or a secondary offering. On April 26, 2017, the Company filed a motion to dismiss the Delaware cases for failure to state a claim. On December 14, 2018, the court denied the motion to dismiss. The Company filed a motion for interlocutory appeal, which was denied on January 14, 2019. The Company then filed a Notice of Appeal in the Delaware Supreme Court, which was denied on January 30, 2019. On February 10, 2020, the parties agreed to a settlement of all of the derivative lawsuits, and final court approval of the settlement was received on October 27, 2020.

Securities Litigation II. On November 1, 2018, a putative securities class action was filed in the U.S. District Court for the Northern District of California naming the Company and certain of its officers as defendants. The complaint alleges violations of Sections 10(b) and 20 of the Securities Exchange Act of 1934, as amended (the "Exchange Act") arising out of alleged materially false and misleading statements about the Company's guidance for the fourth quarter of 2016 and full fiscal year 2016 that was provided during the third and fourth quarters of 2016. On November 15, 2018, a second putative securities class action was filed in the same court alleging similar claims against the same defendants. On April 25, 2019, the two actions were consolidated, and a consolidated amended class action complaint was filed on June 24, 2019. The consolidated complaint also alleges violations of Sections 10(b) and 20 of the Exchange Act against the Company and certain officers relating to the Company's 2016 guidance, on behalf of a putative class of stockholders who purchased Fitbit stock from August 2, 2016 through January 30, 2017. Plaintiffs seek class certification, unspecified compensatory damages, and reasonable costs and expenses including attorneys' fees. On August 23, 2019, the Company filed a motion to dismiss. On March 23, 2020, the court granted the motion to dismiss with leave to amend. On April 28, 2020, the court entered judgment after plaintiffs indicated that they did not intend to file an amended complaint. Plaintiffs filed a notice of appeal of the judgment to the United States Court of Appeals for the Ninth Circuit on May 27, 2020. Plaintiffs filed their opening brief on September 25, 2020, and the Company's opposition brief is due on November 25, 2020.

Koninklijke Philips and Philips North America Patent Litigation. On December 4, 2017, Koninklijke Philips N.V. filed suit in Germany in the Regional Court of Mannheim alleging infringement of its European patent ("EP") by certain of Fitbit's products of the German part of EP 1 247 229 B1 ("EP229"). In October 2018, the case was stayed pending an appeal of a January 2014 decision by the European Patent Office ("EPO") to revoke EP229. On May 31, 2019, the EPO Board of Appeal dismissed the appeal, affirming the decision to revoke EP229. Koninklijke Philips appealed the EPO Board of Appeal decision on July 30, 2019.

On May 30, 2018, Koninklijke Philips filed a second patent infringement suit in the Regional Court of Mannheim alleging infringement by certain of Fitbit's products of the German part of EP 1 076 806 B1 ("EP806"). In October 2018, the case was stayed pending the decision in a parallel nullity proceeding challenging the validity of EP806. A hearing in the nullity proceeding is scheduled for November 11, 2020.

On July 22, 2019, Philips North America LLC filed a patent infringement suit in U.S. District Court for the District of Massachusetts alleging infringement of U.S. Patent Nos. 6,013,007, 7,088,233, 8,277,377, and 6,976,958 by certain of Fitbit's products. On November 13, 2019, the Company filed a motion to dismiss. On November 27, 2019, Philips filed an amended complaint. On December 10, 2019, the Company filed a motion to dismiss the amended complaint. A hearing on the motion to dismiss was held on August 20, 2020, but the Court has not yet issued an order. In addition, the Court held a claim construction hearing on August 5, 2020, but has not yet issued an order. On September 3, 2020, Philips filed an amended complaint, withdrawing all allegations of infringement of U.S. Patent No. 6,976,958.

On December 10, 2019, Philips North America and Koninklijke Philips filed a complaint for patent infringement in the International Trade Commission ("ITC") naming Fitbit, Garmin International, Inc., Garmin USA, Inc., Garmin Ltd., d/b/a Garmin Switzerland GmbH, Ingram Micro Inc., Maintek Computer (Suzhou) Co., Ltd., and Inventec Appliances (Pudong) as proposed respondents. The complaint asserts that all proposed respondents' accused products infringe U.S. Patent Nos. 7,845,228 (the "'228 patent"), 9,820,698 (the "'698 Patent"), and 9,717,464 (the "'464 patent") (collectively, the "ITC Patents"), and requests that the ITC institute an investigation and thereafter issue a limited exclusion order and cease and desist orders. On January 10, 2020, the ITC instituted the investigation, titled "In the Matter of Certain Wearable Monitoring Devices, Systems, and Components Thereof." On October 1, 2020, the ITC Administrative Law Judge ("ALJ") granted summary determination that Fitbit's accused products do not infringe the '464 and '698 Patents. The ALJ also denied the parties' respective motions for summary determination of non-infringement and infringement of the '228 Patent, and determined that Philips satisfied the economic prong of the domestic industry requirement for the '228 patent. The ITC held an evidentiary hearing regarding the '228 patent (and the '464 patent with respect to certain remaining allegations against Garmin) on October 21, 2020 through October 23, 2020. The initial determination is due by February 4, 2021, and the target date for completion of the investigation is June 4, 2021.

On April 2, 2020, the Company filed a complaint for declaratory judgment against Koninklijke Philips in the U.S. District Court for the Northern District of California requesting that the court declare that Fitbit's products do not infringe the ITC Patents. On July 9, 2020, the court ordered that the case be transferred to the U.S. District Court for the District of Massachusetts following a motion filed by Koninklijke Philips. On October 15, 2020, the court stayed the action pending the ITC investigation between the parties.

On April 8, 2020, the Company filed a lawsuit against Philips North America and Koninklijke Philips in the U.S. District Court for the Northern District of California alleging infringement of U.S. Patent Nos. 7,145,462 and 8,868,377 by certain of Philips' products. On August 26, 2020, the court ordered that the case be transferred to the U.S. District Court for the District of Massachusetts following a motion filed by Philips. On September 11, 2020, Philips filed a motion to dismiss certain of the claims in the Company's complaint.

The Company believes that the plaintiffs' allegations are without merit and intends to vigorously defend against the claims.

Wynit. In September 2017, Wynit Distribution LLC ("Wynit") filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. Wynit was previously the Company's largest customer. The Company ceased to recognize revenue from Wynit, which totaled $8.1 million during the third quarter of 2017. Additionally, the Company recorded a charge of $35.8 million during the third quarter of 2017 comprised of cost of revenue of $5.5 million associated with shipments to Wynit in the third quarter of 2017 and bad debt expense of $30.3 million associated with all of Wynit's outstanding accounts receivables. The Company maintains credit insurance that covers a portion of the exposure related to its customer receivables. The Company recorded an insurance receivable based on an analysis of its insurance policies, including their exclusions, an assessment of the nature of the claim, and information from its insurance carrier. As of September 30, 2017, the Company had recorded an insurance receivable of $26.8 million, included in prepaid expenses and other current assets, associated with the amount it had concluded was probable related to the claim. The $26.8 million insurance receivable allowed the Company to recover $22.7 million of bad debt expense and $4.1 million of cost of revenue, resulting in a net charge of $9.0 million in the consolidated statement of operations comprised of net bad debt expense of $7.6 million and net cost of revenue of $1.4 million. The Company received $21.4 million of the insurance receivable during the fourth quarter of 2017 and the remaining $5.4 million in the first quarter of 2018.

During 2018, the Company released $12.4 million in product return and rebate reserves related to Wynit, as it believed the possibility of future claims associated with these reserves was remote. This reserve release resulted in a $12.4 million increase in revenue during the year ended December 31, 2018.

On September 4, 2019, plaintiff Nauni Manty, as the chapter 7 trustee of the bankruptcy estate of Wynit Distribution, LLC, et al, filed a complaint in U.S. Bankruptcy Court in the District of Minnesota. The complaint sought: (1) avoidance and recovery under 11 U.S.C. §§ 547, 550, and 551 against Fitbit; and (2) avoidance and preservation under 11 U.S.C. §§ 547, 551 of a second lien granted to Fitbit on substantially all the debtors' assets. On March 30, 2020, the bankruptcy court approved a settlement of the trustee's claims in an amount that is not material to the Company, and the case has been dismissed.

Other. The Company is and, from time to time, may in the future become, involved in other legal proceedings in the ordinary course of business. The Company currently believes that the outcome of any of these existing legal proceedings, including the aforementioned cases, either individually or in the aggregate, will not have a material impact on the operating results, financial condition or cash flows of the Company. With respect to existing legal proceedings, the Company has either determined that the existence of a material loss is not reasonably possible or that it is unable to estimate a reasonably possible loss or range of loss. The Company may incur substantial legal fees, which are expensed as incurred, in defending against these legal proceedings.

Indemnification

In the ordinary course of business, the Company enters into commercial agreements that may include indemnification provisions. Pursuant to such agreements, the Company may indemnify, hold harmless and defend an indemnified party for losses suffered or incurred by the indemnified party. Some of the provisions will limit losses to those arising from third-party actions. In some cases, the indemnification will continue after the termination of the agreement. The maximum potential amount of future payments the Company could be required to make under these provisions is not determinable. To date, the Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification provisions. The Company has also entered into indemnification agreements with its directors and officers that may require the Company to indemnify its directors and officers against liabilities that may arise by reason of their status or service as directors or officers to the fullest extent permitted by Delaware corporate law. The Company also currently has directors' and officers' insurance.

7. Stockholders' Equity

Equity Incentive Plans

In May 2015, the Company's board of directors and stockholders adopted and approved the 2015 Equity Incentive Plan (the "2015 Plan"). The 2015 Plan became effective on June 16, 2015 and serves as the successor to the Amended and Restated 2007 Stock Plan (the "2007 Plan"). The Company ceased granting awards under the 2007 Plan upon the effectiveness of the 2015 Plan. However, any outstanding stock options and restricted stock units ("RSUs") granted under the 2007 Plan remain subject to the terms of the 2007 Plan. As of October 3, 2020, 33.7 million shares of Class A common stock were reserved and available for future issuance under the 2015 Plan.

Stock Options

Stock option activity under the equity incentive plans was as follows (in thousands, except per share amounts):

	Stock Options Outstanding		
	Number of Shares Subject to Stock Options	Weighted–Average Exercise Price	Aggregate Intrinsic Value [1]
Balance—December 31, 2019	12,871	$ 3.51	
Granted	—		
Exercised	(1,469)	$ 2.04	
Forfeited or canceled	(147)	$ 6.96	
Balance—October 3, 2020	11,255	$ 3.66	$ 40,248
Stock options vested and expected to vest—October 3, 2020	11,255	$ 3.66	$ 40,248
Stock options exercisable—October 3, 2020	11,255	$ 3.66	$ 40,248

[1] The aggregate intrinsic values of stock options outstanding, exercisable, vested and expected to vest as of October 3, 2020 were calculated as the difference between the exercise price of the stock options and the fair value of the Class A common stock of $6.92 as of October 3, 2020.

Restricted Stock Units

RSU activity under the equity incentive plans was as follows (in thousands, except per share amounts):

	RSUs Outstanding	Weighted-Average Grant Date Fair Value
Unvested balance—December 31, 2019	18,932	$ 5.68
Granted	9,904	$ 6.41
Vested	(8,808)	$ 6.16
Forfeited or canceled	(944)	$ 5.90
Unvested balance—October 3, 2020	19,084	$ 5.83

Stock-Based Compensation Expense

Total stock-based compensation expense recognized was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
Cost of revenue	$ 1,846	$ 1,446	$ 6,059	$ 4,397
Research and development	10,633	10,557	33,194	34,437
Sales and marketing	2,701	2,587	8,376	8,900
General and administrative	3,197	3,494	10,248	11,441
Total stock-based compensation expense	$ 18,377	$ 18,084	$ 57,877	$ 59,175

As of October 3, 2020, the total unrecognized stock-based compensation expense related to unvested stock options and RSUs was $97.4 million, which the Company expects to recognize over an estimated weighted average period of 1.8 years.

8. Income Taxes

The Company is subject to income tax in the United States as well as other tax jurisdictions in which it conducts business. Earnings from non-U.S. activities are subject to local country income tax.

For the three and nine months ended October 3, 2020, the Company recorded an expense for income taxes of $4.0 million and a benefit for income taxes of $125.6 million, respectively, for an effective tax rate of (7.9)% and 47.6%, respectively. The effective tax rate for the three and nine months ended October 3, 2020 was different than the statutory federal tax rate primarily due to the impact of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), which enables the Company to carry back current year, 2018 and 2019 net operating losses into prior taxable periods. As a result, the Company released valuation allowance on deferred tax assets related to those net operating losses that can be carried back and benefited in the prior years at the U.S. tax rate of 35%. The tax expense for the three months ended October 3, 2020 was primarily from a true-up to the tax benefit recorded through the second quarter of 2020 due to changes in the mix of income/losses between the Company’s jurisdictions in the third quarter of 2020.

For the three and nine months ended September 28, 2019, the Company recorded an expense for income taxes of $1.7 million and $4.0 million, respectively, for an effective tax rate of (3.3)% and (2.0)%, respectively. The effective tax rate for the three and nine months ended September 28, 2019 was different than the statutory federal tax rate primarily due to the impact of a full valuation allowance on the Company’s U.S. and certain of its foreign deferred tax assets, the mix of income/ losses between the Company’s foreign jurisdictions, and pretax losses in jurisdictions for which no tax benefit will be recognized.

On March 27, 2020, the CARES Act was signed into law. The CARES Act includes, among other items, provisions relating to refundable payroll tax credits, deferment of the employer portion of certain payroll taxes, net operating loss carryback periods, alternative minimum tax credit refunds, modifications to the net interest deduction limitations and technical corrections to tax depreciation methods for qualified improvement property.

The CARES Act allows losses incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding tax years and to offset 100% of regular taxable income in such years.

Accounting for income taxes for interim periods generally requires the provision for income taxes to be determined by applying an estimate of the annual effective tax rate for the full fiscal year to income or loss before income taxes, excluding unusual or infrequently occurring discrete items (“Ordinary” income), for the reporting period. The Company anticipates that some of the net operating losses generated in 2020 can be carried back to prior taxable years, and recognizes the benefit in its annual effective tax rate. The Company has also recorded the tax benefit of carrying back 2018 and 2019 net operating losses as a discrete tax benefit. The Company will continue to evaluate the potential impact of the CARES Act.

The U.S. Treasury Department has adopted regulations requiring related parties in an intercompany cost-sharing arrangement to share expenses related to share-based compensation in proportion to the economic activity of the related parties. On June 7, 2019, the U.S. Court of Appeals for the Ninth Circuit issued an opinion in Altera Corp. v. Commissioner upholding these regulations, which reversed the prior decision of the U.S. Tax Court. On November 12, 2019, the Ninth Circuit Court of

Appeals denied the plaintiff's request for an en banc rehearing. The plaintiff filed a petition for a writ of certiorari in the U.S. Supreme Court on February 10, 2020. On June 22, 2020, the U.S. Supreme Court declined to issue a writ of certiorari in the Altera v. Commissioner case. The actions of the U.S. Supreme Court did not have a material impact on the Company's consolidated financial statements.

The Company accounts for deferred taxes under ASC Topic 740, "Income Taxes," which involves weighing positive and negative evidence concerning the realizability of the Company's deferred tax assets in each jurisdiction. In evaluating its ability to realize the net deferred tax assets, the Company considered all available positive and negative evidence, including its past operating results and the forecast of future market growth, forecasted earnings, future taxable income, and prudent and feasible tax planning strategies. As of October 3, 2020, the Company maintains a valuation allowance against all of its U.S. deferred tax assets and against certain of its foreign deferred tax assets. The Company will continue to assess the realizability of its deferred tax assets in each of the applicable jurisdictions going forward.

As of October 3, 2020, the total amount of gross unrecognized tax benefits was $83.1 million, of which $46.3 million would affect the effective tax rate if recognized. The Company did not have any tax positions as of October 3, 2020 which it is reasonably possible that the total amount of gross unrecognized tax benefits will increase or decrease within the following 12 months.

The material jurisdictions in which the Company is subject to potential examination include the United States and Ireland. The Company believes that adequate amounts have been reserved for these jurisdictions. For the United States, the Company is currently under examination by the Internal Revenue Service ("IRS") for fiscal 2015 to 2019. For state and non-U.S. tax returns, the Company is generally no longer subject to tax examinations for years prior to 2014.

9. Net Loss per Share

The following table sets forth the computation of the Company's basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
Numerator:				
Net loss	$ (54,452)	$ (51,893)	$ (138,255)	$ (199,876)
Denominator:				
Weighted-average shares of common stock—basic for Class A and Class B	270,443	258,753	267,958	256,046
Effect of dilutive securities	—	—	—	—
Weighted-average shares of common stock—diluted for Class A and Class B	270,443	258,753	267,958	256,046
Net loss per share:				
Basic	$ (0.20)	$ (0.20)	$ (0.52)	$ (0.78)
Diluted	$ (0.20)	$ (0.20)	$ (0.52)	$ (0.78)

The following potentially dilutive common shares were excluded from the computation of diluted net loss per share for the periods presented because including them would have been anti-dilutive (in thousands):

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
Stock options to purchase common stock	11,255	15,384	11,255	15,584
RSUs	19,084	18,279	19,084	20,998
Warrant	230	230	230	230
Diluted impact of Employee Stock Purchase Plan	—	1,412	—	1,351
Total	30,569	$ 35,305	30,569	38,163

10. Significant Customer Information and Other Information

Retailer and Distributor Concentration

Retailers and distributors that accounted for equal to or greater than 10% of total revenue for the three and nine months ended October 3, 2020 and September 28, 2019 were as follows:

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
C	11 %	*	12 %	*
G	— %	12 %	—	*
D	— %	11 %	—	*

* Represents less than 10%.

Retailers and distributors that accounted for equal to or greater than 10% of accounts receivable at October 3, 2020 and December 31, 2019 were as follows:

	October 3, 2020	December 31, 2019
C	13 %	18 %
D	—	11
E	—	10

* Represents less than 10%.

Geographic and Other Information

Revenue by geographic region, based on ship-to destinations, was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
United States	$ 195,001	$ 206,654	$ 461,769	$ 522,607
Americas excluding United States	25,960	16,722	47,158	51,227
Europe, Middle East, and Africa	102,401	82,951	231,782	257,612
Asia Pacific	40,570	40,873	72,653	101,200
Total	$ 363,932	$ 347,200	$ 813,362	$ 932,646

As of October 3, 2020 and December 31, 2019, long-lived assets, which represent property and equipment, located outside the United States were $27.5 million and $27.9 million, respectively.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

As discussed in the section titled “Note About Forward-Looking Statements,” the following discussion and analysis contains forward-looking statements that involve risks and uncertainties, as well as 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. Factors that could cause or contribute to such differences include, but are not limited to, those identified below and in the section titled “Risk Factors” included under Part II, Item 1A below.

Overview

The Fitbit platform combines wearable devices with software and services to give our users tools to help them reach their health and fitness goals, augmented by general purpose features that add further utility and drive user engagements. Our wearable devices enable users to view data about their daily activity, exercise, and sleep in real time. Today, most of our revenue comes from the sale of wearable devices, including both trackers and smartwatches. Our products are available in over 100 countries worldwide through a variety of channels, including retail stores, retailer websites, and Fitbit.com, and through Fitbit Health Solutions.

On November 1, 2019, we entered into an Agreement and Plan of Merger, or Merger Agreement, with Google LLC, or Google, pursuant to which Google has agreed to acquire us for $7.35 per share in cash, valuing us at a fully diluted equity value of approximately $2.1 billion. Under the terms of, and subject to the conditions specified in, the Merger Agreement, we will become a wholly owned subsidiary of Google (the “Merger”). The Merger was approved by our stockholders on January 3, 2020. The Merger is subject to customary closing conditions, including regulatory approvals. The duration of regulatory approvals cannot be foreseen with certainty. While the Merger is expected to close in 2020, the time frame may extend beyond that. The Merger Agreement may be terminated by mutual agreement of the parties or by either us or Google under specified conditions. We will be required to pay Google a termination fee of $80 million in certain circumstances, such as a material, uncured breach of our obligations under the Merger Agreement, and Google will be required to pay us a termination fee of $250 million in certain circumstances related to a failure to obtain regulatory approvals or the existence of a restraint arising under the antitrust laws.

Our business during the first three quarters of 2020 was negatively affected by the outbreak of the novel coronavirus COVID-19. As discussed further below, we expect the COVID-19 pandemic and associated mitigation efforts to continue to negatively impact our results in 2020, although the nature and extent will depend on future developments that are evolving and highly uncertain. We remain committed to our mission to empower and inspire people to live healthier, more active lives, while prioritizing the health and safety of our workforce.

In the first three quarters of 2020, we focused on adding offerings for users looking to manage their overall health. In the third quarter of 2020, we introduced three new devices: Fitbit Sense, the world’s first smartwatch with an electrodermal activity (EDA) sensor to help manage stress; Fitbit Versa 3, adding on-device GPS and a speaker to our most popular smartwatch family; and Fitbit Inspire 2, an enhanced version of our most affordable heart rate tracking device. With the purchase of Fitbit Sense and Fitbit Inspire 2, we offer a six-month and one-year free trial to Fitbit Premium, respectively, while certain other Fitbit devices offer a three-month free trial to Fitbit Premium. In the first quarter of 2020, we introduced Fitbit Charge 4, which innovates on our Charge family of trackers with built-in GPS. Additionally, we added more content to Fitbit Premium, our paid subscription service offering personalized health insights, guidance, advanced sleep tools, customized programs, mindfulness content, and over 200 workouts from various brands. To help support our users during the COVID-19 pandemic, in the first quarter of 2020, we announced a 90-day free trial for new Fitbit Premium users and, in the third quarter of 2020, Fitbit Premium reached over 500,000 paid subscribers during its first year since launch. During the third quarter of 2020, we also launched Fitbit Premium + Health Coaching, a virtual one-on-one coaching service matching users to a dedicated certified health professional to create personalized plans using their Fitbit data.

Acquiring customers through the sale of our devices increases the size of our community of users and also increases the potential for future demand for devices and other monetization opportunities, such as software services or coaching revenue. While software revenue continued to be immaterial in the first three quarters of 2020, we believe a growing community of active users provides an opportunity to introduce or further develop software services for our community in the future. We continue to focus on growing our Fitbit Health Solutions channel, which delivers health and wellness solutions for employers, health plans, and health systems and provides an opportunity to drive demand for our devices and software services. Revenue from the Fitbit Health Solutions channel was approximately 8% of total revenue in the first three quarters of 2020.

For the full year 2020, we expect devices sold and revenue to decline compared to full year 2019 primarily as a result of the impact of the COVID-19 pandemic discussed further below, as well as due to the timing of our new product launches. We expect smartwatches to grow as a percentage of revenue compared to the prior year. We expect growth in our higher margin Fitbit Premium and Fitbit Health Solutions revenue streams in 2020 compared to 2019. We expect research and development expenses to increase for the full year 2020 over 2019 as we increase our investment into the expanding wearable device market, which we anticipate will be partially offset by a projected decrease in sales and marketing and general and administrative expenses, with the exception of higher costs related to the Merger Agreement.

Impact of COVID-19

The outbreak of the novel coronavirus COVID-19, which was declared a global pandemic by the World Health Organization in March 2020, adversely impacted our business in the first three quarters of 2020. The pandemic and associated containment measures have caused disruptions in the development, manufacture, shipment, and sales of our products. Such disruptions have been due primarily to temporary closures of our facilities, those of our customers and retailers who sell our products, and those of our contract manufacturers and other supply chain vendors; difficulties in transporting goods and materials; restrictions on travel; and quarantines, stay-at-home orders, and social distancing guidelines in effect in many of the regions in which we operate. In addition, the COVID-19 pandemic and related mitigation efforts have disrupted the economies of the United States and numerous other countries, which is impacting consumer sentiment and discretionary spending.

We have temporarily closed our headquarters in San Francisco, California and other facilities worldwide to protect the health of our employees. We have implemented a work-from-home policy for the majority of our global workforce and we are severely restricting business travel, in light of the recommendations or requirements of government authorities. The costs to implement our work-from-home policy during the first three quarters of 2020 were not material. We will continue to monitor the situation to determine suitable actions, which may vary by location. For example, we may adapt or extend our work-from-home policy beyond what is required by government authorities as we believe to be appropriate for the health and safety of our workforce or in our best interests, although such actions could adversely impact the efficiency and effectiveness of our organization.

During the first three quarters of 2020, our operating results were negatively impacted by decreased retail activity and retail store closures due to COVID-19, which was partially offset by increased revenue from our direct channel, Fitbit.com. Operating results were also impacted by additional reserves for product returns, rebates and promotions, and price protection on certain products, primarily as a result of declining demand due to COVID-19.

The current circumstances are dynamic and unprecedented, and the impacts of the COVID-19 pandemic on our business operations, including the duration and severity of the effect on overall consumer demand, are highly uncertain and cannot be predicted. However, these impacts have had, and we expect will continue to have, a significant adverse effect on our operations, revenue, liquidity, financial conditions, and financial results. The impact will depend largely on future developments, including the duration and severity of the pandemic; potential resurgence(s) of COVID-19 in the future; the effectiveness of actions taken by governments, businesses, and individuals in response to COVID-19; the stability of capital and financial markets; and how quickly and to what extent economic and operating conditions that pre-dated the pandemic can resume.

We are focused on preserving our liquidity and managing our cash flow through the financial challenges presented by COVID-19 by reducing our discretionary spending, closely managing inventory levels, and reducing marketing spend. While we have been significantly impacted by the COVID-19 pandemic, we believe, based on our current forecasts, that we have sufficient liquidity to meet our working capital and capital expenditure needs through the anticipated closing of the Merger with Google. If the transaction were to be materially delayed or fail to close, or if revenues were to be materially below our forecasts, we would likely need to raise additional funds, which we may not be able to do on favorable terms or at all. We have received various tax benefits from the Coronavirus Aid, Relief and Economic Security Act (“CARES Act”), as described in Note 8 of the Notes to Condensed Consolidated Financial Statements and below in the section titled “Components of our Operating Results” under “Income Tax Expense (Benefit).” For further information regarding the impact of COVID-19 on our business, please see the below discussion under “Operating Results” and Item 1A, Risk Factors in this Quarterly Report on Form 10-Q.

Financial Highlights

The following are financial highlights for the three and nine months ended October 3, 2020 and September 28, 2019 (in thousands):

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
Revenue	$ 363,932	$ 347,200	$ 813,362	$ 932,646
Net loss	$ (54,452)	$ (51,893)	$ (138,255)	$ (199,876)
Adjusted EBITDA	$ (34)	$ (19,439)	$ (108,133)	$ (93,455)
Devices sold	3,303	3,540	7,943	9,999

See the section titled "Key Business Metrics" for additional information regarding devices sold and adjusted EBITDA, including a reconciliation of adjusted EBITDA to net income (loss).

Key Business Metrics

In addition to the measures presented in our condensed consolidated financial statements, we use the following key metrics to evaluate our business, measure our performance, develop financial forecasts, and make strategic decisions.

Devices Sold

Devices sold represents the number of wearable devices that are sold during a period, net of expected returns. Devices sold does not include sales of accessories. Growth rates between devices sold and revenue are not necessarily correlated because our revenue is affected by other variables, such as the types of products sold during the period, the introduction of new product offerings with differing U.S. manufacturer's suggested retail prices, the effect of rebates and promotions, and sales of accessories and premium services.

Activations - Repeat and Re-Activated Users

We define an "Activation" as the first instance of a Fitbit device (excluding Aria, Aria 2, Flyer and other accessories) pairing to a user account during the three months prior to the date of measurement. A "Repeat User" is defined as a Fitbit user who activated a Fitbit device to his or her account during the measurement period and activated a different Fitbit device to his or her account during a prior period. A "Re-Activated User" is defined as Repeat User who has not synced his or her prior device and taken at least 100 steps for 90 days or more prior to the measurement period with such device. In the three and nine months ended October 3, 2020, 53.9% and 45.1%, respectively, of Activations came from Repeat Users, with Re-Activated Users representing 53.1% and 55.5%, respectively, of those Repeat Users. The number of Activations from Repeat Users and the number of Re-Activated Users for any period is measured promptly after the measurement period and is not updated.

We believe that the Activations metric is a potential indicator of repeat purchase behavior but not a guarantee of repeat purchase behavior. Actual repeat purchase behavior may depend on a number of factors, including but not limited to our ability to anticipate and satisfy consumer preferences.

Active Users

We grow our community of users through device sales and investment in software to drive engagement. We define an active user as a registered Fitbit user who, within the three months prior to the date of measurement, has (a) an active Fitbit Premium or Fitbit Coach subscription, (b) paired a wearable device or Aria scale with his or her Fitbit account, or (c) logged at least 100 steps with a wearable device or a weight measurement using an Aria scale. Active users can be new users who joined the community during the past 90 days, existing users who have remained active, or previously active users who were inactive for 90 days or greater, if they meet the preceding definition of an active user. The active user number includes users who have downloaded our mobile apps without purchasing any of our wearable devices for users who have downloaded free versions of Fitbit Premium but are not subscribers to its paid premium offerings.

Adjusted EBITDA

To supplement our condensed consolidated financial statements presented in accordance with U.S. GAAP, we monitor and consider adjusted EBITDA, which is a non-GAAP financial measure. This non-GAAP financial measure is not based on any standardized methodology prescribed by U.S. GAAP and is not necessarily comparable to similarly titled measures presented by other companies.

We define adjusted EBITDA as net loss adjusted to exclude stock-based compensation expense, acquisition-related costs, the impact of restructuring, depreciation and intangible assets amortization, interest income (expense), net, and income tax expense (benefit).

We use adjusted EBITDA to evaluate our operating performance and trends and make planning decisions. We believe that adjusted EBITDA helps identify underlying trends in our business that could otherwise be masked by the effect of the expenses and other items that we exclude in adjusted EBITDA. In particular, exclusion of the effect of stock-based compensation expense and certain other expenses in calculating adjusted EBITDA can provide a useful measure for period-to-period comparisons of our business. Accordingly, we believe that adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results, enhances overall understanding of our past performance and future prospects, and allows for greater transparency with respect to a key financial metric used by our management in its financial and operational decision-making.

Adjusted EBITDA is not prepared in accordance with U.S. GAAP, and should not be considered in isolation of, or as an alternative to, measures prepared in accordance with U.S. GAAP. There are a number of limitations related to the use of this non-GAAP financial measure rather than net loss, which is the nearest U.S. GAAP equivalent of adjusted EBITDA. For example, adjusted EBITDA excludes stock-based compensation expense, which has been, and will continue to be for the foreseeable future, a significant recurring expense for our business and an important part of our compensation strategy. Accordingly, adjusted EBITDA should be considered along with other operating and financial performance measures presented in accordance with U.S. GAAP.

The following table presents a reconciliation of net loss to adjusted EBITDA (in thousands):

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
Net loss	(54,452)	(51,893)	(138,255)	(199,876)
Stock-based compensation expense	18,377	18,084	57,877	59,175
Acquisition-related costs	18,239	—	57,166	—
Restructuring	—	—	—	2,458
Depreciation and intangible assets amortization	13,563	15,089	41,683	49,314
Interest expense (income), net	268	(2,388)	(1,038)	(8,476)
Income tax expense (benefit)	3,971	1,669	(125,566)	3,950
Adjusted EBITDA	$ (34)	$ (19,439)	$ (108,133)	$ (93,455)

Non-GAAP Free Cash Flow

We define non-GAAP free cash flow as net cash provided by (used in) operating activities less purchase of property and equipment. We consider free cash flow to be a liquidity measure that provides useful information to management and investors about the amount of cash generated by the business that can possibly be used for investing in our business and strengthening our balance sheet, but it is not intended to represent the residual cash flow available for discretionary expenditures.

The following table presents a reconciliation of net cash used in operating activities to non-GAAP free cash flow (in thousands):

	Nine Months Ended	
	October 3, 2020	September 28, 2019
Net cash used in operating activities	$ (62,608)	$ (185,112)
Purchase of property and equipment	(22,419)	(26,277)
Non-GAAP free cash flow	$ (85,027)	$ (211,389)
Net cash provided by investing activities	$ 118,723	$ 7,277
Net cash used in financing activities	$ (17,210)	$ (8,690)

Components of our Operating Results

Revenue

We have three sources of revenue: consumer device revenue, Fitbit Health Solutions revenue, and consumer services revenue. The vast majority of our total revenue comes from the sale of wearable devices through the retail, direct, and Fitbit Health Solutions channels. Within the Fitbit Health Solutions channel, revenue is composed of devices, services, and software, with most of our revenue driven by device sales. Consumer services revenue includes revenue from our Premium subscription and extended warranty offerings.

Cost of Revenue

Cost of revenue consists of product costs, including costs of contract manufacturers for production, shipping and handling costs, warranty replacement costs, packaging, fulfillment costs, manufacturing and tooling equipment depreciation, warehousing costs, hosting costs, write-downs of excess and obsolete inventory, platform fees associated with consumer services revenue, amortization of developed technology intangible assets acquired, and certain allocated costs related to management, facilities, and personnel-related expenses and other expenses associated with supply chain logistics. Personnel-related expenses include salaries, bonuses, benefits, and stock-based compensation.

Operating Expenses

Operating expenses consist of research and development, sales and marketing, and general and administrative expenses.

Research and Development. Research and development expenses consist primarily of personnel-related expenses, consulting and contractor expenses, tooling and prototype materials, and allocated overhead costs.

Substantially all of our research and development expenses are related to developing new products and services and improving our existing products and services. To date, research and development expenses have been expensed as incurred, because the release of products and services for sale has been short and development costs qualifying for capitalization have been insignificant.

Sales and Marketing. Sales and marketing expenses represent a significant component of our operating expenses and consist primarily of advertising and marketing promotions of our products and services and personnel-related expenses, as well as sales incentives, trade show and event costs, sponsorship costs, consulting and contractor expenses, travel, point-of-purchase display expenses and related amortization, and allocated overhead costs.

General and Administrative. General and administrative expenses consist of personnel-related expenses for our finance, legal, human resources, and administrative personnel, as well as the costs of professional services, allocated overhead, information technology, bad debt expense, amortization of intangible assets acquired, and other administrative expenses.

Interest Income (Expense), Net

Interest income (expense), net consists of interest expense associated with our debt financing arrangements, amortization of debt issuance costs, and interest income earned on our cash, cash equivalents, and marketable securities.

Other Income (Expense), Net

Other income (expense), net consists of foreign currency gains and losses.

Income Tax Expense (Benefit)

We are subject to income taxes in the United States and foreign jurisdictions in which we do business. These foreign jurisdictions have statutory tax rates different from those in the United States. Accordingly, our effective tax rates will vary depending on the relative proportion of foreign to U.S. income and changes in tax laws.

On March 27, 2020, the CARES Act was signed into law. The CARES Act includes, among other items, provisions relating to refundable payroll tax credits, deferment of the employer portion of certain payroll taxes, net operating loss carryback periods, alternative minimum tax credit refunds, modifications to the net interest deduction limitations and technical corrections to tax depreciation methods for qualified improvement property.

The CARES Act allows losses incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding tax years and to offset 100% of regular taxable income in such years. We anticipate that, as a result of the CARES Act, some of the net operating losses generated in 2020, and all of the net operating losses generated in 2018 and 2019, will be carried back to prior taxable years resulting in material cash benefits to us. We will continue to evaluate the potential impact of the CARES Act.

The U.S. Treasury Department has adopted regulations requiring related parties in an intercompany cost-sharing arrangement to share expenses related to share-based compensation in proportion to the economic activity of the related parties. On June 7, 2019, the U.S. Court of Appeals for the Ninth Circuit issued an opinion in Altera Corp. v. Commissioner upholding these regulations, which reversed the prior decision of the U.S. Tax Court. On November 12, 2019, the Ninth Circuit Court of Appeals denied the plaintiff's request for an en banc rehearing. The plaintiff filed a petition for a writ of certiorari in the U.S. Supreme Court on February 10, 2020. On June 22, 2020, the U.S. Supreme Court declined to issue a writ of certiorari in the Altera v. Commissioner case. The actions of the U.S. Supreme Court did not have a material impact on our consolidated financial statements.

Operating Results

The following tables set forth the components of our condensed consolidated statements of operations for each of the periods presented and as a percentage of our revenue for those periods (in thousands, except percentages). The period-to-period comparison of operating results is not necessarily indicative of results for future periods.

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
Consolidated Statements of Operations Data:				
Revenue	$ 363,932	$ 347,200	$ 813,362	$ 932,646
Cost of revenue[(1)]	228,120	239,248	529,586	627,027
Gross profit	135,812	107,952	283,776	305,619
Operating expenses:				
Research and development[(1)]	90,771	65,693	256,093	213,651
Sales and marketing[(1)]	60,726	71,296	183,157	222,972
General and administrative[(1)]	35,493	23,083	112,583	74,640
Total operating expenses	186,990	160,072	551,833	511,263
Operating loss	(51,178)	(52,120)	(268,057)	(205,644)
Interest income (expense), net	(268)	2,388	1,038	8,476
Other income (expense), net	965	(492)	3,198	1,242
Loss before income taxes	(50,481)	(50,224)	(263,821)	(195,926)
Income tax expense (benefit)	3,971	1,669	(125,566)	3,950
Net loss	$ (54,452)	$ (51,893)	$ (138,255)	$ (199,876)

Table of Contents

(1) Includes stock-based compensation expense as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
Stock-Based Compensation Expense:				
Cost of revenue	$ 1,846	$ 1,446	$ 6,059	$ 4,397
Research and development	10,633	10,557	33,194	34,437
Sales and marketing	2,701	2,587	8,376	8,900
General and administrative	3,197	3,494	10,248	11,441
Total stock-based compensation expense	$ 18,377	$ 18,084	$ 57,877	$ 59,175

	Three Months Ended		Nine Months Ended	
	October 3, 2020	September 28, 2019	October 3, 2020	September 28, 2019
	(as a percentage of revenue)			
Consolidated Statements of Operations Data:				
Revenue	100 %	100 %	100 %	100 %
Cost of revenue	63	69	65	67
Gross profit	37	31	35	33
Operating expenses:				
Research and development	24	19	30	23
Sales and marketing	17	21	23	24
General and administrative	10	7	14	8
Total operating expenses	51	46	67	55
Operating loss	(14)	(15)	(32)	(22)
Interest income (expense), net	—	1	—	1
Other income (expense), net	—	—	—	—
Loss before income taxes	(14)	(14)	(32)	(21)
Income tax expense (benefit)	1	—	(15)	—
Net loss	(15) %	(15) %	(17) %	(21) %

Revenue

	Three Months Ended		Change		Nine Months Ended		Change	
(dollars in thousands)	October 3, 2020	September 28, 2019	$	%	October 3, 2020	September 28, 2019	$	%
Revenue	$ 363,932	$ 347,200	$ 16,732	5 %	$ 813,362	$ 932,646	$ (119,284)	(13)%

Revenue increased $16.7 million, or 5%, to $363.9 million for the three months ended October 3, 2020, from $347.2 million for the three months ended September 28, 2019, primarily as a result of a higher smartwatch mix due to the introduction of our two new smartwatches in the third quarter of 2020, as well as an increase in average selling price. Sales of smartwatches increased to 60% of revenue for the third quarter of 2020 from 59% of revenue for the same period in 2019, while demand for trackers decreased to 36% of revenue from 40% of revenue in the same period in 2019. As a result of new product launches in the third quarter of 2020 with innovative features at higher price points, average selling price increased by 8% to $104 for the third quarter of 2020, from $96 in the third quarter of 2019. As a result of fewer new product introductions, or NPIs, of smartwatches and trackers in 2020 compared to 2019, revenue from NPIs decreased to $187.9 million, or 52% of revenue, in the third quarter of 2020, from $211.7 million, or 61% of revenue, during the third quarter of 2019. Total devices sold decreased 7% year over year, to 3.3 million devices sold in the third quarter of 2020, from 3.5 million devices sold during the same period in 2019. Revenue from our direct channel, Fitbit.com, increased 54% to $42.0 million, or 12% of revenue, in the three months ended October 3, 2020, compared to $27.2 million, or 8% of revenue, in the same period in 2019.

Revenue decreased $119.3 million or 13%, to $813.4 million for the nine months ended October 3, 2020, from $932.6 million for the nine months ended September 28, 2019, primarily as a result of decreased retail activity and retail store closures due to COVID-19 during the first half of 2020. The decrease in retail revenue was partially offset by an increase in revenue from our direct channel, Fitbit.com, which increased 47% to $131.0 million, or 16% of revenue, in the nine months ended October 3, 2020, compared to $88.8 million, or 10% of revenue, in the same period in 2019. As a result of the increased revenue from our direct channel, which experiences fewer discounts and returns, our recent new product launches with innovative features at higher price points, and fewer promotions compared to the prior year, average selling price increased by 5% to $96 for the first three quarters of 2020, from $91 for the first three quarters of 2019. As a result of fewer product introductions of smartwatches and trackers in 2020 compared to 2019, revenue from NPIs decreased to $482.9 million, or 59% of revenue, during the first three quarters of 2020, from $606.8 million, or 65% of revenue, during the first three quarters of 2019. Total devices sold decreased 21% year over year, to 7.9 million devices sold in the first three quarters of 2020, from 10.0 million devices sold during the same period in 2019. Sales of our smartwatches increased to 53% of revenue for the first three quarters of 2020 from 47% of revenue for the same period in 2019, while demand for our trackers decreased to 43% of revenue for the first three quarters of 2020, from 52% of our revenue in the same period in 2019.

U.S. revenue, based on ship-to destinations, decreased $11.7 million, or 6%, to $195.0 million for the three months ended October 3, 2020, from $206.7 million for the three months ended September 28, 2019. International revenue, based on ship-to destinations, increased $28.4 million, or 20%, to $168.9 million for the three months ended October 3, 2020, from $140.5 million for the three months ended September 28, 2019, primarily due to an increase of 23% in the Europe, Middle East, and Africa region.

U.S. revenue decreased $60.8 million, or 12%, to $461.8 million for the nine months ended October 3, 2020, from $522.6 million for the nine months ended September 28, 2019. International revenue decreased $58.4 million, or 14%, to $351.6 million for the nine months ended October 3, 2020, from $410.0 million for the nine months ended September 28, 2019, primarily due to a decrease of 28% in the Asia Pacific region. The increase in revenue from our direct channel, Fitbit.com, was primarily in the United States for the nine months ended October 3, 2020.

Cost of Revenue

	Three Months Ended		Change		Nine Months Ended		Change	
(dollars in thousands)	October 3, 2020	September 28, 2019	$	%	October 3, 2020	September 28, 2019	$	%
Cost of revenue	$ 228,120	$ 239,248	$ (11,128)	(5)%	$ 529,586	$ 627,027	$ (97,441)	(16)%
Gross profit	135,812	107,952	27,860	26 %	283,776	305,619	(21,843)	(7)%
Gross margin	37 %	31 %			35 %	33 %		

Cost of revenue decreased to $228.1 million for the three months ended October 3, 2020, from $239.2 million for the three months ended September 28, 2019. The decrease in cost of revenue was due to a $13.5 million reduction in product costs and a $7.6 million reduction in warranty expense, both associated with the decreases in devices sold compared to the same period in 2019, as well as a $4.5 million decrease in excess and obsolete inventory write-downs compared to the prior period. The reduction in warranty expense was also associated with lower customer support contact rates due to the improved quality of our products. The decrease in cost of revenue was partially offset by a $6.1 million increase in platform fees associated with an increase in consumer services revenue.

Cost of revenue decreased to $529.6 million for the nine months ended October 3, 2020, from $627.0 million for the nine months ended September 28, 2019. In the first quarter of 2020, we were granted an exclusion from tariffs on our products manufactured in China, resulting in a $21.3 million benefit during the period for tariff costs incurred in 2019. The decrease in cost of revenue for the nine months ended October 3, 2020 was also due to a $76.8 million reduction in product costs and a $13.7 million reduction in warranty expense, both associated with the decreases in devices sold compared to the same period in 2019, as well as an $8.6 million decrease in excess and obsolete inventory write-downs compared to the prior period. The reduction in warranty expense was also associated with lower customer support contact rates due to the improved quality of our products. The decrease in cost of revenue was partially offset by a $11.1 million increase in platform fees associated with an increase in consumer services revenue and a $4.0 million increase in shipping and handling costs due to the increase in shipments in our direct channel, Fitbit.com.

Gross margin increased to 37% for the three months ended October 3, 2020, from 31% for the three months ended September 28, 2019, primarily due to a decrease in discounts, rebates and promotions, an increase in consumer services revenue, and an increase in revenue from our direct channel, Fitbit.com.

Gross margin increased to 35% for the nine months ended October 3, 2020, from 33% for the nine months ended September 28, 2019, primarily due to a decrease in discounts, rebates and promotions, lower warranty costs, an increase in consumer services revenue, and an increase in revenue from our direct channel, Fitbit.com. The increase in gross margin was also driven by the benefit of the tariffs exclusion during the first three quarters of 2020.

Research and Development

	Three Months Ended		Change		Nine Months Ended		Change	
(dollars in thousands)	October 3, 2020	September 28, 2019	$	%	October 3, 2020	September 28, 2019	$	%
Research and development	$ 90,771	$ 65,693	$ 25,078	38 %	$ 256,093	$ 213,651	$ 42,442	20 %

Research and development expenses increased $25.1 million, or 38%, to $90.8 million for the three months ended October 3, 2020, from $65.7 million for the three months ended September 28, 2019. The increase was primarily due to a $21.4 million increase in personnel-related expenses, including bonuses connected with the Merger, and a $3.3 million increase in tooling expenses, offset by a $1.7 million decrease in travel expenses. Headcount increased 13% for the three months ended October 3, 2020 compared to the prior year period.

Research and development expenses increased $42.4 million, or 20%, to $256.1 million for the nine months ended October 3, 2020, from $213.7 million for the nine months ended September 28, 2019. The increase was primarily due to a $39.0 million increase in personnel-related expenses, including bonuses connected with the Merger, and a $3.9 million increase in tooling expenses, offset by a $3.8 million decrease in travel expenses. Headcount increased 4% for the nine months ended October 3, 2020 compared to the prior year period.

Sales and Marketing

	Three Months Ended		Change		Nine Months Ended		Change	
(dollars in thousands)	October 3, 2020	September 28, 2019	$	%	October 3, 2020	September 28, 2019	$	%
Sales and marketing	$ 60,726	$ 71,296	$ (10,570)	(15)%	$ 183,157	$ 222,972	$ (39,815)	(18)%

Sales and marketing expenses decreased $10.6 million, or 15%, to $60.7 million for the three months ended October 3, 2020, from $71.3 million for the three months ended September 28, 2019. The decrease was primarily due to a $15.2 million reduction in marketing expenses due to timing of media spend to support product launches and a $1.7 million decrease in customer support costs due to the improved quality and reduced case volume of our products, offset by an increase of $5.2 million in personnel-related expenses, including bonuses connected with the Merger. Headcount decreased 1% for the three months ended October 3, 2020 compared to the prior year period.

Sales and marketing expenses decreased $39.8 million, or 18%, to $183.2 million for the nine months ended October 3, 2020, from $223.0 million for the nine months ended September 28, 2019. The decrease was primarily due to a $43.9 million reduction in marketing expenses due to timing of media spend to support product launches, an $8.1 million decrease in customer support costs due to the improved quality and reduced case volume of our products, and a $2.0 million decrease in travel expenses, offset by an increase of $8.3 million in personnel-related expenses, including bonuses connected with the Merger. Headcount increased 1% for the nine months ended October 3, 2020 compared to the prior year period.

General and Administrative

	Three Months Ended		Change		Nine Months Ended		Change	
(dollars in thousands)	October 3, 2020	September 28, 2019	$	%	October 3, 2020	September 28, 2019	$	%
General and administrative	$ 35,493	$ 23,083	$ 12,410	54 %	$ 112,583	$ 74,640	$ 37,943	51 %

General and administrative expenses increased $12.4 million, or 54%, to $35.5 million for the three months ended October 3, 2020, from $23.1 million for the three months ended September 28, 2019. The increase was primarily due to an $8.9 million increase in personnel-related expenses, including bonuses connected with the Merger, a $7.2 million increase in legal fees primarily related to litigation, and a $4.3 million increase in consulting and legal fees related to the Merger Agreement with

Google, offset by a $5.6 million decrease in credit loss allowances. Headcount decreased 3% for the three months ended October 3, 2020 compared to the prior year period.

General and administrative expenses increased $37.9 million, or 51%, to $112.6 million for the nine months ended October 3, 2020, from $74.6 million for the nine months ended September 28, 2019. The increase was primarily due to $16.9 million in consulting and legal fees related to the Merger Agreement with Google, a $16.1 million increase in legal fees primarily related to litigation, and a $10.7 million increase in personnel-related expenses, including bonuses connected with the Merger, offset by a $4.0 million decrease in allocated overhead. Headcount decreased 1% for the nine months ended October 3, 2020 compared to the prior year period.

Interest and Other Income (Expense), Net

	Three Months Ended		Change		Nine Months Ended		Change	
(dollars in thousands)	October 3, 2020	September 28, 2019	$	%	October 3, 2020	September 28, 2019	$	%
Interest income (expense), net	$ (268)	$ 2,388	$ (2,656)	(111)%	$ 1,038	$ 8,476	$ (7,438)	(88)%
Other income (expense), net	965	(492)	1,457	(296)%	3,198	1,242	1,956	157 %

Interest income (expense), net decreased $2.7 million, to an expense of $0.3 million for the three months ended October 3, 2020, from income of $2.4 million for the three months ended September 28, 2019, primarily due to decreases in cash, cash equivalents, and marketable securities balances, as well as lower interest rates earned. Other income (expense), net increased primarily due to an increase in foreign currency gains.

Interest income (expense), net decreased $7.4 million, to $1.0 million for the nine months ended October 3, 2020, from $8.5 million for the nine months ended September 28, 2019, primarily due to decreases in cash, cash equivalents, and marketable securities balances, as well as lower interest rates earned. Other income (expense), net increased primarily due to an increase in foreign currency gains.

Income Tax Expense (Benefit)

	Three Months Ended		Change		Nine Months Ended		Change	
(dollars in thousands)	October 3, 2020	September 28, 2019	$	%	October 3, 2020	September 28, 2019	$	%
Income tax expense (benefit)	$ 3,971	$ 1,669	$ 2,302	138 %	$ (125,566)	$ 3,950	$ (129,516)	(3,279)%
Effective tax rate	(7.9)%	(3.3) %			47.6 %	(2.0) %		

Income tax expense increased $2.3 million, to an income tax expense of $4.0 million for the three months ended October 3, 2020, from an income tax expense of $1.7 million for the three months ended September 28, 2019. Our effective tax rate was (7.9)% and (3.3)% for the three months ended October 3, 2020 and September 28, 2019, respectively. The change in our effective tax rate for the three months ended October 3, 2020 was primarily due to the impact of carrying back current year, 2018 and 2019 net operating losses into prior taxable periods under the provisions adopted under the CARES Act. The tax expense for the three months ended October 3, 2020 includes a true-up to the tax benefit recorded through the second quarter of 2020 for the carryback of net operating losses due to changes in the mix of income/losses between our jurisdictions in the third quarter of 2020.

Income tax expense decreased $129.5 million, to an income tax benefit of $125.6 million for the nine months ended October 3, 2020, from an income tax expense of $4.0 million for the nine months ended September 28, 2019. Our effective tax rate was 47.6% and (2.0)% for the nine months ended October 3, 2020 and September 28, 2019, respectively. The change in our effective tax rate for the nine months ended October 3, 2020 was primarily due to the impact of carrying back current year, 2018 and 2019 net operating losses into prior taxable periods under the provisions adopted under the CARES Act.

Liquidity and Capital Resources

Our operations have been financed primarily through cash flow from operating activities and net proceeds from the sale of our equity securities. As of October 3, 2020, we had cash and cash equivalents of $373.4 million and marketable securities of $43.1 million, approximately 72% of which are held by a U.S. legal entity in the United States.

Of our total cash, cash equivalents, and marketable securities, $117.2 million is held by our foreign subsidiaries. Our intent is to indefinitely reinvest our earnings from foreign operations, and based on our current plans, we do not anticipate that we will require funds generated from foreign operations to fund our domestic operations. In the event funds from foreign operations are needed to fund operations in the United States in the future, we may be required to accrue and pay additional taxes on repatriated funds at that time.

While we have been significantly impacted by the COVID-19 pandemic, we believe, based on our current forecasts, that we have sufficient liquidity to meet our working capital and capital expenditure needs through the anticipated closing of the Merger with Google. If the transaction were to be materially delayed or fail to close, or if revenues were to be materially below our forecasts, we would likely need to raise additional funds, which we may not be able to do on favorable terms or at all. Our future capital requirements may vary materially from those currently planned and will depend on many factors, including our levels of revenue, the timing and extent of spending on research and development efforts and other business initiatives, the expansion of sales and marketing activities, the timing of NPIs, market acceptance of our products, acquisitions, challenges presented by COVID-19, and overall economic conditions. We are focused on navigating the financial challenges presented by COVID-19 by preserving our liquidity and managing our cash flow, including through reducing our discretionary spending, closely managing inventory levels, and reducing marketing spend. To the extent that current and anticipated future sources of liquidity are insufficient to fund our future business activities and requirements, we may be required to seek additional equity or debt financing. The sale of additional equity would result in additional dilution to our stockholders. The incurrence of debt financing would result in debt service obligations and the instruments governing such debt could provide for operating and financing covenants that would restrict our operations.

Letters of Credit

As of October 3, 2020, we had outstanding letters of credit of $24.8 million issued to cover various security deposits on our facility leases.

Cash Flows

The following table summarizes our cash flows for the periods indicated (in thousands):

	Nine Months Ended	
	October 3, 2020	**September 28, 2019**
Net cash provided by (used in):		
Operating activities	$ (62,608)	$ (185,112)
Investing activities	118,723	7,277
Financing activities	(17,210)	(8,690)
Net change in cash and cash equivalents	$ 38,905	$ (186,525)

Cash Flows from Operating Activities

Net cash used in operating activities of $62.6 million for the nine months ended October 3, 2020 was primarily due to our net loss of $138.3 million, partially offset by total non-cash adjustments of $115.3 million and a decrease in net operating assets and liabilities of $39.7 million. The decrease in net operating assets and liabilities compared to the first three quarters of 2019 included a decrease in accounts receivable of $76.4 million and a decrease in inventory of $21.4 million, offset by a decrease in accounts payable and accrued liabilities of $89.8 million, and an increase in prepaid expenses and other assets of $9.1 million. The $115.3 million total non-cash adjustments for the first three quarters of 2020 included stock-based compensation expense of $57.9 million, depreciation expense of $33.3 million, provision for inventory obsolescence of $14.2 million, non-cash lease expense of $11.1 million, and intangible assets amortization of $8.4 million.

Our days sales outstanding in accounts receivable, calculated as the number of days represented by the accounts receivable balance as of period end, increased from 74 days as of December 31, 2019, to 78 days as of October 3, 2020, due to slower collections during the third quarter of 2020 compared to the fourth quarter of 2019.

Cash Flows from Investing Activities

Net cash provided by investing activities for the nine months ended October 3, 2020 of $118.7 million was due to maturities and sales of marketable securities of $200.9 million, offset by purchases of marketable securities of $59.7 million and purchases of property and equipment of $22.4 million.

Cash Flows from Financing Activities

Net cash used in financing activities for the nine months ended October 3, 2020 was due to $18.8 million in net cash used for payment of taxes on Class A common stock issued under our employee equity incentive plans and $1.4 million paid for financing leases, offset by $3.0 million in proceeds from the exercise of stock options.

Contractual Obligations and Other Commitments

Our future minimum lease payments under our operating leases as of October 3, 2020 was $79.1 million. We had no financing leases as of October 3, 2020.

The aggregate amount of open purchase orders as of October 3, 2020 was approximately $430.5 million. Of the aggregate amount, $156.9 million related to our migration to a third-party hosting provider, of which $17.3 million was accrued for as of October 3, 2020. We cannot determine the aggregate amount of such purchase orders that represent contractual obligations because purchase orders may represent authorizations to purchase rather than binding agreements. Our purchase orders are based on our current needs and are fulfilled by our suppliers, contract manufacturers, and logistics providers within short periods of time. We subcontract with other companies to manufacture our products.

During the normal course of business, we and our contract manufacturers procure components based upon a forecasted production plan. If we cancel all or part of the orders, or materially reduce forecasted orders, in certain circumstances we may be liable to our suppliers and contract manufacturers for the cost of the excess components purchased by our contract manufactures. As of October 3, 2020, $7.9 million was accrued for such liabilities to contract manufacturers.

We have recorded a liability for uncertain tax positions of $48.6 million as of October 3, 2020.

Off-Balance Sheet Arrangements

As of October 3, 2020, we did not have any off-balance sheet arrangements or holdings in variable interest entities.

Critical Accounting Polices and Estimates

Our management's discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported revenue generated and expenses incurred during the reporting periods. Our estimates are based on our historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

There have been no material changes to our critical accounting policies and estimates from those disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019 filed with the SEC on February 27, 2020.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risks in the ordinary course of our business. These risks primarily include interest rate and foreign currency risks as follows:

Interest Rate Risk

Our exposure to changes in interest rates relates primarily to our investment portfolio. As of October 3, 2020, we had cash and cash equivalents of $373.4 million and marketable securities of $43.1 million, which consisted primarily of bank deposits, money market funds, U.S. government and agency securities, commercial paper, and corporate notes and bonds. The primary objectives of our investment activities are to preserve principal and provide liquidity without significantly increasing risk. Our investment policy specifies credit quality standards for our investments and limits the amount of credit exposure to any single issue, issuer, or type of investment.

To date, we have not been exposed, nor do we anticipate being exposed, to material risks due to changes in interest rates. A hypothetical 10% change in interest rates during any of the periods presented would not have had a material impact on our condensed consolidated financial statements.

Foreign Currency Risk

To date, all of our inventory purchases have been denominated in U.S. dollars. Our international sales are primarily denominated in foreign currencies and any unfavorable movement in the exchange rate between U.S. dollars and the currencies in which we conduct sales in foreign countries could have an adverse impact on our revenue. A portion of our operating expenses are incurred outside the United States and are denominated in foreign currencies, which are also subject to fluctuations due to changes in foreign currency exchange rates. In addition, our suppliers incur many costs, including labor costs, in other currencies. To the extent that exchange rates move unfavorably for our suppliers, they may seek to pass these additional costs on to us, which could have a material impact on our gross margins. Our operating results and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates.

To partially mitigate the impact of changes in currency exchange rates on net cash flows from our foreign currency denominated revenue and expenses, we may enter into foreign currency exchange forward and option contracts. We also hedge certain monetary assets and liabilities denominated in foreign currencies from time to time, which reduces but does not eliminate our exposure to currency fluctuations between the date a transaction is recorded and the date that cash is collected or paid. In general, the market risks of these contracts are offset by corresponding gains and losses on the transactions being hedged.

We had no outstanding contracts in cash flow hedges for forecasted revenue transactions as of October 3, 2020. We had no outstanding balance sheet hedges as of October 3, 2020. We assessed our exposure to movements in currency exchange rates by performing a sensitivity analysis of adverse changes in exchange rates and the corresponding impact to our results of operations. A hypothetical change of 10% in exchange rates would not have materially affected our operating results.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of October 3, 2020. Based on the evaluation of our disclosure controls and procedures as of October 3, 2020, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including the Chief Executive Officer and Chief Financial Officer, recognizes that our disclosure controls or our internal control over financial reporting cannot prevent or detect all possible instances of errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

PART II

Item 1. Legal Proceedings

For a discussion of legal proceedings, see Note 6, “Commitments and Contingencies,” in the notes to our condensed consolidated financial statements.

Further, we are and, from time to time, we may become, involved in legal proceedings or be subject to claims arising in the ordinary course of our business. We are not presently a party to any other legal proceedings that in the opinion of our management, if determined adversely to us, would individually or taken together have a material adverse effect on our business, operating results, financial condition, or cash flows.

Item 1A. Risk Factors

An investment in our Class A common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information in this Quarterly Report on Form 10-Q, including the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our condensed consolidated financial statements and related notes, before making a decision to invest in our Class A common stock. Our business, operating results, financial condition, or prospects could be materially and adversely affected by any of these risks and uncertainties. If any of these risks actually occurs, the trading price of our Class A common stock could decline and you might lose all or part of your investment. Our business, operating results, financial performance, or prospects could also be harmed by risks and uncertainties not currently known to us or that we currently do not believe are material.

Risks Related to Our Business

The announcement and pendency of our agreement to be acquired by Google LLC could have an adverse effect on our business.

On November 1, 2019, we entered into the Merger Agreement with Google, pursuant to which a wholly-owned subsidiary of Google will, upon the terms and subject to the conditions set forth in the Merger Agreement, merge with and into us, and we will be the surviving corporation of the Merger and will become a wholly owned subsidiary of Google. On January 3, 2020, our stockholders voted to adopt the Merger Agreement at a special meeting of our stockholders. Upon the terms and subject to the conditions set forth in the Merger Agreement, at the effective time of the Merger, each share of our Class A common stock and Class B common stock issued and outstanding immediately prior to the effective time of the Merger will be canceled and automatically converted into the right to receive $7.35 in cash, without interest.

Uncertainty about the effect of the proposed Merger on our employees, customers, users, partners, and suppliers may have an adverse effect on our business and operations that may be material to our company. Our employees may experience uncertainty about their roles following the Merger. There can be no assurance we will be able to attract and retain key talent, including senior leaders, to the same extent that we have previously been able to attract and retain employees. Any loss or distraction of such employees could have an adverse effect on our business and operations. In addition, we have diverted, and will continue to divert, significant management attention and resources towards the completion of the Merger, which could adversely affect our business and operations.

Our customers and users may experience uncertainty associated with the Merger, including with respect to treatment of user data and concerns about possible changes to our products and services or policies. Similarly, our partners and suppliers may experience uncertainty associated with the Merger, including with respect to current or future business relationships with us. Uncertainty may cause customers or users to refrain from purchasing our products and services, and partners and suppliers may seek to change existing business relationships, which could result in an adverse effect on our business, operations, and financial condition in a way that may be material to our company.

Pursuant to the terms of the Merger Agreement, we are subject to certain restrictions on the conduct of our business, including the ability in certain cases to enter into contracts, acquire or dispose of assets, incur indebtedness, or incur capital expenditures, until the Merger becomes effective or the Merger Agreement is terminated. These restrictions may prevent us from taking actions with respect to our business that we may consider advantageous and result in our inability to respond effectively to competitive pressures and industry developments, and may otherwise harm our business and operations.

The failure to complete the Merger with Google could adversely affect our business.

Completion of the Merger with Google is subject to conditions beyond our control that may prevent, delay, or otherwise adversely affect its completion in a material way, including the expiration or termination of applicable waiting periods under antitrust and competition laws, and similar competition approvals or consents that must be obtained from regulatory entities in the United States and certain foreign jurisdictions, including the European Union. On August 4, 2020, the European Commission, or the EC, announced it had initiated a Phase II review of the Merger. On October 16, 2020, the European Commission extended the deadline for its Phase II investigation to January 8, 2021. The duration of a Phase II review cannot be foreseen with certainty. The process to obtain regulatory approvals could substantially delay, or prevent, the consummation of the Merger, including beyond 2020. In addition, the extent to which the COVID-19 pandemic, discussed further below, may impact the timing of receipt of necessary regulatory approvals and consents for completion of the Merger is uncertain and cannot be predicted. If the Merger or a similar transaction is not completed, the share price of our Class A common stock may drop to the extent that the current market price of our Class A common stock reflects an assumption that a transaction will be completed. In addition, the Merger Agreement provides that we will be required to pay Google a termination fee of $80 million in certain circumstances, such as a material, uncured breach of our obligations under the Merger Agreement. Further, a failure to complete the Merger may result in negative publicity and a negative impression of us in the investment community and may necessitate us having to obtain additional financing, which may be unavailable on terms favorable to us, or at all. Any disruption to our business resulting from the announcement and pendency of the Merger and from intensifying competition from our competitors, including any adverse changes in our relationships with our customers, users, partners, and suppliers, could continue or accelerate in the event of a failure to complete the Merger. There can be no assurance that our business, these relationships, or our financial condition will not be adversely affected, as compared to the condition prior to the announcement of the Merger, if the Merger is not consummated. In addition, the negative impact of a failure to complete the Merger could be exacerbated by the significant business and financial risks associated with the COVID-19 pandemic, discussed further below.

The outbreak of COVID-19 has had, and we expect will continue to have, an adverse effect on our business, results of operations, and financial condition.

The emergence of the novel coronavirus (SARS-CoV-2), and the disease caused by it known as COVID-19, designated as a pandemic by the World Health Organization in March 2020, has led to a global public health crisis and significant business disruptions and volatility in financial markets. The spread of the pandemic and the implementation of preventative requirements and practices (including state and local governmental restrictions on non-essential businesses, as well as personal activities and travel) have resulted in unprecedented changes in and disruption to business and economic conditions, giving rise to declines in consumer confidence and discretionary spending and the prospect of a global recession. These conditions have caused, and may continue to cause, adverse impacts on our business, liquidity, results of operations, and stock price that we may not be able to fully mitigate, due to the occurrence of, among others, some or all of the following:

- temporary closures of, or reduced staffing at, our facilities and those of our suppliers, contract manufacturers, logistics providers, distributors, retailers, and other business partners due to "stay-at-home" regulations and employee illness or reluctance to appear at worksites, including policies we may deem appropriate to adopt beyond what is required by government authorities, which may impact worker productivity for us and/or our business partners and our ability to develop, manufacture, and sell products for an indefinite period of time;
- interruptions in, or higher costs for, the sourcing of components and the manufacture, distribution, shipment, marketing, and sale of our products, which may cause supply constraints and affect our ability to meet consumer demand, leading to lost sales opportunities;
- disruptions in the operations of our distributors or retailers, including store closures, that cause them to delay or cancel orders for our products, seek extended payment terms, reduce future orders, experience credit or liquidity issues that impact their ability to pay for our products, or become insolvent and cease operating as going concerns;
- reduced consumer demand for our products and services, including due to extended shelter-in-place orders, continued or additional store closures, and any prolonged economic downturn;
- our potential need to raise additional capital to the extent that current and anticipated future sources of liquidity are insufficient to fund our business activities and requirements, which may increase our debt or dilute the value of our common stock; and
- volatility in, or a reduction of, the market price of our Class A common stock.

Given the evolving health, political, governmental, and economic conditions, the impact that COVID-19 could have on our future business is highly uncertain and difficult to predict. The impact will depend largely on future developments, including the duration and severity of the pandemic; potential resurgence(s) of COVID-19 in the future; the effectiveness of actions taken by governments, businesses, and individuals in response to the pandemic; the stability of capital and financial markets; and how quickly and to what extent economic and operating conditions that pre-dated the pandemic can resume. We similarly are unable to predict future impacts of COVID-19 on the financial circumstances of our customers, distributors, retailers, and other business partners, or on our user community's demand for our products and services. In addition, the adverse effects of COVID-19 could exacerbate other risk factors discussed herein. This situation is changing rapidly, and additional impacts may arise that we are not aware of currently. If we fail to anticipate and adequately address adverse impacts associated with the COVID-19 pandemic in a timely manner, our business, results of operations, and financial condition may be adversely affected.

We operate in a highly competitive market. If we do not compete effectively, our prospects, operating results, and financial condition could be adversely affected.

The wearable devices market is highly competitive, with companies offering a variety of products and services. Wearables can be broadly defined as trackers, fitness watches, and smartwatches, as well as devices beyond the wrist. In terms of devices sold, we have primarily operated in the health and fitness tracker and smartwatch segments of the wearables market. We expect competition in our market to intensify in the future as new and existing competitors introduce new or enhanced products and services that are potentially more competitive than our products and services.

The wearable devices market has a multitude of participants, including large, broad-based consumer electronics companies that either compete in our market or adjacent markets or have announced plans to do so, such as Apple, Samsung, Google, LG, and Amazon. For example, Apple sells the Apple Watch, which is a smartwatch with broad-based functionalities including some health and fitness tracking capabilities, and Apple has sold a significant volume of its smartwatches since introduction. Moreover, smartwatches with health and fitness functionalities may displace the market for traditional tracker devices. For example, the Apple Watch includes electrocardiogram (ECG) functionality, fall detection capability, and a sleep tracking feature. We also face competition from manufacturers of lower-cost devices, such as Xiaomi with its Mi Band devices, and Huawei. Market participants also include specialized consumer electronics companies such as Garmin, as well as traditional watch companies such as Fossil. In addition, we compete with a wide range of stand-alone health and fitness-related mobile apps that can be purchased or downloaded through mobile app stores.

We believe many of our competitors and potential competitors have significant advantages, including longer operating histories; ability to leverage their sales efforts and marketing expenditures across a broader portfolio of products and services; larger and broader customer bases; more established relationships with a larger number of suppliers, contract manufacturers, and channel partners; greater brand recognition; ability to leverage app stores that they may operate; experience manufacturing particular wearable devices, such as smartwatches; and greater financial, research and development, marketing, distribution, and other resources than we do.

Some of our competitors may aggressively discount their products and services in order to gain market share, which could result in pricing pressures, reduced profit margins, lost market share, or a failure to grow market share for us. In addition, our new products may have varying selling prices and costs compared to legacy products, which could negatively impact our gross margins and operating results. Our competitors and potential competitors may also be able to develop products or services that are equal or superior to ours, achieve greater market acceptance of their products and services, and increase sales by utilizing different distribution channels than we do.

Furthermore, current or potential competitors may be acquired by third parties with greater available resources. As a result of such acquisitions, our current or potential competitors might be able to adapt more quickly to new technologies and consumer needs, devote greater resources to the promotion or sale of their products and services, initiate or withstand substantial price competition, take advantage of acquisition or other opportunities more readily, or develop and expand their products and services more quickly than we do. If we are not able to compete effectively against our current or potential competitors, our prospects, operating results, and financial condition could be adversely affected.

If we are unable to anticipate and satisfy consumer preferences in a timely manner, our business may be adversely affected.

Our success depends on our ability to anticipate and satisfy consumer preferences in a timely manner. All of our products and services are subject to changing consumer preferences that cannot be predicted with certainty. In terms of devices sold, we have primarily operated in the tracker and smartwatch segments of the wearable devices market. Consumer preference has increasingly shifted to the smartwatch segment of the wearables market. Although we are continuing to build out our smartwatch offerings, consumers may ultimately decide not to purchase our products and services as their preferences could shift rapidly to different types of wearable devices, or away from these types of products and services altogether. In addition, adoption of our products may vary by geographic region.

Our newer products and services may have different features, designs, or prices than our existing or earlier products and the products of some of our competitors, which may not appeal to consumers or only appeal to a smaller subset of consumers. For example, in the second quarter of 2019, Fitbit Versa Lite Edition sales were weaker than expected, which we attribute to our initial go-to-market pricing and promotional strategies. It is also possible that competitors could introduce new products and services that negatively impact consumer preference for our wearable devices, which could result in decreased sales of our products and services and a loss in market share.

In addition, although we intend to build out our recurring consumer services revenue offerings, it is possible that consumers or enterprise customers may not be receptive to these new services or that revenue from these offerings may continue to be immaterial. For example, in the third quarter of 2019, we launched Fitbit Premium, a paid subscription service that delivers a personalized experience with guidance and coaching. In the third quarter of 2018, we introduced Fitbit Care, a connected health platform for health plans and employers. To date, revenue from consumer services offerings has been an immaterial portion of our overall revenue. In addition, we have limited experience operating services outside of our core device business. Our ability to forecast revenue and other financial and operating results for any new service, such as Fitbit Premium and Fitbit Care, is inherently uncertain, and our actual results may vary significantly from what we desire or predict or from the estimates of analysts.

Our future success depends on our ability to anticipate and respond effectively to shifts in consumer preferences. If we fail to anticipate and satisfy consumer preferences in a timely manner, or if it is perceived that our future products and services will not satisfy consumer preferences, our business may be adversely affected.

If we are unable to successfully develop, timely introduce, and effectively manage the introduction of new products and services or enhance existing products and services, our business may be adversely affected.

We must continually develop and introduce new products and services and improve and enhance our existing products and services to maintain or increase our sales. We believe that our future growth depends on continuing to engage and expand our user base by introducing new form factors, software services, and other offerings. For example, in the third quarter of 2020, we launched Fitbit Sense, our most advanced health smartwatch, Fitbit Versa 3, and Fitbit Inspire 2, and in the first quarter of 2020, we launched Charge 4, the latest evolution of our Charge family of trackers. In the third quarter of 2019, we launched Fitbit Premium, a paid subscription service, and in the third quarter of 2018, we introduced Fitbit Care, a connected health platform for health plans and employers. We typically have several products and services in development at the same time. The success of new or enhanced products and services depends on a number of factors including, among other things, anticipating and effectively addressing consumer preferences and demand; timely and successful research and development; appropriate pricing and go-to-market strategies; the success of our sales and marketing efforts; effective forecasting and management of product demand, purchase commitments, and inventory levels; effective management of manufacturing and supply costs; and the quality of or any defects in our products.

The development of our products and services is complex and costly. Given the complexity, we occasionally have experienced, and could experience in the future, delays in the development and introduction of new and enhanced products and services, product costs that are higher than planned, or lower than expected manufacturing yields of new and enhanced products, which may adversely affect our revenue and gross margins. Moreover, we have experienced, and may continue to experience, delays in the development and introduction of new or enhanced products and services due to the effects of the COVID-19 pandemic.

If revenues decline, we may be forced to reduce costs and may not be able to compete effectively. Unanticipated problems in developing products and services could also divert substantial research and development resources, which may impair our ability to develop new products and services, or enhancements of existing products and services, and could substantially increase our costs. Problems in the design or quality of our products or services may also have an adverse effect on our brand, business, financial condition, and operating results.

We must also successfully manage introductions of new or enhanced products or services. Introductions of new or enhanced products or services could adversely impact the sales of our existing products to retailers and consumers. For instance, retailers often purchase less of our existing products in advance of new product launches, retailers may be granted stock rotation rights and price protection, and we may experience higher returns from retailers or users of existing products, although some may continue to purchase existing products in lieu of new or enhanced products. We may face challenges managing the inventory of new or existing products, which could lead to excess inventory and discounting of such products. In addition, our new products may have varying selling prices and costs compared to legacy products, which could negatively impact our gross margins and operating results. For example, in 2019, gross margins decreased on a year-over-year basis, due in part to a decrease in average selling price associated with new products. We have also historically incurred higher levels of sales and marketing expenses accompanying each product introduction.

Accordingly, if we fail to successfully develop, manufacture, market, and manage the introduction of new or enhanced products, we may incur higher than expected costs, weaker than anticipated demand for new or enhanced products, and changes in demand for existing products, and our operating results, business, and reputation could be harmed.

Our operating results could be materially harmed if we are unable to accurately forecast consumer demand for our products and services and adequately manage our inventory.

If we fail to accurately forecast consumer demand, we may experience excess inventory levels or a shortage of products available for sale. Demand for our products and services could be affected by many factors that may be difficult to predict, including changes in consumer preferences, the nature of new product and service introductions by us and our competitors, channel inventory levels, sales promotions by us or our competitors, changes in wearable device market conditions, and changes in general economic conditions or consumer confidence in future economic conditions, such as those caused by the COVID-19 pandemic.

To ensure adequate inventory supply, we must forecast inventory needs and expenses and place orders sufficiently in advance with our suppliers and contract manufacturers based on our estimates of future demand for particular products. We have previously faced and may continue to face challenges acquiring adequate and timely supplies of our products to satisfy demand, particularly in connection with new product introductions, or NPIs, which we believe may negatively affect our revenue. As we continue to introduce new products, we also may face challenges managing the inventory of existing products.

Inventory levels in excess of consumer demand may result in inventory write-downs or write-offs, the sale of inventory at discounted prices, and other actions, which have caused and may continue to cause our gross margin to decline and could impair the strength of our brand. For example, during 2019 and the first three quarters of 2020, we recorded write-downs for excess and obsolete inventory, accelerated depreciation of manufacturing and tooling equipment, price protection on certain products, and rebates. Reserves and write-downs for rebates, promotions, and excess inventory and tooling and manufacturing capacity are recorded based on our forecast of future demand. Actual future demand could be less than our forecast, which may result in additional reserves and write-downs in the future, or actual demand could be stronger than forecast, which may result in a reduction to previously recorded reserves and write-downs in the future and increase the volatility of our operating results.

Conversely, if we underestimate consumer demand for our products, we may in future periods be unable to meet customer, retailer or distributor demand for our products, or we may incur higher costs to secure the necessary production capacity and components, which could cause our business and operating results to be adversely affected and cause damage to our brand and customer relationships.

No assurance can be given that we will not incur additional charges in future periods related to our inventory management or that we will not underestimate or overestimate forecasted sales in a future period.

An economic downturn or economic uncertainty may adversely affect consumer discretionary spending and demand for our products and services.

Our products and services may be considered discretionary items for consumers. Factors affecting the level of consumer spending for discretionary items include general economic conditions, consumer confidence in future economic conditions, fears of recession, the availability and cost of consumer credit, levels of unemployment, and tax rates. Many of these factors have been adversely impacted by the COVID-19 pandemic. Volatility in global economic conditions or a global economic downturn may make it more difficult to predict demand for our products and services and may cause consumers to decline to make, delay, or reduce purchases. Our sensitivity to economic cycles and any related fluctuation in consumer demand for our products and services may have an adverse effect on our operating results and financial condition.

Our quarterly operating results or other operating metrics may fluctuate significantly, which could cause the trading price of our Class A common stock to decline.

Our quarterly operating results and other operating metrics have fluctuated in the past and may continue to fluctuate from quarter to quarter. We expect that this trend will continue as a result of a number of factors, many of which are outside of our control and may be difficult to predict, including:

- the impact of our pending Merger with Google;
- the global macroeconomic impact of the COVID-19 pandemic;
- the level of demand for our wearable devices and our ability to maintain or increase the size and engagement of our community of users;
- the timing and success of new product and service introductions by us and the transition from legacy products;
- the timing and success of new product and service introductions by our competitors or any other change in the competitive landscape of our market;
- the mix of products sold in a quarter;
- the continued market acceptance of, and the growth of the market for, wearable devices, and evolution of this market into smartwatches and other form factors;
- pricing pressure as a result of competition or otherwise;
- delays or disruptions in our supply, manufacturing, or distribution chain;
- errors in our forecasting of the demand for our products, which could lead to lower revenue or increased costs, or both;
- seasonal buying patterns of consumers;
- increases in levels of channel inventory resulting from sales to our retailers and distributors in anticipation of future demand;
- increases in and timing of sales and marketing and other operating expenses that we may incur to grow and expand our operations and to remain competitive;
- impact of sales and marketing efforts and promotions by competitors, which are difficult to predict;
- insolvency, credit, or other difficulties faced by our distributors and retailers affecting their ability to purchase or pay for our products;
- insolvency, credit, or other difficulties confronting our suppliers, contract manufacturers, or logistics providers leading to disruptions in our supply or distribution chain;
- levels of product returns, stock rotation, and price protection rights;
- levels of warranty claims or estimated costs of warranty claims;
- adverse litigation judgments, settlements, or other litigation-related costs;
- changes in the legislative or regulatory environment, such as with respect to privacy, information security, health and wellness devices, medical devices, consumer product safety, advertising, and taxes;
- product recalls, regulatory proceedings, or other adverse publicity about our products;
- fluctuations in foreign exchange rates;
- costs related to the acquisition of businesses, talent, technologies, or intellectual property, including potentially significant amortization costs and possible write-downs;
- changes in the trade policies of the United States or other countries, such as the imposition of new tariffs on goods made in China; and
- general economic conditions in either domestic or international markets.

Any one of the factors above, or the cumulative effect of several factors, may result in significant fluctuations in our operating results.

The variability and unpredictability of our quarterly operating results or other operating metrics could result in our failure to meet our expectations, those of any analysts that publish financial coverage of us, or those of investors with respect to revenue or other operating results for a particular period. If we fail to meet or exceed such expectations for these or any other reasons, the market price of our Class A common stock could fall substantially, and we could face costly lawsuits, including securities class action suits.

We may not be able to achieve revenue growth or profitability in the future.

Our historical revenue growth in certain periods should not be considered indicative of our future performance. Our revenue has declined in recent periods, and we expect our revenue growth to be slower than in the past or to decline in future periods due to a number of factors, which may include slowing demand for our products and services, increasing competition, a decrease in the growth of our overall market, our failure for any reason to capitalize on growth opportunities, the maturation of our business, and the impact of the COVID-19 pandemic on our business and the global economy.

From 2014 to 2016, our annual revenue grew rapidly from $745.4 million to $2.2 billion. However, our annual revenue in each of 2017, 2018, and 2019 declined compared to the prior year, and our revenue in the first three quarters of 2020 declined 13% compared to the first three quarters 2019. In future periods, we could again experience a decline in revenue, or revenue could grow more slowly than we expect.

In addition, we have not consistently achieved profitability on a quarterly or annual basis. For example, we recorded a net loss of $320.7 million in 2019 and a net loss of $138.3 million for the nine months ended October 3, 2020.

Because we have a limited history operating our business at its current scale, it is difficult to plan for and model future growth, particularly in light of the rapidly evolving nature of the market in which we operate, substantial uncertainty concerning how these markets may develop, and other economic factors beyond our control, and we may not be able to achieve revenue growth or profitability in the future. Failure to manage our future growth effectively could have an adverse effect on our business, which, in turn, could have an adverse impact on our operating results and financial condition.

If we fail to manage our operating expenses effectively, our financial performance may be negatively impacted.

Our success depends in part on our ability to manage our operating expenses effectively. Although the number of our employees increased only 6% on a year-over-year basis to 1,764 employees as of October 3, 2020, our employee headcount and the scope and complexity of our business have increased significantly in recent years. We incurred a net loss of $320.7 million in 2019 and a net loss of $138.3 million for the nine months ended October 3, 2020.

In addition, we are investing in areas we believe will grow revenue and our operating expenses might increase as a result of these investments. The development of our products and services is complex and costly, and we typically have several products and services in development at the same time. Our research and development efforts may require us to incur substantial expenses to support the development of our next generation devices and other new products and services. Our research and development expenses were $256.1 million for the nine months ended October 3, 2020 and $300.4 million for 2019.

We could also be required to continue to expand our sales and marketing, product development, and distribution functions; upgrade our business information technology systems and other processes and technology; and obtain more space for our workforce. These efforts could increase the strain on our resources, and we could experience serious operating difficulties, including difficulties in hiring, training, and managing employees.

If our continued investments do not result in future revenue as expected, we may incur greater than expected losses or lower than expected profits, and our liquidity position may be adversely affected.

Conversely, in the future, we may need to strategically realign our resources, adjust our product line and/or enact price reductions in order to stimulate demand, implement additional restructuring and workforce reductions, or downsize our facilities for a reduced workforce. Any such actions may result in the recording of special charges, including inventory-related write-offs, workforce reductions, or other restructuring costs. Additionally, our estimates with respect to the useful life or ultimate recoverability of our assets, including purchased intangible assets and tooling, could also change and result in impairment charges.

If we are unable to operate efficiently and manage our costs, we may continue to incur significant losses in the future and may not be able to achieve or maintain profitability.

We rely on a limited number of suppliers, contract manufacturers, and logistics providers, and each of our products is manufactured by a single contract manufacturer.

We rely on a limited number of suppliers, contract manufacturers, and logistics providers. In particular, we use contract manufacturers located in Asia, and each of our products is manufactured by a single contract manufacturer. Our reliance on a limited number of suppliers and a sole contract manufacturer for each of our products presents various risks. These include the risk that in the event of an interruption from any part of our supply chain for any reason, such as a natural catastrophe, labor dispute, global disease outbreaks such as the COVID-19 pandemic, system interruption, or actions taken in regard to increased tariffs on goods produced in certain countries such as China, we may not be able to develop an alternate source without incurring material additional costs and substantial delays. In particular, the COVID-19 pandemic has caused, and will likely continue to cause, interruptions in the development, manufacturing (including the sourcing of key components), and shipment of our products, which could adversely impact our revenue, gross margins, and operating results. Such interruptions may be due to, among other things, temporary closures of our facilities or those of our customers, contract manufacturers, and other vendors in our supply chain; governmental restrictions on non-essential business and travel; and quarantines.

In addition, if we experience a significant increase in demand, or if we need to replace an existing supplier, contract manufacturer, or logistics provider, or move our contract manufacturing to a different country, we may be unable to supplement or replace such supply, contract manufacturing, or logistics capacity on terms that are acceptable to us, which may adversely impact our ability to deliver our products to customers in a timely manner. For example, for certain of our products, it may take a significant amount of time to onboard a contract manufacturer that has the capability and resources to build the product to our specifications in sufficient volume. Identifying suitable suppliers, contract manufacturers, and logistics providers is an extensive process that requires us to become satisfied with their quality control, technical capabilities, responsiveness and service, financial stability, regulatory compliance, and labor and other ethical practices. In addition, our contract manufacturers often make significant investments to build capacity based upon our forecasted production. If we experience a significant decrease in demand as compared to our forecast, our contract manufacturers may seek to renegotiate the terms of their commitments or choose to limit or terminate their relationship with us. Accordingly, an interruption in performance by, or the loss of, any key supplier, contract manufacturer, or logistics provider could adversely impact our revenue, gross margins, and operating results.

Because some of the key components in our products come from a limited or single source of supply, we are susceptible to supply shortages, long lead times for components, and supply changes, any of which could disrupt our supply chain.

Some of the key components used to manufacture our products come from a limited or single source of supply. Our contract manufacturers generally purchase these components on our behalf, subject to certain approved supplier lists. We are subject to the risk of shortages and long lead times in the supply of these components and the risk that our suppliers may discontinue or modify components used in our products. In addition, the lead times associated with certain components are lengthy and preclude rapid changes in quantities and delivery schedules. We have in the past experienced and may in the future experience component shortages, and the predictability of the availability of these components may be limited. While component shortages have historically been immaterial, they could be material in the future.

In the event of a component shortage or supply interruption from suppliers of these components, we may not be able to develop suitable alternate sources in a timely manner. In addition, some of our suppliers, contract manufacturers, and logistics providers may have more established relationships with our competitors, and as a result of such relationships, such suppliers may choose to limit or terminate their relationship with us. Developing suitable alternate sources of supply for these components may be time-consuming, difficult, and costly and we may not be able to source these components on terms that are acceptable to us, or at all, which may adversely affect our ability to meet our requirements or to fill our orders in a timely or cost-effective manner. Any interruption or delay in the supply of any of these parts or components, or the inability to obtain these parts or components from alternate sources at acceptable prices and within a reasonable amount of time, would harm our ability to meet our scheduled product deliveries to our customers and users. This could harm our relationships with our channel partners and users and cause delays in shipment of our products, which could adversely affect our operating results. In addition, increased component costs could result in lower gross margins. If we are unable to buy these components in quantities sufficient to meet our requirements on a timely basis, this could negatively affect our ability to deliver products and services to our customers and users, which could adversely impact our revenue, gross margins, and operating results.

Our future success depends on the continuing efforts of our key employees, including our founders, James Park and Eric N. Friedman, and on our ability to attract and retain highly skilled personnel and senior management.

Our future success depends, in part, on our ability to continue to attract and retain highly skilled personnel. In particular, we are highly dependent on the contributions of our co-founders, James Park and Eric N. Friedman, as well as other members of our management team. The loss or incapacitation of any key personnel, including as a result of COVID-19 infection, could make it more difficult to manage our operations and research and development activities to deliver on our product road map, reduce our employee retention and revenue, and impair our ability to compete. Although we have generally entered into employment offer letters with our key personnel, these agreements have no specific duration and provide for at-will employment, which means they may terminate their employment relationship with us at any time.

Competition for highly skilled personnel is often intense, especially in the San Francisco Bay area where our corporate headquarters are located, and we may incur significant costs to attract personnel. We may not be successful in attracting, integrating, or retaining qualified personnel to fulfill our current or future needs. We have from time to time experienced, and we expect to continue to experience, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. Job candidates and existing employees often consider the value of the equity awards they receive in connection with their employment, and the significant decline in the price of our Class A common stock since our initial public offering may adversely affect our ability to attract or retain highly skilled employees. Fluctuations in the price of our Class A common stock may also make it more difficult or costly to use equity awards to motivate, incentivize and retain our employees. Furthermore, there can be no assurances that the number of shares reserved for issuance under our equity incentive plans will be sufficient to grant equity awards adequate to recruit new employees and to compensate existing employees. Additionally, new legislation, executive actions and regulatory changes affecting immigration may make it harder to access, attract and retain highly skilled employees. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be severely harmed.

We spend significant amounts on advertising and other marketing campaigns to acquire new users, which may not be successful or cost effective.

In order to increase awareness of our products and services and acquire new users, we have spent, and may continue to spend, significant amounts on advertising and other marketing campaigns in various media, such as television, print advertising, and social media. In 2019 and the nine months ended October 3, 2020 advertising expenses, excluding co-op advertising and rebates which are recorded as contra-revenue, were $170.4 million and $64.5 million, respectively, representing approximately 12% and 8% of our revenue, respectively. Co-op advertising costs were $89.8 million and $47.3 million for 2019 and the nine months ended October 3, 2020, respectively. A significant portion of our advertising and marketing spend is typically incurred in the fourth quarter as part of our holiday promotions, as well as when new products are released. While we seek to structure our advertising campaigns in the manner that we believe is most likely to encourage people to buy our products and services, our campaigns may be less effective than anticipated if we fail to identify advertising opportunities that satisfy our anticipated return on advertising spend or fail to accurately predict user acquisition, including the conditions and behaviors that drive user behavior. In addition, the timing of our advertising and promotional spend may impact the timing of expected sales of our products and services. Particularly during the holiday season, there is significant competition for consumer spending, and we may not realize our expected sales or recover our advertising and promotional spend if other promotions or products are more compelling. If new products do not meet customer expectations, we may not recover our advertising and promotional spend for NPIs. If any of our advertising campaigns prove less successful than anticipated in attracting new users, we may not be able to recover our advertising spend, and our rate of user acquisition may fail to meet market expectations, either of which could have an adverse effect on our business. There can be no assurance that our advertising and other marketing efforts will result in increased sales of our products and services. Further, promotional activity may adversely affect our gross margin.

Our current and future products and services may experience quality problems from time to time that can result in adverse publicity, product recalls, litigation, regulatory proceedings, and warranty claims resulting in significant direct or indirect costs, decreased revenue and operating margin, and harm to our brand.

We sell complex products and services that could contain design and manufacturing defects in their materials, hardware, and firmware. These defects could include defective materials or components, or “bugs,” that can unexpectedly interfere with the products’ intended operations or cause injuries to users or property. Although we extensively test new and enhanced products and services before their release, there can be no assurance we will be able to detect, prevent, or fix all defects. For example, our products may fail to provide accurate measurements and data to all users under all circumstances, or there may be reports or claims of inaccurate measurements under certain circumstances.

Failure to detect, prevent, or fix defects, or an increase in defects, could result in a variety of consequences, including a greater number of returns of products than expected from users and retailers, increases in warranty costs, regulatory proceedings, product recalls, and litigation, which could harm our revenue and operating results. We generally provide a 45-day right of return for purchases through Fitbit.com and a 12-month limited warranty on all of our products, though warranty duration and scope may vary by jurisdiction in compliance with applicable local law. The occurrence of real or perceived quality problems or material defects in our current and future products could expose us to warranty claims in excess of our current reserves. Moreover, we may offer stock rotation rights and price protection to our distributors. If we experience greater returns from retailers or users, or greater warranty claims, in excess of our reserves, our business, revenue, gross margin, and operating results could be harmed. In addition, any negative publicity or lawsuits filed against us related to the perceived quality and safety of our products could also affect our brand and decrease demand for our products and services, adversely affecting our operating results and financial condition.

We have limited control over our suppliers, contract manufacturers, and logistics providers, which subjects us to significant risks, including the potential inability to obtain or produce quality products on a timely basis or in sufficient quantity.

We have limited control over our suppliers, contract manufacturers, and logistics providers, including aspects of their specific manufacturing processes and their labor, environmental, or other practices, which subjects us to significant risks, including the following:

- inability to satisfy demand for our products;
- reduced control over delivery timing and product reliability;
- reduced ability to oversee the manufacturing process and components used in our products;
- reduced ability to monitor compliance with our product manufacturing specifications;
- price increases;
- insolvency, credit problems, or other financial difficulties confronting our suppliers, contract manufacturers, or logistic providers;
- risks related to the computer systems used by our suppliers, contract manufacturers, or logistic providers, such as system failures, viruses, cyberattacks, computer hackers and similar disruptions;
- difficulties in establishing additional or alternative contract manufacturing relationships if we experience difficulties with our existing suppliers, contract manufacturers or logistic providers;
- shortages of materials or components;
- misappropriation of our intellectual property;
- suppliers, contract manufacturers, and logistics providers may choose to limit or terminate their relationship with us;
- exposure to natural catastrophes, political unrest, terrorism, public health issues including pandemics, labor disputes, and economic instability resulting in the disruption of trade from foreign countries in which our products are manufactured;
- changes in local economic conditions in countries where our suppliers, contract manufacturers, or logistics providers are located;
- the imposition of new laws and regulations, including those relating to labor conditions, quality and safety standards, imports, duties, taxes, and other charges on imports, as well as trade restrictions and restrictions on currency exchange or the transfer of funds and tariffs; and
- insufficient warranties and indemnities on components supplied to our contract manufacturers.

If there are defects in the manufacture of our products, we may face negative publicity, government investigations, and litigation, and we may not be fully compensated by our contract manufacturers for any financial or other liability that we suffer as a result.

Any insolvency, credit problems, or other financial difficulties impacting our retailers and distributors could expose us to financial risk.

Some of our retailers and distributors have experienced, and/or may continue or begin to experience, including as a result of adverse impacts associated with the COVID-19 pandemic, insolvency, credit challenges, or other financial difficulties that could expose us to significant financial risk. A decline in the liquidity or credit capacity of any retailer or distributor may impede their ability to sell our products and may also cause delays in payment of, or an inability to pay, their outstanding balances to us, which could expose us to financial risk. For example, Wynit Distribution, LLC, or Wynit, historically our largest customer, filed for bankruptcy protection in September 2017, which caused us to incur $7.6 million in net bad debt expenses and $1.4 million in net cost of revenues in 2017. Credit and financial difficulties of our retailers and distributors may also lead to a reduction in sales, price reductions, increased returns of our products, and adverse effects on our brand and operating results.

We maintain credit insurance for the majority of our customer balances, perform ongoing credit evaluations of retailers and distributors, and maintain allowances for potential credit losses on customer accounts when deemed necessary. We may not have sufficient insurance coverage to cover losses resulting from the credit and financial difficulties of retailers and distributors. In addition, deteriorations in the financial conditions of retailers and distributors and/or general economic conditions, including as a result of the COVID-19 pandemic, may lead to an increase in our credit insurance premiums and make it more difficult or impossible to obtain sufficient coverage, which could increase our exposure and result in increased bad debt expense or additional write-offs. Any reduction in sales by our current retailers or distributors, loss of large retailers or distributors, or decrease in revenue from our retailers or distributors could adversely affect our revenue, operating results, and financial condition.

We depend on retailers and distributors to sell and market our products, and our failure to maintain and further develop our sales channels could harm our business.

We primarily sell our products through retailers and distributors and depend on these third parties to sell and market our products to consumers. Any changes to our current mix of retailers and distributors could adversely affect our gross margin and could negatively affect both our brand image and our reputation. Our sales depend in part on retailers adequately displaying our products, including providing attractive space and point of purchase displays in their stores, and training their sales personnel to sell our products. Our retailers also often offer products and services of our competitors. If our retailers and distributors are not successful in selling our products, overestimate demand for our products, or promote competing products and services more effectively than our products and services, our revenue would decrease and our gross margins could decline due to increased product returns or price protection claims. In addition, our success in expanding and entering into new markets internationally will depend on our ability to establish relationships with new retailers and distributors. We also sell and will need to continue to expand our sales through online retailers, such as Amazon.com, and through our direct channel, Fitbit.com, as consumers increasingly make purchases online. If we do not maintain our relationship with existing retailers and distributors or develop relationships with new retailers and distributors, our ability to sell our products and services could be adversely affected and our business may be harmed. Additionally, the businesses of our retailers and distributors have suffered, and may continue to suffer, as a result of the COVID-19 pandemic which may impact their ability to sell and market our products and services to customers or cause delays in the delivery of our products due to the prioritization of the shipment of other goods.

In 2019 and 2018, our five largest retailers and distributors accounted for approximately 42% of our revenue during each period. Of these retailers and distributors, D&H Distribution Company accounted for approximately 11% and 10% of our revenue in 2019 and 2018, respectively, and Amazon.com accounted for approximately 10% of our revenue in both 2019 and 2018. No other retailers or distributors accounted for 10% or more of our revenue during these periods. The loss of, or reduction in business with, one or more of our large retailers or distributors could have a significant adverse impact on our operating results. For example, Wynit, historically our largest customer at the time, filed for bankruptcy protection in September 2017. While we have agreements with these large retailers and distributors, these agreements do not require them to purchase any meaningful amount of our products.

Consolidation of retailers or concentration of retail market share among a few retailers may increase and concentrate our credit risk and impair our ability to sell products.

The electronics retail and sporting goods markets in some countries, including the United States, our largest market, are dominated by a few large retailers with many stores. These retailers have in the past increased their market share and may continue to do so in the future by expanding through acquisitions and construction of additional stores. This can further concentrate our credit risk to a relatively small number of retailers, and, if any of these retailers experience credit or liquidity issues, it would increase the risk that our receivables from these customers may not be paid. In addition, increasing market share concentration among one or a few retailers in a particular country or region increases the risk that if any one of them substantially reduces their purchases of our wearable devices, we may be unable to find a sufficient number of other retail outlets for our products to sustain the same level of sales. These situations also may result in pricing pressure to us. Any reduction in sales by our retailers would adversely affect our revenue, operating results, and financial condition.

To date, we have derived substantially all of our revenue from sales of our wearable devices, and revenue from our Fitbit Health Solutions channel has historically accounted for approximately 10% of our revenue.

To date, substantially all of our revenue has been derived from sales of our wearable devices, and we expect to continue to derive the substantial majority of our revenue from sales of these devices for the foreseeable future. In 2019, 2018 and 2017, we derived less than 10% of our revenue from sales of devices and software services through our Fitbit Health Solutions channel, through which we offer devices and software services to employers, health plans and health systems. However, in the future we plan to increase sales through this channel. For example, in September 2018, we launched Fitbit Care, a connected health platform that combines health coaching and virtual care, wearable devices, and personalized digital interventions to better support patients outside the walls of the clinical environment. If reception from employers, health plans, health systems or end users is unfavorable, or if we are unable to successfully further develop, market and sell our devices and software services through the Fitbit Health Solutions channel, we may be deprived of a potentially significant source of revenue in the future and our future growth and financial performance may be adversely affected.

To date, we have derived substantially all of our revenue from sales of our wearable devices, and sales of our subscription-based premium services to consumers have historically accounted for less than 5% of our revenue.

To date, substantially all of our revenue has been derived from sales of our wearable devices, and we expect to continue to derive the substantial majority of our revenue from sales of these devices for the foreseeable future. In 2019, 2018 and 2017, we derived less than 5% of our revenue from sales of our subscription-based premium services to consumers. However, in the future we plan to increase sales of subscriptions to these services. For example, in the third quarter of 2019, we launched Fitbit Premium, a paid subscription service that delivers a personalized experience with guidance and coaching. In the third quarter of 2020, we added content to that service, including analytics for our stress management score and a health metrics dashboard, in addition to launching Fitbit Premium + Health Coaching, a one-on-one health coaching service. In the third quarter of 2020, we began offering free trials of Fitbit Premium with the purchase of certain devices, ranging from three months to one year. If consumer reception is unfavorable or we are unable to successfully further develop, market and sell our premium services, we may be deprived of a potentially significant source of revenue in the future and our growth and financial performance may be adversely affected.

If additional tariffs on Chinese-origin goods are imposed, related countermeasures are taken by China, or we experience supply chain transformation setbacks, it could have an adverse impact on our business.

Certain of our manufacturing operations are located in China, making the pricing and availability of our products susceptible to international trade risks. In 2018, the United States imposed additional duties under Section 301 of the U.S. Trade Act of 1974, ranging from 10% to 25%, on a variety of goods imported from China. While these tariffs initially did not affect our products, in May 2019, the United States proposed to place tariffs on essentially all remaining Chinese-origin imports. Subsequently, the Trump Administration announced that 15% tariffs would be imposed on a subset of these goods, including wearable devices, which went into effect September 1, 2019. These tariffs were reduced to 7.5% on February 14, 2020.

We began exploring possibilities to mitigate the impact of tariffs in 2018, in response to the Trump Administration's concerns regarding China and the ongoing tariff threat. We have made changes to our supply chain and manufacturing operations to significantly reduce our exposure to tariffs on Chinese-origin products. We were also granted an exclusion from the existing Section 301 tariffs on our Chinese-origin products, effective through December 31, 2020. However, if additional tariffs are imposed, related countermeasures are taken by China, or we experience setbacks in our supply chain transformation efforts, our revenue, gross margins, and operating results may be adversely affected.

We have been, and may in the future be, subject to claims and lawsuits alleging that our products fail to provide accurate measurements and data to our users.

Our products and services are used to track and display various information about users' activities, such as daily steps taken, calories burned, distance traveled, floors climbed, active minutes, sleep duration and quality, heart rate and heart rhythm, skin temperature, blood oxygen saturation, and electrodermal activity, as well as GPS-based information such as speed, distance, and exercise routes on certain of our devices. We anticipate new features and functionality in the future, as well. From time to time, there have been reports and claims made against us alleging that our products do not provide accurate measurements and data to users, including claims asserting that certain features of our products do not operate as advertised. Such reports and claims have resulted in negative publicity and, in some cases, have required us to expend time and resources to defend litigation. If our products fail to provide accurate measurements and data to users, or if there are reports or claims of inaccurate measurements, claims of false advertisement, or claims of inaccuracy regarding the overall health benefits of our products and services in the future, we may become the subject of negative publicity, litigation, including class action litigation, regulatory proceedings, and warranty claims, and our brand, operating results, and business could be harmed.

Our gross margins have declined, and may continue to decline, and we have experienced operating losses as a result of decreased revenues and increased product costs and operating expenses.

Our business is subject to significant pressure on pricing and costs caused by many factors, including intense competition, NPIs, the cost of components used in our products, labor costs, constrained sourcing capacity, inflationary pressure, pressure from users to reduce the prices we charge for our products and services, warranty claims, changes in consumer demand, and impacts of the COVID-19 pandemic. Costs for our manufactured products and the components used to make our products are affected by, among other things, energy prices, consumer demand, fluctuations in commodity prices and currency, tariffs, and other factors that are generally unpredictable and beyond our control. Any change to pricing and costs could have an adverse effect on, among other things, our average selling price, the cost of our products, gross margins, operating results, financial condition, and cash flows. Moreover, if we are unable to offset any decreases in our average selling price by increasing our sales volumes or by adjusting our product mix, or if our sales volume declines and we are not able to reduce our costs, our operating results and financial condition may be harmed.

A substantial portion of our expenses are personnel related and include salaries, stock-based compensation, and benefits, which are not seasonal in nature. Accordingly, in the event of revenue shortfalls, we are generally unable to mitigate a negative impact on operating margins in the short term. To the extent such revenue shortfalls recur in future periods, our operating results would be harmed.

Our success depends on our ability to maintain our brand. If events occur that damage our brand, our business and financial results may be harmed.

Our success depends on our ability to maintain the value of the "Fitbit" brand. The "Fitbit" name is integral to our business as well as to implementation of our strategies for expanding our business. Maintaining, promoting, and positioning our brand depends largely on the success of our marketing and merchandising efforts; our ability to provide consistent, high quality products and services; our ability to successfully secure, maintain, and defend our rights to use the "Fitbit" mark and other trademarks important to our brand; and our ability to maintain a consistently high level of customer service. Our brand could be harmed if we fail to achieve these objectives and by any associated negative publicity.

The unlawful actions of third parties can harm our brand. The popularity of the "Fitbit" name makes it a target for counterfeiting or imitation. In recent years there has been an increase in third parties attempting to sell counterfeit and "knock-off" devices that try to replicate our products and that may infringe on our intellectual property.

Fitbit products and components may also be diverted or misappropriated from our contract manufacturers, distributors, authorized retailers, and other business partners and sold on the "gray market." Gray market products result in shadow inventory that is not visible to us, making it difficult to forecast demand accurately. Also, gray market products are often heavily discounted, which adversely affects demand for devices sold by us and by our channel partners and negatively impacts our margins. In addition, gray market activities may result in customer satisfaction issues as devices purchased outside our authorized sales channels may be substandard, including those that have been designated for scrap, altered, mishandled, damaged, or previously used. Further, gray market products may not be eligible for warranty replacement, which can erode customer satisfaction.

Any occurrence of counterfeiting, imitation, gray market sales, or other confusion with our brand could adversely affect our reputation, place negative pricing pressure on our products, reduce sales of our products, and impair the value of our brand. Additionally, counterfeit and unauthorized grey market sales may result in secondary warranty replacement and service costs. Maintaining, protecting, and enhancing our brand may require us to make substantial investments, which may not be successful. If we fail to effectively maintain, promote, and position our brand and protect our reputation, or if we incur significant expenses in this effort, our business, financial condition, and operating results may be adversely affected.

Our business is affected by seasonality and if our sales fall below our forecasts, our overall financial conditions and operating results could be adversely affected.

Our revenue and operating results are affected by general seasonal spending trends associated with holidays. For example, our fourth quarter has typically been our strongest quarter in terms of revenue and operating income, reflecting our historical strength in sales during the holiday season. We generated approximately 35%, 38% and 35% of our full year revenue during the fourth quarters of 2019, 2018 and 2017, respectively. Accordingly, any shortfall in expected fourth quarter revenue would adversely affect our annual operating results, as well as our cash flow. We may also experience excess inventory levels or a shortage of products available for sale if we fail to accurately forecast consumer demand for the holiday season. In addition, revenue for our Fitbit Health Solutions channel is affected by seasonal trends associated with the health-care industry. For example, medical benefit plans typically start at the beginning of the calendar year, which may drive sales through the Fitbit Health Solutions channel in our first quarter.

Yearly or quarterly comparisons of our operating results may not be useful, and our results in any particular period will not necessarily be indicative of the results to be expected for any future period. Seasonality in our business can also be significantly impacted by the introduction of new or enhanced products and services, including the costs associated with such introductions.

We collect, store, process, and use personal information and other customer data, which subjects us to governmental regulation and other legal obligations related to privacy, information security, and data protection, and any security breaches or our actual or perceived failure to comply with such legal obligations could harm our business.

We collect, store, process, and use personal information and other user data, and we rely on third parties that are not directly under our control to do so. Data may also be shared as described in our privacy policy. Our users' exercise and activity-related data and other personal information may include, among other information, names, addresses, phone numbers, email addresses, payment account information, height, weight, and information such as heart rates and heart rhythm, sleeping patterns, GPS-based location, skin temperature, blood oxygen saturation, electrodermal activity, and activity patterns.

Due to the volume of the personal information and data we manage and the nature of our products, the security features of our platform and information systems are critical. If our security measures, some of which we manage using third-party solutions, are breached or fail, unauthorized persons may be able to obtain access to or acquire our users' data. Furthermore, if third-party service providers that host user data on our behalf experience security breaches or violate applicable laws, agreements, or our policies, such events may also put our users' information at risk and could in turn have an adverse effect on our business. Additionally, if we or any third party, including third-party applications with which our users choose to share their Fitbit data, experience a breach of systems compromising our users' personal data, our brand and reputation could be adversely affected, use of our products and services could decrease, and we could be exposed to a risk of loss, litigation, and regulatory proceedings.

Depending on the nature of the information compromised, in the event of a data breach or other unauthorized access to or acquisition of our user data, we may also have obligations to notify users about the incident and we may need to provide some form of remedy, such as a subscription to a credit monitoring service, for the individuals affected by the incident. A growing number of legislative and regulatory bodies have adopted consumer notification requirements in the event of unauthorized access to or acquisition of certain types of personal data. Such breach notification laws continue to evolve and may be inconsistent from one jurisdiction to another. Complying with these obligations could cause us to incur substantial costs and could increase negative publicity surrounding any incident that compromises user data. Our users may also inadvertently disclose or lose control of their passwords, creating the perception that our systems are not secure against third-party access. While we maintain insurance coverage that, subject to policy terms and conditions and a significant self-insured retention, is designed to address certain aspects of cyber risks, such insurance coverage may be insufficient to cover all losses or all types of claims that may arise in the event we experience a security breach. In addition, any such security breaches may result in negative publicity, adversely affect our brand, decrease demand for our products and services, and adversely affect our operating results and financial condition.

Our failure to comply with U.S. and foreign laws related to privacy, data security, and data protection, such as the European Union's General Data Protection Regulation, or GDPR, and the California Consumer Privacy Act, or CCPA, could adversely affect our financial condition, operating results, and brand.

We are or may become subject to a variety of laws and regulations in the United States and abroad regarding privacy, data protection, and data security. These laws and regulations are continuously evolving and developing. The scope and interpretation of the laws that are or may be applicable to us are often uncertain and may be conflicting, particularly with respect to foreign laws.

In particular, there are numerous U.S. federal, state, and local laws and regulations and foreign laws and regulations regarding privacy and the collection, sharing, use, processing, disclosure, and protection of personal data. Such laws and regulations often have changes in scope, may be subject to differing interpretations, and may be inconsistent among different jurisdictions. For example, the GDPR, which became effective in May 2018, includes operational requirements for companies that receive or process personal data of residents of the European Union that are broader and more stringent than those previously in place in the European Union. The GDPR includes significant penalties for non-compliance, including fines of up to €20 million or 4% of total worldwide revenue. Additionally, California has enacted the CCPA, which became effective in January 2020. The CCPA requires covered companies to provide California consumers with new disclosures and expands the rights afforded consumers regarding their data.

Additionally, we are subject to evolving laws and regulations regarding the transfer of personal data outside of the European Economic Area, or EEA. Recently, the Court of Justice of the European Union ruled that the EU-U.S. Privacy Shield is an invalid transfer mechanism, but upheld Standard Contractual Clauses as a valid transfer mechanism. The validity of data transfer mechanisms remains subject to legal, regulatory, and political developments in both Europe and the United States The invalidation of the EU-U.S. Privacy Shield and potential invalidation of other data transfer mechanisms could have a significant adverse impact on our ability to process and transfer personal data outside of the EEA.

Certain privacy laws and regulations also apply to the collection of personal information from children, including the Children's Online Privacy Protection Act in the United States and the GDPR. In 2018, we introduced Fitbit Ace, our first activity tracker designed for children, and in 2019, we introduced Fitbit Ace 2, our tracker for children ages 6 and older for use with Fitbit family accounts.

Certain health-related laws and regulations such as the Health Insurance Portability and Accountability Act of 1996, or HIPAA, and the Health Information Technology for Economic and Clinical Health Act, or HITECH, may also have an impact on our business. For example, we offer HIPAA-compliant capabilities to certain customers of our corporate wellness offerings who are "covered entities" under HIPAA, which may include our execution of HIPAA Business Associate Agreements, or BAAs, with such covered entities. In addition, changes in applicable laws and regulations may result in the user data we collect being deemed protected health information under HIPAA and HITECH. Furthermore, because we accept payment via credit cards, we are subject to payment card association operating rules and certification requirements, including the Payment Card Industry Data Security Standard, or PCI DSS. If we are unable to comply with the applicable privacy and security requirements under HIPAA, HITECH, or PCI DSS, or we fail to comply with BAAs that we enter into with covered entities, we could be subject to claims, legal liabilities, penalties, fines, and negative publicity, which could harm our operating results.

Governments are continuing to focus on privacy and data security, and it is possible that new privacy or data security laws will be enacted or existing laws will be amended in a way that is material to our business. Any significant change to applicable laws, regulations, or industry practices regarding our users' data could require us to modify our services and features, possibly in a material manner, and may limit our ability to develop new products, services, and features. Although we have made efforts to design our policies, procedures, and systems to comply with the current requirements of applicable state, federal, and foreign laws, changes to applicable laws and regulations in this area could subject us to additional regulation and oversight, any of which could significantly increase our operating costs.

We strive to comply with all applicable laws, policies, legal obligations, and industry codes of conduct relating to privacy, data security, and data protection. The costs of compliance with, and other burdens imposed by, the GDPR, CCPA, HIPAA, and similar laws may limit the use and adoption of our products and services, and/or require us to incur substantial compliance costs, which could have an adverse impact on our business. In addition, given that the scope, interpretation, and application of these laws and regulations are often uncertain and may be conflicting, it is possible that these obligations may be interpreted and applied in a manner that is inconsistent from one jurisdiction to another and may conflict with other rules or our practices. Any failure or perceived failure by us or third-party service-providers to comply with our privacy or security policies or privacy-related legal obligations, the failure or perceived failure by third-party apps with which our users choose to share their Fitbit data to comply with their privacy policies or privacy-related legal obligations as they relate to the Fitbit data shared with them, or any compromise of security that results in the unauthorized release or transfer of personal data, may result in governmental enforcement actions, litigation, damages, penalties, and negative publicity, and could also have an adverse effect on our brand and operating results.

Cybersecurity risks could adversely affect our business and disrupt our operations.

The threats to network and data security are increasingly diverse and sophisticated. Despite our efforts and processes to prevent breaches, our devices, as well as our servers, computer systems, and those of third parties that we use in our operations, are vulnerable to cybersecurity risks, including cyber-attacks such as viruses and worms, phishing attacks, denial-of-service attacks, physical or electronic break-ins, employee theft or misuse, and similar disruptions from unauthorized tampering with our servers and computer systems or those of third parties that we use in our operations. These threats may be increased due to the work-from-home policies implemented by us and certain of our business partners as a result of mitigation measures related to the COVID-19 pandemic. These attacks could lead to interruptions, delays, loss of critical data, unauthorized access to user data, and loss of consumer confidence. In addition, we may be the target of email scams that attempt to acquire personal information or company assets. Despite our efforts to create security barriers to such threats, we may not be able to entirely mitigate these risks. Any cyber-attack that attempts to obtain our or our users' data and assets, disrupt our service, or otherwise access our systems, or those of third parties we use, if successful, could adversely affect our business, operating results, and financial condition, be expensive to remedy, and damage our reputation. In addition, any such breaches may result in negative publicity, adversely affect our brand, decrease demand for our products and services, and adversely affect our operating results and financial condition.

Any material disruption of our information technology systems, or those of third-party partners and data center providers, could materially damage user and business partner relationships and subject us to significant reputational, financial, legal, and operational consequences.

We depend on our information technology systems, as well as those of third parties, to develop new products and services, operate our website, host and manage our services, store data, process transactions, respond to user inquiries, and manage inventory and our supply chain. Any material disruption or slowdown of our systems or those of third parties whom we depend upon, including a disruption or slowdown caused by our failure to successfully manage significant increases in user volume or successfully upgrade our or their systems, system failures, or other causes, could cause outages or delays in our services, which could harm our brand and adversely affect our operating results. In addition, such disruption could cause information, including data related to orders, to be lost or delayed which could—especially if the disruption or slowdown occurred during the holiday season—result in delays in the delivery of products to stores and users or lost sales, which could reduce demand for our merchandise, harm our brand and reputation, and cause our revenue to decline. Our e-commerce platform, analytics capabilities and core Fitbit web and mobile application experiences are powered by systems that reside in cloud infrastructure environments. Should one of those providers experience a catastrophic event in their ecosystem of cloud data centers, capacity will become constrained in other centers as their clients work to bring up systems in new locations. In the event our location was impacted, we would require this constrained capacity to bring our business critical and customer facing services back online, or if other centers were impacted, our ability to add capacity in our center may be constrained due to this increased demand from other clients. This would be problematic only if we needed to scale our systems to meet increased demand during the same time period. Problems with our third-party data center service providers, the telecommunications network providers with whom they contract, or with the systems by which telecommunications providers allocate capacity among their users could adversely affect the experience of our users. Our third-party data center service providers could decide to close their facilities or cease providing us services without adequate notice. Any changes in third-party service levels at our data centers or any errors, defects, disruptions, or other performance problems with our platform could harm our brand and may damage the data of our users. If changes in technology cause our information systems, or those of third parties whom we depend upon, to become obsolete, or if our or their information systems are inadequate to handle our growth, we could lose users and our business and operating results could be adversely affected.

Our failure or inability to protect our intellectual property rights, or claims by others that we are infringing upon or unlawfully using their intellectual property, could diminish the value of our brand and weaken our competitive position, and adversely affect our business, financial condition, operating results, and prospects.

We currently rely on a combination of patent, copyright, trademark, trade secret, and unfair competition laws, as well as confidentiality agreements and procedures and licensing arrangements, to establish and protect our intellectual property rights. We have devoted substantial resources to the development of our proprietary technologies and related processes. In order to protect our proprietary technologies and processes, we rely in part on trade secret laws and confidentiality agreements with our employees, licensees, independent contractors, commercial partners, and other advisors. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. We cannot be certain that the steps taken by us to protect our intellectual property rights will be adequate to prevent infringement of such rights by others, including imitation of our products and misappropriation of our brand. Additionally, the process of obtaining patent or trademark protection is expensive and time-consuming, and we may not be able to file, apply for, or prosecute all necessary or desirable patent applications or trademark applications at a reasonable cost or in a timely manner. We have obtained and applied for U.S. and foreign trademark registrations for the “Fitbit” brand and a variety of our product names, and we will continue to evaluate the registration of additional trademarks as appropriate. However, we cannot guarantee that any of our pending trademark or patent applications will be approved by the applicable governmental authorities. Moreover, intellectual property protection may be unavailable or limited in some foreign countries where laws or law enforcement practices may not protect our intellectual property rights as fully as in the United States, and it may be more difficult for us to successfully challenge the use of our intellectual property rights by other parties in these countries. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights, and our failure or inability to obtain or maintain trade secret protection or otherwise protect our proprietary rights could adversely affect our business.

We are and may in the future be subject to patent infringement and trademark claims and lawsuits in various jurisdictions, and we cannot be certain that our products or activities do not violate the patents, trademarks, or other intellectual property rights of third-party claimants. Companies in the technology industry, and other patent, copyright, and trademark holders seeking to profit from royalties in connection with grants of licenses, own large numbers of patents, copyrights, trademarks, domain names, and trade secrets and frequently commence litigation based on allegations of infringement, misappropriation, or other violations of intellectual property or other rights. Companies and individuals may also be subject to criminal prosecution for trade secret theft under 18 U.S.C. section 1832. For example, we have been involved in litigation with Jawbone, as well as in a related federal criminal investigation concerning alleged theft of Jawbone’s trade secrets, which is described in Note 6 of the “Notes to Consolidated Financial Statements” included elsewhere in this Quarterly Report on Form 10-Q.

We intend to vigorously defend and prosecute litigation matters against us. Litigation is inherently uncertain, and any judgment or injunctive relief entered against us or any adverse settlement could materially and adversely impact our business, financial condition, operating results, and prospects. In addition, litigation can involve significant management time and attention and can be expensive, regardless of outcome. During the course of these litigation matters, there may be announcements of the results of hearings and motions, and other interim developments related to the litigation matters. If securities analysts or investors regard these announcements as material and negative, the market price of our Class A common stock may decline.

Further, from time to time, we have received and may continue to receive letters from third parties alleging that we are infringing upon their intellectual property rights. Successful infringement claims against us could result in significant monetary liability, prevent us from selling some of our products and services, or require us to change our technology, design, or branding. In addition, resolution of claims may require us to redesign our products, license rights from third parties at a significant expense, or cease using those rights altogether. We have also in the past and may in the future bring claims against third parties for infringing our intellectual property rights. Costs of supporting such litigation and disputes may be considerable, and there can be no assurances that a favorable outcome will be obtained. Patent infringement, trademark infringement, trade secret misappropriation, and other intellectual property claims and proceedings brought against us or brought by us, whether successful or not, could require significant attention of our management and resources and have in the past and could further result in substantial costs, harm to our brand, and have an adverse effect on our business.

We are regularly subject to general litigation, regulatory disputes, and government inquiries.

We are regularly subject to claims, lawsuits, including potential class actions, government investigations, and other proceedings involving intellectual property, privacy, consumer protection, product liability, accessibility claims, securities, tax, labor and employment, commercial disputes, and other matters. The number and significance of these disputes and inquiries have increased as we have grown larger, our business has expanded in scope and geographic reach, and our products and services have increased in complexity.

The outcome and impact of such claims, lawsuits, government investigations, and proceedings cannot be predicted with certainty. Regardless of the outcome, such investigations and proceedings can have an adverse impact on us because of legal costs, diversion of management resources, and other factors. Determining reserves for our pending litigation is a complex, fact-intensive process that is subject to judgment calls. It is possible that a resolution of one or more such proceedings could require us to make substantial payments to satisfy judgments, fines, or penalties or to settle claims or proceedings, any of which could harm our business. These proceedings could also result in reputational harm, criminal sanctions, or orders preventing us from offering certain products or services, requiring a change in our business practices in costly ways, or requiring development of non-infringing or otherwise altered products or technologies. Any of these consequences could harm our business.

Our international operations subject us to additional costs and risks, and our continued expansion internationally may not be successful.

We have entered into many international markets in a relatively short time and may enter into additional markets in the future. Outside of the United States, we currently have operations in a number of countries in Asia and Europe, as well as in Australia. There are significant costs and risks inherent in conducting business in international markets, including:

- establishing and maintaining effective controls at foreign locations and the associated increased costs;
- adapting our technologies, products, and services to non-U.S. consumers' preferences and customs;
- restrictions on international travel due to the COVID-19 pandemic;
- variations in margins by geography;
- increased competition from local providers of similar products;
- longer sales or collection cycles in some countries;
- compliance with foreign laws and regulations;
- compliance with the laws of numerous taxing jurisdictions where we conduct business, potential double taxation of our international earnings, and potentially adverse tax consequences due to U.S. and foreign tax laws as they relate to our international operations;
- compliance with anti-bribery laws, such as the FCPA and the U.K. Bribery Act, by us, our employees, and our business partners;
- complexity and other risks associated with current and future foreign legal requirements, including legal requirements related to consumer protection, consumer product safety, and data privacy frameworks, such as the GDPR, and any applicable privacy and data protection laws in foreign jurisdictions where we currently conduct business or intend to conduct business in the future;
- currency exchange rate fluctuations and related effects on our operating results;
- economic and political instability in some countries, particularly in China and Belarus;
- the uncertainty of protection for intellectual property rights in some countries and practical difficulties of enforcing rights abroad;
- tariffs and customs duties and the classification of our products by applicable governmental bodies; and
- other costs of doing business internationally.

Our products are manufactured overseas and imported into the United States, the European Union, and other countries and may be subject to duties, tariffs and anti-dumping penalties imposed by applicable customs authorities. Those duties and tariffs are based on the classification of each of our products and are routinely subject to review by the applicable customs authorities. We are unable to predict whether those authorities will agree with our classifications, and if those authorities do not agree with our classifications, additional duties, tariffs or other trade restrictions may be imposed on the importation of our products. Such actions could result in increases in the cost of our products generally and might adversely affect our sales and profitability.

These factors and other factors could harm our international operations and, consequently, materially impact our business, operating results, and financial condition. Further, we may incur significant operating expenses as a result of our international expansion, and it may not be successful. We have limited experience with regulatory environments and market practices internationally, and we may not be able to penetrate or successfully operate in new markets. We may also encounter difficulty expanding into new international markets because of limited brand recognition in certain parts of the world, leading to delayed acceptance of our products and services by users in these new international markets. If we are unable to continue to expand internationally and manage the complexity of our global operations successfully, our financial condition and operating results could be adversely affected.

We may experience difficulties managing our cloud infrastructure migration.

In 2018 we announced our move to the Google Cloud Platform. Cloud infrastructure migrations are complex, time-consuming, and can involve substantial expenditures. Our cloud service is critical to developing and providing products and services to our customers, scaling our business for future growth, accurately maintaining data, and otherwise operating our business. Any such implementation involves risks inherent in the conversion to a new system, including loss of information; potential disruption to our normal operations; and deficiencies in our design, implementation or maintenance of the system, which could adversely affect our business.

The market for wearable devices is still evolving and if it does not continue to grow, grows more slowly than we expect, or fails to grow as large as we expect, our business and operating results would be harmed.

The market for wearable devices, which includes both health and fitness trackers and smartwatches, is still evolving and it is uncertain whether wearable devices will sustain high levels of demand and wide market acceptance. Our success will depend to a substantial extent on the willingness of people to widely adopt these products and services. Adoption of our products and services depends in part on the increasing prevalence of wearable devices driven by the introduction of new form factors, related software services and other offerings. However, it is not certain whether consumers will respond to these new form factors, software services and other offerings, and if our offerings fail to satisfy consumer preferences, our business may be adversely affected.

Furthermore, some individuals may be reluctant or unwilling to use wearable devices due to concerns regarding data privacy and security. If the wider public does not perceive the benefits of our wearable devices or chooses not to adopt them as a result of concerns regarding privacy or data security or for other reasons, then the market for these products and services may not further develop, may develop more slowly than we expect, may not achieve the growth potential we expect, or the growth may not be sustained, any of which would adversely affect our operating results. The development and growth of this market may not be sustained.

Our business and products are subject to a variety of additional U.S. and foreign laws and regulations that are central to our business; our failure to comply with these laws and regulations could harm our business or our operating results.

We are or may become subject to a variety of laws and regulations in the United States and abroad that involve matters central to our business, including laws and regulations regarding consumer protection, advertising, privacy, intellectual property, manufacturing, medical devices, anti-bribery and anti-corruption, and economic or other trade prohibitions or sanctions.

The manufacturing, labeling, distribution, importation, marketing, and sale of our products are subject to extensive regulation by various U.S. state and federal and foreign agencies, including the U.S. Consumer Product Safety Commission, or CPSC, FTC, the U.S. Food and Drug Administration, or FDA, the Federal Communications Commission, and state attorneys general, as well as by various other federal, state, provincial, local, and international regulatory authorities in the countries in which our products and services are manufactured, distributed, marketed or sold. If we fail to comply with any of these regulations, we could become subject to enforcement actions or the imposition of significant monetary fines, other penalties, or claims, which could harm our operating results or our ability to conduct our business.

The global nature of our business operations also creates various domestic and foreign regulatory challenges and subjects us to laws and regulations such as the U.S. Foreign Corrupt Practices Act, or FCPA, the U.K. Bribery Act, and similar anti-bribery and anti-corruption laws in other jurisdictions, and our products are also subject to U.S. export controls, including the U.S. Department of Commerce's Export Administration Regulations and various economic and trade sanctions regulations established by the Treasury Department's Office of Foreign Assets Controls. If we become liable under these laws or regulations, we may be forced to implement new measures to reduce our exposure to this liability. This may require us to expend substantial resources or to discontinue certain products or services, which would negatively affect our business, financial condition, and operating results. In addition, the increased attention on liability issues as a result of lawsuits, regulatory proceedings, and legislative proposals could harm our brand or otherwise impact the growth of our business. Any costs incurred as a result of compliance or other liabilities under these laws or regulations could harm our business and operating results.

Our Fitbit ECG App, Aria scales, and Fitbit Flow emergency resuscitators are subject to FDA and corresponding international regulations, and sales of these products or future regulated products could be adversely affected if we fail to comply with the applicable requirements.

Medical devices, including our Fitbit ECG App, Aria scales, and Fitbit Flow emergency resuscitators, are regulated by the FDA and corresponding state regulatory agencies in the United States and separate governmental authorities outside of the United States, and we may have future software features or hardware products that are regulated as medical devices. In the United States, the medical device industry is regulated by governmental authorities, principally the FDA and corresponding state regulatory agencies. Generally, before we can market or sell a new regulated product or make a significant modification to an existing medical device in the United States, we must comply with FDA Quality Management System regulations, and must obtain regulatory clearance or approval from the FDA, unless an exemption from pre-market review applies. In the European Economic Area, medical devices must be developed and manufactured according to applicable medical device standards and specifications, undergo a conformity assessment, and obtain a Declaration of Conformity – Conformité Européenne, or CE marking, before they can be placed on the market. An audit of the quality management system may also be required depending on the medical device's classification. In addition, certain future software functionality, whether standalone or embedded in existing or future devices, may be regulated as a medical device and require pre-market review and clearance or approval and CE marking. The process of obtaining regulatory clearances or approvals and CE markings to market a medical device can be costly and time consuming, and we may not be able to obtain these on a timely basis, or at all, for future products. Any delay in, or failure to receive or maintain, clearance or approval and CE marking for any medical device products under development could prevent us from generating revenue from these products.

Medical devices are also subject to numerous ongoing compliance requirements under the regulations of the FDA and corresponding state regulatory agencies, as well as by separate governmental authorities outside of the United States, which can be costly and time consuming. For example, under FDA regulations medical device manufacturers are required to, among other things, (i) establish a quality management system to help ensure that their products consistently meet applicable requirements and specifications, (ii) establish and maintain procedures for receiving, reviewing, and evaluating complaints, (iii) establish and maintain a corrective and preventive action procedure, (iv) report certain device-related adverse events and product problems to the FDA, and (v) report to the FDA the removal or correction of a distributed product.

Additionally, in June 2020, we obtained Emergency Use Authorization, or EUA, from the FDA of Fitbit Flow, an emergency resuscitator for use during the COVID-19 pandemic. The emergency use of Fitbit Flow must be consistent with the terms of the EUA. The EUA will be effective until the relevant emergency declaration is terminated or the EUA is revoked.

If we experience any product problems requiring reporting to the FDA or if we otherwise fail to comply with applicable FDA regulations or the regulations of corresponding state regulatory agencies, or the regulations of governmental authorities outside of the United States, with respect to our Fitbit ECG App, Aria scales or future regulated products, or fail to comply with the terms of the EUA, with respect to Fitbit Flow, we could jeopardize our ability to sell our products and could be subject to enforcement actions such as fines, civil penalties, injunctions, recalls of products, delays in the introduction of products into the market, and refusal of the FDA or other regulators to grant future clearances or approvals or CE markings, which could harm our reputation, business, operating results, and financial condition.

In addition, in the United States, the FDA has taken the position that device manufacturers are prohibited from promoting their products other than for the uses and indications set forth in the approved product labeling, and any failure to comply could subject us to significant civil or criminal exposure, administrative obligations and costs, and/or other potential penalties from, and/or agreements with, the federal government. Similar prohibitions and consequences for non-compliance apply in the European Economic Area.

Government regulations outside the United States have, and may continue to, become increasingly stringent and common. In the European Economic Area, for example, the European Union Medical Device Regulation was published in 2017 and, when it enters into full force in 2021, will include additional significant pre-market and post-market requirements. Penalties for regulatory non-compliance could be severe, including fines and revocation or suspension of a company's business license, mandatory price reductions, and criminal sanctions. Future laws and regulations may have an adverse effect on us.

Our financial performance is subject to risks associated with changes in the value of the U.S. dollar versus local currencies.

Our primary exposure to movements in foreign currency exchange rates relates to non-U.S. dollar denominated sales and operating expenses worldwide. Weakening of foreign currencies relative to the U.S. dollar, while beneficial to our operating expenses, adversely affects the U.S. dollar value of our foreign currency-denominated sales and earnings, and generally leads us to raise international pricing, potentially reducing demand for our products. In some circumstances, for competitive or other reasons, we may decide not to raise local prices to fully offset the strengthening of the U.S. dollar, or at all, which would adversely affect the U.S. dollar value of our foreign currency denominated sales and earnings. Conversely, a strengthening of foreign currencies relative to the U.S. dollar, while generally beneficial to our foreign currency-denominated sales and earnings, could cause us to reduce international pricing, incur losses on our foreign currency derivative instruments, and incur increased operating expenses, thereby limiting any benefit. Additionally, strengthening of foreign currencies may also increase our cost of product components denominated in those currencies, thus adversely affecting gross margins.

We may use derivative instruments, such as foreign currency forward contracts, to hedge certain exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset any, or more than a portion, of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place. In addition, our counterparties may be unable to meet the terms of the agreements. We seek to mitigate this risk by limiting counterparties to major financial institutions and by spreading the risk across several major financial institutions.

U.S. federal income tax reform and changes in other tax laws could adversely affect us.

In December 2017, U.S. federal tax legislation commonly referred to as the Tax Cuts and Jobs Act, or the 2017 Tax Act, was signed into law, significantly reforming the Internal Revenue Code of 1986, as amended, or the Code. The 2017 Tax Act, among other things, includes changes to U.S. federal tax rates, imposes significant additional limitations on the deductibility of business interest, allows for the expensing of capital expenditures, puts into effect the migration from a "worldwide" system of taxation to a partial "territorial" system, and modifies or repeals many business deductions and credits.

In March 2020, U.S. federal tax legislation named the Coronavirus Aid, Relief, and Economic Security Act, or the CARES Act, was signed into law. Such legislation modified the 2017 Tax Act by, among other things, eliminating the limitation on the deduction of net operating losses to 80% of current year taxable income for tax years beginning before January 1, 2021, increasing the amount of interest expense that may be deducted from 30% to 50% of adjusted taxable income for tax years beginning in 2019 or 2020, and permitting the carryback of net operating losses incurred in tax years beginning in 2018-2020.

The 2017 Tax Act is a far-reaching and complex revision to the U.S. federal income tax laws with disparate and, in some cases, countervailing impacts on different categories of taxpayers and industries. The long-term impact of the 2017 Tax Act, as modified by the CARES Act, on the overall economy, the industries in which we operate and our partners' businesses still cannot be reliably predicted. There can be no assurance that the 2017 Tax Act, as modified by the CARES Act, will not negatively impact our future operating results. The estimated impact of the 2017 Tax Act, as modified by the CARES Act, is based on our management's current knowledge and assumptions, following consultation with our tax advisors. Because of our valuation allowance in the U.S., ongoing tax effects of the 2017 Tax Act, as modified by the CARES Act, are not expected to materially change our effective tax rate in future periods.

In addition, new legislation or regulations, or modifications to existing legislation or regulations, that could affect our tax burden could be enacted by any governmental authority. We cannot predict the timing or extent of such tax-related developments that could negatively impact our financial results. Additionally, we use our best judgment in attempting to quantify and reserve for these tax obligations. However, a challenge by a taxing authority, our ability to utilize tax benefits such as loss carryforwards or tax credits, or a deviation from other tax-related assumptions could have a material adverse effect on our business, results of operations, or financial condition.

Changes in our tax rates or exposure to additional tax liabilities could adversely affect our earnings and financial condition.

We are subject to income taxes in the United States and foreign jurisdictions in which we do business. These foreign jurisdictions have statutory tax rates different from those in the United States. Accordingly, our provision for income taxes is subject to volatility and could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in foreign currency exchange rates, or by changes in the relevant tax, accounting, and other laws, regulations, principles, and interpretations, or by changes in the valuation of our deferred tax assets and liabilities. As we operate in numerous taxing jurisdictions, the application of tax laws can be subject to diverging and sometimes novel and conflicting interpretations by tax authorities of these jurisdictions.

If we are unable to protect our domain names, our brand, business, and operating results could be adversely affected.

We have registered domain names for websites, or URLs, that we use in our business, such as Fitbit.com. If we are unable to maintain our rights in these domain names, our competitors or other third parties could capitalize on our brand recognition by using these domain names for their own benefit. In addition, although we own the “Fitbit” domain name under various global top level domains such as .com and .net, as well as under various country-specific domains, we might not be able to, or may choose not to, acquire or maintain other country-specific versions of the “Fitbit” domain name or other potentially similar URLs. The regulation of domain names in the United States and elsewhere is generally conducted by Internet regulatory bodies and is subject to change. If we lose the ability to use a domain name in a particular country, we may be forced to either incur significant additional expenses to market our solutions within that country, including the development of a new brand and the creation of new promotional materials, or elect not to sell our solutions in that country. Either result could substantially harm our business and operating results. Regulatory bodies could establish additional top-level domains, appoint additional domain name registrars, or modify the requirements for holding domain names. As a result, we may not be able to acquire or maintain the domain names that utilize the name “Fitbit” in all of the countries in which we currently conduct or intend to conduct business. Further, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights varies among jurisdictions and is unclear in some jurisdictions. Domain names similar to ours have already been registered in the United States and elsewhere, and we may be unable to prevent third parties from acquiring and using domain names that infringe, are similar to, or otherwise decrease the value of, our brand or our trademarks. Protecting and enforcing our rights in our domain names and determining the rights of others may require litigation, which could result in substantial costs, divert management attention, and not be decided favorably to us.

Our use of “open source” software could negatively affect our ability to sell our products and subject us to possible litigation.

A portion of the technologies we use incorporates “open source” software, and we may incorporate open source software in the future. From time to time, companies that incorporate open source software into their products have faced claims challenging the ownership of open source software or compliance with open source license terms. Therefore, we could be subject to suits by parties claiming ownership of what we believe to be open source software or noncompliance with open source licensing terms. Some open source licenses may subject us to certain unfavorable conditions, including requirements that we offer our products and services that incorporate the open source software for no cost or that we make publicly available all or part of the source code for modifications or derivative works. Additionally, if a third-party software provider has incorporated open source software into software that we license or obtain from such provider, we could be required to disclose or provide at no cost all or part of our source code that incorporates such licensed software. If a copyright holder that distributes open source software that we use or license or other third party were to allege that we had not complied with the conditions of the applicable license, we could be required to incur significant legal expenses defending against such allegations and may be required to release portions of our proprietary source code, subject to significant damages, re-engineer our products and services, enjoined from the sale of our products and services that contained the open source software if re-engineering our products or services cannot be accomplished on a timely basis, or take other remedial action that may divert resources away from our development efforts. Any of the foregoing could disrupt the distribution and sale of our products and services and harm our business.

We may engage in merger and acquisition activities, which could require significant management attention, disrupt our business, dilute stockholder value, and adversely affect our operating results.

As part of our business strategy, and subject to Google's approval in accordance with the Merger Agreement, we may make investments in other companies, products, or technologies. For example, in 2016, we acquired assets from Coin, Inc., Pebble Industries, Inc., and Vector Watch S.R.L, and in 2018 we acquired Twine Health, Inc. 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. If we do complete acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, and any acquisitions we complete could be viewed negatively by users or investors. In addition, if we fail to successfully integrate such acquisitions, or the technologies associated with such acquisitions, into our company, the revenue and operating results of the combined company could be adversely affected.

Acquisitions may disrupt our or the acquired company’s ongoing operations, divert management from their primary responsibilities, subject us to additional liabilities, increase our expenses, and adversely impact our business, financial condition, operating results, and cash flows. We may not successfully evaluate or utilize the acquired technology and accurately forecast the financial impact of an acquisition transaction, including accounting charges. Due diligence performed prior to closing acquisitions may not uncover certain risks or liabilities that could materially impact our business and financial results.

We may have to pay cash, incur liabilities and/or debt, or issue equity securities to pay for any such acquisition, each of which may affect our financial condition or the value of our capital stock and could result in dilution to our stockholders. Additionally, we may receive indications of interest from other parties interested in acquiring some or all of our business. The time required to evaluate such indications of interest could require significant attention from management, disrupt the ordinary functioning of our business, and adversely affect our operating results.

There have been reports that some users of certain of our devices have experienced skin irritations, which could result in additional negative publicity or otherwise harm our business. In addition, some of our users have filed personal injury lawsuits against us relating to certain of our devices, which could divert management's attention from our operations and result in substantial legal fees and other costs.

Due to the nature of some of our wearable devices, some users have had in the past and may in the future experience skin irritations or other biocompatibility issues not uncommon with jewelry or other wearable products that stay in contact with skin for extended periods of time. There have been reports by some users of certain of our devices experiencing skin irritations. This negative publicity could harm sales of our products and also adversely affect our relationships with retailers that sell our products, including causing them to be reluctant to continue to sell our products. In addition, in the past, some of our users have filed personal injury lawsuits against us arising out of such claims relating to certain of our devices. While we do not believe that these lawsuits are material, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of any proceedings arising from such claims, and these actions or other third-party claims against us may result in the diversion of our management's time and attention from other aspects of our business and may cause us to incur substantial litigation or settlement costs. If large numbers of users experience these problems, we could be subject to enforcement actions or the imposition of significant monetary fines, other penalties, or proceedings by the CPSC or other U.S. or foreign regulatory agencies and face additional personal injury or class action litigation, any of which could have an adverse impact on our business, financial condition, and operating results.

We may be subject to CPSC recalls, regulatory proceedings, and litigation in various jurisdictions, including multi-jurisdiction federal and state class action and personal injury claims, which may require significant management attention and disrupt our business operations, and adversely affect our financial condition, operating results, and our brand.

We face product liability, product safety, and product compliance risks relating to the marketing, sale, use, and performance of our products. The products we sell must be designed and manufactured to be safe for their intended purposes and must comply with applicable certain federal and state laws and regulations. For example, all of our current products are subject to the Consumer Product Safety Act and the Consumer Product Safety Improvement Act, which empower the CPSC. The CPSC may take action against hazards presented by consumer products, up to and including product recalls. We are required to report certain incidents related to the safety and compliance of our products to the CPSC, and failure to do so could result in a civil penalty.

Over the last several years, the CPSC has conducted investigations into several of our products. Although the CPSC did not find a substantial product hazard, there can be no assurances that investigations will not be conducted in the future or that product hazards or other defects will not be found in the future with respect to our products. Regulatory investigations and proceedings, product recalls, and litigation have had and may continue to have an adverse impact on our financial condition, operating results, and brand. They may also divert management's attention from our operations and result in substantial legal fees and costs, regardless of their merit. Furthermore, because of the global nature of our product sales, in the event we experience defects with respect to products sold outside the United States, we could become subject to recalls, regulatory proceedings, and litigation by foreign governmental agencies and private litigants, which could significantly increase the costs of managing any product issues.

If we fail to maintain an effective system of disclosure controls and internal control over financial reporting, our ability to produce timely and accurate financial statements or comply with applicable regulations could be impaired.

We are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, and the rules and regulations of the applicable listing standards of the New York Stock Exchange. We expect that the requirements of these rules and regulations will continue to increase our legal, accounting, and financial compliance costs; make some activities more difficult, time-consuming, and costly; and strain our personnel, systems, and resources.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. We are also required to make a formal assessment and provide an annual management report on the effectiveness of our internal control over financial reporting, which must be attested to by our independent registered public accounting firm. In order to maintain the effectiveness of our disclosure controls and procedures and internal control over financial reporting, we have expended, and anticipate that we will continue to expend, resources, including accounting-related costs and management oversight.

As disclosed in Item 9A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2019, we did not maintain effective controls over the accuracy of invoicing gross revenue for fiscal years 2018 and 2017. This represented a material weakness that did not result in the identification of any adjustments to our annual or interim consolidated financial statements. A material weakness is defined as a deficiency, or 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 will not be prevented or detected on a timely basis. Management identified and implemented changes to our internal control over financial reporting to remediate the control deficiencies that led to this material weakness, and the material weakness was remediated as of December 31, 2019. However, we cannot provide assurance that remediation efforts will be sufficient to identify or prevent future material weaknesses, and the enhanced controls and procedures could require increased management time and attention and resources.

Additionally, current controls and any new controls that we develop may become inadequate because of changes in conditions in our business. Further, additional weaknesses in our disclosure controls and internal control over financial reporting may be discovered in the future. Any failure to maintain or develop effective controls or any difficulties encountered in their implementation or improvement could harm our operating results or cause us to fail to meet our reporting obligations and may result in a restatement of our financial statements for prior periods. Any failure to maintain effective internal control over financial reporting also could adversely affect the results of periodic management evaluations and annual independent registered public accounting firm attestation reports regarding the effectiveness of our internal control over financial reporting. Ineffective disclosure controls and procedures and internal control over financial reporting could also cause investors to lose confidence in our reported financial and other information, which would likely have a negative effect on the trading price of our Class A common stock. In addition, if we are unable to continue to meet these requirements, we may not be able to remain listed on the New York Stock Exchange.

Our business is subject to the risk of disruptions caused by epidemics, political events, war, terrorism, earthquakes, fire, power outages, floods, and other catastrophic events.

War, terrorism, geopolitical uncertainties, trade restrictions, public health crises, such as pandemics and epidemics (including, for example, the COVID-19 pandemic), protests and civil unrest, natural disasters and other catastrophic events may cause damage or disruption to the economy and commerce on a global, regional or country-specific basis, and could disrupt supply or delivery of, or demand for, our products.

Our business is also vulnerable to damage or interruption from earthquakes, fires, floods, power losses, telecommunications failures, human errors, break-ins, and similar events. The third-party systems and operations and contract manufacturers we rely on, such as the data centers we lease, are subject to similar risks. For example, a significant natural disaster, such as an earthquake, fire, or flood, could have an adverse effect on our business, operating results, and financial condition, and our insurance coverage may be insufficient to compensate us for losses that may occur. Our corporate offices and one of our data center facilities are located in California, a state that experiences earthquakes. In addition, the facilities at which our contract manufacturers manufacture our products are located in parts of Asia that experience typhoons and earthquakes. Acts of terrorism, which may be targeted at metropolitan areas that have higher population density than rural areas, could also cause disruptions in our business or that of our suppliers, contract manufacturers, and logistics providers, or to the economy as a whole. We may not have sufficient protection or recovery plans in some circumstances, such as natural disasters affecting California or other locations where we have data centers or store significant inventory of our products. As we rely heavily on our data center facilities, computer and communications systems, and the Internet to conduct our business and provide high-quality customer service, these disruptions could negatively impact our ability to run our business and either directly or indirectly disrupt suppliers' businesses, which could have an adverse effect on our business, operating results, and financial condition.

If our estimates or judgments relating to our critical accounting policies prove to be incorrect, our operating results could be adversely affected.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, as provided in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Quarterly

Report on Form 10-Q. The results of these estimates form the basis for making judgments about the carrying values of assets, liabilities, and equity, and the amount of revenue and expenses that are not readily apparent from other sources. Significant assumptions and estimates used in preparing our consolidated financial statements include those related to revenue recognition, inventories, product warranty reserves, business combinations, accounting for income taxes, and stock-based compensation expense. Our operating results may be adversely affected if our assumptions change or if actual circumstances differ from those in our assumptions, which could cause our operating results to fall below the expectations of securities analysts and investors, resulting in a decline in the price of our Class A common stock.

We are exposed to fluctuations in the market values of our investments.

Credit ratings and pricing of our investments can be negatively affected by liquidity, credit deterioration, financial results, economic risk, political risk, sovereign risk, changes in interest rates, or other factors. As a result, the value and liquidity of our cash, cash equivalents, and marketable securities may fluctuate substantially. Therefore, although we have not realized any significant losses on our cash, cash equivalents, and marketable securities, future fluctuations in their value could result in a significant realized loss, which could adversely affect our financial condition and operating results.

Regulations related to conflict minerals may cause us to incur additional expenses and could limit the supply and increase the costs of certain metals used in the manufacturing of our products.

We are subject to requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 that require us to conduct due diligence on and disclose whether or not our products contain conflict minerals as defined under these provisions. The implementation of these requirements could adversely affect the sourcing, availability, and pricing of the materials used in the manufacture of components used in our products. In addition, we incur additional costs to comply with the disclosure requirements, including costs related to conducting diligence procedures to determine the sources of minerals that may be used or necessary to the production of our products and, if applicable, potential changes to products, processes, or sources of supply as a consequence of such due diligence activities. It is also possible that we may face reputational harm if we determine that certain of our products contain minerals not determined to be conflict free or if we are unable to alter our products, processes, or sources of supply to avoid such materials.

Risks Related to Ownership of Our Class A Common Stock

The market price of our Class A common stock has been and will likely continue to be volatile, and you could lose all or part of your investment.

The market price of our Class A common stock has been, and will likely continue to be, volatile. Since shares of our Class A common stock were sold in our initial public offering in June 2015 at a price of $20.00 per share, our stock price has ranged from $2.81 to $51.90 through October 3, 2020. The trading prices of the securities of technology companies in general have been highly volatile, and since the outbreak of the COVID-19 pandemic, the price of many technology and other companies' shares has fallen significantly. The extent to which, and for how long, the COVID-19 pandemic may impact the market price of our Class A common stock is uncertain.

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

- the COVID-19 pandemic and any associated economic downturn;
- overall performance of the equity markets;
- actual or anticipated fluctuations in our revenue and other operating results;
- changes in the financial projections we may provide to the public or our failure to meet these projections;
- failure of securities analysts to initiate or maintain coverage of us, changes in financial estimates by any securities analysts who follow us, or our failure to meet these estimates or the expectations of investors;
- recruitment or departure of key personnel;
- the economy as a whole and market conditions in our industry;
- negative publicity related to problems in our manufacturing or the real or perceived quality of our products, as well as the failure to timely launch new products that gain market acceptance;

- rumors and market speculation involving us or other companies in our industry;
- announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures, or capital commitments;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- lawsuits threatened or filed against us;
- other events or factors, including those resulting from war, incidents of terrorism, or responses to these events; and
- sales of shares of our Class A common stock by us or our stockholders.

In addition, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. Stock prices of many companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. We are currently subject to securities litigation, which is described in Note 6 of the “Notes to Consolidated Financial Statements” included elsewhere in this Quarterly Report on Form 10-Q. This or any future securities litigation could subject us to substantial costs, divert resources and the attention of management from our business, and adversely affect our business.

Sales of substantial amounts of our Class A common stock in the public markets, or the perception that they might occur, could cause the market price of our Class A common stock to decline.

Sales of a substantial number of shares of our Class A common stock into the public market, particularly sales by our directors, executive officers, and principal stockholders, or the perception that these sales might occur, could cause the market price of our Class A common stock to decline.

As of October 3, 2020, there were 272.2 million shares of Class A and Class B common stock outstanding. All shares of our common stock are available for sale in the public market, subject in certain cases to volume limitations under Rule 144 under the Securities Act of 1933, as amended, or Securities Act, and various vesting agreements, as well as our insider trading policy.

In addition, as of October 3, 2020, we had stock options outstanding that, if fully exercised, would result in the issuance of 1.3 million shares of Class A common stock and 9.9 million shares of Class B common stock (which shares of Class B common stock generally convert to Class A common stock upon their sale or transfer). We also had restricted stock units, or RSUs, outstanding as of October 3, 2020 that may be settled for 19.1 million shares of Class A common stock. As of October 3, 2020, all of the shares issuable upon the exercise of stock options or settlement of RSUs, and the shares reserved for future issuance under our equity incentive plans, are registered for public resale under the Securities Act. Accordingly, these shares may be freely sold in the public market upon issuance subject to applicable vesting requirements.

In addition, certain holders of our capital stock have rights, subject to some conditions, to require us to file registration statements for the public resale of their shares or to include such shares in registration statements that we may file for us or other stockholders.

The dual class structure of our common stock has the effect of concentrating voting control with our founders and certain other holders of our Class B common stock, including our directors, executive officers, and significant stockholders. This will limit or preclude your ability to influence corporate matters, including the election of directors, amendments of our organizational documents, and any merger, consolidation, sale of all or substantially all of our assets, or other major corporate transaction requiring stockholder approval.

Our Class B common stock has ten votes per share and our Class A common stock has one vote per share. As of October 3, 2020, our directors, executive officers, and holders of more than 5% of our common stock, and their respective affiliates, held a substantial majority of the voting power of our capital stock. Because of the ten-to-one voting ratio between our Class B and Class A common stock, our co-founders, who currently serve as our chief executive officer and chief technology officer, control a majority of the combined voting power of our common stock and therefore are able to control all matters submitted to our stockholders for approval until the earlier of June 17, 2027 or the date the holders of a majority of our Class B common stock choose to convert their shares. This concentrated control will limit or preclude your ability to influence corporate matters for the foreseeable future, including the election of directors, amendments of our organizational documents, and any merger, consolidation, sale of all or substantially all of our assets, or other major corporate transaction requiring stockholder approval. In addition, this may prevent or discourage unsolicited acquisition proposals or offers for our capital stock that you may feel are in your best interest as one of our stockholders.

Transfers by holders of Class B common stock will generally result in those shares converting to Class A common stock, subject to limited exceptions, such as certain transfers effected for estate planning purposes. The conversion of Class B common stock to Class A common stock will have the effect, over time, of increasing the relative voting power of those holders of Class B common stock who retain their shares in the long term.

If securities or industry analysts do not publish research, or publish inaccurate or unfavorable research, about our business, the price of our Class A common stock and trading volume could decline.

The trading market for our Class A common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. We do not have any control over these analysts. If industry analysts cease coverage of us, the trading price for our common stock would be negatively affected. If one or more of the analysts who cover us downgrade our Class A common stock or publish inaccurate or unfavorable research about our business, our common stock price would likely decline. If one or more of these analysts cease coverage of us or fail to publish reports on us regularly, demand for our Class A common stock could decrease, which might cause our Class A common stock price and trading volume to decline.

We do not intend to pay dividends for the foreseeable future.

We have never declared or paid any cash dividends on our common stock and do not intend to pay any cash dividends in the foreseeable future. We anticipate that we will retain all of our future earnings for use in the development of our business and for general corporate purposes. Any determination to pay dividends in the future will be at the discretion of our board of directors. Accordingly, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investments.

Provisions in our charter documents and under Delaware law could make an acquisition of our company more difficult, limit attempts by our stockholders to replace or remove our current management, limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers, or employees, and limit the market price of our common stock.

Provisions in our restated certificate of incorporation and restated bylaws may have the effect of delaying or preventing a change of control or changes in our management. Our restated certificate of incorporation and restated bylaws include provisions that:

- provide that our board of directors will be classified into three classes of directors with staggered three-year terms at such time as the outstanding shares of our Class B common stock represent less than a majority of the combined voting power of our common stock;
- permit the board of directors to establish the number of directors and fill any vacancies and newly created directorships;
- require super-majority voting to amend some provisions in our restated certificate of incorporation and restated bylaws;
- authorize the issuance of "blank check" preferred stock that our board of directors could use to implement a stockholder rights plan;
- provide that only the chairman of our board of directors, our chief executive officer, or a majority of our board of directors will be authorized to call a special meeting of stockholders;
- provide for a dual class common stock structure in which holders of our Class B common stock have the ability to control the outcome of matters requiring stockholder approval, even if they own significantly less than a majority of the outstanding shares of our Class A and Class B common stock, including the election of directors and significant corporate transactions, such as a merger or other sale of our company or its assets;
- 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; 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.

In addition, our restated certificate of incorporation provides that the Court of Chancery of the State of Delaware will be the exclusive forum for: 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 pursuant to the Delaware General Corporation Law, or DGCL, our restated certificate of incorporation, or our restated bylaws; or any action asserting a claim against us that is governed by the internal affairs doctrine. This choice of forum provision may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or any of our directors, officers, or other employees, which may discourage lawsuits with respect to such claims. Alternatively, if a court were to find the choice of forum provision contained in our restated certificate of incorporation to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving such action in other jurisdictions, which could harm our business, operating results, and financial condition.

Moreover, Section 203 of the DGCL may discourage, delay, or prevent a change in control of our company. Section 203 imposes certain restrictions on mergers, business combinations, and other transactions between us and holders of 15% or more of our common stock.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Sales of Unregistered Securities

None.

Item 6. Exhibit Index

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
31.1	Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer.					X
31.2	Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer.					X
32.1#	Section 1350 Certification of Chief Executive Officer.					X
32.2#	Section 1350 Certification of Chief Financial Officer.					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.					
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 Labels Linkbase Document.					X
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document.					X
104	Cover Page Interactive Data File - the cover page from the registrant’s Quarterly Report on Form 10-Q for the quarterly period ended October 3, 2020 is formatted in iXBRL.					X

These certifications are deemed not filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, nor shall they be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act.

SIGNATURES

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

FITBIT, INC.

Date:	November 4, 2020	/s/ Ronald W. Kisling
		Ronald W. Kisling Chief Financial Officer *(Principal Financial and Accounting Officer)*

EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James Park, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fitbit, 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 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:	November 4, 2020	/s/ James Park
		James Park President, Chief Executive Officer, and Chairman *(Principal Executive Officer)*

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Ronald W. Kisling, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fitbit, 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 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: November 4, 2020

/s/ Ronald W. Kisling

Ronald W. Kisling
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, James Park, President, Chief Executive Officer and Chairman of Fitbit, Inc., do hereby 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 my knowledge:

- the Quarterly Report on Form 10-Q of Fitbit, Inc. for the fiscal quarter ended October 3, 2020 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- the information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Fitbit, Inc.

Date:	November 4, 2020	By:	/s/ James Park
			James Park
			President, Chief Executive Officer, and Chairman *(Principal Executive Officer)*

EXHIBIT 32.2

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Ronald W. Kisling, Chief Financial Officer of Fitbit, Inc., do hereby 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 my knowledge:

- the Quarterly Report on Form 10-Q of Fitbit, Inc. for the fiscal quarter ended October 3, 2020 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- the information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Fitbit, Inc.

Date:	November 4, 2020	By:	/s/ Ronald W. Kisling
			Ronald W. Kisling
			Chief Financial Officer *(Principal Financial and Accounting Officer)*