

Here's How Stitch Fix Will Recover From Its Disappointing Quarter

Management sees a change in growth taking shape as it ramps up the direct-buy service.



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Stitch Fix ([NASDAQ:SFIX](#)) saw its share price dive sharply following its fiscal fourth-quarter earnings report. While demand started to pick up again, leading to an acceleration in revenue growth, earnings came in lower than analysts were expecting.

Looking closer at the earnings report, the quarter wasn't that disappointing. Investors missed some crucial details during the conference call that show how Stitch Fix's ability to use data science to recommend items to clients should result in market share gains over the next few years.



IMAGE SOURCE: GETTY IMAGES.

Momentum is shifting back to Stitch Fix

Stitch Fix posted revenue growth of 11% year over year in its latest quarter, which is below pre-COVID levels but up sequentially from the fiscal third quarter. Most importantly, it shows the company gaining market share against the many other apparel retailers that continue to report sales declines.

This performance is also noteworthy given Stitch Fix [pulled back on advertising](#) from late March through May, which limited the growth of new clients. Yet during the earnings call, CEO Katrina Lake said: "Over the last few months, our business has exhibited some of the strongest levels of performance we've seen since going public."

In July, Stitch Fix saw a 50% year-over-year increase in first Fix shipments to new clients. That's the highest level of sequential growth in three years, which contributed to longer wait times for some customers.

Lake said, "We believe this elevated first Fix demand will also drive incremental subsequent Fix volume in the quarters ahead, given that the majority of our clients choose to receive Fixes on a recurring basis."

Direct-buy service still gaining traction

[Direct buy](#) is still looking like Stitch Fix's secret weapon to gain more share in apparel spending long term. In June, Stitch Fix rolled out a new feature of direct buy called Trending For You, which widened the selection of items that clients can choose to purchase. It also removes the requirement that clients must have a prior Fix before purchasing an item using direct buy.

The value of this service lies in the fact that nearly two-thirds of clients who use direct buy returned to make a repeat purchase. Moreover, the return rates for direct buy are less than half the levels typically seen in online apparel retail.

In the first two weeks after launching Trending For You, Stitch Fix saw a 30% increase in direct buy orders. Stitch Fix also made a recent tweak to its recommendation engine for direct-buy clients, which led to more items purchased, higher conversion, and purchases of items with higher average prices than the company's traditional "fixes".

It's clear that as management unveils more ways that clients can shop the service, engagement and spending per client should rise. The penetration rate among Stitch Fix's 3.5 million active clients is low so far, so there is still a long way to go before direct buy is making its mark on the company's

performance. But President Elizabeth Spaulding mentioned during the call that it offers a "step change" in the company's growth trajectory.

Just getting started

The shift to e-commerce spreading throughout the [retail industry](#) plays to the strengths of Stitch Fix. Management expects \$30 billion of market share to move online within the next 18 months. "We anticipate capturing more than our fair share of this given the relevance of our model, particularly with the expansion of direct buy," Spaulding said.

Stitch Fix is a very small player with just \$1.71 billion of trailing 12-month revenue in a large apparel industry. There remains significant headroom for the business to grow long term as Stitch Fix expands its offerings to reach new clients and drive higher engagement with existing ones.

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*Stock Advisor returns as of September 24, 2020

[John Ballard](#) owns shares of Stitch Fix. The Motley Fool owns shares of and recommends Stitch Fix. The Motley Fool has a [disclosure policy](#).

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