

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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 September 30, 2022

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: 001-40378



The Honest Company, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)
12130 Millennium Drive, #500
Los Angeles, CA
(Address of Principal Executive Offices)

90-0750205
(I.R.S. Employer
Identification No.)

90094
(Zip Code)

(888) 862-8818

(Registrant's Telephone Number, Including Area Code)

N/A

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$0.0001 par value per share	HNST	The Nasdaq Stock Market LLC

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

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

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

As of November 8, 2022, the registrant had 92,672,893 shares of common stock, \$0.0001 par value per share outstanding.

The Honest Company, Inc.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains “forward-looking statements” (within the meaning of Section 27A of the Securities Act of 1933, as amended (“Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (“Exchange Act”)) about us and our industry that involve substantial risks and uncertainties. In some cases, you can identify forward-looking statements because they contain words such as “anticipate,” “believe,” “contemplate,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “potential,” “predict,” “project,” “should,” “target,” “will” or “would” or the negative of these words or other similar terms or expressions. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements that we make. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those in the forward-looking statements, including, without limitation, those set forth in Part II, Item 1A, “Risk Factors,” if any, and other factors set forth in other parts of this Quarterly Report on Form 10-Q. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements. These forward-looking statements include, but are not limited to, statements concerning the following:

- our expectations regarding our revenue, cost of revenue, operating expenses, gross margin, adjusted EBITDA and other operating results;
- our strategic initiatives and priorities, including the timing, focus and cadence of our marketing, innovation, and distribution and costovation strategies;
- our ability to offset the high inflationary environment, including commodity prices, labor costs, input cost and transportation cost inflation with price increases, productivity or investing in digital capabilities and a growing revenue base;
- our ability to implement our strategy to deliver sustained long-term growth;
- the effect of COVID-19 or other public health crises or macroeconomic factors on our business and the global economy, including shifting consumer demand between our Digital and Retail channels and the impact from supply chain disruptions;
- economic conditions, including a recession and inflationary pressures and their impact on consumer spending and our profit margin;
- our continued revenue growth through our omnichannel strategy and ability to capture growth in whitespace opportunities in the Retail channel;
- our ability to effectively manage our growth;
- the costs and success of our marketing efforts, and our ability to grow brand awareness and maintain, protect and enhance our brand;
- our ability to drive household penetration and increase market share in our product categories;
- our investments in innovation and digital capabilities to fuel growth;
- the market shift towards clean and natural products and the whitespace opportunity it provides for further market penetration and category growth in the clean and natural segments;
- our strategies to address the reduction in demand of certain products in our Household and Wellness product category and the related impact on our business;
- our ability to acquire new consumers and successfully retain existing consumers, including their level of spend with us;
- our expansion with retail and digital customers;
- our ability to retain new distribution partners;
- our ability to bring new products to market and to identify and successfully launch new category adjacencies;
- anticipated trends, growth rates, and challenges in our business and in the markets in which we operate;
- expectations regarding consumer demand and the timing and amount of orders from key customers;
- our ability to achieve or sustain our profitability;
- our practices, commitments and performance related to environmental, social and governance matters;
- future investments in our business, our anticipated capital expenditures and our estimates regarding our capital requirements;
- our ability to offset rising consumer uncertainty and tighter inventory management by retailers;
- our ability to effectively manage our inventory and maintain sufficient inventory to satisfy customer demands and meet revenue targets;
- our ability to liquidate excess inventory related to drops in consumer demand for our products, product discontinuations or product restages;
- our ability to gauge consumer trends and changing consumer preferences;
- our reliance on key personnel and our ability to identify, recruit and retain skilled personnel;
- our ability to obtain, maintain, protect and enforce our intellectual property rights and any costs associated therewith;
- our ability to compete effectively with existing competitors and new market entrants;
- our ability to successfully enter new markets and expand internationally;
- our ability to identify and complete acquisitions that complement and expand our reach and platform;

- seasonality;
- the financial condition of, and our relationships with, our suppliers, manufacturers, distributors and retailers;
- the ability of our suppliers and manufacturers to comply with safety, environmental or other laws or regulations;
- our ability to comply or remain in compliance with laws and regulations that currently apply or become applicable to our business in the United States, such as the U.S. Food and Drug Administration governmental regulation and state regulation, and in other jurisdictions where we elect to do business;
- outcome of legal or administrative proceedings; and
- the growth rates of the markets in which we compete.

PART I—FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.

The Honest Company, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)
(in thousands, except share and per share amounts)

	September 30, 2022	December 31, 2021
Assets		
Current assets		
Cash and cash equivalents	\$ 24,087	\$ 50,791
Short-term investments	16,744	42,388
Accounts receivable, net	38,871	31,784
Inventories	100,278	75,668
Prepaid expenses and other current assets	14,435	13,165
Total current assets	194,415	213,796
Operating lease right-of-use asset	31,486	—
Property and equipment, net	14,891	52,952
Goodwill	2,230	2,230
Intangible assets, net	387	440
Other assets	4,951	3,179
Total assets	\$ 248,360	\$ 272,597
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 30,703	\$ 28,743
Accrued expenses	29,968	19,003
Deferred revenue	781	731
Total current liabilities	61,452	48,477
Long term liabilities		
Lease financing obligation, net of current portion	—	37,527
Operating lease liabilities, net of current portion	31,790	—
Other long-term liabilities	33	7,487
Total liabilities	93,275	93,491
Commitments and contingencies		
Stockholders' equity (deficit)		
Preferred stock, \$0.0001 par value, 20,000,000 shares authorized at September 30, 2022 and December 31, 2021, none issued or outstanding as of September 30, 2022 and December 31, 2021	—	—
Common stock, \$0.0001 par value, 1,000,000,000 and 150,000,000 shares authorized at September 30, 2022 and December 31, 2021, respectively; 92,590,227 and 91,512,140 shares issued and outstanding as of September 30, 2022 and December 31, 2021, respectively	9	9
Additional paid-in capital	582,396	570,794
Accumulated deficit	(427,237)	(391,656)
Accumulated other comprehensive loss	(83)	(41)
Total stockholders' equity	155,085	179,106
Total liabilities and stockholders' equity	\$ 248,360	\$ 272,597

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

The Honest Company, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(Unaudited)
(in thousands, except share and per share amounts)

	For the three months ended September 30,		For the nine months ended September 30,	
	2022	2021	2022	2021
Revenue	\$ 84,580	\$ 82,651	\$ 231,792	\$ 238,258
Cost of revenue	58,963	52,892	161,984	153,177
Gross profit	25,617	29,759	69,808	85,081
Operating expenses				
Selling, general and administrative	23,491	18,568	63,068	65,356
Marketing	12,140	13,687	38,121	41,868
Research and development	1,725	2,092	5,643	6,082
Total operating expenses	37,356	34,347	106,832	113,306
Operating loss	(11,739)	(4,588)	(37,024)	(28,225)
Interest and other income (expense), net	(29)	(526)	657	(1,362)
Loss before provision for income taxes	(11,768)	(5,114)	(36,367)	(29,587)
Income tax provision	20	22	60	67
Net loss	\$ (11,788)	\$ (5,136)	\$ (36,427)	\$ (29,654)
Net loss per share attributable to common stockholders:				
Basic and diluted	\$ (0.13)	\$ (0.06)	\$ (0.40)	\$ (0.33)
Weighted-average shares used in computing net loss per share attributable to common stockholders:				
Basic and diluted	92,460,987	90,397,409	92,020,423	64,399,183
Other comprehensive income (loss)				
Unrealized gain (loss) on short-term investments, net of taxes	37	10	(42)	(96)
Comprehensive loss	\$ (11,751)	\$ (5,126)	\$ (36,469)	\$ (29,750)

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

The Honest Company, Inc.
Condensed Consolidated Statements of Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit)

(Unaudited)

(in thousands, except share amounts)

	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount				
Balances at December 31, 2020	49,100,928	\$ 376,404	34,089,186	\$ 3	\$ 116,055	\$ (352,977)	\$ 94	\$ (236,825)
Net loss	—	—	—	—	—	(4,484)	—	(4,484)
Other comprehensive loss	—	—	—	—	—	—	(82)	(82)
Stock options exercised	—	—	38,188	—	33	—	—	33
Stock-based compensation	—	—	—	—	1,838	—	—	1,838
Balances at March 31, 2021	49,100,928	\$ 376,404	34,127,374	\$ 3	\$ 117,926	\$ (357,461)	\$ 12	\$ (239,520)
Net loss	—	—	—	—	—	(20,034)	—	(20,034)
Other comprehensive loss	—	—	—	—	—	—	(24)	(24)
Stock options exercised	—	—	53,694	—	295	—	—	295
Dividends paid (\$0.42 per share)	—	—	—	—	(35,000)	—	—	(35,000)
Issuance of common stock pursuant to initial public offering, net of underwriting commissions and discounts and offering costs of \$12.2 million	—	—	6,451,613	1	91,038	—	—	91,039
Conversion of redeemable convertible preferred stock to common stock upon initial public offering	(49,100,928)	(376,404)	49,649,023	5	376,400	—	—	376,405
Vested restricted stock units	—	—	6,703	—	—	—	—	—
Stock-based compensation	—	—	—	—	6,626	—	—	6,626
Balances at June 30, 2021	—	\$ —	90,288,407	\$ 9	\$ 557,285	\$ (377,495)	\$ (12)	\$ 179,787
Net loss	—	—	—	—	—	(5,136)	—	(5,136)
Other comprehensive income (loss)	—	—	—	—	—	—	10	10
Stock options exercised	—	—	139,299	—	613	—	—	613
Vested restricted stock	—	—	162,462	—	—	—	—	—
Common stock withheld for tax obligation and net settlement	—	—	(61,722)	—	(565)	—	—	(565)
Stock-based compensation	—	—	—	—	4,776	—	—	4,776
Balance at September 30, 2021	—	\$ —	90,528,446	\$ 9	\$ 562,109	\$ (382,631)	\$ (2)	\$ 179,485

The Honest Company, Inc.
Condensed Consolidated Statements of Redeemable Convertible Preferred Stock and Stockholders' Equity (Deficit)
(Unaudited)
(in thousands, except share amounts)

	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount				
Balances at December 31, 2021	—	\$ —	91,512,140	\$ 9	\$ 570,794	\$ (391,656)	\$ (41)	\$ 179,106
Net loss	—	—	—	—	—	(14,626)	—	(14,626)
Other comprehensive loss	—	—	—	—	—	—	(77)	(77)
Stock options exercised	—	—	21,556	—	113	—	—	113
Stock-based compensation	—	—	—	—	3,548	—	—	3,548
Vested restricted stock units	—	—	42,125	—	—	—	—	—
Shares withheld related to net share settlement of equity awards	—	—	(3,611)	—	(20)	—	—	(20)
ASC 842 transition effect	—	—	—	—	—	845	—	845
Balances at March 31, 2022	—	\$ —	91,572,210	\$ 9	\$ 574,435	\$ (405,437)	\$ (118)	\$ 168,889
Net loss	—	—	—	—	—	(10,012)	—	(10,012)
Other comprehensive loss	—	—	—	—	—	—	(2)	(2)
Stock options exercised	—	—	22,000	—	9	—	—	9
Stock-based compensation	—	—	—	—	3,912	—	—	3,912
Vested restricted stock	—	—	761,394	—	—	—	—	—
Shares issued under employee stock purchase plan	—	—	58,111	—	157	—	—	157
Common stock withheld for tax obligation and net settlement	—	—	(4,439)	—	(17)	—	—	(17)
Balances at June 30, 2022	—	\$ —	92,409,276	\$ 9	\$ 578,496	\$ (415,449)	\$ (120)	\$ 162,936
Net loss	—	—	—	—	—	(11,788)	—	(11,788)
Other comprehensive income (loss)	—	—	—	—	—	—	37	37
Stock options exercised	—	—	—	—	—	—	—	—
Stock-based compensation	—	—	—	—	3,900	—	—	3,900
Vested restricted stock	—	—	180,951	—	—	—	—	—
Shares issued under employee stock purchase plan	—	—	—	—	—	—	—	—
Common stock withheld for tax obligation and net settlement	—	—	—	—	—	—	—	—
Balance at September 30, 2022	—	\$ —	92,590,227	\$ 9	\$ 582,396	\$ (427,237)	\$ (83)	\$ 155,085

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

The Honest Company, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(in thousands)

	For the nine months ended September 30,	
	2022	2021
Cash flows from operating activities		
Net loss	\$ (36,427)	\$ (29,654)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,025	3,135
Stock-based compensation	11,360	13,240
Other	4,805	204
Changes in assets and liabilities:		
Accounts receivable, net	(7,087)	(8,859)
Inventories	(24,609)	(1,188)
Prepaid expenses and other assets	(3,228)	(7,552)
Accounts payable, accrued expenses and other long-term liabilities	7,604	(5,783)
Deferred revenue	49	98
Operating lease liabilities	(5,161)	—
Net cash used in operating activities	(50,669)	(36,359)
Cash flows from investing activities		
Purchases of short-term investments	(12,782)	(65,267)
Proceeds from sales of short-term investments	—	26,858
Proceeds from maturities of short-term investments	38,219	9,862
Purchases of property and equipment	(1,433)	(187)
Net cash provided by (used in) investing activities	24,004	(28,734)
Cash flows from financing activities		
Proceeds from initial public offering, net of underwriting commissions and discounts	—	96,517
Taxes paid related to net share settlement of equity awards	(37)	(565)
Dividends paid	—	(35,000)
Proceeds from exercise of stock options	122	941
Payment of initial public offering costs	—	(5,477)
Proceeds from 2021 ESPP	157	—
Payments on finance lease liabilities	(281)	(857)
Net cash provided by (used in) financing activities	(39)	55,559
Net decrease in cash and cash equivalents	(26,704)	(9,534)
Cash and cash equivalents		
Beginning of the period	50,791	37,200
End of the period	\$ 24,087	\$ 27,666
Supplemental disclosures of noncash activities		
Equipment acquired under capital lease obligations	\$ —	\$ 105
Capital expenditures included in accounts payable and accrued expenses	\$ 92	\$ 27

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

The Honest Company, Inc.
Notes to Condensed Consolidated Financial Statements
As of September 30, 2022

(in thousands, except share and per share amounts, percentages and as otherwise indicated)
(Unaudited)

1. Nature of Business

The Honest Company, Inc. (the “Company”) was incorporated in the State of California on July 19, 2011 and on May 23, 2012 was re-incorporated in the State of Delaware under the same name. The Company is a mission-driven lifestyle brand that formulates, designs and sells clean products with a focus on sustainability and thoughtful design. The Company sells its products through digital and retail sales channels in the following product categories: Diapers and Wipes, Skin and Personal Care, and Household and Wellness.

Initial Public Offering

The Company’s registration statement on Form S-1 (“IPO Registration Statement”) related to its initial public offering (“IPO”) was declared effective on May 4, 2021, and the Company’s common stock began trading on the Nasdaq Global Select Market on May 5, 2021. On May 7, 2021, the Company completed its IPO of 25,807,000 shares of the Company’s common stock, \$0.0001 par value per share at an offering price of \$16.00 per share. The Company sold 6,451,613 shares and certain existing stockholders sold an aggregate of 19,355,387 shares. The Company received aggregate net proceeds of approximately \$91.0 million after deducting underwriting discounts and commissions of \$6.7 million and other offering expenses of \$5.5 million. The Company granted the underwriters an option for a period of 30 days to purchase up to an additional 3,871,050 shares of common stock from the selling stockholders at \$16.00 per share less the underwriting discounts and commissions. In May 2021, the underwriters fully exercised the option to purchase these additional shares from the selling stockholders. The Company did not receive any proceeds from the sale of shares of its common stock by the selling stockholders.

Upon completion of the IPO, the Company paid \$9.5 million in cash bonuses to certain employees including members of management, as well as \$0.2 million in related payroll taxes and expenses. Cash bonuses of \$9.1 million were recorded in sales, general and administrative expenses and \$0.4 million were recorded in research and development expenses in the accompanying condensed consolidated statements of comprehensive loss upon completion of the IPO.

In April 2021, the Company’s board of directors declared a cash dividend of \$35.0 million to the holders of record of its common stock and its redeemable convertible preferred stock as of May 3, 2021, which the Company paid on June 29, 2021.

Immediately prior to the completion of the IPO, the Company filed an Amended and Restated Certificate of Incorporation, which authorized a total of 1,000,000,000 shares of common stock and 20,000,000 shares of preferred stock. Upon the filing of the Amended and Restated Certificate of Incorporation, 49,100,928 shares of the Company’s redeemable convertible preferred stock then outstanding with a carrying value of \$376.4 million were automatically converted into 49,649,023 shares of the Company’s common stock. Upon completion of the IPO, the Company recognized a gain on extinguishment of the redeemable convertible preferred stock for earnings per share purposes of \$29.0 million from the conversion of redeemable convertible preferred stock to common stock. Following the completion of the IPO, the Company has one class of authorized and outstanding common stock.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial information. Certain information and disclosures normally included in consolidated financial statements prepared in accordance with GAAP have been condensed or omitted. Accordingly, these condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes for the year ended December 31, 2021. The condensed consolidated financial statements are unaudited. The unaudited interim condensed consolidated financial statements have been prepared on a basis consistent with that used to prepare the audited annual consolidated financial statements and include, in the opinion of management, all adjustments, consisting of normal recurring items, necessary for the fair statement of the condensed consolidated financial statements. The consolidated balance sheet as of December 31, 2021 has been derived from the audited financial statements at that date but does not include all of the disclosures required by GAAP.

The condensed consolidated financial statements include the accounts of the Company, and its wholly owned subsidiaries after elimination of intercompany transactions and balances. The Company had a change in accounting policy from those disclosed in the audited consolidated financial statements and related notes for the year ended December 31, 2021 related to the

adoption of ASC 842 (defined below). Refer to “Recently Adopted Accounting Pronouncements” below and Note 13 included in these condensed consolidated financial statements for more information on leases.

Stock Split

In April 2021, the Company effected a 1-for-2 forward stock split of its common and redeemable convertible preferred stock. In connection with the forward stock split, each issued and outstanding share of common stock, automatically and without action on the part of the holders, became two shares of common stock and each issued and outstanding share of redeemable convertible preferred stock, automatically and without action on the part of the holders, became two shares of redeemable convertible preferred stock. The par value per share of common and redeemable convertible preferred stock was not adjusted. All share, per share and related information presented in the condensed consolidated financial statements and accompanying notes have been retroactively adjusted, where applicable, to reflect the impact of the stock split.

Segment Reporting and Geographic Information

The Company’s Chief Executive Officer, as the chief operating decision maker, organizes the Company, manages resource allocations, and measures performance on the basis of one operating segment. All of the Company’s long-lived assets are located in the United States and substantially all of the Company’s revenue is from customers located in the United States.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and contingent liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company’s estimates, which are subject to varying degrees of judgment, include the valuation of inventories, sales returns and allowances, allowances for doubtful accounts, valuation of short-term investments, capitalized software, useful lives associated with long-lived assets, valuation allowances with respect to deferred tax assets, accruals and contingencies, recoverability of non-cash marketing credits, recoverability of goodwill and long-lived assets, and the valuation and assumptions underlying stock-based compensation and for the periods prior to the Company’s IPO, the fair value of common stock. On an ongoing basis, the Company evaluates its estimates compared to historical experience and trends, which form the basis for making judgments about the carrying value of assets and liabilities.

In March 2020, the World Health Organization declared the outbreak of the novel coronavirus disease (“COVID-19”) a pandemic. The full extent to which the outbreak of the COVID-19 pandemic and any COVID-19 variants will impact the Company’s business, results of operations and financial condition is still unknown and will depend on future developments, which are uncertain and cannot be predicted, including, but not limited to, the duration and spread of the outbreak of COVID-19 and its variants, their severity, the actions to contain the virus and its variants or treat their impact, and how quickly and to what extent normal economic and operating conditions can resume.

In light of the unknown ultimate duration and severity of COVID-19 and the impact of any COVID-19 variants, the Company faces a greater degree of uncertainty than normal in making certain judgments and estimates needed to apply significant accounting policies. The Company assessed certain accounting matters and estimates that generally require consideration of forecasted information in context with the information reasonably available to the Company as of September 30, 2022 and through the date these condensed consolidated financial statements were issued. Management is not aware of any specific event or circumstance that would require an update to estimates or judgments or a revision to the carrying value of assets or liabilities. However, these estimates and judgments may change as new events occur and additional information is obtained, which may result in changes being recognized in the Company’s consolidated financial statements in future periods. For example, based on macro trends within our Household and Wellness product category, consumer demand for sanitizing and disinfecting products has decelerated at a more rapid than expected rate as more consumers are vaccinated and retailers continue to manage heavy inventories of sanitization and disinfecting products in stores. The Company recorded an inventory write-down of \$0.8 million during the nine months ended September 30, 2022 and \$5.6 million for the year ended December 31, 2021 relating to certain sanitization and disinfecting products as the amount of inventory was significantly in excess of the decreasing demand. During the three months ended September 30, 2022, the Company donated \$1.5 million of excess sanitization products. The Company will continue to monitor and evaluate the uncertainty and volatility of these conditions, in particular, the impact on the amount and valuation of the Company’s inventory in the future.

Cash and Cash Equivalents

Cash equivalents consist of short-term, highly liquid investments with stated maturities of three months or less from the date of purchase. Cash equivalents comprise amounts invested in money market funds.

Accounts Receivable

Accounts receivable is presented net of allowances. The Company does not accrue interest on its trade receivables. On a periodic basis, the Company evaluates accounts receivable estimated to be uncollectible, and provides allowances as necessary for doubtful accounts. The allowance for doubtful accounts was \$0.2 million as of both September 30, 2022 and December 31, 2021.

Deferred IPO Costs

Deferred offering costs consisted of costs incurred in connection with the sale of the Company's common stock in its IPO, including certain legal, accounting, and other IPO-related expenses. Immediately upon the completion of the Company's IPO, deferred offering costs of \$5.5 million were reclassified into stockholders' equity from other assets as a reduction from the proceeds of the offering.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company uses the following hierarchy in measuring the fair value of the Company's assets and liabilities, focusing on the most observable inputs when available:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Observable inputs other than Level 1 quoted prices, such as quoted prices for similar assets and liabilities in active markets, quoted prices in markets that are not active for identical or similar assets and liabilities, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Valuations are based on inputs that are unobservable and significant to the overall fair value measurement of the assets or liabilities. Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

Fair value is based on quoted market prices, if available. If listed prices or quotes are not available, fair value is based on internally developed models that primarily use market-based or independently sourced market parameters as inputs. Cash equivalents, consisting primarily of money market funds, represent highly liquid investments with maturities of three months or less at purchase. Market prices, which are Level 1 in the fair value hierarchy, are used to determine the fair value of the money market funds. Investments in debt securities are measured using broker provided indicative prices developed using observable market data, which are considered Level 2 in the fair value hierarchy. Certain assets, including long-lived assets, goodwill and intangible assets are also subject to measurement at fair value on a non-recurring basis if they are deemed to be impaired as a result of an impairment review. The fair value is measured using Level 3 inputs in the fair value hierarchy.

Recent Accounting Pronouncements

As an "emerging growth company," the Jumpstart Our Business Startups Act of 2012 ("JOBS Act"), allows the Company to delay adoption of new or revised accounting pronouncements applicable to public companies until such pronouncements are made applicable to private companies. The Company has elected to use the adoption dates applicable to private companies. As a result, the Company's financial statements may not be comparable to the financial statements of issuers who are required to comply with the effective date for new or revised accounting standards that are applicable to public companies.

Recently Adopted Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No 2016-02, *Leases (Topic 842)*, as subsequently amended, collectively codified under Topic 842. Topic 842 requires lessees to recognize on the balance sheet assets and liabilities for leases with lease terms of more than twelve months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike prior guidance which requires only capital leases to be recognized on the balance sheet, the new ASU requires both types of leases to be recognized on the balance sheet. ASU 2016-02 was effective for public business entities for fiscal years beginning after December 15, 2018. In June 2020, FASB issued ASU No. 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842) – Effective Dates for Certain Entities*, which extended the effective date of this guidance for certain non-public entities for fiscal years beginning

after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022, with early adoption permitted.

The Company adopted this guidance on January 1, 2022 on a modified retrospective basis under ASU 2018-11. As such, prior periods were not respectively adjusted. The Company also elected the package of practical expedients to leases that commenced before the effective date whereby the Company elected to not reassess the following:

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

The Company made an accounting policy election to not recognize lease assets and lease liabilities for leases in all asset classes with lease terms less than twelve months. The Company recognizes lease expense for such leases generally on a straight-line basis over the lease term. The Company also elected to combine lease and non-lease components on its leases into a single lease component.

Upon adoption of this guidance on January 1, 2022, the Company recognized \$36.1 million in right-of-use assets (“ROU”) and corresponding lease liabilities of \$37.5 million, net of the current portion of lease liability of \$7.0 million, on its condensed consolidated balance sheet. In addition, the Company recognized a decrease to assets and liabilities of \$37.6 million and \$38.4 million, respectively, and a decrease to the beginning accumulated deficit of \$0.8 million, as a result of the derecognition of its build-to-suit arrangement that was reassessed to be an operating lease under the new guidance. The adoption of this guidance did not have a material impact on the Company’s condensed consolidated statements of comprehensive loss or the condensed consolidated statements of cash flows. Refer to Note 13 included in these condensed consolidated financial statements for more information on leases.

Recently Issued Accounting Pronouncements – Not Yet Adopted

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, to amend the accounting for credit losses for certain financial instruments. This guidance replaces the incurred loss impairment methodology with a methodology that reflects expected credit losses. In November 2019, FASB issued ASU No. 2019-10 which delayed the effective dates of the guidance. This guidance is effective for public business entities that meet the definition of an SEC filer, excluding entities eligible to be smaller reporting companies (“SRC”) for fiscal years beginning after December 15, 2019 and all other entities for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is evaluating the adoption of this guidance and the potential effects on the consolidated financial statements.

3. Revenue

Disaggregation of Revenue

Revenue by sales channel:	For the three months ended September 30,		For the nine months ended September 30,	
	2022	2021	2022	2021
<i>(In thousands)</i>				
Digital	\$ 33,782	\$ 39,114	\$ 105,913	\$ 116,395
Retail	50,798	43,537	125,879	121,863
Total revenue	<u>\$ 84,580</u>	<u>\$ 82,651</u>	<u>\$ 231,792</u>	<u>\$ 238,258</u>

Revenue by product category:	For the three months ended September 30,		For the nine months ended September 30,	
	2022	2021	2022	2021
<i>(In thousands)</i>				
Diapers and Wipes	\$ 55,222	\$ 53,847	\$ 150,411	\$ 151,251
Skin and Personal Care	21,992	25,375	66,534	75,486
Household and Wellness	7,366	3,429	14,847	11,521
Total revenue	<u>\$ 84,580</u>	<u>\$ 82,651</u>	<u>\$ 231,792</u>	<u>\$ 238,258</u>

Non-Monetary Transactions

During the three and nine months ended September 30, 2022, the Company entered into trade agreements with a vendor to exchange excess inventory for future marketing and transportation credits. The Company recognized revenue reflecting the fair value of the marketing and transportation credits, with the corresponding asset included in prepaid expenses and other current assets and other assets, respectively, in the accompanying condensed consolidated balance sheets. The Company may use the marketing and transportation credits over four years from the date of the respective agreement, with an option to extend for another two years if agreed upon by both parties. For the three and nine months ended September 30, 2022, the Company recognized \$1.6 million and \$2.9 million, respectively, of revenue and \$0.8 million and \$1.6 million, respectively, of associated cost of revenue based on the timing of delivery of goods. For the three and nine months ended September 30, 2021, the Company recognized \$0.6 million and \$4.5 million, respectively, of revenue and \$0.4 million and \$3.8 million, respectively, of associated cost of revenue based on the timing of delivery of goods. The Company assesses the recoverability of the marketing and transportation credits periodically. Factors considered in evaluating the recoverability include management's history of credit usage and future plans with respect to advertising, freight and other services for which these credits can be used. Any impairment losses are charged to operations as they become determinable. During the nine months ended September 30, 2022, the Company recorded no impairment losses related to these credits and used an aggregate of \$1.2 million of credits.

4. Investments

As of September 30, 2022 and December 31, 2021, all investments in debt securities are classified as available-for-sale investments. All investments are reported within current assets because the securities represent investments of cash available for current operations. As of September 30, 2022 and December 31, 2021, the Company held \$16.7 million and \$36.4 million, respectively, of investments with contractual maturities of less than one year. As of September 30, 2022, the Company did not have any investments with contractual maturities between one and two years. As of December 31, 2021, the Company held \$6.0 million of investments with contractual maturities between one and two years. Available-for-sale investments are recorded at fair value, and unrealized holding gains and losses are recorded as a component of other comprehensive income (loss).

The following table summarizes the Company's available-for-sale investments:

	As of September 30, 2022			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Total Estimated Fair Value
<i>(In thousands)</i>				
Corporate bonds	\$ 10,966	\$ —	\$ (59)	\$ 10,907
Commercial paper	576	—	—	576
Certificates of deposit	2,984	—	(13)	2,971
U.S. government and agency securities	2,301	—	(11)	2,290
Total investments	<u>\$ 16,827</u>	<u>\$ —</u>	<u>\$ (83)</u>	<u>\$ 16,744</u>

	As of December 31, 2021			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Total Estimated Fair Value
<i>(In thousands)</i>				
Corporate bonds	\$ 18,605	\$ —	\$ (28)	\$ 18,577
Certificates of deposit	17,099	—	(5)	17,095
U.S. government and agency securities	6,725	—	(9)	6,716
Total investments	<u>\$ 42,429</u>	<u>\$ —</u>	<u>\$ (42)</u>	<u>\$ 42,388</u>

Realized gains and losses on investments in debt securities were immaterial for the three and nine months ended September 30, 2022 and 2021.

5. Fair Value Measurements

Financial assets measured and recorded at fair value on a recurring basis consist of the following as of:

	September 30, 2022			
	Level 1	Level 2	Level 3	Total
<i>(In thousands)</i>				
Cash equivalents				
Money market funds	\$ 15,236	\$ —	\$ —	\$ 15,236
Total cash equivalents	15,236	—	—	15,236
Short-term investments				
Corporate bonds	—	10,907	—	10,907
Commercial paper	—	576	—	576
Certificates of deposit	—	2,971	—	2,971
U.S. government and agency securities	—	2,290	—	2,290
Total short-term investments	—	16,744	—	16,744
Total	<u>\$ 15,236</u>	<u>\$ 16,744</u>	<u>\$ —</u>	<u>\$ 31,980</u>

December 31, 2021

<i>(In thousands)</i>	Level 1	Level 2	Level 3	Total
Cash equivalents				
Money market funds	\$ 29,411	\$ —	\$ —	\$ 29,411
Total cash equivalents	29,411	—	—	29,411
Short-term investments				
Corporate bonds	—	18,577	—	18,577
Certificates of deposit	—	17,095	—	17,095
U.S. government and agency securities	—	6,716	—	6,716
Total short-term investments	—	42,388	—	42,388
Total	\$ 29,411	\$ 42,388	\$ —	\$ 71,799

The carrying amounts for the Company's cash equivalents, accounts receivable, accounts payable, and accrued expenses approximate fair value due to their short maturities.

6. Credit Facilities

In April 2021, the Company entered into a first lien credit agreement ("2021 Credit Facility"), with JPMorgan Chase Bank, N.A., as administrative agent and lender, and the other lenders party thereto, which provides for a \$35.0 million revolving credit facility that matures on April 30, 2026. The 2021 Credit Facility includes a subfacility that provides for the issuance of letters of credit in an amount of up to \$10.0 million at any time outstanding, which reduces the amount available under the 2021 Credit Facility. As of September 30, 2022, there were outstanding standby letters of credit of \$4.8 million related to lease obligations with \$30.2 million available to be drawn upon. The 2021 Credit Facility is subject to customary fees for loan facilities of this type, including a commitment fee based on the average daily undrawn portion of the revolving credit facility. The Company recognizes the commitment fee as incurred in interest and other expense, net in the condensed consolidated statements of comprehensive loss. For the three and nine months ended September 30, 2022, the commitment fee incurred was immaterial. The interest rate applicable to the 2021 Credit Facility is, at the Company's option, either (a) the LIBOR (or a replacement rate established in accordance with the terms of the 2021 Credit Facility) (subject to a 0.00% LIBOR floor), plus a margin of 1.50% or (b) the CB floating rate minus a margin of 0.50%. The CB floating rate is the higher of (a) the Wall Street Journal prime rate and (b)(i) 2.50% plus (ii) the adjusted LIBOR rate for a one-month interest period. As of September 30, 2022, there was no outstanding balance under the 2021 Credit Facility.

The 2021 Credit Facility contains covenants that restrict, among other things, the Company's ability to sell assets, make investments and acquisitions, make capital expenditures, grant liens, pay dividends and make certain other restricted payments. The Company is also subject to certain affirmative and negative covenants including the requirement that it maintains a total net leverage ratio of not more than 3.50:1.00 during the periods set forth in the 2021 Credit Facility. Failure to do so, unless waived by the lenders under the 2021 Credit Facility pursuant to its terms, as amended, would result in an event of default under the 2021 Credit Facility. As of September 30, 2022, the Company was in compliance with the net leverage ratio covenant.

7. Accrued Expenses

Accrued expenses consisted of the following as of:

<i>(In thousands)</i>	September 30, 2022	December 31, 2021
Payroll and payroll related expenses	\$ 3,014	\$ 2,497
Accrued inventory purchases	14,277	8,838
Accrued returns	161	1,455
Accrued rent ⁽¹⁾	7,587	—
Other accrued expenses	4,929	6,213
Total accrued expenses	\$ 29,968	\$ 19,003

8. Commitments and Contingencies

Litigation

From time to time, the Company is subject to various claims and contingencies which are in the scope of ordinary and routine litigation incidental to its business, including those related to regulation, business transactions, employee-related matters and taxes, among others. When the Company becomes aware of a claim or potential claim, the likelihood of any loss or exposure is assessed. If it is probable that a loss will result and the amount or range of the loss can be reasonably estimated, the Company records a liability for the loss and discloses the possible loss in the consolidated financial statements. Legal costs are expensed as incurred.

On September 17, 2019, the Nevada Department of Taxation (the "Department") issued a Deficiency Notice against the Company to initiate administrative legal proceedings before the Department for the alleged non-compliance with employee retention requirements provided in exchange for tax benefits in establishing the Company's Las Vegas distribution center in a December 2016 Abatement Agreement the Company had executed with the State of Nevada via its Governor's Office of Economic Development. The Company has denied the allegations. An administrative hearing was held in the matter on January 15, 2021. On June 9, 2021 the court upheld the Department's Deficiency Notice against the Company in its entirety. The loss resulting from this matter was \$0.7 million including penalties and interest, for which the Company has paid \$0.6 million as of December 31, 2021. During the year ended December 31, 2021, the Company recorded interest expense of \$0.1 million in interest and other income (expense), net on the condensed consolidated statements of comprehensive loss. The Company filed its Notice of Appeal on July 1, 2021 and its opening brief on January 28, 2022. The Department filed its answering brief on March 4, 2022 and the Company filed its reply brief on March 23, 2022. The Nevada Tax Commission heard the appeal on May 2, 2022. The Nevada Tax Commission upheld the Company's appeal and overturned the Department's Deficiency Notice. The Company intends to submit a refund request for the taxes and interest paid, following the Department's June 9, 2021 decision, that were subject to abatement under the December 2016 Abatement Agreement. The Company recognized \$0.7 million in other income in interest and other income (expense), net on the condensed consolidated statements of comprehensive loss during the nine months ended September 30, 2022 related to the anticipated refund of taxes and interest paid.

On September 23, 2020, the Center for Advanced Public Awareness ("CAPA") served a 60-Day Notice of Violation on the Company, alleging that the Company violated California's Health and Safety Code ("Prop 65") because of the amount of lead in the Company's Diaper Rash Cream and seeking statutory penalties and product warnings available under Prop 65. On October 22, 2021, CAPA filed a complaint in California Superior Court in the County of San Francisco (the "Court") for the alleged Prop 65 violations contained in its 60-Day Notice of Violation. The Company filed its answer and notice of related cases against Prestige Consumer Healthcare, Inc., Burt's Bees, Inc., and Hain Celestial Group, Inc. on January 7, 2022 and has stipulated to relate these cases and transfer them to the Court's Complex Division. The Company intends to vigorously defend itself in this matter. The matter's outcome and materiality are uncertain at this time. Therefore, the Company cannot estimate the probability of loss or make an estimate of the loss or range of loss in this matter.

On September 15, 2021, Cody Dixon filed a putative class action complaint in the U.S. District Court for the Central District of California alleging federal securities law violations by the Company, certain current officers and directors, and certain underwriters in connection with the Company's IPO. A second putative class action complaint containing similar allegations against the Company and certain current officers and directors was filed by Stephen Gambino on October 8, 2021 in the U.S. District Court for the Central District of California. These related complaints have been transferred to the same court and a Lead Plaintiff has been appointed in the matter, and a putative consolidated class action complaint was filed by the Lead Plaintiff on February 21, 2022. A derivative complaint was filed by Hayato Ono on behalf of the Company on November 29, 2021 in the U.S. District Court for the Central District of California, alleging breach of fiduciary duties, unjust enrichment, waste, gross mismanagement, and federal securities law violations by the Company's directors and certain officers. On December 17, 2021, a second derivative complaint containing similar allegations against the Company's directors and certain officers was filed by Mike Wang in the U.S. District Court for the Central District of California. These two federal derivative cases have been transferred to the same judge who is presiding over the securities class action complaints. A third derivative complaint was filed by Leah Bisch and Raluca Corobana in California Superior Court for the County of Los Angeles on January 3, 2022 with similar allegations. Each of these federal and state court derivative cases have been stayed pending the outcome of a motion for summary judgment in the securities class action. The Company is also aware that a fourth derivative complaint was filed by David Butler in the U.S. District Court for the District of Delaware on October 19, 2022 with similar allegations, but that complaint has not yet been served on the Company. Defendants' motion to dismiss the putative consolidated class action complaint was filed on March 14, 2022. On July 18, 2022, the Company's motion to dismiss was granted in part and denied in part. The Company believes the securities complaints are without merit and intends to vigorously defend itself against these allegations. These matters are in the preliminary stages of litigation with uncertain outcomes at this time. Therefore, the Company cannot estimate the probability of the loss or make an estimate of the loss or range of loss in these matters.

On August 10, 2022, Catrice Sida and Kris Yerby filed a putative class action complaint in the U.S. District Court for the Northern District of California alleging violations of California’s Unfair Competition Law, False Advertising Law, Consumers Legal Remedies Act, breach of warranty, and unjust enrichment related to plant-based claims on certain of the Company’s wipes products and seeking declaratory relief, injunctive relief, monetary damages, punitive damages and statutory penalties, and attorneys’ fees and costs. The Company filed its motion to dismiss on October 17, 2022. Plaintiffs filed their opposition to the Company’s motion to dismiss on November 1, 2022 and the Company’s reply was filed on November 8, 2022. The Company believes this complaint is without merit and intends to vigorously defend itself in this matter. The matter is in the preliminary stages of litigation and its outcome is uncertain at this time. Therefore, the Company cannot estimate the probability of loss or make an estimate of the range of loss in this matter.

As of September 30, 2022 and December 31, 2021, the Company was not subject to any other currently pending legal matters or claims that based on its current evaluation are expected to have a material adverse effect on its financial position, results of operations, or cash flows should such matters be resolved unfavorably. Refer to Note 14 included in these condensed consolidated financial statements for more information on a litigation matter.

Indemnifications

In the ordinary course of business, the Company may provide indemnifications of varying scope and terms to investors, directors and officers with respect to certain matters, including, but not limited to, losses arising out of the Company’s breach of such agreements, services to be provided by the Company, or from intellectual property infringement claims made by third parties. These indemnifications may survive termination of the underlying agreement and the maximum potential amount of future payments the Company could be required to make under these indemnification provisions may not be subject to maximum loss clauses. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions is indeterminable. The Company has never paid a material claim, nor has the Company been involved in litigation in connection with these indemnification arrangements. As of September 30, 2022 and December 31, 2021, the Company has not accrued a liability for these guarantees as the likelihood of incurring a payment obligation, if any, in connection with these guarantees is not probable or reasonably estimable due to the unique facts and circumstances involved.

9. Stock-Based Compensation

Stock Options

The following table summarizes the stock option activity:

	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>
Outstanding at December 31, 2021	16,440,539	\$ 5.26
Granted	—	\$ —
Exercised	(43,556)	\$ 2.81
Forfeited/Cancelled	(1,381,685)	\$ 5.52
Outstanding at September 30, 2022	<u>15,015,298</u>	<u>\$ 5.24</u>

2021 Equity Incentive Plan

In April 2021, the Company’s board of directors adopted the Company’s 2021 Equity Incentive Plan (the “2021 Plan”), which became effective in connection with the IPO. All equity-based awards granted on or after the effectiveness of the 2021 Plan are granted under the 2021 Plan. The 2021 Plan provides for grants of incentive stock options (“ISOs”) within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the “Code”), to the Company’s employees and its parent and subsidiary corporations’ employees, and for the grant of nonstatutory stock options (“NSOs”), stock appreciation rights, restricted stock awards, restricted stock units (“RSUs”) awards, performance awards and other forms of awards to the Company’s employees, directors and consultants and any of its affiliates’ employees and consultants. Initially, the maximum number of shares of the Company’s common stock that may be issued under its 2021 Plan will not exceed 25,025,580 shares of the Company’s common stock. In addition, the number of shares of the Company’s common stock reserved for issuance under its 2021 Plan will automatically increase on January 1 of each year for a period of ten years, beginning on January 1, 2022 and continuing through January 1, 2031, in an amount equal to (1) 4% of the total number of shares of the Company’s common stock outstanding on December 31 of the immediately preceding year, or (2) a lesser number of shares determined by the Company’s board of directors prior to the date of the increase. On January 1, 2022, 3,660,485 additional shares were reserved for issuance pursuant to this provision. The maximum number of shares of the Company’s common stock that may be issued on the exercise of ISOs under its 2021 Plan is 75,100,000 shares.

The following table summarizes the RSU activity:

	Number of Shares		Weighted Average Grant Date Fair Value Per Share	
	Non-Employee Directors	Officers and Employees	Non-Employee Directors	Officers and Employees
Unvested RSUs at December 31, 2021	103,561	2,867,306	\$ 16.00	\$ 13.58
Granted	485,806	3,030,953	\$ 3.51	\$ 5.11
Vested ⁽¹⁾	(121,256)	(863,214)	\$ 13.84	\$ 12.96
Forfeited	(4,641)	(662,714)	\$ 8.09	\$ 10.80
Unvested RSUs at September 30, 2022	463,470	4,372,331	\$ 3.55	\$ 8.25

(1) Includes 8,050 shares of common stock that were withheld to cover taxes on the release of vested RSUs and became available for future grants pursuant to the 2021 Plan.

As of September 30, 2022, there was \$34.5 million of unrecognized stock-based compensation expense related to unvested RSUs, which is expected to be recognized over a weighted-average period of 2.7 years.

2021 Employee Stock Purchase Plan

In April 2021, the Company's board of directors adopted the Company's 2021 Employee Stock Purchase Plan (the "2021 ESPP"). The Company authorized the issuance of 1,175,000 shares of common stock under the 2021 ESPP. In addition, the number of shares available for issuance under the 2021 ESPP will be annually increased on January 1 of each year for a period of ten years, beginning on January 1, 2022 and continuing through January 1, 2031 by the lesser of (i) 1% of the total number of shares of common stock outstanding on December 31 of the immediately preceding year; and (ii) 3,525,000 shares, except before the date of any such increase, the Company's board of directors may determine that such increase will be less than the amount set forth in clauses (i) and (ii). On January 1, 2022, 915,121 additional shares were reserved for issuance pursuant to this provision. Subject to any limitations contained therein, the 2021 ESPP allows eligible employees to contribute (in the form of payroll deductions or otherwise to the extent permitted by the administrator) an amount established by the administrator from time to time in its discretion to purchase common stock at a discounted price per share.

Under the 2021 ESPP, eligible employees are granted the right to purchase shares of common stock at the lower of 85% of the fair value at the time of grant or 85% of the fair value at the time of exercise. The right to purchase shares of common stock is granted in May and November of each year for an offering period of approximately six months. The first offering period under the 2021 ESPP commenced in May 2021 and the second offering in November 2021. For the three months ended September 30, 2022, no shares were purchased under the 2021 ESPP. For the nine months ended September 30, 2022, 58,111 shares were purchased under the 2021 ESPP. As of September 30, 2022, the Company had 1,992,520 remaining authorized shares available for purchase.

The following table summarizes the key input assumptions used in the Black-Scholes option-pricing model to estimate the grant-date fair value of the 2021 ESPP:

	For the nine months ended September 30, 2022
Expected life of options (in years)	0.50
Expected stock price volatility	73.27%
Risk free interest rate	1.52%
Expected dividend yield	—%
Weighted average grant-date fair value per share	\$1.12

Stock-Based Compensation Expense

Stock-based compensation expense related to RSU awards, 2021 ESPP purchases and stock options, as applicable, are as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2022	2021	2022	2021
<i>(In thousands)</i>				
Selling, general and administrative	\$ 3,852	\$ 4,466	\$ 10,929	\$ 12,408
Research and development	48	310	431	832
Total stock-based compensation expense	\$ 3,900	\$ 4,776	\$ 11,360	\$ 13,240

10. Net Income (Loss) per Share Attributable to Common Stockholders

The Company computes net income (loss) per share using the two-class method required for participating securities. The two-class method requires net income be allocated between common stock and participating securities based upon their respective rights to receive dividends as if all income for the period had been distributed. In periods where the Company has net losses, losses are not allocated to participating securities as they are not required to fund the losses. The Company considers its redeemable convertible preferred stock to be participating securities as preferred stockholders have rights to participate in dividends with the common stockholders.

Basic net income (loss) attributable to common stockholders per share is calculated by dividing net income (loss) attributable to common stockholders by the weighted-average number of shares of common stock outstanding. The Company computes diluted net income per share under a two-class method where income is reallocated between common stock, potential common stock and participating securities. Diluted net income (loss) per share attributable to common stockholders adjusts the basic net income (loss) per share attributable to common stockholders and the weighted-average number of shares of common stock outstanding for the potentially dilutive impact of stock options using the treasury stock method.

The following table sets forth the computation of the Company's basic and diluted net loss per share attributable to common stockholders:

	For the three months ended September 30,		For the nine months ended September 30,	
	2022	2021	2022	2021
<i>(In thousands, except for share and per share values)</i>				
Numerator:				
Net loss	\$ (11,788)	\$ (5,136)	\$ (36,427)	\$ (29,654)
Add: gain on conversion of preferred stock ⁽¹⁾	—	—	—	28,994
Less: dividends paid to preferred stockholders ⁽²⁾	—	—	—	(20,637)
Net loss attributable to common stockholders - basic and diluted	\$ (11,788)	\$ (5,136)	\$ (36,427)	\$ (21,297)
Denominator:				
Weighted average shares of common stock outstanding - basic	92,460,987	90,397,409	92,020,423	64,399,183
Weighted average shares of common stock outstanding - diluted	92,460,987	90,397,409	92,020,423	64,399,183
Net loss per share, attributable to common shareholders:				
Basic and diluted	\$ (0.13)	\$ (0.06)	\$ (0.40)	\$ (0.33)

(1) The conversion price of the Company's Series C and Series D redeemable convertible preferred stock was adjusted as the offering price in the initial public offering was below a certain threshold resulting in the preferred stockholders receiving a fixed dollar amount on conversion settled into a variable number of shares, or a stock-settled redemption feature. Upon the settlement of this redemption feature, the Company recorded a gain on extinguishment of the redeemable convertible preferred stock of \$29.0 million as an adjustment to net loss to arrive at net loss attributable to common stockholders to calculate earnings per share. The extinguishment gain was measured as the difference between the carrying amount of the redeemable convertible preferred stock and the fair value of common stock upon the IPO date that the preferred stock converted into.

(2) In April 2021, the Company's board of directors declared a cash dividend of \$35.0 million to the holders of record of our common stock as of May 3, 2021, that was contingent upon the closing of the Company's IPO. On June 29, 2021, the Company paid the dividend, of which \$20.6 million was paid to the holders of the Company's redeemable convertible preferred stock.

The following potentially dilutive shares were excluded from the computation of diluted net income (loss) per share because including them would have been antidilutive:

	For the three months ended September 30,		For the nine months ended September 30,	
	2022	2021	2022	2021
Stock options to purchase common stock	15,015,298	17,446,457	15,015,298	17,446,457
Unvested restricted stock units	4,835,801	2,549,347	4,835,801	2,549,347
Employee stock purchase plan	68,497	30,789	68,497	30,789
Total	19,919,596	20,026,593	19,919,596	20,026,593

11. Income Taxes

In determining quarterly provisions for income taxes, the Company uses the annual estimated effective tax rate applied to the actual year-to-date loss, adjusted for discrete items arising in that quarter. The Company's annual estimated effective tax rate differs from the U.S. federal statutory rate of 21% primarily as a result of a valuation allowance against net deferred tax assets, stock-based compensation, state taxes, nondeductible executive compensation and other permanent differences.

The Company has evaluated the available positive and negative evidence supporting the realization of its gross deferred tax assets, including cumulative losses, and the amount and timing of future taxable income, and has determined it is more likely than not that the assets will not be realized. Accordingly, the Company has recorded a full valuation allowance against the U.S. federal and state deferred tax assets as of each balance sheet date presented.

On August 16, 2022, President Biden signed into law the Inflation Reduction Act of 2022 (the "Act"), which contains provisions that will be effective on January 1, 2023, including a 15% corporate minimum tax and a 1% excise tax on stock buybacks. While the Company is still evaluating the impact of the Act, the Company does not expect any material changes on its consolidated financial position, results of operations and cash flows.

During the three and nine months ended September 30, 2022 and 2021, the Company has not recorded any uncertain tax positions and has not recognized interest or penalties in the condensed consolidated statements of comprehensive loss.

12. Related Party Transactions

In April 2020, the Company engaged Summit House Studios LLC, a third-party consultant, to provide digital ad production services. Summit House Studios LLC is owned by a major shareholder of the Company. Based on services provided, the Company incurred \$0.1 million and \$0.4 million, respectively, of advertising costs for this related party during the three and nine months ended September 30, 2021, which is reported as marketing expense in the Company's condensed consolidated statements of comprehensive loss. The Company incurred \$0.2 million advertising costs for this related party during the nine months ended September 30, 2022. The Company did not incur any advertising costs for this related party during the three months ended September 30, 2022.

13. Leases

The Company's lease portfolio includes both real estate and non-real estate type leases which are accounted for as either finance or operating leases. Real estate leases generally include office and warehouse facilities and non-real estate leases generally include office equipment and machinery. The Company determines if a contract is or contains a lease at inception. The Company's leases have remaining lease terms of less than one to six years. Renewal options that are deemed reasonably certain are included as part of the lease term for purposes of calculating the ROU assets and lease liability. The Company elected the practical expedient to not separate lease and non-lease components, as such non-lease components are included in the calculation of the ROU asset and lease liability and included in the lease expense over the term of the lease. The Company uses a discount rate to calculate the ROU asset and lease liability. When the implicit rate is known or provided in the lease documents, the Company is required to use this rate. In cases in which the implicit rate is not known, the Company uses an estimated incremental borrowing rate. Most of the Company's leases do not contain an implicit interest rate; therefore, judgement is required in determining a rate that reflects what would be paid to borrow, on a collateralized basis and over a similar term, for the lease obligations. The Company takes into consideration the terms of its 2021 Credit Facility, lease terms, and current interest rates to determine the incremental borrowing rate at lease commencement date. As of September 30, 2022, the Company's weighted-average discount rate was 2.29%, while the weighted-average remaining lease term was 4.8 years.

Operating lease ROU assets and lease liabilities are recorded on the date the Company takes possession of the leased assets with expense recognized on a straight-line basis over the lease term. Leases with an estimated total term of 12 months or less are not recorded on the balance sheet and the lease expense is recognized on a straight-line basis over the lease term. Generally, the Company's lease agreements do not contain material residual value guarantees or material restrictive covenants.

As a result of the adoption of ASC 842, the following adjustments were made to the opening balances of the Company's Condensed Consolidated Balance Sheet (in thousands):

	December 31, 2021	Impact due to Adoption of ASC 842	January 1, 2022
Assets			
Property and equipment, net ⁽¹⁾	\$ 52,952	\$ (37,581)	\$ 15,371
Operating lease ROU ⁽²⁾	—	36,127	36,127
Liabilities, redeemable convertible preferred stock and stockholders' equity (deficit)			
Accrued expenses ⁽²⁾	\$ 19,003	\$ 5,113	\$ 24,116
Lease financing obligation, net of current portion ⁽¹⁾	37,527	(37,527)	—
Operating lease liabilities, net of current portion ⁽²⁾	—	37,531	37,531
Other long-term liabilities ⁽³⁾	7,487	(7,415)	72
Accumulated equity (deficit) ⁽⁴⁾	(391,656)	845	(390,811)

(1) Represents the derecognition of non-Company owned property that was capitalized under previously existing built-to-suit accounting policies.

(2) Represents the recognition of operating lease ROU assets and corresponding current and non-current lease liabilities.

(3) Represents reclassification of deferred rent to operating lease ROU assets upon adoption of ASC 842.

(4) Represents a decrease to the beginning fiscal 2022 accumulated deficit related to the adoption of ASC 842.

The components of lease expense were as follows (in thousands):

	For the three months ended September 30, 2022	For the nine months ended September 30, 2022
Finance lease expense:		
Amortization	\$ 62	\$ 241
Interest on lease liabilities ⁽¹⁾	1	7
Operating lease expense:		
Operating lease expense ⁽²⁾	1,795	5,362
Sublease income	(501)	(1,504)
Total lease expense, net	\$ 1,357	\$ 4,106

- (1) Interest expense on the Company's build-to-suit lease was previously included in interest and other income (expense), net on the condensed consolidated statements of comprehensive loss and with the adoption of ASC 842 it is now included in cost of revenue, along with the operating lease expense, on the condensed consolidated statements of comprehensive loss.
- (2) Represents the straight-line lease expense of operating leases, inclusive of amortization of ROU assets and the interest component of operating lease liabilities.

Based on the nature of the ROU assets, amortization of finance leases and amortization of operating ROU assets, operating lease expense and other lease expense are recorded within either cost of revenue or selling, general and administrative expenses and interest on finance lease liabilities is recorded within interest and other income (expense) in the condensed consolidated statements of comprehensive loss.

The following tables set forth the amount of lease assets and lease liabilities included in the Company's condensed consolidated balance sheets (in thousands):

Assets	Financial Statement Line Item	September 30, 2022
Finance lease assets	Property and equipment, net	\$ 91
Operating lease assets	Operating lease right-of-use asset	31,486
Total lease assets		\$ 31,577
Liabilities		
Current		
Finance lease liabilities	Accrued expenses	\$ 53
Operating lease liabilities	Accrued expenses	7,587
Non-current		
Finance lease liabilities	Other long-term liabilities	\$ 33
Operating lease liabilities	Operating lease liabilities, net of current portion	31,790
Total lease liabilities		\$ 39,463

Supplemental information related to the Company's leases for the nine months ended September 30, 2022 was as follows:

Weighted-average remaining lease term (in years)

Finance leases	1.6
Operating leases	4.8

Weighted-average discount rate

Finance leases	3.00 %
Operating leases	2.29 %

Cash paid for amounts included in the measurement of lease liabilities (in thousands)

Operating cash flows used in finance leases	\$ 7
Operating cash flows used in operating leases	\$ 5,161
Finance cash flows used in finance leases	\$ 281

The Company did not have any non-cash ROU assets obtained in exchange for lease liabilities during the nine months ended September 30, 2022 for either finance or operating leases.

Future minimum lease payments required under operating and finance leases as of September 30, 2022, were as follows (in thousands):

	<u>Operating Leases</u>	<u>Finance Leases</u>
Remaining 2022	\$ 2,068	\$ 10
2023	8,468	57
2024	8,704	21
2025	8,950	—
2026	9,201	—
2027	4,245	—
Thereafter	—	—
Future minimum lease payments	<u>\$ 41,636</u>	<u>\$ 88</u>
Less: Amount representing interest	(2,259)	(2)
Present value of future lease payments	<u>\$ 39,377</u>	<u>\$ 86</u>

As of December 31, 2021, the future minimum rental payments under noncancelable leases with offsetting sublease revenue are as follows:

<i>(in thousands)</i>	<u>Facility Leases</u>	<u>Subleases</u>	<u>Build-to-Suit Lease</u>	<u>Capital Leases</u>
Years Ending December 31,				
2022	\$ 5,231	\$ (1,936)	\$ 2,639	\$ 280
2023	5,754	(1,994)	2,714	57
2024	5,916	(2,054)	2,788	21
2025	6,082	(2,115)	2,868	—
2026	6,253	(2,179)	2,948	—
Thereafter	1,357	(369)	2,888	—
Future minimum lease payments (income)	<u>\$ 30,593</u>	<u>\$ (10,647)</u>	<u>\$ 16,845</u>	<u>\$ 358</u>
Less: Amount representing interest				(8)
Present value of future lease payments				<u>\$ 350</u>

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

You should read the following discussion and analysis of our financial condition and results of operations together with our condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q, as well as our audited consolidated financial statements and related notes as disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2021 (the “Annual Report”), filed with the Securities and Exchange Commission (“SEC”) on March 28, 2022. This discussion, particularly information with respect to our future results of operations or financial condition, business strategy and plans, and objectives of management for future operations, includes forward-looking statements that involve risks and uncertainties as described under the heading “Special Note Regarding Forward-Looking Statements” in this Quarterly Report on Form 10-Q.

Overview

The Honest Company, Inc. (“Honest” and, together with its consolidated subsidiaries, the “Company,” “we,” “us” and “our”) is a digitally-native, mission-driven brand focused on leading the clean lifestyle movement, creating a community for conscious consumers and seeking to disrupt multiple consumer product categories. Our commitment to our core values, continual innovation and engaging our community has differentiated and elevated our brand and our products. Since our launch in 2012, we have been dedicated to developing clean, sustainable, effective and thoughtfully-designed products. By doing so with transparency, we have cultivated deep trust around what matters most to our consumers: their health, their families and their homes. We are an omnichannel brand, ensuring our products are available wherever our consumers shop. Our differentiated platform positions us for continued growth through our trusted brand, award-winning multi-category product offerings, deep digital-first connection with consumers and omnichannel accessibility.

Our integrated multi-category product architecture is intentionally designed to serve our consumers every day, at every age and through every life stage, no matter where they are on their journey. Our three product categories are Diapers and Wipes, Skin and Personal Care, and Household and Wellness, which represented 65%, 26%, and 9%, respectively, of our revenue for the three months ended September 30, 2022, compared to 65%, 31%, and 4%, respectively, of our revenue for the three months ended September 30, 2021, and 65%, 29%, and 6%, respectively, of our revenue for the nine months ended September 30, 2022, compared to 63%, 32%, and 5%, respectively, of our revenue for the nine months ended September 30, 2021. At the center of our product ecosystem are our diapers, which are a strategic consumer acquisition tool that acts as an entry point for our portfolio, as new parents often go on to purchase products from our other categories for their everyday family needs. Our integrated multi-category product architecture is designed to drive loyalty, increase our consumer wallet share and generate attractive consumer lifetime value.

We believe that our consumers are modern, aspirational, conscious and style-forward and that they seek out high quality, effective and thoughtfully-designed products. We believe that they are passionate about living a conscious life and are enthusiastic ambassadors for brands they trust. As purpose-driven consumers, they transcend any one demographic, spanning gender, age, geography, ethnicity and household income. Honest consumers are often young, mobile-centric and digitally-inclined. We build relationships with these consumers through a disruptive digital marketing strategy that engages them with “snackable” digital content (short-form, easily digestible content), immerses them in our brand values, and inspires them to join the Honest community. Our direct connection with our community enables us to understand what consumers’ needs are and inspires our product innovation pipeline, generating a significant competitive advantage over more traditional consumer packaged goods, or CPG, peers.

Our omnichannel approach seeks to meet consumers wherever they want to shop, balancing deep consumer connection with broad convenience and accessibility. Since our launch, we have built a well-integrated omnichannel presence by expanding our retail accessibility across both Digital and Retail channels, including the launch of strategic partnerships with Costco, Target, Amazon and Walmart in 2013, 2014, 2017 and 2022, respectively. For the three months ended September 30, 2022, we generated 40% and 60% of our revenue from our Digital and Retail channels, respectively, compared to 47% and 53%, respectively, for the three months ended September 30, 2021. For the nine months ended September 30, 2022, we generated 46% and 54% of our revenue from our Digital and Retail channels, respectively, compared to 49% and 51%, respectively, for the nine months ended September 30, 2021. We maintain direct relationships with our consumers via our flagship digital platform, Honest.com, which allows us to influence brand experience and better understand consumer preferences and behavior. We increase accessibility of our products to more consumers through both the third-party pureplay ecommerce sites that, with Honest.com, comprise our Digital channel, and our Retail channel, which includes leading retailers and their websites. As of September 30, 2022, our products can be found in approximately 50,000 retail locations across the United States, Canada and Europe. Our integrated omnichannel presence provides meaningful benefits to our consumers which we believe is not easily replicated by our competitors. This distinctive business model has allowed us to efficiently scale our business while remaining agnostic as to the channel where consumers purchase our products.

Initial Public Offering

On May 7, 2021, we completed our initial public offering ("IPO") of 25,807,000 shares of our common stock at a stock price of \$16.00 per share, resulting in aggregate net proceeds to us of approximately \$91.0 million, after deducting the underwriting discount and commissions of \$6.7 million and offering expenses of \$5.5 million. We sold 6,451,613 shares and certain existing stockholders sold an aggregate of 19,355,387 shares. We granted the underwriters an option for a period of 30 days to purchase up to an additional 3,871,050 shares of common stock from the selling stockholders at \$16.00 per share less the underwriting discounts and commissions. In May 2021, the underwriters fully exercised the option to purchase these additional shares from the selling stockholders. We did not receive any proceeds from the sale of shares of our common stock by the selling stockholders.

Key Factors Affecting Our Performance

We believe that the growth of our business and our future success are dependent on many factors. While each of these factors presents significant opportunities for us, they also pose important challenges that we must successfully address to enable us to sustain the growth of our business and improve our operations while staying true to our mission, including those discussed below and in the section of this Quarterly Report on Form 10-Q titled "Risk Factors."

Ability to Grow Our Brand Awareness

Our brand is integral to the growth of our business and is essential to our ability to engage and stay connected with the growing clean lifestyle consumer. Honest is still unknown to many consumers, with unaided brand awareness of 29% among diaper buyers according to our consumer research conducted in January 2022. In order to increase share of wallet of existing conscious consumers and to attract new consumers, our brand has to maintain its trustworthiness and authenticity. Our ability to attract new consumers will depend, among other things, on our ability to successfully produce products that are free of defects and communicate the value of those products as clean, sustainable and effective, the efficacy of our marketing efforts and the offerings of our competitors. Beyond preserving the integrity of our brand, our performance will depend on our ability to augment our reach and increase the number of consumers aware of Honest and our product portfolio. Given higher costs of digital marketing and increased retail distribution, we have and expect to continue to shift the focus of our marketing spend towards supporting retail marketing programs and to make changes in our domestic and global marketing initiatives to increase brand awareness. We believe our brand strength will enable us to continue to expand across categories and channels, allowing us to deepen relationships with consumers and expand our access to global markets. Our performance depends significantly on factors that may affect the level and pattern of consumer spending in the product categories in which we operate.

Continued Innovation

Research, development and innovation are core elements underpinning our growth strategy. Through our in-house research and development laboratories, we are able to access the latest advancements in clean ingredients and continue to innovate in the clean conscious lifestyle space. Based in Los Angeles, California, our research and development team, including chemists, in-house toxicologists and an ecotoxicologist, develops innovative clean products based on the latest green technology. At Honest, product innovation never stops. The improvement of existing products and the introduction of new products have been, and continue to be, integral to our growth. We have made significant investments in our product development capabilities and plan to continue to do so in the future. We believe our rigorous approach to product innovation has helped redefine and grow the clean and natural product categories in which we operate. Our continued focus on research and development will be central to attracting and retaining consumers in the future. Our ability to successfully develop, market and sell new products will depend on a variety of factors, including our continued investment in innovation, integrated business planning processes and capabilities.

We use connectivity to our community of consumers to provide lifestyle insights that power innovation across categories. We use innovation to support our growth objectives across our portfolio, as highlighted in the three core pillars of our Innovation Framework: that we bring product innovation that 1) feeds and nurtures our core values, 2) expands within our existing product categories, and 3) grows into new potential product categories adjacent to existing categories that fit with our value proposition to the consumer.

We continue to innovate in each of our product categories in areas such as breakthrough new product formulations, innovative packaging, costovation (defined below) and marketing strategy, with a focus on driving "big bets" across potential product adjacencies where we have: 1) permission to play with consumers, 2) relevant domain expertise, and 3) the opportunity to expand into more places within an existing Honest home. We are also focused on building a portfolio of products in complementary categories through our Innovation Strategy and the momentum created by our Digital Strategy. We are building an Honest community with the goal of creating a more holistic clean, conscious home for consumers and customers alike. We strive for continuous improvement in our existing products' safety, sustainability, efficacy and design profile while achieving better performance often at lower cost, which we refer to as costovation.

Continued Product Category Growth

Our product mix is a driver of our financial performance given our focus on accretive product launches and innovation to increase product margins. Even though our growth strategy aims to boost sales across all categories, we intend to prioritize growth in Skin and Personal Care given its attractive margin characteristics and leverage our brand equity and consumer insights to extend into new adjacent product categories. Since we launched our Innovation Strategy, we have enhanced our product portfolio by strategically discontinuing certain products and making calculated extensions within our three product categories. These product changes have contributed to our revenue and margin growth.

Continued Execution of Omnichannel Strategy

The continued execution of our omnichannel strategy impacts our financial performance. We intend to continue leveraging our marketing strategy to drive increased consumer traffic to our flagship digital platform, Honest.com, as it is a valuable tool for creating direct connections with our consumers, influencing brand experience and understanding consumer preference and behavior. Our partnerships with leading third-party retail platforms and national retailers have broadened our consumer reach, raised our brand awareness and enhanced our margins through operating leverage. We will continue to pursue partnerships with a wide variety of retailers, including online retailers, club retailers, grocery stores, drugstores and specialty retailers. Our ability to execute this strategy will depend on a number of factors, such as competitive dynamics and retailers' satisfaction with the sales and profitability of our products, channel shifts of their customers, and their own supply chain, order timing, and inventory needs, which may fluctuate from period to period.

Operational and Marketing Efficiency

To grow our business, we intend to continue to improve our operational and marketing efficiency, which includes attracting new consumers, increasing community engagement and improving fulfillment and distribution operations. We invest significant resources in marketing and content generation, use a variety of brand and performance marketing channels and work continuously to improve brand exposure at our retail customers to acquire new consumers. It is important to maintain reasonable costs for these marketing efforts relative to the revenue we expect to derive from our consumers. We leverage our proprietary Honest Omni-Analytics to generate valuable consumer insights that guide our omnichannel strategy and inform our marketing spend optimization. Our future success depends in part on our ability to effectively attract consumers on a cost-efficient basis and achieve efficiencies in our operations.

Our paid advertising includes search engine marketing, display, paid social media and product placement and traditional advertising, such as direct mail, television, radio and magazine advertising. Paid advertising costs significantly increased industry-wide in 2021, which negatively impacted our ability to cost-effectively drive traffic to Honest.com and contributed to the decline in Digital revenue in 2021 and for the three and nine months ended September 30, 2022. We expect these elevated costs in paid advertising to continue to impact marketing efficiencies, costs and revenue in our Digital channel for the remainder of 2022.

Overall Macro Trends

We have strategically positioned ourselves to benefit from several macro trends related to changes in consumer behavior. We believe consumers' increasing interest in a conscious lifestyle has contributed to higher demand for our products. Further, the rise in digital shopping has complemented our flagship digital platform, Honest.com, our presence with third-party ecommerce players and our Retail customers' websites. During the three and nine months ended September 30, 2022, we continued to see our retail consumption growth be at a higher level than our digital consumption growth as more consumers chose to return to in-store shopping. Changes in macro-level consumer spending trends, including as a result of the COVID-19 pandemic or broader macroeconomic conditions, such as inflation, have resulted and could in the future result in fluctuations in our operating results.

The COVID-19 pandemic caused general business disruption worldwide beginning in January 2020. The full extent to which the COVID-19 pandemic will directly or indirectly impact our cash flow, business, financial condition, results of operations and prospects will depend on future developments that are uncertain.

Business Operations

As a result of the COVID-19 pandemic, our headquarters were temporarily closed but have since reopened in a hybrid capacity. During the pandemic we implemented travel restrictions and social distancing measures, including replacing many in-person meetings with virtual interactions, as well as other precautions for the safety of our employees, many of which we have continued into 2022. These actions represented a significant change in how we operate our business, but we believe that we successfully navigated this transition. We will continue to take actions as may be required or recommended by government or health authorities or as we determine are in the best interests of our employees and business partners in light of the pandemic.

The operations of our retail customers, manufacturers and suppliers have also been impacted by the COVID-19 pandemic. While the duration and extent of the COVID-19 pandemic depends on future developments that cannot be accurately predicted at this time, it has already had an adverse effect on the global economy and the ultimate societal and economic impact of the COVID-19 pandemic remains unknown. In particular, the conditions caused by this pandemic may negatively impact collections of accounts receivable and reduce expected spending from new consumers, all of which could adversely affect our business, financial condition, results of operations and prospects in the future, and has led to tighter inventory management by retailers, which has negatively impacted our revenue and fulfillment operations, and may continue in the future. Prolonged unfavorable economic conditions, including as a result of COVID-19 or similar outbreaks, and any resulting recession or slowed economic growth, may have an adverse effect on our sales and profitability.

Supply Chain Disruptions

We have experienced some impacts on our inventory availability and delivery capacity since the COVID-19 outbreak. The out-of-stock inventory due to supply chain disruptions has been significant on several key items, particularly in our Skin and Personal Care and Diapers and Wipes product categories. In the fourth quarter of 2021, we experienced lower than expected inventory receipts due largely to global supply chain delays, including a delay in receiving shipments from overseas, which we also experienced in the second quarter of 2022. For example, due to new COVID-19 lockdown restrictions in China in the second quarter of 2022, many of the ports shut down which has negatively impacted and may in the future negatively impact our ability to timely receive shipments of our products. To the extent that additional prevention and mitigation measures are implemented in the future, or there is uncertainty about the effectiveness of these or any other measures to contain the spread of COVID-19, there has been and continues to be an adverse impact on global economic conditions and consumer confidence and spending, which has adversely affected our supply chain as well as the demand for our products and has impacted our revenue and ability to service our customer orders. We have taken measures to bolster key aspects of our supply chain, such as ensuring sufficient inventory to support our continued growth, new distribution and longer lead times.

As a result of the COVID-19 pandemic and other macroeconomic trends, we and our distribution partners have experienced some disruptions to the operations of our fulfillment centers, including a nationwide truck driver shortage. For example, during the fourth quarter of 2021, some employees at our warehouse facilities were ill with COVID-19 and/or following quarantine protocols, which coupled with the nationwide truck driver shortage, negatively impacted our and our distribution partner's ability to fulfill orders in a timely manner and had a negative impact on our results of operations. In addition, an international freight forwarder partner experienced a cyber attack during the first quarter of 2022 resulting in a delay in the shipment and launch of our *Beauty Restage* products in Europe. Also, in the third quarter of 2022, some of our digital and retail customers began to reduce inventory on hand and have changed fulfillment schedules, which has negatively impacted our fulfillment operations and our revenue and is expected to continue to do so in the future.

We continue to work with our existing manufacturing, logistics and other supply chain partners to ensure our ability to service our consumers and retail and third-party ecommerce customers. We have experienced and anticipate continued increases in commodity prices, labor costs, input costs and transportation costs in 2022. For example, some of our contracts with third-party manufacturers have clauses that trigger good faith renegotiation of purchase costs in the case of significant raw material cost escalation. In the fourth quarter of 2021, we were informed by two third-party manufacturers in our Diapers and Wipes and Skin and Personal Care categories, respectively, that those hurdles had been met. In addition, in the third quarter of 2022, we received requests from the same two third-party manufacturers to renegotiate purchase costs due to continued increases in raw material costs. As a result, we negotiated and agreed to higher purchase prices which has negatively impacted our cost of revenue during the three and nine months ended September 30, 2022 and will continue to have a negative impact on our results of operations. Due to continued elevated input costs such as fluff pulp, we anticipate further escalation of purchase costs and cost of revenue in the fourth quarter of 2022 and in 2023. Moreover, the demand for sustainable packaging and ingredients is outpacing the supply and increasing the cost of these raw materials. For example, there is a supplier shortage or significant demand of and cost impacts to various raw materials used in manufacturing and distributing our products, including tree-free paper, post-consumer recycled plastic resin, post-consumer recycled cardboard shipping cartons for our Honest.com shipments, surfactants, fluff pulp and other diaper raw materials and palm kernel oil. We implemented price increases that took effect in the first half of 2022 and plan to implement additional pricing increases in December 2022 and in the future as needed to offset current and future input cost inflation and have pursued productivity initiatives to offset these price increases. However, we may not be able to increase our prices or productivity sufficient to offset these costs. We continue to experience significant increasing input cost levels that have and could continue to hamper our ability to drive margin expansion. Customer demand for our products may change based on price increases.

Consumer Preferences

We believe that during 2020, COVID-19 drove a demand shift towards our Digital channel as consumers shifted to online shopping amid the pandemic. Given our digitally-native brand and strong digital penetration, we believe we benefited from this trend. Additionally, in 2020 we benefited from increasing consumer and customer demand for sanitization and disinfecting products, which drove revenue growth in our Household and Wellness product category. In 2021, we saw a significant decline in

consumer demand for sanitization and disinfecting products as consumers returned to pre-COVID routines. In addition, retailers continue to manage heavy inventories of these products in stores and warehouse facilities.

In 2021, we began to see increased consumer willingness to return to in-store shopping as the economy reopened and more of the population became vaccinated, driving revenue growth within our Retail channel, specifically within our Diapers and Wipes and Skin and Personal Care product categories in 2021. During the three and nine months ended September 30, 2022, the Retail channel revenue continued to increase compared to our Digital channel due to expanded and new distribution, marketing efforts and strong retail consumption across product categories.

Inventory

Inventory is reflected at net realizable value which includes a reserve for excess inventory. We estimate reserve requirements based on current and forecasted demand, including the ability to liquidate excess inventory and estimated liquidation value. For example, given the significant decline in consumer demand for sanitizing and disinfecting products, we recorded an inventory write-down of \$5.6 million during the year ended December 31, 2021 relating to certain sanitization and disinfecting products as the amount of inventory was significantly in excess of existing and projected demand. Management is implementing various strategies to address this reduction in demand and the related impact on gross margin, including higher markdowns and promotions to clear through inventory, liquidation efforts, focusing on products with highest customer interest and developing new creative advertising to drive demand. There is no guarantee that customer demand will increase in our favor or that we will be able to successfully implement these strategies in light of rising consumer uncertainty and tighter inventory management by retailers. Depending on future consumer behavior in relation to changes in the COVID-19 pandemic and related aging of inventory, among other factors, we may incur additional inventory write-downs, customer returns or incur additional donation expense to reduce excess inventory. During the three months ended September 30, 2022, the Company donated \$1.5 million of excess sanitization products.

Due to increasing supply chain lead times and new retail distribution, we have increased our inventory levels to ensure in-stock position to service customers and consumers. In addition, inflation in input costs including higher product costs, inbound shipping and warehouse labor has resulted in a higher dollar value of inventory. For example, in the nine months ended September 30, 2022, inventory has increased by \$24.6 million. We will continue to increase inventory levels as needed to support the growth of the business and respond to the dynamic supply chain environment.

Inflation Reduction Act of 2022

On August 16, 2022, President Biden signed into law the Inflation Reduction Act of 2022 (the “Act”), which contains provisions that will be effective on January 1, 2023, including a 15% corporate minimum tax and a 1% excise tax on stock buybacks. While we are still evaluating the impact of the Act, we do not expect any material changes on our consolidated financial position, results of operations and cash flows.

Components of Results of Operations

Revenue

We generate revenue through the sale of our products through Digital and Retail channels in the following product categories: Diapers and Wipes, Skin and Personal Care, and Household and Wellness. The Digital channel includes direct sales to the consumer through our website and sales to third-party ecommerce customers, who resell our products through their own online platforms. The Retail channel includes sales to traditional brick and mortar retailers and their respective websites, who may also resell our products through their own online platforms. Our revenue is recognized net of allowances for returns, discounts, credits and any taxes collected from consumers.

In 2019 we entered into a license agreement with Butterblu, LLC, or Butterblu, pursuant to which we licensed certain of our trademarks to Butterblu for the manufacture and distribution of certain baby apparel products in exchange for royalties. For the three and nine months ended September 30, 2022, we collected \$0.1 million and \$1.0 million, respectively, and for the three and nine months ended September 30, 2021, we collected \$0.2 million and \$0.7 million, respectively, in royalty revenue related to our license agreement. In August 2022, we terminated the license agreement in advance of its expiration date and entered into a supplier services agreement with Butterblu, pursuant to which Butterblu provides certain design, manufacturing, sales and marketing services to us. As part of the supplier services agreement, we acquired all of Butterblu's existing inventory of Honest baby apparel products for \$5.5 million, and have agreed to purchase and own inventory for the term of the service agreement which is until December 31, 2026, unless terminated sooner. We entered into this supplier services agreement to create growth opportunities and synergies between our portfolio of products. Butterblu continues to operate and maintain our baby apparel offerings independently through the honestbabyclothing.com website. Honest Baby Clothing® sales are now reflected as revenue in our condensed consolidated statements of operations. For both the three and nine months ended September 30, 2022, we recognized \$3.8 million in revenue, excluding royalty revenue, which was included in our Household and Wellness product category, and \$3.0 million of associated cost of revenue. Our baby apparel offerings and our supplier services agreement with Butterblu are not currently material to our business.

Cost of Revenue

Cost of revenue includes the purchase price of merchandise sold to customers, inbound and outbound shipping and handling costs, freight and duties, shipping and packaging supplies, credit card processing fees and warehouse fulfillment costs incurred in operating and staffing warehouses, including rent. Cost of revenue also includes depreciation and amortization for warehouse fulfillment facilities and equipment, allocated overhead and direct and indirect labor for warehouse personnel.

Gross Profit and Gross Margin

Gross profit represents revenue less cost of revenue. Gross margin is gross profit expressed as a percentage of revenue. Our gross margin may in the future fluctuate from period to period based on a number of factors, including the mix of products we sell, the channel through which we sell our products, the innovation initiatives we undertake in each product category, the promotional environment in the marketplace, manufacturing costs, commodity prices and transportation rates, among other factors.

Operating Expenses

Our operating expenses consist of selling, general and administrative, marketing and research and development expenses.

Selling, General and Administrative

Selling, general and administrative expenses consist primarily of personnel costs, principally for our selling and administrative functions. These include personnel-related expenses, including salaries, bonuses, benefits and stock-based compensation expense. Selling, general and administrative expenses also include technology expenses, professional fees, facility costs, including insurance, utilities and rent relating to our headquarters, third-party product development and marketing costs, depreciation and amortization and overhead costs. We expect our general and administrative expenses to increase in absolute dollars as we continue to grow our business and organizational capabilities. Since our IPO, we have also incurred additional costs for employees and third-party professional fees related to operating as a public company and costs to comply with the rules and regulations applicable to companies listed on a national securities exchange, costs related to compliance and reporting obligations, and increased expenses for insurance, investor relations and professional services.

Marketing

Marketing expenses include costs related to our branding initiatives, retail customer marketing activities, point of purchase displays, targeted online advertising through sponsored search, display advertising, email and influencer marketing campaigns, market research, content production and other public relations and promotional initiatives. Given higher costs in digital marketing and increased retail distribution, we have shifted the focus of our marketing spend towards supporting retail marketing programs and top of funnel marketing activities. We will continue to invest in marketing initiatives in our product

categories and hero products with key retailers, as well as expand brand awareness, introduce new product innovation across multiple product categories and implement new marketing strategies in the United States and abroad. As we expand our distribution in existing international markets and launch new products, we expect to make marketing investments to build brand awareness, drive trial and set the foundation for future revenue growth in global markets.

Research and Development

Research and development expenses consist primarily of personnel-related expenses for our research and development team. Research and development expenses also include costs incurred for the development of new products, improvement in the quality of existing products and the development and implementation of new technologies to enhance the quality and value of products. This includes the expense related to claims and clinical trials as well as formulation and packaging testing. Research and development expenses also include allocated depreciation and amortization and overhead costs. We expect research and development expenses to increase in absolute dollars as we invest in the enhancement of our product offerings through innovation and the introduction of new adjacent product categories.

Interest and Other Income (Expense), Net

Interest income consists primarily of interest income earned on our short-term investments and our cash and cash equivalents balances. Prior to the adoption of Financial Accounting Standards Board Accounting Standard Update No 2016-02, *Leases (Topic 842)*, interest expense consisted primarily of the portion of rent payments recognized as imputed interest expense under build-to-suit accounting associated with our leasing arrangements.

Other income (expense), net consists of our foreign currency exchange gains, losses relating to transactions denominated in currencies other than the U.S. dollar and contingent gains. We expect our foreign currency gains and losses to continue to fluctuate in the future due to changes in both the volume of foreign currency transactions and foreign currency exchange rates.

Income Tax Provision

We are subject to federal and state income taxes in the United States. Our annual estimated tax rate differed from the U.S. federal statutory rate of 21% primarily as a result of a valuation allowance against deferred tax assets, stock-based compensation, state taxes, nondeductible executive compensation and other permanent differences. We maintain a full valuation allowance for our federal and state deferred tax assets, including net operating loss carryforwards, as we have concluded that it is not more likely than not that the deferred tax assets will be realized.

Results of Operations

The following table sets forth our condensed consolidated statements of operations data for each of the periods indicated:

	For the three months ended September 30,		For the nine months ended September 30,	
	2022	2021	2022	2021
<i>(In thousands)</i>				
Revenue	\$ 84,580	\$ 82,651	\$ 231,792	\$ 238,258
Cost of revenue	58,963	52,892	161,984	153,177
Gross profit	25,617	29,759	69,808	85,081
Operating expenses				
Selling, general and administrative ⁽¹⁾	23,491	18,568	63,068	65,356
Marketing	12,140	13,687	38,121	41,868
Research and development ⁽¹⁾	1,725	2,092	5,643	6,082
Total operating expenses	37,356	34,347	106,832	113,306
Operating loss	(11,739)	(4,588)	(37,024)	(28,225)
Interest and other income (expense), net	(29)	(526)	657	(1,362)
Loss before provision for income taxes	(11,768)	(5,114)	(36,367)	(29,587)
Income tax provision	20	22	60	67
Net loss	\$ (11,788)	\$ (5,136)	\$ (36,427)	\$ (29,654)

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2022	2021	2022	2021
<i>(In thousands)</i>				
Selling, general and administrative	\$ 3,852	\$ 4,466	\$ 10,929	\$ 12,408
Research and development	48	310	431	832
Total	\$ 3,900	\$ 4,776	\$ 11,360	\$ 13,240

The following table sets forth our condensed consolidated statements of operations data expressed as a percentage of revenue*:

	For the three months ended September 30,		For the nine months ended September 30,	
	2022	2021	2022	2021
<i>(as a percentage of revenue)</i>				
Revenue	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenue	69.7	64.0	69.9	64.3
Gross profit	30.3	36.0	30.1	35.7
Operating expenses				
Selling, general and administrative	27.8	22.5	27.2	27.4
Marketing	14.4	16.6	16.4	17.6
Research and development	2.0	2.5	2.4	2.6
Total operating expenses	44.2	41.6	46.1	47.6
Operating loss	(13.9)	(5.6)	(16.0)	(11.8)
Interest and other income (expense), net	—	(0.6)	0.3	(0.6)
Loss before provision for income taxes	(13.9)	(6.2)	(15.7)	(12.4)
Income tax provision	—	—	—	—
Net loss	(13.9) %	(6.2) %	(15.7) %	(12.4) %

* Amounts may not sum due to rounding.

Comparison of the Three and Nine Months Ended September 30, 2022 and 2021

Revenue

	For the three months ended September 30,				For the nine months ended September 30,			
	2022	2021	\$ change	% change	2022	2021	\$ change	% change
<i>(In thousands, except percentages)</i>								
By Product Category								
Diapers and Wipes	\$ 55,222	\$ 53,847	\$ 1,375	2.6 %	\$ 150,411	\$ 151,251	\$ (840)	(0.6) %
Skin and Personal Care	21,992	25,375	(3,383)	(13.3)	66,534	75,486	(8,952)	(11.9)
Household and Wellness	7,366	3,429	3,937	114.8	14,847	11,521	3,326	28.9
Total Revenue	\$ 84,580	\$ 82,651	\$ 1,929	2.3 %	\$ 231,792	\$ 238,258	\$ (6,466)	(2.7) %

	For the three months ended September 30,				For the nine months ended September 30,			
	2022	2021	\$ change	% change	2022	2021	\$ change	% change
<i>(In thousands, except percentages)</i>								
By Channel								
Digital	\$ 33,782	\$ 39,114	\$ (5,332)	(13.6)%	\$ 105,913	\$ 116,395	\$ (10,482)	(9.0)%
Retail	50,798	43,537	7,261	16.7	125,879	121,863	4,016	3.3
Total Revenue	\$ 84,580	\$ 82,651	\$ 1,929	2.3%	\$ 231,792	\$ 238,258	\$ (6,466)	(2.7)%

Revenue was \$84.6 million for the three months ended September 30, 2022, as compared to \$82.7 million for the three months ended September 30, 2021. The increase of \$1.9 million, or 2.3%, was driven by a \$3.9 million and \$1.4 million revenue increase in Household and Wellness and Diapers and Wipes products, respectively, partially offset by a revenue decrease of \$3.4 million in Skin and Personal Care. The revenue increase in Household and Wellness was primarily driven by \$3.8 million in revenue from Honest Baby Clothing as a result of our transition from a license agreement to a supplier services agreement with Butterblu. The revenue increase in Diapers and Wipes was primarily driven by a \$1.9 million increase in wipes revenue driven by strong consumption as consumers continued to expand alternate usage of wipes beyond diapering, as well as distribution gains, price increases and larger-size offerings, offset by a decrease in diaper revenue of \$0.5 million due to \$4.5 million decrease in revenue in our Digital channel, which was offset by a \$3.9 million increase in revenue in our Retail channel driven by distribution gains and strong consumption trends. The Skin and Personal Care revenue decrease was primarily driven by a \$5.7 million decrease in revenue due to a rotational program with a key club retailer during the three months ended September 30, 2021 that did not occur during the three months ended September 30, 2022, offset by an increase in revenue due to the launch of baby personal care products with a new retail customer, price increases and an increase in beauty product revenues due to product innovation.

We estimate that pricing actions taken in the first half of 2022 contributed \$3.4 million to revenue for the three months ended September 30, 2022.

Revenue was \$231.8 million for the nine months ended September 30, 2022, as compared to \$238.3 million for the nine months ended September 30, 2021. The decrease of \$6.5 million, or 2.7%, was primarily due to a \$9.0 million decrease in revenue from Skin and Personal Care products, and a \$0.8 million decrease in revenue from Diapers and Wipes, offset by a \$3.3 million increase in revenue from Household and Wellness products. The revenue decrease from Skin and Personal Care was primarily driven by \$4.4 million in liquidation sales in advance of our *Beauty Restage* to clear out legacy inventory and a decrease of \$5.7 million in revenue due to a rotational program with a key club retailer that occurred during the nine months ended September 30, 2021 and did not occur during the nine months ended September 30, 2022, offset by price increases and distribution gains. The revenue decrease in Diapers and Wipes was primarily driven by a decrease in diaper revenue due to lower traffic and decreased revenue in our Digital channel as the price of digital marketing escalated and impacted our ability to cost-effectively drive traffic to our Honest.com and digital customers, offset by an increase in our wipes revenue, price increases and distribution gains. The revenue increase in Household and Wellness was primarily driven by \$3.8 million in revenue from Honest Baby Clothing as a result of our transition from a license agreement to a supplier services agreement with Butterblu.

We estimate that pricing actions taken in the first half of 2022 contributed \$7.4 million to revenue for the nine months ended September 30, 2022.

The increase in revenue in our Retail channel for the three months ended September 30, 2022, compared to the three months ended September 30, 2021, was primarily driven by new distribution, an increase in revenue at a key retailer driven by strong consumption supported by investments in merchandising and marketing, offset by a decrease in revenue due to a rotational program at a key club retailer that did not repeat this year. The decrease in revenue in our Digital channel for the three months ended September 30, 2022, compared to the three months ended September 30, 2021, was primarily driven by a reduction in revenue by a key digital customer due to an inventory reduction and the timing of shipments related to its national promotional event that occurred during the three months ended September 30, 2021, that did not occur during the three months ended September 30, 2022, as well as higher digital marketing costs which impacted our ability to cost-effectively drive traffic to Honest.com and digital customers.

The increase in revenue in our Retail channel for the nine months ended September 30, 2022, compared to the nine months ended September 30, 2021, was primarily due to an increase in revenue across product categories related to new retail distribution gains and strong consumption growth, offset by two rotational programs (sanitization and disinfecting and baby and personal care) with a key club customer during the nine months ended September 30, 2021, that did not occur during the nine months ended September 30, 2022. The decrease in revenue in our Digital channel for the nine months ended September 30, 2022, compared to the nine months ended September 30, 2021, was primarily due to consumers returning to in-store shopping and higher digital marketing costs which impacted the ability to cost-effectively drive traffic to Honest.com and digital customers.

Cost of Revenue and Gross Profit

	For the three months ended September 30,				For the nine months ended September 30,			
	2022	2021	\$ change	% change	2022	2021	\$ change	% change
<i>(In thousands, except percentages)</i>								
Cost of revenue	\$ 58,963	\$ 52,892	\$ 6,071	11.5 %	\$ 161,984	\$ 153,177	\$ 8,807	5.7 %
Gross profit	\$ 25,617	\$ 29,759	\$ (4,142)	(13.9) %	\$ 69,808	\$ 85,081	\$ (15,273)	(18.0) %

Cost of revenue was \$59.0 million for the three months ended September 30, 2022, as compared to \$52.9 million for the three months ended September 30, 2021. The increase of \$6.1 million, or 11.5%, was primarily due to higher fulfillment costs, especially in transportation, freight and warehouse labor costs, product costs driven by higher revenue from Honest Baby Clothing and increased product costs for our diapers and personal care, as compared to the three months ended September 30, 2021, partially offset by cost reduction projects. Cost of revenue as a percentage of revenue increased by 572 basis points primarily due to higher input costs, along with higher trade promotion levels as compared to the three months ended September 30, 2021, partially offset by pricing increases taken in the first half of 2022 and cost reduction projects.

Cost of revenue was \$162.0 million for the nine months ended September 30, 2022, as compared to \$153.2 million for the nine months ended September 30, 2021. The increase of \$8.8 million, or 5.7%, was primarily due to higher fulfillment costs, especially in transportation, freight and warehouse labor costs, product costs driven by higher revenue from Honest Baby Clothing and increased product costs for our diapers and personal care products, as well as rent expense related to our warehouse facility due to the derecognition of our built-to-suit lease as a result of the adoption of ASC 842 (previously recognized in interest expense). Cost of revenue as a percentage of revenue increased by 559 basis points primarily due to higher input costs, along with higher trade promotion levels as compared to the nine months ended September 30, 2021, partially offset by pricing increases taken in the first half of 2022 and cost reduction projects.

Gross profit was \$25.6 million for the three months ended September 30, 2022, as compared to \$29.8 million for the three months ended September 30, 2021. The decrease of \$4.1 million, or 13.9%, was primarily due to higher input costs and higher expenses associated with promotional activity, partially offset by pricing increases that went into effect in 2022 and cost savings.

Gross profit was \$69.8 million for the nine months ended September 30, 2022, as compared to \$85.1 million for the nine months ended September 30, 2021. The decrease of \$15.3 million, or 18.0%, was primarily due to the decrease in revenue in our Skin and Personal Care product category, fixed cost deleverage, higher input costs and higher expenses associated with promotional activity, partially offset by pricing increases that went into effect in 2022, favorable product mix and cost savings, including the consolidation of a distribution center.

Operating Expenses

Selling, General and Administrative Expenses

	For the three months ended September 30,				For the nine months ended September 30,			
	2022	2021	\$ change	% change	2022	2021	\$ change	% change
<i>(In thousands, except percentages)</i>								
Selling, general and administrative	\$ 23,491	\$ 18,568	\$ 4,923	26.5 %	\$ 63,068	\$ 65,356	\$ (2,288)	(3.5) %

Selling, general and administrative expenses were \$23.5 million for the three months ended September 30, 2022, as compared to \$18.6 million for the three months ended September 30, 2021. The increase of \$4.9 million, or 26.5%, was primarily due to \$1.7 million increase in legal fees, \$1.5 million increase in employee-related expenses due to higher headcount and \$1.4 million increase in donation expenses.

Selling, general and administrative expenses were \$63.1 million for the nine months ended September 30, 2022, as compared to \$65.4 million for the nine months ended September 30, 2021. The decrease of \$2.3 million, or 3.5%, was primarily due to non-recurring IPO related expenses for the nine months ended September 30, 2021 that did not occur during the nine months ended September 30, 2022, offset by an increase of \$2.6 million in legal fees, a \$2.1 million increase in employee-related expenses due to higher headcount, a \$1.9 million increase in donation expenses and a \$0.7 million increase in insurance costs related to operating as a public company. The IPO-related expenses during the nine months ended September 30, 2021 included \$9.1 million in bonus payments made to certain employees, including members of management, excluding payroll taxes and

expenses, \$1.9 million in stock-based compensation expense related to the vesting of performance based awards and \$1.0 million in accounting expenses related to the IPO during the nine months ended September 30, 2021.

Marketing Expenses

	For the three months ended September 30,				For the nine months ended September 30,			
	2022	2021	\$ change	% change	2022	2021	\$ change	% change
<i>(In thousands, except percentages)</i>								
Marketing	\$ 12,140	\$ 13,687	\$ (1,547)	(11.3)%	\$ 38,121	\$ 41,868	\$ (3,747)	(8.9)%

Marketing expenses were \$12.1 million for the three months ended September 30, 2022, as compared to \$13.7 million for the three months ended September 30, 2021. The decrease of \$1.5 million, or 11.3%, was primarily due to a \$4.2 million reduction in digital advertising, offset by a \$2.0 million increase in retail marketing to support new distribution and an \$0.6 million increase in public relations and influencer marketing.

Marketing expenses were \$38.1 million for the nine months ended September 30, 2022, as compared to \$41.9 million for the nine months ended September 30, 2021. The decrease of \$3.7 million, or 8.9%, was primarily due to a \$8.1 million reduction in digital advertising, offset by a \$3.6 million increase in retail marketing to support new distribution and higher return shopper marketing, as well as \$0.8 million increase in public relations and influencer marketing.

Research and Development Expenses

	For the three months ended September 30,				For the nine months ended September 30,			
	2022	2021	\$ change	% change	2022	2021	\$ change	% change
<i>(In thousands, except percentages)</i>								
Research and development	\$ 1,725	\$ 2,092	\$ (367)	(17.5)%	\$ 5,643	\$ 6,082	\$ (439)	(7.2)%

Research and development expenses were \$1.7 million for the three months ended September 30, 2022, as compared to \$2.1 million for the three months ended September 30, 2021. The decrease of \$0.4 million, or 17.5%, was primarily related to a \$0.3 million decrease in stock-based compensation expense.

Research and development expenses were \$5.6 million for the nine months ended September 30, 2022, as compared to \$6.1 million for the nine months ended September 30, 2021. The decrease of \$0.4 million, or 7.2%, was primarily related to a \$0.4 million decrease in stock-based compensation expense.

Interest and Other Income (Expense), Net

	For the three months ended September 30,			For the nine months ended September 30,		
	2022	2021	\$ change	2022	2021	\$ change
<i>(In thousands, except percentages)</i>						
Interest income (expense), net	\$ 140	\$ (440)	\$ 580	\$ 322	\$ (1,353)	\$ 1,675
Other income (expense), net	(169)	(86)	(83)	335	(9)	344
Interest and other income (expense), net	\$ (29)	\$ (526)	\$ 497	\$ 657	\$ (1,362)	\$ 2,019

Interest and other income (expense), net was net expense of \$29 thousand for the three months ended September 30, 2022, as compared to net expense of \$0.5 million for the three months ended September 30, 2021. The decrease of \$0.5 million was primarily due to a decrease in interest expense related to the derecognition of our built-to-suit lease as a result of the adoption of ASC 842. Under the new lease accounting related to the adoption of ASC 842, all lease expense related to the built-to-suit lease is now included in the cost of revenue.

Interest and other income (expense), net was net income of \$0.7 million for the nine months ended September 30, 2022, as compared to net expense of \$1.4 million for the nine months ended September 30, 2021. The increase of \$2.0 million was primarily due to a decrease in interest expense related to the derecognition of our built-to-suit lease as a result of the adoption of ASC 842. Under the new lease accounting related to the adoption of ASC 842, all lease expense related to the built-to-suit lease is now included in the cost of revenue. Additionally, during the nine months ended September 30, 2022, \$0.7 million of other income was related to the recognition of taxes and interest to be refunded from the Nevada Department of Taxation legal settlement. Refer to Note 8 included in these condensed consolidated financial statements for more information on the legal settlement.

Liquidity and Capital Resources

We have incurred net losses and net cash outflows from operating activities since our inception. Prior to our IPO, our available liquidity and operations were financed primarily through the sale of redeemable convertible preferred stock, equity securities and to a lesser extent, debt financing. Upon the closing of our IPO, we received net proceeds of approximately \$91.1 million, after deducting underwriting discounts and commissions of \$6.7 million and offering expenses of \$5.4 million. As of September 30, 2022, we had \$24.1 million of cash and cash equivalents and \$16.7 million of short-term investments. Although we are dependent on our ability to generate sufficient cash flow from operations or raise capital to achieve our business objectives, we believe our existing cash, cash equivalents, and short-term investments will be sufficient to meet our short-term and long-term working capital and capital expenditure needs. Future capital requirements will depend on many factors, including our rate of revenue growth, gross margin and the level of expenditures in all areas of the Company. To the extent that existing capital resources and sales growth are not sufficient to fund future activities, we will need to raise capital through additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all. Failure to raise additional capital, if and when needed, could have a material adverse effect on our financial position, results of operations, and cash flows.

2021 Credit Facility

In April 2021, we entered into a first lien credit agreement (the “2021 Credit Facility”), with JPMorgan Chase Bank, N.A., as administrative agent and lender, and the other lenders party thereto, which provides for a \$35.0 million revolving credit facility that matures on April 30, 2026. The 2021 Credit Facility includes a subfacility that provides for the issuance of letters of credit in an amount of up to \$10.0 million at any time outstanding, which reduces the amount available under the 2021 Credit Facility.

As of September 30, 2022, there were outstanding standby letters of credit of \$4.8 million related to lease obligations with \$30.2 million available to be drawn upon. The 2021 Credit Facility is subject to customary fees for loan facilities of this type, including a commitment fee based on the average daily undrawn portion of the revolving credit facility. We recognize the commitment fee as incurred in interest and other income (expense), net in the condensed consolidated statements of comprehensive loss. For the three and nine months ended September 30, 2022, the commitment fee incurred was immaterial. The interest rate applicable to the 2021 Credit Facility is, at our option, either (a) the LIBOR (or a replacement rate established in accordance with the terms of the 2021 Credit Facility) (subject to a 0.00% LIBOR floor), plus a margin of 1.50% or (b) the CB floating rate minus a margin of 0.50%. The CB floating rate is the higher of (a) the Wall Street Journal prime rate and (b)(i) 2.50% plus (ii) the adjusted LIBOR rate for a one-month interest period.

The 2021 Credit Facility will terminate and borrowings thereunder, if any, will be due on April 30, 2026. As of September 30, 2022, there was no outstanding balance under the 2021 Credit Facility. We are required to follow certain covenants. As of September 30, 2022, we are in compliance with the net leverage ratio covenant.

Refer to Note 6 included in these condensed consolidated financial statements for more information on the 2021 Credit Facility.

Cash Flows

The following table summarizes our cash flows for the periods presented:

<i>(In thousands)</i>	For the nine months ended September 30,	
	2022	2021
Net cash used in operating activities	\$ (50,669)	\$ (36,359)
Net cash provided by (used in) investing activities	\$ 24,004	\$ (28,734)
Net cash (used in) provided by financing activities	\$ (39)	\$ 55,559

Operating Activities

Our largest source of operating cash is from the sales of our products through Digital and Retail channels to our consumers and customers. Our primary uses of cash from operating activities are for cost of revenue expenses, selling, general and administrative expenses, marketing expenses and research and development expenses. We have generated negative cash flows from operating activities and have supplemented working capital requirements through net proceeds from the sale and maturity of short-term investments.

Net cash used in operating activities of \$50.7 million for the nine months ended September 30, 2022 was primarily due to net loss of \$36.4 million, non-cash adjustments of \$18.2 million and a net decrease in cash related to changes in operating assets and liabilities of \$32.4 million. Non-cash adjustments primarily consisted of stock-based compensation of \$11.4 million, amortization of operating ROU assets of \$4.6 million and depreciation and amortization of \$2.0 million. Changes in cash flows related to operating assets and liabilities primarily consisted of a \$24.6 million increase in inventory reflecting cost inflation, the purchase of \$5.5 million of Honest Baby Clothing inventory from Butterblu and an increase in weeks of supply due to longer lead times and in advance of new distribution, a \$7.1 million increase in accounts receivable due to growth in Retail channel revenue, a \$5.2 million use of cash due to operating lease obligations and a \$3.2 million increase in prepaid expenses and other assets, offset by a \$7.6 million increase in accounts payable due to higher inventory purchases and cost inflation in the nine months ended September 30, 2022.

Net cash used in operating activities of \$36.4 million for the nine months ended September 30, 2021 was primarily due to net loss of \$29.7 million, non-cash adjustments of \$16.6 million and a net decrease in cash related to changes in operating assets and liabilities of \$23.3 million. Non-cash adjustments primarily consisted of stock-based compensation of \$13.2 million and depreciation and amortization of \$3.1 million. Changes in cash flows related to operating assets and liabilities primarily consisted of a \$8.9 million increase in accounts receivable due to higher revenue from retail customers, a \$7.6 million increase in prepaid expenses and other assets due to timing of payments, as well as the non-monetary sale of our legacy beauty inventory for future marketing and transportation credits, a \$1.2 million increase in inventory due to timing of inventory purchases and a \$5.8 million use of cash due to the timing of payments associated with our accounts payable and operating leasing obligations.

Investing Activities

Our primary source of investing cash is the sale and maturity of short-term investments and our primary use of investing cash is the purchase of short-term investments and property and equipment.

Net cash provided by investing activities of \$24.0 million for the nine months ended September 30, 2022 was primarily due to proceeds from maturities of short-term investments of \$38.2 million, offset by purchases of short-term investments of \$12.8 million.

Net cash used in investing activities of \$28.7 million for the nine months ended September 30, 2021 was due to purchases of short-term investments of \$65.3 million, offset by proceeds from the sales and maturities of short-term investments of \$26.9 million and \$9.9 million, respectively.

Financing Activities

Our financing activities primarily consisted of proceeds from sales of securities, payment of offering costs, proceeds from stock option award exercises and principal payments of financing lease obligations.

Net cash used in financing activities of \$39 thousand for the nine months ended September 30, 2022 primarily consisted of principal payments of financing lease obligations, partially offset by proceeds from stock option exercises and the 2021 ESPP.

Net cash provided by financing activities of \$55.6 million for the nine months ended September 30, 2021 primarily consisted of proceeds from our IPO of \$96.5 million, net of underwriting discounts and commissions, offset by dividend payments of \$35.0 million and payments of offering costs in connection with our IPO of \$5.5 million.

Dividends

In April 2021, our board of directors declared a cash dividend of \$35.0 million to the holders of record of our common stock and our redeemable convertible preferred stock as of May 3, 2021, which we paid on June 29, 2021 (the "2021 Dividend"). Other than the 2021 Dividend, we have not declared or paid cash dividends on our capital stock, and we do not anticipate declaring or paying any cash dividends other than the 2021 Dividend in the foreseeable future. Any future determination regarding the declaration and payment of dividends, if any, will be at the discretion of our board of directors and will depend on then-

existing conditions, including our financial condition, operating results, contractual restrictions (including any restrictions in our then-existing debt arrangements), capital requirements, business prospects and other factors our board of directors may deem relevant. The 2021 Credit Facility contains restrictions on our ability to pay dividends.

Non-GAAP Financial Measure

We prepare and present our condensed consolidated financial statements in accordance with GAAP. However, management believes that adjusted EBITDA, a non-GAAP financial measure, provides investors with additional useful information in evaluating our performance.

We calculate adjusted EBITDA as net income (loss), adjusted to exclude: (1) interest and other (income) expense, net; (2) income tax provision; (3) depreciation and amortization; (4) stock-based compensation expense, including payroll tax; (5) the IPO bonuses in the second quarter of 2021, including associated payroll taxes and expenses, and third-party costs associated with our IPO in 2021; and (6) in certain periods, litigation and settlement fees associated with certain non-ordinary course litigation.

Adjusted EBITDA is a financial measure that is not required by, or presented in accordance with GAAP. We believe that adjusted EBITDA, when taken together with our financial results presented in accordance with GAAP, provides meaningful supplemental information regarding our operating performance and facilitates internal comparisons of our historical operating performance on a more consistent basis by excluding certain items that may not be indicative of our business, results of operations or outlook. In particular, we believe that the use of adjusted EBITDA is helpful to our investors as it is a measure used by management in assessing the health of our business, determining incentive compensation and evaluating our operating performance, as well as for internal planning and forecasting purposes.

Adjusted EBITDA is presented for supplemental informational purposes only, has limitations as an analytical tool and should not be considered in isolation or as a substitute for financial information presented in accordance with GAAP. Some of the limitations of adjusted EBITDA include that (1) it does not reflect capital commitments to be paid in the future; (2) although depreciation and amortization are non-cash charges, the underlying assets may need to be replaced and adjusted EBITDA does not reflect these capital expenditures; (3) it does not consider the impact of stock-based compensation expense; (4) it does not reflect other non-operating expenses, including interest expense; (5) it does not include the IPO bonuses, including associated payroll taxes and expenses, or third-party costs associated with the preparation of the IPO; (6) it does not reflect tax payments that may represent a reduction in cash available to us; and (7) does not include certain non-ordinary cash expenses that we do not believe are representative of our business on a steady-state basis. In addition, our use of adjusted EBITDA may not be comparable to similarly titled measures of other companies because they may not calculate adjusted EBITDA in the same manner, limiting its usefulness as a comparative measure. Because of these limitations, when evaluating our performance, you should consider adjusted EBITDA alongside other financial measures, including our net income (loss) and other results stated in accordance with GAAP.

The following table presents a reconciliation of net income (loss), the most directly comparable financial measure stated in accordance with GAAP, to adjusted EBITDA, for each of the periods presented:

<i>(In thousands)</i>	For the three months ended September 30,		For the nine months ended September 30,	
	2022	2021	2022	2021
Reconciliation of Net Loss to Adjusted EBITDA				
Net loss	\$ (11,788)	\$ (5,136)	\$ (36,427)	\$ (29,654)
Interest and other (income) expense, net	29	526	(657)	1,362
Income tax provision	20	22	60	67
Depreciation and amortization	639	1,019	2,025	3,135
Stock-based compensation	3,900	4,776	11,360	13,240
Securities litigation expense	1,612	—	2,607	—
Related IPO and other transaction-related expenses ⁽¹⁾	—	—	—	12,160
Payroll tax expense related to stock-based compensation	14	123	81	135
Adjusted EBITDA	\$ (5,574)	\$ 1,330	\$ (20,951)	\$ 445

(1) Includes IPO-related costs, including transaction-related third-party expenses, which are generally incremental costs incurred associated with the preparation of the IPO.

Material Cash Requirements

As of September 30, 2022, there were no material changes to our material cash requirements from those described under “Management's Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q are prepared in accordance with GAAP. The preparation of condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ significantly from our estimates. To the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

Our critical accounting estimates are described under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates” in our Annual Report and the notes to the audited consolidated financial statements appearing in our Annual Report. During the three and nine months ended September 30, 2022, there were no material changes to our critical accounting estimates from those discussed in our Annual Report. Refer to Note 2 and 13 to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for a discussion of the adoption of ASC 842 and related policy changes.

Recent Accounting Pronouncements

Refer to Note 2 to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for a discussion of recently adopted accounting pronouncements and recently issued accounting pronouncements not yet adopted.

Emerging Growth Company Status

In April 2012, the JOBS Act was enacted. Section 107(b) of the JOBS Act provides that an emerging growth company can take advantage of an extended transition period for complying with new or revised accounting standards. Thus, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to take advantage of the extended transition period to comply with new or revised accounting standards and to adopt certain of the reduced disclosure requirements available to emerging growth companies. As a result of the accounting standards election, we are not subject to the same implementation timing for new or revised accounting standards as

other public companies that are not emerging growth companies which may make comparison of our financials to those of other public companies more difficult.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Under SEC rules and regulations, as a smaller reporting company, we are not required to provide the information required by this item.

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 in the reports that we file or submit under the Exchange Act is (1) recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms and (2) accumulated and communicated to our management, including our principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated, as of the period ended September 30, 2022, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on that evaluation, 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 that occurred during the quarter ended September 30, 2022 that has materially affected, or is reasonably likely to materially affect our internal control over financial reporting.

Limitations on Effectiveness of Controls and Procedures

In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

The information contained under the heading “Litigation” in Note 8 to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q is incorporated by reference into this Item.

Item 1A. Risk Factors.

RISK FACTOR SUMMARY

Our business is subject to numerous risks. The following summary highlights some of the risks you should consider with respect to our business and prospects. You should carefully consider the risks and uncertainties described in our Annual Report, together with all of the other information in this Quarterly Report on Form 10-Q, as well as our audited consolidated financial statements and related notes as disclosed in our Annual Report. The risks and uncertainties described in our Annual Report and in this Quarterly Report on Form 10-Q are not the only ones we face. Additional risk and uncertainties that we are unaware of or that we deem immaterial may also become important factors that adversely affect our business. The realization of any of these risks and uncertainties could have a material adverse effect on our reputation, business, financial condition, results of operations, growth and future prospects as well as our ability to accomplish our strategic objectives. In that event, the market price of our common stock could decline and you could lose part or all of your investment.

Some of the more significant risks we face include the following:

- We have incurred net losses each year since our inception and we may not be able to achieve or maintain profitability in the future.
- Our growth may not be indicative of our future growth and we may not be able to effectively manage our growth or evaluate our future prospects. If we fail to effectively manage our future growth or evaluate our future prospects, our business could be adversely affected.
- Our quarterly operating results may fluctuate, which could cause our stock price to decline.
- Economic conditions, including a recession and inflationary pressures such as price increases in commodity prices, labor costs, input costs and transportation costs and their impact on consumer spending and our profit margin.
- Consolidation of retail customers, the loss of a significant retail or third-party ecommerce customer or a significant change in such customers' purchasing patterns could negatively impact our sales and ability to achieve or maintain profitability.
- Our business, including our costs and supply chain, is subject to risks associated with sourcing, manufacturing, warehousing and logistics, and the loss of any of our key suppliers or logistical service providers could negatively impact our business.
- We may not be able to compete successfully in our highly competitive market.
- If we fail to cost-effectively acquire new consumers or retain our existing consumers, our business could be adversely affected. Our sales and profit are dependent upon our ability to expand our existing consumer relationships and acquire new consumers.
- We must expend resources to maintain consumer awareness of our brand, build brand loyalty and generate interest in our products. Our marketing strategies and channels will evolve and our efforts may or may not be successful.
- Increasing scrutiny and evolving expectations from stakeholders with respect to our environmental, social and governance (ESG) practices, performance and disclosures.
- Our brand and reputation may be diminished due to real or perceived quality, safety, efficacy or environmental impact issues with our products, which could have an adverse effect on our business, financial condition, results of operations and prospects.
- Our ability to maintain our competitive position is largely dependent on the services of our senior management and other key personnel, including our founder and Chief Creative Officer, Jessica Warren and our Chief Executive Officer, Nick Vlahos.
- A disruption in our operations could have an adverse effect on our business.
- The COVID-19 pandemic has had and may continue to have an adverse effect on our business, financial condition, results of operations and prospects.
- We rely on third-party suppliers, manufacturers, retail and ecommerce customers and other vendors, and they may not continue to produce products or provide services that are consistent with our standards or applicable regulatory requirements, which could harm our brand, cause consumer dissatisfaction, and require us to find alternative suppliers of our products or services.
- Health and safety incidents or advertising inaccuracies or product mislabeling may have an adverse effect on our business by exposing us to lawsuits, product recalls or regulatory enforcement actions, increasing our operating costs and reducing demand for our product offerings.
- International trade disputes and the U.S. government's trade policy could adversely affect our business.
- Our business may be adversely affected if we are unable to provide our consumers with a technology platform that is able to respond and adapt to rapid changes in technology.

RISK FACTORS

Other than the risk factors set forth below, there have been no material changes to the risk factors set forth in the section titled “Risk Factors” included in our Annual Report.

The COVID-19 pandemic and overall macro economic trends have had and may continue to have an adverse effect on our business, financial condition, results of operations and prospects.

In connection with the COVID-19 pandemic, governments have implemented significant measures, including closures, quarantines, travel restrictions and other social distancing directives, intended to control the spread of the virus. Companies have also taken precautions, such as requiring employees to work remotely or on a hybrid remote schedule, imposing travel restrictions and temporarily closing businesses. For example, due to new COVID-19 lockdown restrictions in China in the second quarter of 2022, many of the ports shut down which has negatively impacted and may in the future negatively impact our ability to timely receive shipments of our products. To the extent that additional prevention and mitigation measures are implemented in the future, or there is uncertainty about the effectiveness of these or any other measures to contain the spread of COVID-19, there has been and continues to be an adverse impact on global economic conditions and consumer confidence and spending, which has adversely affected our supply chain as well as the demand for our products and has impacted our revenue and ability to service our customer orders. For example, the out-of-stock inventory due to supply chain disruptions has been significant on several key items, particularly in our Skin and Personal Care and Diapers and Wipes product categories. While at this time we are working to manage potential disruptions to our supply chain, the fluid nature of the COVID-19 pandemic and uncertainties regarding the related economic impact, as well as overall macroeconomic trends, are likely to result in sustained market turmoil, which could also have an adverse effect on our business, financial condition, results of operations and prospects.

The impact of the COVID-19 pandemic and overall macroeconomic trends on any of our suppliers, manufacturers, retail or ecommerce customers or transportation or logistics providers has and may continue to negatively affect the price and availability of our materials and impact our supply chain. For example, there is a supplier shortage or significant demand of and cost impacts to various raw materials used in manufacturing and distributing our products, including tree-free paper, post-consumer recycled plastic resin, post-consumer recycled cardboard shipping cartons for our Honest.com shipments, surfactants, fluff pulp and other diaper raw materials and palm kernel oil. If the disruptions caused by the COVID-19 pandemic continue for an extended period of time, our ability to meet the demands of our consumers may be materially impacted. For example, government restrictions have limited and may in the future limit the personnel available to receive or ship products at our distribution centers. In addition, the conditions caused by the COVID-19 pandemic may negatively impact collections of accounts receivable, result in reduced orders from retail or digital partners or cause some of our retail customers to go out of business, all of which could adversely affect our business, financial condition, results of operations and prospects. Also, in the third quarter of 2022, some of our digital and retail customers began to reduce inventory on hand and have changed fulfillment schedules, which has negatively impacted our fulfillment operations and our revenue and is expected to continue to do so in the future. For example, Target implemented a new inventory management system to decrease weeks of supply on hand. Additionally, Amazon is holding fewer weeks of inventory supply on hand, which could impact the consumer experience and ultimate consumption, and has and could continue to negatively impact our results of operations.

In addition, any depression or recession resulting from the COVID-19 pandemic or other factors may adversely change customer and consumer behavior and demand, including with respect to our products, which could have an adverse effect on our business, financial condition, results of operations and prospects. For example, economic conditions, including inflationary pressures such as price increases in commodity prices, labor costs, input costs and transportation costs have impacted our profit margin and could impact consumer spending decisions to choose lower priced products, particularly as a result of our price increases intended to offset these input costs. We may not be able to increase our prices or productivity sufficient to offset these costs. Our Digital channel has been negatively impacted in recent periods as consumers return to in-store shopping and our Retail channel may be impacted if governments continue to implement regional business closures, quarantines, travel restrictions and other social distancing directives to slow the spread of the COVID-19 virus. Further, to the extent our third-party ecommerce or retail customers' operations are negatively impacted by the COVID-19 pandemic or other macroeconomic trends, our consumers may reduce demand for or spending on our products, or consumers or ecommerce or retail customers may delay payments to us or request payment or other concessions. There may also be significant reductions or volatility in consumer demand for our products due to travel restrictions or social distancing directives, as well as the temporary inability of consumers to purchase our products due to illness, quarantine or financial hardship, shifts in demand away from one or more of our products, decreased consumer confidence and spending or pantry-loading activity, any of which may negatively impact our business, including as a result of an increased difficulty in planning for operations. For example, based on macro Household and Wellness trends, consumer demand for sanitizing and disinfecting products has decelerated at a more rapid than expected rate as more consumers have become vaccinated and retailers continue to manage heavy inventories of sanitization and disinfecting products in stores. We recorded an inventory write-off of \$0.8 million during the nine months ended September 30, 2022 and \$5.6 million for the year ended December 31, 2021 relating to certain sanitization and disinfecting products as the amount of inventory was significantly in excess of existing demand, and we may record inventory write-offs in the future. Additionally, we may be unable to effectively modify our trade promotion and advertising activities to reflect changing consumer viewing and shopping habits due to event cancellations, reduced in-store visits and travel restrictions, among other things.

The extent of the COVID-19 pandemic's effect on our operational and financial performance will depend on future developments, including the duration and intensity of the COVID-19 pandemic and the impact of any new variants of COVID-19, all of which are uncertain and difficult to predict considering the rapidly evolving landscape. As a result, it is not currently possible to ascertain the overall impact of the COVID-19 pandemic on our business. However, if the pandemic continues to persist as a severe worldwide health crisis, the pandemic could continue to have an adverse effect on our business, financial condition, results of operations and prospects, and may also have the effect of heightening many of the other risks described in this "Risk Factors" section.

We rely on third-party suppliers, manufacturers, retail and ecommerce customers and other vendors, and they may not continue to produce products or provide services that are consistent with our standards or applicable regulatory requirements, which could harm our brand, cause consumer dissatisfaction, and require us to find alternative suppliers of our products or services.

We do not own or operate any manufacturing facilities. We use multiple third-party suppliers and manufacturers based primarily in the United States, China and Mexico and other countries to a lesser extent, to source, manufacture and partner with us for the innovation of all of our products, including product components, under our owned brand. We engage many of our third-party suppliers and manufacturers on a purchase order basis and in some cases are not party to long-term contracts with them. The ability and willingness of these third parties to supply, manufacture and to partner in innovation of our products may be affected by raw material availability and prices, competing orders placed by other companies and the demands of those companies. Our operating results have been negatively impacted by increases in the costs of manufacturing our products, and we have no guarantees that costs will not continue to rise. For example, some of our contracts with third-party manufacturers have clauses that trigger good faith renegotiation of purchase costs in the case of significant raw material cost escalation. In the fourth quarter of 2021, we were informed by two third-party manufacturers in our Diapers and Wipes and Skin and Personal Care categories, respectively, that those hurdles had been met. In addition, in the third quarter of 2022, we received requests from the same two third-party manufacturers to renegotiate purchase costs due to continued increases in raw material costs. As a result, we negotiated and agreed to higher purchase prices which will negatively impact our cost of goods in 2022 and we expect higher purchase prices in 2023, which will negatively impact our cost of goods in 2023, which we may not be able to offset with price increases. If we experience significant increases in demand, or need to replace a significant number of existing suppliers or manufacturers, there can be no assurance that additional supply and manufacturing capacity will be available when required on terms that are acceptable to us, or at all, or that any supplier or manufacturer will allocate sufficient capacity to us in order to meet our requirements. Furthermore, our reliance on suppliers and manufacturers outside of the United States, the number of third parties with whom we transact and the number of jurisdictions to which we sell complicates our efforts to comply with customs duties and excise taxes; any failure to comply could adversely affect our business.

In addition, quality control problems, such as the use of materials and delivery of products that do not meet our quality control standards and specifications or comply with applicable laws or regulations, could harm our brand and business or cause consumer dissatisfaction. For example, as disinfecting and sanitization products have faced supply chain challenges, decelerating market demand and aging and slower turning inventory, we have received some product quality complaints from customers and consumers that have resulted and may in the future result in additional refunds, returns, write-offs and remediation costs. Remediation costs would be significant, including the cost to rework a product to be in sellable condition or the cost to destroy a product that cannot be remediated, and while immaterial as of September 30, 2022, it could have an adverse effect on our business, financial condition and results of operations. Quality control problems could result in regulatory action, such as restrictions on importation, products of inferior quality or product stock outages or shortages, harming our sales and creating inventory write-downs for unusable products.

We have also outsourced portions of our fulfillment process, as well as certain technology-related functions, to third-party service providers. Specifically, we rely on third parties in a number of foreign countries and territories, we are dependent on third-party vendors for credit card processing, and we use third-party hosting and networking providers to host our sites. The failure of one or more of these entities to provide the expected services on a timely basis, or at all, or at the prices we expect, or the costs and disruption incurred in changing these outsourced functions to being performed under our management and direct control or that of a third party, could have an adverse effect on our business, financial condition, results of operations and prospects. We are not party to long-term contracts with some of our retail and ecommerce customers, and upon expiration of these existing agreements, we may not be able to renegotiate the terms on a commercially reasonable basis, or at all.

Further, our third-party manufacturers, suppliers and retail and ecommerce customers may:

- have economic or business interests or goals that are inconsistent with ours;
- take actions contrary to our instructions, requests, policies or objectives;
- be unable or unwilling to fulfill their obligations under relevant purchase orders or manufacturing or supply agreements, including obligations to meet our production deadlines, quality standards, pricing guidelines and product specifications, and to comply with applicable regulations, including those regarding the safety and quality of products;
- have financial difficulties;

- encounter raw material or labor shortages;
- encounter increases in raw material or labor costs which may affect our procurement costs;
- encounter difficulties with proper payment of custom duties or excise taxes;
- disclose our confidential information or intellectual property to competitors or third parties;
- engage in activities or employ practices that may harm our reputation; and
- work with, be acquired by, or come under control of, our competitors.

Our results of operations could be harmed if we are unable to accurately forecast demand for our products.

To ensure adequate inventory supply, we must forecast inventory needs and place orders with our third-party manufacturers before firm orders are placed by our consumers or our retail and third-party ecommerce customers. If we fail to accurately forecast consumer and customer demand, we may experience excess inventory levels or a shortage of products to deliver to our consumers and customers. Factors that could affect our ability to accurately forecast demand for our products include: an unanticipated increase or decrease in consumer demand for our products, in particular due to rising consumer uncertainty in the current macroeconomic environment; our failure to accurately forecast acceptance for our new products; product introductions by competitors; unanticipated changes in general market conditions or other factors, which may result in cancellations of advance orders or a reduction or increase in the rate of reorders or at-once orders placed by retailers or the timing of their orders; the impact on demand due to unseasonable weather conditions; weakening of economic conditions or consumer or customer confidence in future economic conditions, which could reduce demand for discretionary items, such as our products; and terrorism or acts of war, or the threat thereof, or political or labor instability or unrest, which could adversely affect consumer or customer confidence and spending or interrupt production and distribution of product and raw materials. For example, we periodically participate in non-recurring retail rotational programs, including a key club retailer rotational program that was not renewed in 2022, and key retailer-specific programs or other customer test programs, which might not be successful or continue long-term, including a rotational program at Costco that has not been renewed for 2023, which could make forecasting demand for products in these programs challenging. Also, in the third quarter of 2022, some of our digital and retail customers began to reduce inventory on hand and have changed fulfillment schedules, which has negatively impacted our fulfillment operations and our revenue and is expected to continue to do so in the future. For example, Target implemented a new inventory management system to decrease weeks of supply on hand. Additionally, Amazon is holding fewer weeks of inventory supply on hand, which could impact the consumer experience and ultimate consumption, and has and could continue to negatively impact our results of operations.

Inventory levels in excess of consumer or customer demand have resulted and may result in inventory write-downs or write-offs and the sale of excess inventory at discounted prices or in less preferred distribution channels, which could impair our brand image and harm our business. For example, based on macro Household and Wellness trends, consumer demand for sanitizing and disinfecting products has decelerated at a more rapid than expected rate as more consumers have become vaccinated and retailers continue to manage heavy inventories of sanitization and disinfecting products in stores. We recorded an inventory write-off of \$0.8 million during the nine months ended September 30, 2022 and \$5.6 million for the year ended December 31, 2021 relating to certain sanitization and disinfecting products as the amount of inventory was significantly in excess of existing demand, and we may record inventory write-offs in the future. For example, during the three months ended September 30, 2022, we donated \$1.5 million of excess sanitization products. In addition, if we underestimate the demand for our products, our third-party manufacturers may not be able to produce products to meet our consumer or customer requirements, and this could result in delays in the shipment of our products and our ability to recognize revenue, lost sales, as well as damage to our reputation and retailer and distributor relationships. For example, the out-of-stock inventory due to supply chain disruptions has been significant on several key items, particularly in our Skin and Personal Care and Diapers and Wipes product categories.

The difficulty in forecasting demand also makes it difficult to estimate our future results of operations and financial condition from period to period. A failure to accurately predict the level of demand for our products could adversely affect our business, financial condition, results of operations and prospects.

We must expend resources to maintain consumer awareness of our brand, build brand loyalty and generate interest in our products. Our marketing strategies and channels will evolve and our efforts may or may not be successful.

In order to remain competitive and expand and keep market share for our products across our various channels, we may need to increase our marketing and advertising spending to maintain and increase consumer awareness, protect and grow our existing market share or promote new products, which could impact our operating results. Additionally, we may choose to change one of our marketing or advertising partners, which may prove to be unsuccessful. Substantial advertising and promotional expenditures may be required to maintain or improve our brand's market position or to introduce new products to the market, and we are increasingly engaging with non-traditional media, including consumer outreach through social media and web-based channels, which may not prove successful. An increase in our marketing and advertising efforts may not maintain our current reputation or lead to increased brand awareness. Further, social media platforms frequently change the algorithms that determine the ranking and display of results of a user's search and may make other changes to the way results are displayed, which may

negatively affect the placement of our links. Moreover, social media platforms and other digital advertising platforms have increased the costs of digital advertising which has made such marketing less cost effective and reduced the number of visits to our website and social media channels. In addition, social media platforms typically require compliance with their policies and procedures, which may be subject to change or new interpretation with limited ability to negotiate, which could negatively impact our marketing capabilities. If we are unable to maintain and promote a favorable perception of our brand and products on a cost-effective basis, our business, financial condition, results of operations and prospects could be adversely affected.

Our business, including our costs and supply chain, is subject to risks associated with sourcing, manufacturing, warehousing, distribution and logistics, and the loss of any of our key suppliers or logistical service providers could negatively impact our business.

All of the products we offer are manufactured by a limited number of third-party manufacturers, and as a result we have been and may continue to be subject to price fluctuations or demand disruptions. Our operating results have been negatively impacted by increases in the costs of manufacturing our products, and we have no guarantees that costs will not continue to rise. For example, some of our contracts with third-party manufacturers have clauses that trigger good faith renegotiation of purchase costs in the case of significant raw material cost escalation. In the fourth quarter of 2021, we were informed by two third-party manufacturers in our Diapers and Wipes and Skin and Personal Care categories, respectively, that those hurdles had been met. In addition, in the third quarter of 2022, we received requests from the same two third-party manufacturers to renegotiate purchase costs due to continued increases in raw material costs. As a result, we negotiated and agreed to higher purchase prices which will negatively impact our cost of goods in 2022 and we expect higher purchase prices in 2023, which will negatively impact our cost of goods in 2023, which we may not be able to offset with price increases. We have also continued to experience record-high freight and shipping costs. As we expand into new categories and product types, we expect that we may not have strong purchasing power in these new areas, which could lead to higher costs than we have historically seen in our current categories. We may also be limited in our ability to pass increased costs on to consumers, which could adversely affect our operating results. Moreover, in the event of a significant disruption in the supply of the materials used in the manufacture of the products we offer, we and the vendors that we work with might not be able to locate alternative suppliers of materials of comparable quality at an acceptable price.

Products and merchandise we receive from manufacturers and suppliers may not be of sufficient quality or free from damage, or such products may be damaged during shipping, while stored in our warehouse fulfillment centers or with third-party ecommerce or retail customers or when returned by consumers. We may incur additional expenses and our brand or reputation could be harmed if customers or consumers and potential consumers believe that our products do not meet their expectations, are not properly labeled or are damaged. For example, as disinfecting and sanitization products have faced supply chain challenges, decelerating market demand and aging and slower turning inventory, the Company has received some product quality complaints from customers and consumers that have resulted or may result in additional refunds, returns, write-offs and remediation costs.

We purchase significant amounts of product supply from a limited number of suppliers with limited supply capabilities. There can be no assurance that our current suppliers will be able to accommodate our anticipated growth or continue to supply current quantities at preferential prices. An inability of our existing suppliers to provide materials in a timely or cost-effective manner could impair our growth and have an adverse effect on our business, financial condition, results of operations and prospects. For example, Valor Brands LLC (dba Ontex North America), or Ontex, which manufactures and supplies certain diaper products for us, have opened a new manufacturing facility in North Carolina and its new facility may not be able to manufacture our diapers in a timely, cost-effective manner or meet our quality standards. In addition, we do not maintain long-term supply contracts with many of our suppliers and these suppliers could discontinue selling to us at any time. However, we have a long-term supply agreement with Ontex for the manufacture and supply of certain diaper products. The current term of the supply agreement with Ontex ends on December 31, 2023. In addition, our agreement with Ontex provides that Ontex will be our exclusive supplier of diaper and training pant products so long as Ontex is able to provide us such products. Either party may terminate the agreement if the other party materially breaches the agreement and does not cure the breach within a specified notice period, or upon the other party's insolvency. If the agreement with Ontex is terminated, is not renewed, or if Ontex becomes insolvent, ceases or significantly reduces its operations or experiences financial distress, as a result of the COVID-19 pandemic or otherwise, or if any environmental, economic or other outside factors impact their operations, our ability to procure diaper manufacturing services may be impaired, and we may not be able to obtain, or may face increased costs related to, such services. The loss of Ontex, or of any of our other significant suppliers, or the discontinuance of any preferential pricing or exclusive incentives they currently offer to us could have an adverse effect on our business, financial condition, results of operations and prospects.

We continually seek to expand our base of suppliers, especially as we identify new products that necessitate new or additional materials. We also require our new and existing suppliers to meet our ethical and business partner standards. Suppliers may also have to meet governmental and industry standards and any relevant standards required by our consumers, which may require additional investment and time on behalf of suppliers and us. If any of our key suppliers becomes insolvent, ceases or significantly reduces its operations or experiences financial distress, as a result of the COVID-19 pandemic or otherwise, if any environmental, economic or other outside factors impact their operations or if we are unable to identify or enter into distribution relationships with new suppliers or to replace the loss of any of our existing suppliers, we may experience a competitive disadvantage, our business may be disrupted and our business, financial condition, results of operations and prospects could be adversely affected.

Our principal suppliers currently provide us with certain incentives such as volume purchasing, trade discounts, cooperative advertising and market development funds. A reduction or discontinuance of these incentives would increase our costs and could reduce our ability to achieve or maintain profitability. Similarly, if one or more of our suppliers were to offer these incentives, including preferential pricing, to our competitors, our competitive advantage would be reduced, which could have an adverse effect on our business, financial condition, results of operations and prospects.

In addition, we have warehouse fulfillment centers located in Las Vegas, Nevada, Breinigsville, Pennsylvania and the Netherlands, all of which are managed by a single distribution partner, GEODIS Logistics LLC, or GEODIS. We have an agreement with GEODIS pursuant to which GEODIS provides warehousing, distribution and fulfillment services to us. Our agreement with GEODIS may be terminated for any reason by us or by GEODIS on delivery of prior written notice, and is renewable on an annual basis. If the agreement with GEODIS is terminated, is not renewed or if one fulfillment center is consolidated into another warehouse fulfillment center or if GEODIS becomes insolvent, ceases or significantly reduces its operations or experiences financial distress, as a result of the COVID-19 pandemic or otherwise, or if any environmental, economic or other outside factors impact their operations, our ability to procure warehousing, distribution and fulfillment services may be impaired, and we may not be able to obtain, or may face increased costs related to, such services and our business, financial condition, results of operations and prospects could be adversely affected. For example, we are negotiating the renewal of our agreement with GEODIS for services at our Las Vegas, Breinigsville and Netherlands fulfillment centers. If we are not successful negotiating that renewal, our business, financial condition, results of operations and prospects could be adversely affected. As part of these negotiations GEODIS may pass on increased service and inflation related costs to us, including warehouse labor cost, which would negatively impact our cost of revenue.

We are subject to international business uncertainties.

In 2021, international sales represented 2% of total revenue and part of our strategy is to accelerate growth outside of the United States. In addition, our business relies on third-party suppliers and manufacturers located in China, Mexico, and certain other foreign countries. We intend to continue to sell to consumers outside the United States and maintain our relationships in China, Mexico, and other foreign countries where we have suppliers and manufacturers. Further, we may establish additional relationships in other countries to grow our operations. The substantial up-front investment required, the lack of consumer awareness of our products in jurisdictions outside of the United States, differences in consumer preferences and trends between the United States and other jurisdictions, the risk of inadequate intellectual property protections and differences in packaging, labeling and related laws, rules and regulations are all substantial matters that need to be evaluated prior to doing business in new territories. We cannot be assured that our international efforts will be successful. International sales and increased international operations may be subject to risks such as:

- difficulties in staffing and managing foreign operations and geographically dispersed operations;
- burdens of complying with a wide variety of laws and regulations, including more stringent regulations relating to data privacy and security, particularly in the European Union;
- adverse tax effects and foreign exchange controls making it difficult to repatriate earnings and cash;
- political and economic instability;
- terrorist activities and natural disasters;
- trade restrictions;
- differing employment practices and laws and labor disruptions;
- the imposition of government controls;
- an inability to use or to obtain adequate intellectual property protection for our brand and key products;
- difficulties in enforcing contracts and legal decisions;
- tariffs and customs duties and the classifications of our goods by applicable governmental bodies;
- a legal system subject to undue influence or corruption;
- a business culture in which illegal sales practices may be prevalent;
- logistics and sourcing; and
- military conflicts.

The occurrence of any of these risks could have an adverse effect on our international business and consequently our overall business, financial condition, results of operations and prospects.

In addition, following Russia's military invasion of Ukraine in February 2022, the United States, European Union, and other nations announced various sanctions against Russia and Belarus. The invasion of Ukraine and the retaliatory measures that have been taken, and could be taken in future, by the United States, NATO, and other countries have created global security concerns that could result in a regional conflict and otherwise have a lasting impact on regional and global economies and supply chains, any or all of which could adversely affect our business, financial condition, results of operations and prospects. For example, although we don't rely directly on Russia for oil supplies, the suppliers we do source oil from could pass on price increases to us, as a result of the overall increase in oil prices. In addition, Russia's invasion of Ukraine has impacted the availability of sunflower seed oil and its derivatives, which are used in a number of our Skin and Personal Care products, and has resulted in heightened demand for replacement ingredients, such as palm kernel oil, which have availability constraints or are subject to trade restrictions. While we believe we have supply assurances or alternate sources of supply for both sunflower seed oil, its derivatives and palm kernel oil, additional market availability constraints of these raw materials could have an adverse effect on our business, financial condition, results of operations and prospects. Additionally, Russia's military invasion has increased the cost of energy in the European Union, which has impacted the cost of raw material component parts from our European Union manufacturers, including the cost of fluff-pulp, a key ingredient in the manufacturing of our diapers. These price increases have led to additional price increase requests from our manufacturers on our diapers, which could lead to additional price increases from us and negatively impact consumer demand. We may also have to seek a raw material replacement, which could impact the timing of new innovation.

Consolidation of retail customers, the loss of a significant retail or third-party ecommerce customer or a significant change in such customer's historical purchasing patterns could negatively impact our sales and ability to achieve or maintain profitability.

Our omnichannel strategy includes selling our products through third-party ecommerce and retail customers (including their websites), which have been undergoing consolidation in recent years. This consolidation has produced larger, more sophisticated organizations with increased negotiating and buying power that are able to resist price increases, demand higher levels of marketing and promotional support, operate with lower inventories, decrease the number of brands that they carry and increase their emphasis on private label products, all of which could negatively impact our business.

We sell products to Target and Amazon under each of their standard vendor agreements. Our vendor agreements with Target and Amazon do not include a term or duration as sales under each vendor agreement are generally made on a purchase order basis. Our vendor agreement with Amazon provides that either party may terminate the agreement with 60 days' prior written notice, provided that we are required to fulfill any purchase orders that we accept before the effective date of termination. Our vendor agreement with Target does not include any termination provisions. The loss of Target and Amazon or any other large customer, the reduction of purchasing levels or the cancellation of any business from Target and Amazon or any other large customer for an extended length of time could negatively impact our sales and ability to achieve or maintain profitability. For example, Target implemented a new inventory management system to decrease weeks of supply on hand. Additionally, Amazon is holding fewer weeks of inventory supply on hand, which could impact the consumer experience and ultimate consumption, and has and could continue to negatively impact our results of operations.

A third-party ecommerce or retail customers may take actions that affect us for reasons that we cannot always anticipate or control, such as their financial condition, changes in their business strategy or operations, the introduction of competing products or the perceived quality of our products. In the second quarter of 2021, we experienced volatility in orders from a key digital customer that reduced its inventory on-hand in consumables to free up space for other products ahead of a major promotional event. Despite operating in different channel segments, our third-party ecommerce and retail customers sometimes compete for the same consumers. Because of actual or perceived conflicts resulting from this competition, third-party ecommerce or retail customers may take actions that negatively affect us. Consequently, our financial results may fluctuate significantly from period to period based on the actions of one or more significant third-party ecommerce or retail customers.

We must successfully maintain, scale and upgrade our information technology systems, and our failure to do so could have an adverse effect on our business, financial condition, results of operations and prospects.

We have identified the need to significantly expand, scale and improve our information technology systems and personnel to support recent and expected future growth. As such, we are in the process of implementing, and will continue to invest in and implement, significant modifications and upgrades to our information technology systems and procedures, including replacing legacy systems with successor systems, making changes to legacy systems or acquiring new systems with new functionality, hiring employees with information technology expertise and building new policies, procedures, training programs and monitoring tools. These types of activities subject us to inherent costs and risks associated with replacing and changing these systems, including impairment of our ability to leverage our Retail channel or fulfill customer orders, potential disruption of our internal control structure, substantial capital expenditures, additional administration and operating expenses, the need to acquire and retain sufficiently skilled personnel to implement and operate the new systems, demands on management time, the introduction of errors or vulnerabilities and other risks and costs of delays or difficulties in transitioning to or integrating new systems into our current systems. These implementations, modifications and upgrades may not result in productivity improvements at a level that outweighs the costs of implementation, or at all. Additionally, difficulties with implementing new technology systems, delays in our timeline for planned improvements, significant system failures, or our inability to successfully

modify our information systems to respond to changes in our business needs may cause disruptions in our business operations and could have an adverse effect on our business, financial condition, results of operations and prospects. For example, we recently replaced our order management system. If we experience any difficulties with this new system, we may encounter problems with fulfilling customer orders, which could have an adverse effect on our business.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.**EXHIBIT INDEX**

Exhibit Number	Exhibit Description
3.1	Amended and Restated Articles of Incorporation, as currently in effect (incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K (File No. 001-40378), filed with the SEC on May 11, 2021).
3.2	Amended and Restated Bylaws, as currently in effect (incorporated herein by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K (File No. 001-40378), filed with the SEC on May 11, 2021).
10.1 †	Amendment Twenty One to the Logistics Services Agreement, dated as of September 2, 2022, by and between the Company and Geodis Logistics, LLC.
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1 *	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2 *	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	Inline XBRL Instance Document
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)

* Furnished herewith and not deemed to be "filed" for purposes of Section 18 of the Exchange Act, and shall not be deemed to be incorporated by reference into any filing under the Securities Act, or the Exchange Act (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

† Portions of this exhibit (indicated by asterisks) have been omitted because the registrant has determined that the information is both not material and is the type that the registrant treats as private or confidential.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 10, 2022

The Honest Company, Inc.
By: /s/ Nikolaos Vlahos

Nikolaos Vlahos
Chief Executive Officer and Director
(Principal Executive Officer)

Date: November 10, 2022

By: /s/ Kelly J. Kennedy

Kelly J. Kennedy
Executive Vice President, Chief Financial Officer
*(Principal Financial Officer and
Accounting Officer)*

AMENDMENT TWENTY-ONE TO THE LOGISTICS SERVICES AGREEMENT

This **AMENDMENT TWENTY-ONE TO THE LOGISTICS SERVICES AGREEMENT** (the “Amendment”), dated as of September 2, 2022, is by and between The Honest Company, Inc. (“CLIENT”) and GEODIS Logistics LLC (“GEODIS”). CLIENT and GEODIS each individually a “Party” and collectively referred to herein as the “Parties.”

RECITALS:

- A. The Parties entered into that certain Logistics Services Agreement dated January 31, 2014, as amended from time-to-time (collectively the “Agreement”);
- B. GEODIS currently provides warehousing, distribution, and fulfillment services for CLIENT at the CLIENT-leased facility located at 5550 Donovan Way, North Las Vegas, NV 89081 (the “Las Vegas Facility”) and the Initial Term of services at the Las Vegas Facility is set to expire September 2, 2022, pursuant to Amendment Twenty to the Agreement;
- C. GEODIS also provides warehousing, distribution, and fulfillment services for CLIENT at the GEODIS-leased facility located at 651 Boulder Drive, Breinigsville, PA 18031 (the “PA Facility”) and the Initial Term of services at the PA Facility is set to expire February 28, 2023, pursuant to Amendment Eighteen to the Agreement; and
- D. The Parties desire to amend the Agreement as set forth herein.

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties agree to amend the Agreement with respect to the Las Vegas Facility and the PA Facility as follows:

1. Las Vegas Facility.

- 1.1. Extension.** The Initial Term of the Agreement, as set forth in Amendment Twenty to the Agreement, is hereby extended from September 2, 2022, through December 31, 2022.

2. PA Facility.

- 2.1. PA Racking Install.** To support the Services at the PA Facility, CLIENT requires additional racking to be installed (which shall be CLIENT-owned equipment), and the installation of the racking requires additional IT infrastructure. CLIENT shall pay the costs associated with the rack install up to a maximum of [***] and the costs associated with the additional IT infrastructure up to a maximum of [***]. These amounts will be billed to CLIENT as incurred and shall be due to GEODIS by CLIENT pursuant to Section 5(C) – Invoices and Payment Terms of the Agreement.

- 3. Future Amendment of the Agreement.** The Parties shall use their respective good faith efforts to negotiate and enter into a mutually acceptable amendment (the “Future Amendment”) to the Agreement which shall extend the Term of the Services at both the Las Vegas Facility and the PA Facility, provide a backstop agreement for the warehouse lease renewal, and address the annual and exceptional review of rates. The Parties will endeavor to complete the Future Amendment on or before December 31, 2022.

4. Any capitalized terms not defined herein shall have the meanings set forth in the Agreement and its amendments. Except as provided herein, the Agreement shall remain unchanged and in full force and effect in accordance with its terms. It is specifically understood and agreed that the foregoing shall not be deemed to be a waiver or amendment of any other provision of the Agreement or either Party's rights or remedies under the Agreement.

IN WITNESS WHEREOF, the Parties hereto have executed this Amendment as of the date set forth above.

THE HONEST COMPANY, INC.

By: /s/ Kelly Kennedy

Name: Kelly Kennedy

Title: Chief Financial Officer

Date: 9/6/2022

GEODIS LOGISTICS LLC

By: /s/ Anthony Jordan

Name: Anthony Jordan

Title: Chief Operating Officer

Date: 9/6/2022

[Signature Page to Amendment 21 to the LSA]

CERTIFICATION

I, Nikolaos Vlahos, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of The Honest Company, 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 officers 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)) 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) [Omitted];
 - (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; and
5. The registrant's other certifying officer(s) 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 10, 2022

By: /s/ Nikolaos Vlahos

Nikolaos Vlahos
Chief Executive Officer and Director
(Principal Executive Officer)

CERTIFICATION

I, Kelly J. Kennedy, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of The Honest Company, 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)) 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) [Omitted];
 - (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; and
5. The registrant's other certifying officer(s) 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 10, 2022

By: /s/ Kelly J. Kennedy

Kelly J. Kennedy
Executive Vice President, Chief Financial Officer
(Principal Financial Officer and Accounting Officer)

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

In connection with the Quarterly Report on Form 10-Q of The Honest Company, Inc. (the "Company") for the period ended September 30, 2022 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Nikolaos Vlahos, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2022

By: /s/ Nikolaos Vlahos

Nikolaos Vlahos
Chief Executive Officer and Director
(Principal Executive Officer)

This certification shall not be deemed "filed" for purposes of Section 18 of the Exchange Act or otherwise subject to the liability of Section 18 of the Exchange Act. Such certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.

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

In connection with the Quarterly Report on Form 10-Q of The Honest Company, Inc. (the “Company”) for the period ended September 30, 2022 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Kelly J. Kennedy, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2022

By: /s/ Kelly J. Kennedy

Kelly J. Kennedy
Executive Vice President, Chief Financial Officer
(Principal Financial Officer and Accounting Officer)

This certification shall not be deemed “filed” for purposes of Section 18 of the Exchange Act or otherwise subject to the liability of Section 18 of the Exchange Act. Such certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.