Crocs, Inc.

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Abbie Zvejnieks: Alright, I think we can go ahead and get started. We have Andrew Rees, CEO of Crocs; and Anne Mehlman, CFO of Crocs. And I'm Abbie Zvejnieks, I'm Senior Analyst covering Global Lifestyle Brands, Athletic and Footwear. So, this is a really fun brand. I'm sure many of you have them in your home, your children have them, and it's one of our top ideas this year. So with that, I'll let you give your opening remarks.

Andrew Rees: Thank you. Thanks for coming to visit with us today, so I will be able to tell you a little bit more about Crocs.

In terms of opening remarks, I think I'll just crank at the stage by saying our business is performing really well. You've seen our results through Q2. The Crocs brand continues to grow this year on top of an incredible growth last year. We're very, very excited about the acquisition of HEYDUDE. We've completed that transaction late last year. We're in the throes of integrating, but also rapidly growing that brand. And we're really excited with the performance to date, but probably more excited about the prospects to the future.

And then if you look at back to school, which we're just kind of wrapping up, that also went extremely well. And we look at this performance on the Crocs brand. We are definitely seeing continued growth trajectory on Crocs. We're seeing incredible acceptance to HEYDUDE as we expand distribution into a broader set of channels.

So, we're happy with the performance, and then think very positive about the future.

As we look into the future, both of our brands, we think are incredible well-positioned even given a potentially uncertain future in terms of kind of consumer spending and consumer enthusiasm. Both brands leverage comfort for the consumer. They both sell at very approachable price points. And we think comfort and value are two incredible attributes to the consumers looking for on a global basis.

We most recently - we've outlined, I think, the growth potential for the Crocs brand. We had investor conference late last year. There's a very detailed investor presentation that lays out the strategy for Crocs. We're committed and continue to remain very positive about the prospect of growing a Crocs brand to $5 billion by 2026. We haven't given longer term guidance for HEYDUDE yet. We still have a lot to learn about that brand. But we think the potential for HEYDUDE is very significant.

So, we're excited to be here. Thank you for joining us.

Abbie Zvejnieks: Great. So, maybe we'll start. For those who are newer to the story, can you please give a quick recap of the Crocs brand turnaround and explosive growth that you've seen, I mean, even starting back before the pandemic? And then talk a little bit about the acquisition of HEYDUDE and what you think that really brings to the portfolio?

Andrew Rees: Yes. So, Crocs has had a - actually, this year is the 20th anniversary of the Crocs brand. So, it started in 2002. So it is as relatively young company. And it's been through a number of phases during that period.

The first phase was kind of that entrepreneurial growth phase, going in public in 2006. That culminated in the financial crisis in 2008 where there were some issues over distribution, et cetera. So, that was kind of the first growth phase.

The second growth phase was really all about international growth. And that was 2009 through 2014 when the Crocs brand penetrated the broader global market and built distribution all through Asia and all through EMEA.

That distribution was not built, I would say on the (solid) foundation. A lot of it was very expensive distribution. So, starting in 2014, when I joined the company, when Blackstone made a substantial investment, we went to a very substantial turnaround. And that turnaround was about rightsizing the SG&A of the company. We took out $80 million of SG&A. We've pointed the distribution towards both digital and wholesale. We have a lot stronger variable cost structure. And it was also repositioning the brand relative to the consumers. So, focusing back on the core (clog), focusing on the core mode of products where the DNA of the company sits, and then really investing in marketing to engage the consumer.

One of the mantras that we had during that time period was that we didn't have an awareness problem. Everybody knows who Crocs is. But if you look at the global awareness for Crocs, it's similar to a global megabrand. It's similar to an Apple. It's similar to a Disney, it's similar to a Coke. We don't have an awareness problem. What we have is a relevance problem. And we focus on digital marketing, we focus on influencer marketing, we use celebrities, we use collaborations, we use very innovative marketing vehicles to really engage the consumer on developments. And that's what we've been doing for the last several years.

So, that rightsizing the SG&A gives us the opportunity to get operating leverage, and then igniting the brand and (unintelligible) relevance allowed us to grow, obviously has resulted in dramatic rise - sorry, strong sales growth and dramatic increases in profitability. So, that kind of gets us to today, Abbie.

And then late last year, we bought HEYDUDE. I mentioned a little bit about that in my kind of introductory remarks. And what we're really doing there is looking to buy a brand that we thought had very strong growth potential. It was meeting some of the same consumer needs that we really felt like we understood very strongly around comfort and value. It was selling to a similar customer to Crocs but for different wearing occasions. So we felt like we could reach those customers very efficiently and effectively.

And then from an investor's perspective, we're providing some risk mitigations relative to the Crocs brand. We're adding a different brand which has a different consumer wearing occasion and trajectory. So, I think it's a very important move from an investor's perspective.

Abbie Zvejnieks: Yes. So, we took some mixed commentaries from some of the footwear retailers that have reported that Crocs isn't called out as a strong performer. So, you said back to school is strong, but are you seeing any shift in terms of consumer preferences, a more casual footwear, or maybe lower price points?

Andrew Rees: Yes, look, we were pleased with back to school. And we kind of look at it in a number of different ways. One was our own DTC selling. So, our selling through digital channels, and also selling through the stores that we operate.

I'm primarily talking about United States. That's where it's the biggest phenomenon. Obviously, it's relevant in the other parts of Western Europe. But it's the biggest phenomenon here in the U.S. So, we saw a strong DTC performance. So, we saw strong traffic, strong conversions, and really strong performance.

But we also saw strong performance in wholesale. And if you look at our wholesale business, what's different about this back to school though is, so last year, as we felt we were in a really good stock position. Last year, back to school, I think was challenging for a lot of the wholesale customers because it didn't have inventory. It didn't have inventory from us. It didn't have inventory from other people. So, they're in a much stronger inventory position. They're in a really strong inventory position from Crocs. And we really focus on sell outs and making sure that we were getting the liquidation of that inventory position that we wanted. And that was really strong.

We definitely sold out more than we sold in, which was deliberate. We wanted to bring inventory levels down as we go into the back half of the year. So, back to school was good.

I would say into your kind of question, we did definitely see some shifts a little bit. There are some consumers and customers that I think are under

pressure. The lower end consumer feels like they're under pressure. They're spending a little bit less. They're spending more cautiously. They buy more on discounts. But the broader consumer, I think, is pretty healthy still. So, I think we performed well.

I suspect we performed - well, I think we know we performed better than the market. We're seeing some market data. And I think we've probably performed better than most other footwear brands out there.

Abbie Zvejnieks: Great. And then maybe I'm going to quickly jump on the inventory levels. So like, can you just talk about your inventory levels, inventory levels across the industries? And then, how are you looking maybe, to promotional environment?

Andrew Rees: You want to touch on inventory?

Anne Mehlman: Sure. So, I think from an inventory perspective related Crocs, I can see HEYDUDE is in a little bit of a different situation - but really with Crocs, is we've definitely seen elevated inventories this year compared to last year, as we were very stocked out last year. So, that's part of it. The second piece is we continue to see long in-transit times, so we have a lot of inventories still on the water.

Mostly in Americas, I would say inventory is a little bit heavier than where we anticipate it being. So, we're working to bring that down through the end of the year.

Our target is to turn four times a year. So, we're still around the target ranges, but we're very focused on turning four times a year. So, we'll see that kind of moderate.

I think overall from an industry level, there is a lot of inventory in the market. You can see it in everybody's inventory data. And is driving some promotions, especially - Andrew talked about this a little bit earlier at meeting - but some of the larger footwear companies have a lot of inventory that came in late. And so they're having to liquidate a lot of that. So, that is driving more

promotional environments this year versus last year. But last year was a historically low level of promotions.

For us, when you think about that and what that means for us from a margin perspective, because we will participate in promotional events to make sure that we maintain our market share. We think about impact of our margins. The impact of the lower level promotions last year versus kind of 2018 and our overall gross margin rebuild is less than 150 basis points. So, obviously we sell all over the world, so that's really big, U.S. impact of that.

Abbie Zvejnieks: Got it. Maybe on that point, looking at margins, the operating margin has increased dramatically since kind of 2018 (wholesale). Can you talk about what is structural in nature here versus transitory like the promotions, and kind of what is factored into your expectation of operating margin of 26% plus from a long-term goal?

Anne Mehlman: Yes, absolutely. So, 26% plus is our operating margin guide long-term. This year, we're going to be between 26% and 27%. So, we talked about that last year we are a little higher. So, there is - it will vary a little bit. But we feel really good about overall that level.

And we talked about that, and Andrew talked about the history and how we rebuilt Crocs, there's two pieces.

So, from a gross margin standpoint, gross margin, I think about a thousand basis points from 2018. And really what that is, is really the rebuild of the brand. So, as we rebuilt the brand, we focus on molded products, which is the most profitable piece of our product line. So, the biggest increase of margin is from where we are now to historical, is the molded products (unintelligible). So, both very profitable, and that's the product piece.

The second thing is we've been taking price in 2018. So, pre-pandemic, we started moving up prices. Starting in 2018, the classic Croc is about $35. And we've moved it steadily up to about $50 from a U.S. perspective. So, the pricing piece has also been part of the rebuild.

So, those are the two biggest pieces of margin. We talked the promotional level being 100, and roughly less than 150 basis points. So that's overall piece is just structural in nature.

And then the second piece of that is SG&A. So as Andrew talked about, we carved out $80 million. We've reinvested. We stood that through clothing retail stores and reducing fixed SG&A, and reinvesting that into flexible SG&A, and to make our base scalable.

So as we grow revenue in markets, especially in subscale markets, we drive a lot of leverage. And you've seen us do that, and you've seen us being able to leverage our revenue growth every single year since 2018.

So, two pieces. And that's led us to be able to maintain best-in-class operating margins.

Abbie Zvejnieks: Great. Maybe focusing on the Crocs brand. You continue to gain market share in a more difficult environment. And so we're seeing strength in molded footwear across the industry, which is really the DNA of the Crocs brand. So, can you just talk about the growth trajectory of the business? What are the biggest levers across product channel, geographies in the longer term?

Andrew Rees: Yes. Great question, Abbie. So, yes, when you go out in a market place, you see a lot more molded footwear from Crocs, but also from lots of different brands. And to be honest, we embrace that and we think that's an incredibly good thing for us as the leader in molded footwear, right.

I think what it's doing is educating the consumer that molded can give them incredible benefits, right. It can give them color, it can give them comfort, it can give them very often value because that is a cheaper product to make. And it's also incredibly durable and easy to maintain, right. So there's a lot of benefits to molded. So we're seeing it penetrate the market. And we think that will sustain, right.

And just as we - if you look at other product categories where the consumer has discovered new materials and the materials are superior to the existing materials, they've penetrated the category and they sustain that penetration.

So, we're seeing that, and we think the innovation that's coming into molded is incredibly powerful.

In terms of our growth trajectory, so I can talk about it on kind of multiple dimensions. If you think about products, we're going to continue to invest in the clogs. That's the core of our business. That's what we're known for. But there were many versions of the clog. The classic has been what's driven the business for the last several years. You will see us continue to innovate in that, and we'll have new clogs that have new wearing occasions, different price points and orientated to different consumers.

We will invest in sandals. That's a key growth category for us. Not had the greatest sandal year this year, but we see lots of potential in the market. And we have a lot of innovation coming for sandals in next year and beyond. And then also Jibbitz.

And so our kind of core product platforms that we really focus on the last several years, we think have a lot of continued runway. And you will see us also experiment with other platforms and really understand whether it's - it looks like flats are coming back as a silhouette. We've historically had a good flats business, so we think that's an opportunity. And we think there are other opportunities.

From a channel perspective, we're very focused on digital. Digital is a premier channel. We want to win in digital both here in the U.S. and internationally.

And then we also embrace wholesale. We're not a company that's trying to shift strategy to DTC. We think wholesale is an incredibly important part of our distribution. We sell to a very broad range of consumers that's very democratic consumer base. And we don't think we can afford to or (suppress) business model for us to reach them all directly. We want to leverage wholesale partners and leverage their capital and their stores and their digital sites to reach a broad base of consumers.

If you think about globally, we do anticipate that our growth will be less in the U.S. and more internationally in the future. We've penetrated a lot of the U.S.

market. We still think we have growth in U.S. market. But the fastest growth rate will be in Asia and also in our EMEALA market, which is Europe, Middle East, Africa, and Latin America. And we're focused on those foreign markets. So, the international markets, as a brand, we're underpenetrated in most of those markets.

So, in a nutshell, I think it's a very similar product strategy that we pursue. It's a very similar channel strategy. But the way of growth will shift to the international markets versus the U.S. markets.

Abbie Zvejnieks: Yes, let's talk about the international market a little bit. So, can you talk about what you're doing to grow the business there, what products and marketing techniques are really resonating back to consumer? And then maybe just a little bit of an update on China.

Andrew Rees: Yes, absolutely. So, I would say from how we're igniting those international markets, it's the same playbook that we use here in the U.S. It's a very similar product strategy. We're using a very similar marketing strategy. We are doing local collaborations. We're using local influencers. We're doing some localizations of the product. But the core backbone of what we do, what we've done here in the U.S. and in many other markets, it's the same scalable strategy. We're seeing that work pretty much everywhere. We don't really have any sort of soft spots where we're seeing it's not going to work in that place. But they're on different timelines and different cadences.

And one of the beautiful things I think about a digital and socially-orientated marketing strategy, it does sort of organically spread around the world. The consumer is connected. And so we do see some benefits from marketing spend potentially here in the U.S. and some key Asia - key international markets. Other markets, you have to spend, I think deliberately in that marketplace. So, it's very much the same strategy that's why we have a lot of confidence around it, and why we see it working.

China, we will see strong growth in Asia this year, our Asia region really, despite China. Obviously, the COVID lockdowns and the zero COVID policy

made doing business in China, I think, pretty challenging. And we're seeing a change from week to week, to be quite honest.

I think a couple of weeks ago, we were getting optimistic that the lockdowns were subsiding. But just over the last two weeks, we've seen actually the lockdowns increased substantially. So, as we look at the China marketplace, doing business today is hard, and that's certainly holding us back. If we try and read through that to the trajectory of the brand and the connectivity of the brand to the consumer, we feel like we're making some really strong progress there.

We've continued to spend our marketing in China despite lockdowns because we really want to continue to build around momentum. We've done reaching collaborations in the China market that has been successful. And we feel like the brand is seeing a positive trajectory in that market. But it's hard for it to come through in kind of dollars and cents because there's fewer and fewer places for the consumer to actually transact.

Abbie Zvejnieks: Got it. Maybe in Jibbitz, this is one of kind of more fund pieces of the business in terms of profitability, in terms of consumer engagement. So, where are you kind of in that goal to double Jibbitz revenue? And then are you seeing uptick of Jibbitz on kind of the non-clog products, like sandals?

Andrew Rees: Yes. So, Jibbitz is super fun, right? So, for those of you who don't know what Jibbitz is, it's the character, or the item that you put through the holes in your shoes. We sell them as an aftermarket add-on. There are 26 holes in a pair of clogs, so 13 in each shoe. So if you fully load that 16 Jibbitz, so it more than doubles the value of the clog, and it's very high margin.

But the most important thing about Jibbitz is it gives you an opportunity to create a much stronger emotional bond with the consumer, right? So, if they're buying a pair of white clogs, they're buying a pair of white clogs like everybody else, right? But as soon as they start adding Jibbitz to those, they're creating a purchase that is uniquely theirs that nobody else in the world has. So, it creates a very strong emotional connection.

To your question, Abbie, we're absolutely on track with our goal to double the Jibbitz business. I would given our very strong growth in '20 and '21, we're probably a little bit ahead of the track that we felt we're going to be on. And as we look at the business, we continue to invest in it. We want to get (sales) faster. We do a lot of social listening relative to what's current with the consumers, and looking to react to that social listening much, much faster than in the past, and have products in the marketplace that they can - the consumer can buy and customize their shoes.

In terms of spreading it beyond the clog, one of our most successful sandal platforms this year was the classic sandal and the classic slide, the two strap and the flip - sorry, the two strap, the flip and the slide. They're all Jibbitable. And we've seen strong uptake from the consumer in terms of Jibbitz in those.

You will also see, I think, especially in the style-centric sandal business, great product, but it's not Jibbitable because there's some consumers and some wearing occasions that the consumer doesn't necessarily want to go down that route.

I would say the other thing to add, we're seeing very strong traction on personalization and Jibbitz in Asia in particular.

Abbie Zvejnieks: Great. I don't know if you can kind of talk about HEYDUDE, where I've personally been just so impressed with the growth there. And I'm from South Carolina, and I see them everywhere when I go home. It's very funny.

But can you update us from the distribution expansion and marketing efforts there? And is there any way you can contextualize the products resonating outside of kind of that (unintelligible)?

Andrew Rees: Yes, so HEYDUDE - so, your face lit up when you started talking about it. It's such a fun brand, right? And we're so excited to own it.

I think there's a few things that are important to understand. Number one, the consumer absolutely loves the brand, right? The consumer engagement, the level of passion is off the charts, right? So, one sort of an amazing statistic is we look at the research that we've done where consumers own HEYDUDE,

the average ownership is four pairs. So, this is a brand that's existed for just four years. And the average ownership is four pairs. If you ask those same consumers what their average ownership of a brand like Converse, which has existed for 100 years, it's less than two pairs. So the consumer loves the product, right?

Now, it's regionally distributed today. And the reason it's being regionally distributed is really the asset and the history. It was owned by a distributor. (Unintelligible) capitalize with four systems using original sales force, contract sales force. So, it got traction where they had salespeople. This is not a commentary that consumers in that portion of the country are the only consumers that like the product. We believe that consumers across the U.S. love the product and will love the product.

So, one of the things that we've been doing is expanding distribution, right. So, we've shifted away from a contract sales force. We use - hired our own sales force. And we're looking at a, I would say kind of a strategic, well-segmented distribution strategy where we're looking at family footwear, we're looking at more base retailers, we're looking at sporting goods, major sporting goods retailers, as well as some mom and pop and specialty high end retailers.

We're starting to build that distribution. We didn't have the luxury of being able to write prebooked orders for most of those top tier retailers last year. But we are finding them products and getting them started on the business. So, I think Academy might have called it out last week. But a number of key retailers have - we've supplied them in the last several weeks with inventory that we're able to make available. They are seeing incredible success on it.

So, I would say we're in early stages of our distribution expansion. It will be much more coordinated and deliberate next year. But we're very excited and very - it's very clear to us that it has legs outside of that core market and will be a prevalent brand across the United States next year and the year after.

Abbie Zvejnieks: Great. Maybe to wrap it up with a fun topic. We've seen really great brand heat from collaborations with some of the biggest celebrities like Justin

Bieber, Post Malone. I guess maybe a quick update on like the collaboration strategy and how we should think about the (units) there.

Andrew Rees: Yes. So you will a lot of collaborations between now and the end of the year. Again, one of the things that was definitely disrupted through the pandemic, right, design and developing products with either celebrities or other brands has been difficult, and the process of bringing collaboration to the market a bit lumpy. We've seen that a lot. But you will see a very strong pipeline through the end of the year.

And I would say the power of our collaborations is the diversity, right? So, it's Post Malone and Justin Bieber, et cetera, but it's also Kentucky Fried Chicken, and Nongshim, which is a Korean noodle brand, which was a huge success, right. And as you look forward, that the portfolio will be as diverse, potentially more diverse than it was in the past.

We just did a Lightning - not really a collaboration, but we did Lightning McQueen re-release last week. So, for those of you that don't know the story, a fun story. A number of years ago, a consumer wrote to us and said, I'd like you to make Lightning McQueen shoes, which we made in kids' size, for adults. And we said, well, we will if you can collect 40,000 signatures that people will buy it. And he went and did that. So, he got 40,000 signatures from …

Abbie Zvejnieks: Change.org?

Andrew Rees: … Change.org to - and so we said, we'll make the shoes. So we made 5,000 pairs and they sold out in like, 30 seconds. So, this release that we did last week was the fourth re-release of the same shoes. But it's literally created the same kind of buzz that it did the first time around.

So, it's about doing thing differently, but it's also about listening to the consumer and responding to the things that excite them. We might not have necessarily predicted that a red, light-up shoe for adults with a Lightning McQueen on it was going to be a massive hit, and a massive hit for

repeatedly. But the consumers told us that it was going to be, and so we responded and created a lot of fund and excitement around it.

And the value of that collaboration is not just the revenue and the profit we get from that shoe, but it's the brand relevance increase, it's the consumer engagement, it's the sign-ups. I think I'll get these numbers wrong, but we've got hundreds of thousands of sign-ups for a small number of pairs. And now we have the contract information for all those consumers.

So, there's a lot of value to these. They're really fund and exciting, but they create a lot of value for the company as well.

Abbie Zvejnieks: Great. I'll get my hands on a pair of these (unintelligible)

Andrew Rees: They're all gone. You have to wait for the next re-release.

Abbie Zvejnieks: Oh, no. Okay, well, thank you guys so much for being here. Thanks.

Andrew Rees: Thank you, Abbie.

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