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Crocs, Inc. (CROX)

Baird Global Consumer, Technology & Services Conference

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CORPORATE PARTICIPANTS

Anne Mehlman
Executive Vice President, Chief Financial Officer & President-Crocs Brand, Crocs, Inc.

Andrew Rees
Chief Executive Officer & Director, Crocs, Inc.

Susan L. Healy
Executive Vice President & Chief Financial Officer, Crocs, Inc.

OTHER PARTICIPANTS

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

MANAGEMENT DISCUSSION SECTION

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Okay. Great, good morning, everyone. I'm Jon Komp, Baird's senior analyst, covering the active lifestyle sector. Very pleased to have Crocs, Inc. with us here this morning to kick off the third day of our conference. And joining us from the company, we have CEO, Andrew Rees; EVP and now Crocs Brand President, Anne Mehlman; and CFO just joined – Susan Healy joined the company. And then also with us, SVP of IR and Corporate Finance, Erinn Murphy as well.

So Crocs, as you may know, sells more than 150 million pairs of footwear annually in more than 80 countries. The Crocs Brand itself is one of the largest non-athletic brands across the globe. And HEYDUDE, which was acquired in 2022, has seen very rapid growth and is going through a period of transition, but has significant upside over time. So I'm going to kick it off to the team to give some opening remarks. We'll have Q&A and then for the audience, a session two on the table tent, so you can submit any questions that we'll work in. So I'll turn it to you.

Anne Mehlman
Executive Vice President, Chief Financial Officer & President-Crocs Brand, Crocs, Inc.

I have to read the Safe Harbor. I have the honor of reading the Safe Harbor this morning, so we'll make some forward-looking statements that aren't historical facts. These statements are subject to risks, and you can review more information, including our risk factors in our SEC filings. This is being webcast and a replay can be found on our website after the event.

Andrew Rees
Chief Executive Officer & Director, Crocs, Inc.

Thank you, Anne. So let me just kind of start off by referring everybody back to May 7. May 7, we announced our Q1 earnings, which were exceptional. So as we kind of think about the components of our business, the Crocs Brand performed extremely well. We saw great growth both here in North America and also internationally.

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HEYDUDE while it exceeded the guidance we provided, we did see some softness in that brand, particularly around Easter and post Easter, and we're super focused from a HEYDUDE perspective on ensuring a healthy marketplace and transitioning to a healthier marketplace than we're seeing today. And so we also saw it prudent to take down our expectations for that brand this year. But that didn't dent our overall expectations.

As we looked at our overall performance from a profit, from a cash flow perspective in Q1, we were able to take up our expectations for the remainder of the year. And we're very confident in the both the growth of the Crocs Brand, our ability to generate exceptional profits and high cash flow for the remainder of the year.

If we were to step back a second, I think a couple of things that are worth highlighting, really three key themes of the run across both of our brands and our entire business. Number one, that is investing in, growing and propelling our icons and engaging our consumers with our icons. So from a Crocs side, we've got our clogs, our Classic Clog in particular. And on the HEYDUDE side, the Wally and Wendy, which are the two iconic key silhouettes within that brand.

Number two, we're looking to gain market share in our tier 1 market. So as we think about the world, both our Crocs Brand as a global distributed brand. HEYDUDE is not today, but we think it will be in the future. We're very focused on the major markets that make up the key footwear markets across the world. So we want to gain market share in those markets that we've been seeing a strong track record of that.

And the third is we want to continue to broaden our brands and attract new consumers by methodically broadening their product offerings and appealing to new consumers and new wearing occasions, that gives us a growth vehicle.

And then as I kind of mentioned earlier, we're in a very fortunate position of having an exceptional profit profile because of our very strong gross margins. We're going to continue, we believe, to generate exceptional profits, very high cash flow. That cash flow will allow us to continue to pay down some of the debt that we took on when we purchased HEYDUDE. But also at the same time, repurchase stock and return cash to shareholders.

And lastly, I would just kind of finish with our consumer proposition. If we look at the current market environment, particularly here in the US and in Western Europe, [indiscernible] (00:04:28) both of our brands are ideally positioned. We give the consumers exceptional value. We give them exceptional product with high comfort, easy on and off which – and the opportunity to personalize those products. So we're very confident in the product offering, our financial profile and our prospects for the future.

And with that, we'll open it up for some questions.

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QUESTION AND ANSWER SECTION

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

That's a great overview. I want to start by talking more about the Crocs Brand. The first quarter was strong, up 16%. You raised guidance for the year and by my count it's now the sixth year. Pretty strong growth back to back to back. So can you talk more about what's driving the strength you're seeing and some of the key drivers for the Crocs Brand?

Andrew Rees
Chief Executive Officer & Director, Crocs, Inc.

A

Absolutely. Yeah. I'm glad you mentioned the sixth year. Right. So I think as we look, we've had a very strong and continuous trajectory of growth on the brand that's been driven by product innovation, that's driven by our digital marketing and then also our focus on our key markets around the world. So let me kind of step through a few things. From a from a product and marketing perspective, I think what hits the headlines for a lot of consumers and for a lot of investors is the collaborations, the partnerships and all the fun stuff we do with the Crocs Brand. And that is super important. It does bring new consumers to the brand. It does allow us to get, I would say, media engagement and create a lot of unearned media and engage with our consumers. But beside that and in addition to that, we're also building out our franchises. So as we look at over the last several years, we've built out some significant product franchises which have a resonance with the consumers, the Echo, which is a kind of more street orientated franchise, was a very strong introduction last year. It continues to grow this year.

Brooklyn, which is an elevated sandal franchise for a more casual comfort consumer, has been in the line for several years and continues to build and grow and we add more product into that franchise. The Crush, which is a height franchise in the clog and sandal arena, has been particularly important in Asia, where that consumer is very focused on a height product. And then most recently this year, we've introduced the Getaway, which is another sandal franchise, uses our what we call Free Feel Technology. So it's a more flexible, comfortable upper material on the shoe introduced – tested last year, introduced this year. We're very excited by the performance of that business.

So in addition to all the, I would say, kind of hype, collaboration, high attention product, we're methodically building out these broader franchises within the business. So product and marketing lens are super important.

Second thing I'd turn to is geographical lens. As we look at the business, we've been very public, we think for the Crocs business, the international is going to drive the growth for the next several years. The headline and the key reason for that is penetration. The international markets that we compete in and we're focused on those major international markets. So we think about that as China, South Korea, Japan and Western Europe in addition to the US. We're underpenetrated to what we are relative to what we are here in the US by about a third. So that's significant upside from a geographic perspective.

So, product angle, marketing angle and then also geography, we're really confident about the future growth trajectory.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

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Maybe if you could expand a little bit more about North America, what you're seeing, I know from the first quarter, one of the themes was we saw good, good sell-in. You saw good sell-through. So maybe expand a little bit more the North America performance and market conditions and some of the key drivers for the year here.

Andrew Rees
Chief Executive Officer & Director, Crocs, Inc.

A

Yeah, I think probably start with the consumer from a North America perspective. We continue to engage the consumer very proactively as we think about the – as we see and we think about the consumer in North America, they're clearly quite selective right now. They're buying the products -they're buying the brands and specifically the products within those brands that they really want. And they're less interested in products that are not engaging brands that are not engaging effectively or key products that they want. I think we're lucky from a Crocs perspective, they clearly want what we have to offer. So we continue to perform well.

And then, if you think about Q1, we saw – we have a very healthy marketplace. So we saw our wholesale customers in North America looking for product a little bit earlier. Easter was also earlier. So we saw them looking for product earlier, which was great. We also saw strong sell-through and reorders from a North America perspective and our DTC business continued to perform well. So kind of think about it, all of our channels performed, but that's really all about kind of consumer engagement and product desire. And I think we're executing extremely well in that marketplace as well. I don't know if there's anything else you want add?

Anne Mehlman
Executive Vice President, Chief Financial Officer & President-Crocs Brand, Crocs, Inc.

A

Yeah. I think just a reminder that because of some of the dynamics with Q1, because of the earlier Easter shift and also the strong kind of early shipments that we had from our wholesalers, Q2, we do expect to be flattish. So just kind of first half of the year, good growth, but just the dynamics of some of that shift.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Maybe expand a little more Andrew or Anne, talking about bringing more new customers into the brand or some of the product strategies and the marketing. You've also had some higher ASP in the newer products. So just maybe talk about the strategies there?

Anne Mehlman
Executive Vice President, Chief Financial Officer & President-Crocs Brand, Crocs, Inc.

A

Yeah. So I think one of the great things is we've had some really exciting new products that actually give us access to new consumers. So the way that we think about that is from a sandals perspective, which – sandals has been one of our strategic initiatives for many years. It gives us access to a larger target market, also about 60% from what we can see on our own dot-com in North America, about 60% of our consumers that purchase sandals are new customers to the brand. So that's a very exciting number.

And as Andrew mentioned, we have some really exciting new franchises like the Getaway. We've also launched the Miami, which is another sandal that's doing very well. So those – that's really important. We've also launched some higher end and kind of more interesting, a little bit more outside the core product. So like the Echo surge where we saw also around 59%, 60% of new – where new consumers purchasing it. So it's a little bit more street that was seeded with the hype of the Salehe Juniper. If you guys haven't seen it. It's a very cool looking sneaker that released on May 30, and sold out in minutes. But – so that's kind of how we think about seeding with new

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customers, right? We create demand and excitement at the top of the pinnacle and then we build into franchises and test around that.

So I think as we continue to kind of expand and test around some of those franchises, that's a big driver of new consumers and some of those have higher ASPs. But also we're very focused on still keeping the majority of our product line under $100. Even the Salehe sneaker, which is a very hyped sneaker, I think was around $120 MSRP, maybe $140.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

It's been great to see pushing the boundaries on some of those products and certainly driving a lot of interest from the consumer. Maybe talk a little bit more about the international side for Crocs as well? [indiscernible] (00:11:54) very strong a key driver you highlighted, there's lots of penetration, but just talk about the regions or the markets and the trends that you see?

Andrew Rees
Chief Executive Officer & Director, Crocs, Inc.

A

Yeah, yeah. Look, we're super excited about international, right? So I would say our company is a very international company, for a long period of time we've had very high proportion of our business coming outside the United States. We're very familiar with many of these international markets which operate quite differently. And you actually have to think about how you operate in each country versus each region, the dynamics of the country, the way you can go to market, the customers you can deal with are all extremely different and I think we have great advantage in that. We're very familiar with that. We have teams on the ground in most of these places that know exactly how to operate and we've got that opportunity to scale in the future.

So we're underpenetrated in those markets. And just a reminder, as we think about the key markets internationally, there are three critical markets in Asia. Obviously, China, we've talked a lot about that. I'll come back to that. South Korea and Japan and we've got India, and then we've got western Europe as probably the big, big opportunity as well.

And we distort our talent, we distort our marketing investment, we distort our infrastructure investments. We distort into those markets significantly. Let me kind of highlight a few. So China, for example, we saw triple digit growth in Q1. You remember that we saw exceptional growth in China last year. We were able to win in Q1, a Super Brand Day on Tmall, which means that's an opportunity for high profile brands to be selected to get a lot of focus, marketing and attention from the platform that was very successful. And we continue to grow our franchise store footprint in China. We'll open significant stores this year. So both our DTC business and our wholesale business are growing very nicely.

But at the same time, as excited as we are about the current trajectory in China, we're still – it's still a far too smaller piece of our business. We see a long term growth opportunity in China. And you might say, what's caused this inflection point? I would say it's product and marketing. And the same marketing model that we use here in the United States, which is digitally, socially orientated is applicable in that market. And it's working extremely well.

Maybe the second area I'll focus on is Western Europe. For several years we've had very strong trajectory in the UK with some of our major wholesale partners and we see that trajectory kind of spreading through other parts of Europe, gaining traction with the Classic Clog, we're driving clog relevance, we're driving resonance to the brand and then we believe behind the clog trajectory will also be able to come into those markets with sandals.

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And maybe the third I'll highlight is India. India is obviously a very important market, growing extremely rapidly. We have gone through some strategic changes in that market, which is really driven by our manufacturing footprint. We now manufacture both clogs – sorry, Crocs and HEYDUDE in that market, which allows us a more DTC orientated business model. So the laws in the market, if you don't manufacture in the market, you can't sell directly to consumers, you have to sell through third parties. Now that we're manufacturing in the market, we can now sell directly to consumers. So we're shifting a lot of our digital platforms to be directly operated. We work with one major franchise store operator, which is Metro which is a leading footwear retailer in the market. We have also other partners in the market that we're expanding. I'm so excited about the prospects for India.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah, that's great. I want to shift a little bit to HEYDUDE for a bit here, and Crocs still drives most of your revenue and profitability today, but HEYDUDE obviously you acquired for the opportunity. But it's been a more challenging first two years under your ownership. So maybe if you could start just to set the ground and HEYDUDE and the reset that you started last year and now including the leadership transition recently here?

Andrew Rees
Chief Executive Officer & Director, Crocs, Inc.

A

Yeah. So look, I would say – look, we're super excited about the prospects for HEYDUDE. We bought a brand back in 2022 that was a little over $0.5 billion in terms of size. That's a pretty scaled brand in the casual footwear business. In our first year of ownership, we close to doubled it. So we grew very rapidly in the first year as we expanded the brand to, I would say, broader distribution. I acknowledge that since that – end of that first year of ownership, we've been flat in terms of overall revenue growth. But that's been due to a couple things, we probably pushed that growth a little bit too fast in that first year and I think didn't adequately segment product across the different customers that we were serving. And we had too much product in the marketplace.

So since then, we've been focused on improving the health of the marketplace, pulling back in terms of sell into the marketplace, we've been resetting some prices on digital and driving a much greater level of segmentation.

We still see a consumer that's extremely engaged in the brand. And we see the opportunity to dramatically increase the awareness and the relevance of the brand. Even today, after the expansion work that we've done and the marketing money we've invested, the brand has about 30% – mid-30% awareness in this country. Right? So the flip side of the 30% awareness means that 70% of customers don't even know what it is. Right? Or, 70% of potential customers don't even know what it is. So we believe we have an opportunity to continue to invest in marketing and product innovation, drive awareness, engage new customers.

And as Jon highlighted, we brought in a new President for that brand 27 days ago, I think – or 28 days ago, Terence Reilly, he rejoined us. He used to be our Chief Marketing Officer at Crocs. Then he left us for a four year period where it's when he was running Stanley not the not the tool company but the cup company and he really turned that company into a kind of social phenomenon. So we're excited to have Terence back, he's an extremely talented marketer and he has already gotten to work. So we're excited about the future. We think the HEYDUDE Brand has a tremendous future. I know many of you don't, but we will see. We'll see who's right.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

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I know where I'll place my bet. But just as you think about 2024 play, just a follow-up on HEYDUDE, 2024, that the outline that you provided calls for a return to a pull market by late in the year and inflection by the fourth quarter. So maybe if you can give a little more color to what you expect there.

Anne Mehlman
Executive Vice President, Chief Financial Officer & President-Crocs Brand, Crocs, Inc.

A

Yeah, I'll take this and just one thing on HEYDUDE. So just a couple of numbers before we talk about this year. So just – we paid down over $1 billion of that HEYDUDE debt in two years because of the strong free cash flow from both of our brands. Also, we've generated about $500 million of operating income from that brand in two years. So, that's pretty good. I'll take it. That's more than Crocs made for a very long time. I think when we think about this year from a HEYDUDE perspective, we definitely have some interesting dynamics in the first half of the year where wholesale is obviously driving a decline. We guided down [ph] 8% to 10% (00:19:36) for the full year and we expect it to improve in Q4 when you think through some of the dynamics, we said that the business would still be down in Q3 we guided for Q2. In Q4 we do expect – we have retail that we're opening, so opening about 30 retail outlets for HEYDUDE, very profitable retail outlets in the kind of spirit of how that's – we've created that for Crocs, also drives increased awareness and gives our consumers the chance to experience our full line for HEYDUDE. So those will be all open and cumulatively impact Q4. And then we have a couple of other things. So we have – our wholesale comps get a little bit easier. And then we've talked about the great market pressures that we've had on Amazon that [indiscernible] (00:20:19).

So that's kind of the three drivers. And then the fourth thing is, is that we sell in typically in Q4 is when you sell into your international distributors, these are – that's a typical timing. This isn't a new thing we're doing with HEYDUDE. It's just a more typical timing for that sell-in, which happens in Q4. So that's how kind of some shaping, how to think about the remainder of the year.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

That's great [indiscernible] (00:20:40) we all will be watching for the brand direction and the marketing flair from Terence as he is there for longer as well. Maybe this is a good point to switch to Susan, the newest member on the stage here, joining Crocs. And I'd love to just hear more of your perspective, the opportunity to join the company as the CFO and a little more on your background.

Susan L. Healy
Executive Vice President & Chief Financial Officer, Crocs, Inc.

A

Absolutely, yeah. So the decision to join Crocs was an easy one and it was really driven by three things. Quality of the brands, quality of the people, and quality of the results. So the brands, you've got two great brands. Crocs, as we all know, is a juggernaut and it's proven to resonate with customers globally. HEYDUDE has a lot of potential, and it has a lot of the same brand characteristics as Crocs. And now we've just now gotten the right leadership team in place to really execute on that potential.

In terms of the people, an incredible management team and I have very big shoes to fill. But across the team and it's a combination of strong management, a great culture at Crocs, and we are investing in talent development across the organization.

And then the results, I mean, they speak for themselves, right? I mean, you have industry leading margins, incredibly strong free cash flow and good growth. It's just a really potent combination.

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You also asked about my background. So I spent my first 15 years on Wall Street. Most of that as an investment banker, and got a lot of exposure to the consumer sector then, including a couple of IPOs. And then more recently, I spent five years at Ulta Beauty, worked for Scott Settersten, who many of you may know and really got a front row seat and was able to be part of best practices at a high growth consumer facing company.

And then I was a public company CFO at IAA up until their $7 billion merger with Ritchie Brothers last year.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

That's great. Well, certainly joining a good team and this may be one of my last few opportunities to ask – point any financial questions towards you Anne. But since you...

Anne Mehlman
Executive Vice President, Chief Financial Officer & President-Crocs Brand, Crocs, Inc.

A

I'll miss it.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

I'm sure you will. Since you've laid out the targets initially for...

Anne Mehlman
Executive Vice President, Chief Financial Officer & President-Crocs Brand, Crocs, Inc.

A

Yeah.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

...2024 and from an operating margin perspective laid out really the pieces of an investment year. Just talk a little bit more about how you see operating margin developing this year or the investments you're making and why it's the right time to make those brand investments?

Anne Mehlman
Executive Vice President, Chief Financial Officer & President-Crocs Brand, Crocs, Inc.

A

Yeah. As Susan just mentioned, we have top tier operating margins and we actually think that's like a competitive advantage if we use it correctly. And we should take our incredible free cash flow and our incredible operating margins and invest that back into the business. Especially we have two growing brands and we're growing not only in North America, especially with HEYDUDE's kind of focus around North America. And then, outside of the US for Crocs. So really that investment is bringing in the right talent, bringing in more talent. Andrew's talked a few times about not having the talent that we were able to port across to HEYDUDE when we bought that brand. So making sure that we have broad, deep talent benches, I think is one.

The second thing is really making sure that we have marketing for – to support the HEYDUDE Brand as well as the Crocs Brand and internationally as we start to set up those markets. So I think – digital, we're a digital-first company and that means digital through – how we reach our consumers, but also digital marketing, and how we continue to kind of stay in the forefront of digital and how we innovate there, I think is really important.

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And then we're building out some outlet stores for HEYDUDE, but also some outlet stores outside of the US for Crocs. So I think all of those are great investments. And we've said Crocs kind of long term was 26% operating margin. We're just not going to be there every year as we can choose to invest and still deliver really high returns.

And I think, coming out of Q1, Q1 obviously our operating margin far exceeded expectations. We left it at approximately 25% for the year, which if you do the math, it's kind of like slightly up. So it's kind of approximately 25% – a little bit higher just on the EPS. So I feel great about that. But we're really excited to continue to have the opportunity to invest in our brands, especially when some brands are not in a position to invest. So that really allows us to take share.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Maybe just to follow on if I could ask a gross margin specific question, but as you think about the evolution for Crocs and now HEYDUDE as well, starting to rebuild the gross margin, how should we think about the broader trend for gross margin on a consolidated basis?

Anne Mehlman
Executive Vice President, Chief Financial Officer & President-Crocs Brand, Crocs, Inc.

A

Yeah, we haven't given long term guidance on that. I will say Crocs kind of the run rate guidance we had out there was like around 58%, obviously we're higher than that. We think that the longest term there are some benefits from a Crocs side of just – you continue to scale. We have a molded product. So our gross margins, if you factor in kind of distribution cost, which is how a lot of brands look at gross margins were higher than anybody else by like I think around 1,000 basis points.

So our gross margins are very strong. But there are some things that we want to do to continue invest, we want to continue to invest and expand our product franchises. And some of those have lower gross margins like sandals, still accretive, they're still molded. We're also investing in net zero. And that means for us bio-based materials into our Crocs shoes really important to our consumers. We have one of the lowest carbon footprints of any brand in our shoe, the Crocs Classic, but we can make that better, but that is a little bit more expensive.

So some of those – so 58% is kind of we haven't adjusted that, but we obviously are running higher than that now. From a HEYDUDE perspective, I think that initial target we have out there is kind of around a 50% gross margin. Again, a little bit less than that now, but we're rebuilding those gross margins. And we said sequentially we would see improvement this year.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

One of the functions or the outputs of such high margins has been great cash flow. So if you could just provide any more color on the – any guardrails around cash generation and then how you view capital allocation in the uses of the cash that you have?

Anne Mehlman
Executive Vice President, Chief Financial Officer & President-Crocs Brand, Crocs, Inc.

A

Yeah. I mean, one of our most powerful financial kind of unlocks as a company is just the enormous amount of free cash flow that we generate that allowed us to pay over $1 billion down in debt, resume our share repurchase program. So when we think about this year, we're focused on continuing to pay down our debt. We hit – our net leverage target is between 1.5 and 1. Last year we finished below that, about 1.3 net leverage. And so, we'll

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continue to kind of pay down some of that variable rate debt this year, which is assumed in our guidance. We also resumed our share repurchase program after we hit the under 2 last year. We said we will repurchase shares this year. That's not assumed in our guidance, gives us some flexibility. So that's a very powerful combination. And we have, I think, over $800 million left on that share repurchase authorization from our board.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

Well, thank you for all that. I look forward to Susan, the opportunity to ask all the financial related questions.

Susan L. Healy
Executive Vice President & Chief Financial Officer, Crocs, Inc.

A

Absolutely, this is the last time you got Anne.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Q

That was great. We have about a minute left. I would love to maybe just finish. Andrew, you obviously had a great start to the year of the Crocs Brand, stronger growth than I think some expected. And any sort of concluding remarks as you think through the balance of 2024 and what you're looking forward to?

Andrew Rees
Chief Executive Officer & Director, Crocs, Inc.

A

Yeah. Thank you, Jon, for the opportunity. So appreciate you having us here today. I think just in closing, what I would say is we feel extremely confident in our brands and our company and our capabilities. We see multiyear, long term growth opportunities for both of our brands across the globe. And so I think that's an extremely – with the profit profile, the gross margin profile that you highlighted, Jon, with our profit profile and our cash flow gives us tremendous confidence about our ability to grow our brands and provide extraordinary financial returns to investors. So we look forward to your support.

Jonathan R. Komp
Analyst, Robert W. Baird & Co., Inc.

Thank you all very much. Thanks for joining us. Management will be available for a breakout session immediately after and then in this room will be Harley-Davidson. If you could all join me in thanking the team.

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