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Crocs, Inc. (CROX)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Crocs, Inc. Fourth Quarter Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to Brendon Frey of ICR. Thank you. Please go ahead.

Brendon Frey

Managing Director, ICR INC.

Thank you. And good morning, everyone, and thank you for joining us today for the Crocs' fourth quarter 2019 earnings call.

Earlier this morning, we announced our latest quarterly results and a copy of the press release can be found on our website at crocs.com. We would like to remind you that some of the information provided on this call is forward-looking and accordingly is subject to the Safe Harbor provision of the federal securities laws. These statements include, but are not limited to, statements regarding future revenues, gross margin, SG&A as a percentage of revenue, operating margin, CapEx and our product pipeline. Crocs is not obligated to update these forward-looking statements to reflect the impact of future events.

We caution you that all forward-looking statements are subject to risks and uncertainties described in the Risk Factors section of our Annual Report on Form 10-K. Accordingly, actual results could differ materially from those described on this call. Please refer to Crocs' Annual Report on Form 10-K as well as other documents filed with the SEC for more information relating to these risk factors.

Adjusted gross margin, income from operations, operating margin, net income and earnings per diluted common share are non-GAAP measures. A reconciliation of these amounts to their GAAP counterparts is contained in the press release we issued earlier this morning.

Joining us on the call today are Andrew Rees, President and Chief Executive Officer; and Anne Mehlman, Executive Vice President and Chief Financial Officer. Following their prepared remarks, we will open the call for your questions.

At this time, I'll turn the call over to Andrew.

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Thank you, Brendon, and good morning, everyone.

This morning, we reported revenues of \$263 million, which were slightly ahead of the upwardly revised guidance we provided in early January. This result marks an all-time fourth quarter record-high for the company, and represents an increase of 22% over the same period last year.

Our strong top line growth allowed us to drive significant SG&A leverage, which, along with 310 basis points of adjusted gross margin expansion, helped fuel adjusted earnings per share of \$0.12 versus an adjusted loss of \$0.10 per share a year ago. These achievements underscore the work we have done expanding the year-round desirability, relevance and consideration of our brand and product offering.

Our fourth quarter performance represents a strong finish to a record revenue year. Anne will review our financial results in more detail shortly, but here are just a few of the many highlights from 2019. Overall global revenues grew 13% to a record of \$1.2 billion for the full year. Excluding store closings and currency, underlying growth was 17%. Adjusted operating margin of 11.6% was approximately 390 basis points over 2018, and adjusted EPS increased 87% to \$1.61.

We invested \$15 million back into the business by our additional marketing programs. We returned cash to shareholders by buying back more than 6 million shares and we relocated our US distribution center to a new automated facility in Ohio.

Importantly, momentum we generated in 2019 has carried into the New Year and we anticipate continuing to drive meaningful growth in 2020. To better understand where the business is headed, it's helpful to understand the key drivers of our recent performance since the same underlying strategies will propel us forward in the future.

Starting with building brand heat. It was an incredibly busy and exciting year. Throughout 2019, we executed numerous programs and campaigns that further strengthened consumer affinity for the Crocs brand around the world. This was the third year of our successful Come As You Are campaign and we once again invested in the strong lineup of brand ambassadors including Zooey Deschanel, Kim Se-Jeong and Suzu Hirose. And late last year, we announced the addition of award-winning actor, activist and entrepreneur, Priyanka Chopra Jonas, to our team for 2020. Priyanka will be featured in many of our marketing assets for 2020, both in the U.S. and in our international markets.

More recently, we've unveiled our newest brand ambassador, Yang Mi, an actress and singer and one of the top celebrities in China with over 100 million followers across the social media platform. We're very excited to have

Yang Mi on board as her reach and appeal is a key component of our growth strategy in this large and important market.

We launched over 20 collaborations in 2019, each of which had an impact on enhancing brand relevance. These included partnerships with Post Malone, Luke Combs, Takashi Murakami and Vera Bradley in the US, PSY in Korea, Vivienne Tam in China and BEAMS in Japan. We'll re-price several of these collaborations in 2020, along with many partnerships that we're really excited about.

Another important part of our 2019 marketing strategy in the US was the introduction of a Crocs' profile on TikTok, a video sharing app popular with teens and young adults. The initial reception has been fantastic evidenced by the fact that our #1000crocs challenge has received 2.8 billion views to-date.

The effect of our marketing efforts is clearly evident and measurable. In Piper Jaffray's most recent study, in just one year, Crocs moved from the number 13 most preferred footwear brand by teens to number 7. In our own annual brand strength survey, we saw double-digit increases in both desirability and relevance, and according to Google, we had 2 of the top 10 most search shoes in 2019 including the coveted number one spot with a Luke Combs collaboration.

To report our perspective, our results continue to be driven by our focus on our four key growth pillars: prioritizing clogs, sandals, visible comfort technology and personalization. Following strong spring/summer and back-to-school seasons for clogs, we've fueled demand during the holidays by refreshing our core assortment with on-trend colors, prints and expanded our offering of Lion clogs for cold weather wearing occasions. The response from consumers was incredibly strong. Q4 clog revenues increased approximately 36% and represented 69% of our footwear sales, up from 62% during last year's fourth quarter providing further proof that our clog silhouette is a year-round style.

At the same time, our sandal business enjoyed a successful holiday and we continue to build awareness of our presence in this category and inspire our female consumers with the breadth of our offering. Sales grew 7% over last year's fourth quarter and grew 10% for 2019. The third consecutive year of double-digit growth for this category. We have exciting plans to build on this momentum in 2020 including seeing more of our celebrities in our new sandals as well as featuring more sandals in our collaborations.

We're also expanding the third component of our product strategy, Visible Comfort Technology With the recent introduction of kids' sizes into our LiteRide collection. Since launching LiteRide in early 2018, it has quickly become one of our top five franchises. Visible Comfort Technology is now co-part of Crocs' DNA and we believe it provides us with the compelling growth opportunities well into the future.

With respect to our Jibbitz Charms business, we saw accelerated momentum as the year progress, culminating in a rollout to select wholesale accounts during the fourth quarter. We made great progress in broadening appeal of our unique Charms by evolving the assortment and regularly refreshing the offering with on-trend, relevant and localized designs. Personalization is a global megatrend and we are seeing growing numbers of consumers worldwide that customize their Crocs footwear. We anticipate that our Jibbitz business will continue to gain momentum in 2020 and beyond, driven by all channels.

Let me now turn briefly to the fourth quarter performance of our sales channels. Our DTC comp which combines our retail and e-commerce results increased 22% for the fourth quarter on top of 16% gain a year ago. E-commerce sales were up 34% on top of 19% growth last year. This represents our 11th consecutive quarter of

strong double-digit e-commerce growth. The increasing brand heat continues to drive more traffic to our own sites, plus we are seeing good traction on global marketplaces.

Retail comps were 16%, our 10th consecutive quarter of positive comps. On a two-year stack, retail comps were up 29%. Fourth quarter wholesale revenues increased 22%, following last year's 10% growth, led by strong sell-through and replenishment orders from many of our leading wholesale partners around the globe.

As we think about Q4 from a geographic perspective, Q4 revenues grew double-digits in each of our three regions with the strongest growth coming from the Americas led by the US. Our performance in our home market is the direct result of our commitment to execute the playbook we outlined a couple of years ago, one that centers on strengthening our relationship and driving relevance with the consumer through great product and marketing. We're confident that the work we've done further igniting brand heat and emphasizing our core clogs and sandals, along with our burgeoning Jibbitz business, has Crocs well-positioned to drive sustainable growth in the US.

We believe the same is true for EMEA and Asia where we are in various stages of implementing the same strategies and playbook we've developed domestically. EMEA showed great progress in Q4, growing 17% in constant currency year-over-year. Asia represents our largest long-term growth opportunity where clog relevance, particularly in China, lags our other key countries. With the much stronger foundation in place in China, we're starting to ramp up our efforts to accelerate growth. In the near term, however, our priority is to ensure that our employees in China, along with our partners and suppliers, safely navigate the health risks associated with the coronavirus. Our thoughts are with everyone affected.

Many of our approximately 350 partner stores are closed temporarily. For those that remain open, they are operating on reduced schedules and experience a lower-than-usual traffic. Despite this difficult situation, we continue to be very optimistic about our long-term growth prospects in China.

Finally, I'm pleased to announce that we recently appointed [ph] Elaine Boltz (00:11:47) to the newly created position of Executive Vice President, Chief Operations and Transformation Officer. [ph] Elaine (00:11:53) brings nearly three decades of leadership, operations, direct-to-consumer and marketing experience to Crocs, having served in senior leadership positions at the TJX Companies, Chico's, and Ann Taylor during her career. In her new role, [ph] Elaine (00:12:08) will have responsibility for our operations functions globally including information technology, supply chain, and enterprise-wide business transformation. I'm confident she'll play a key role enhancing execution of our long-term strategies.

Before I turn the call over to Anne, I want to express my gratitude to the entire Crocs organization for delivering such a strong year of growth and profitability. We've come a long way over the past few years, and this wouldn't have been possible without the hard work and commitment we have seen demonstrated by our global teams on a daily basis.

Normally, at this time of year, we would send New Year's greetings to all our associates, customers, family, and friends in China. These are concerning times for many, and we would like to wish them and all of their families good health over the coming weeks and months. We look forward to healthier times ahead for everyone.

With that said, Anne will now review our financial results in more detail and outline our guidance.

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

Thank you, Andrew, and good morning, everyone.

I'll begin with the short recap of our fourth quarter and full year 2019 results. For reconciliation of the non-GAAP amounts mentioned to their equivalent GAAP amounts, please refer to our press release. As you've already heard, we had a record-setting fourth quarter, exceeding our revenue guidance and achieving a dramatic improvement in our bottom line. Fourth quarter revenue came in at \$263 million compared to \$216 million in the fourth quarter of 2018, a 21.8% increase or 22.7% on a constant currency basis.

Currency negatively impacted our revenue by approximately \$2 million. In addition, store closures reduced revenues by approximately \$2 million, absent which our sales would have been at 23.7%. This is our 11th consecutive quarter of organic sales growth and the 6th consecutive quarter of double-digit organic sales growth.

We sold 13.7 million pairs of shoes, an increase of 18% over last year's fourth quarter. Our average selling price for footwear during Q4 increased 3% to \$18.44 with the increase attributable to less discounting and higher prices on certain product which more than offset the impact of changes in our channel mix and the negative impact of currency.

For 2019, in total, we sold 67.1 million pairs of shoes, 12% more than 2018 at an average selling price of \$17.81, up 1% from prior year or 3% in constant currency. The Americas had another phenomenal quarter with revenues up 28% to \$155.8 million and minimal impact from currency. Growth was robust across every channel.

In addition, we completed the relocation of our Americas distribution center from California to Ohio during Q4. While there were some challenges getting products out in a timely manner which required some additional spending to remedy, we are very excited about the great benefits we expect to receive from our new distribution center investment including higher throughput, greater efficiency and an improved customer experience.

In 2021, we intend to relocate our distribution center in the Netherlands supporting our EMEA region to a larger facility, and are evaluating similar investments this year and beyond designed to support our anticipated growth.

In Asia, Q4 revenues were \$64.4 million, up 15% from last year's fourth quarter. On a constant currency basis, revenues rose 15.4%. DTC comparable sales were up 5.7%, driven by growth in our own dot-com and our expanding marketplace presence, somewhat offset by lower retail comp.

EMEA revenues rose 15% over last year's fourth quarter to \$43 million. On a constant currency basis, revenues grew 17.2%. Our business is benefiting from growing brand heat and our continued focus on digital commerce.

Our fourth quarter adjusted gross margin was 49.3%, well above last year's 46.2%, driven by favorable product mix, lower levels of promotions and discounts, and higher volumes helping to leverage our fixed costs. This was partially offset by higher distribution center costs in the US related to the startup of our new US DC. Compared with our guidance, adjusted gross margin was lower by 70 basis points, due to the cost of scaling activities at our new Ohio distribution center.

Our adjusted SG&A improved by 620 basis points to 44.4% of revenue versus 50.6% in last year's fourth quarter and compared to our guidance of approximately 47% of revenue. The upside to our guidance was driven by our ability to leverage higher revenues in the quarter. Non-recurring charges were \$1.2 million in Q4 compared to \$4.6 million in last year's fourth quarter.

The work done over the past two years to reduce cost is now enabling us to drive significant leverage from revenue growth even as we continue to invest more in marketing.

Our operating margin improved dramatically to 3.2% or 4.9% on an adjusted basis. For Q4, we recorded a tax benefit versus a tax expense last year. Higher than anticipated US profit enabled us to use various tax benefits accumulated during prior years. Fourth quarter diluted adjusted earnings per share, excluding the tax benefit and non-GAAP adjustments, were \$0.12 compared to a non-GAAP loss per diluted share of \$0.10 a year ago.

During Q4, we repurchased approximately 400,000 shares of our common stock on the open market for \$13.7 million at an average share price of \$34.73. For the full year, we repurchased 6.1 million shares of our common stock for \$147.2 million at an average cost of \$24.20 per share. \$508.6 million remains available under our plan for future share purchases.

Our balance sheet continues to be very strong. We ended the year with \$108.3 million in cash and \$205 million in outstanding borrowings. Inventory at December 31, 2019, was \$172 million, up 38.2% compared to \$124.5 million last year. The increase was driven in part by early receipts ahead of Chinese New Year. For the year, our inventory turns were 4.3 times.

As pleased as I am with our strong Q4 performance, I am equally excited by our full year results. We grew revenue by 13% or 17%, excluding approximately \$28 million of currency impact and about \$17 million of store closures. In addition, we have leveraged adjusted SG&A by approximately 430 basis points even as we increased our marketing spend by \$14.5 million.

For the year, adjusted operating margins were 11.6%, up 390 basis points. On a GAAP basis, operating margins were 10.5%. With this result, we achieved our goal outlined two years ago of double-digit operating margin.

Adjusted EPS for the full year was \$1.61 versus \$0.86 last year. Excluding the Q4 tax benefit, our underlying effective tax rate for the year was 13.5%. We plan to host an investor day during the second half of 2020 where we will lay out longer-term financial targets for the company.

As we turn to guidance, I want to remind you that our guidance is based on current currency rate and on the best information we have given the limited visibility with respect to the coronavirus impact. As Andrew touched on earlier, our thoughts and our focus on the well-being of our colleagues and partners in China as they deal with this very difficult situation, with a number of partner stores currently closed and other measures in place to try to prevent further spreading of the coronavirus, we shipped very little product in China so far this quarter.

As a result, we've lowered our Q1 2020 revenue projection for our Asia region by \$20 million to \$30 million. This includes the impact on our China business as well as the impact on other key markets in Asia as we are seeing declines in retail traffic in Singapore, South Korea, Japan and our Southeast Asia distributor markets. It also reflects our best estimates for supply delays out of Asia factories in Q1.

For the first quarter of 2020, we expect revenue to be between \$305 million and \$325 million compared to \$295.9 million in last year's first quarter, including a negative currency impact of \$3 million. We expect operating margins to be between 9% and 12%, including approximately \$3 million of one-time expenses for store closures and other provisions in Asia.

For 2020, we now expect our revenues to grow 8% to 12% over 2019. This includes a negative currency impact of approximately \$10 million as well as an estimated impact of \$40 million to \$60 million related to the coronavirus.

To be clear, the impacts from the coronavirus assumed in our guidance is related to store closures and overall consumer demand in Asia region. It doesn't contemplate a further disruption to our supply chain, nor continued softness in the region during the back half of the year. Our operating margin is expect to increase to approximately 11% to 13%, including estimated transition costs of about \$3 million for the new DC in the Netherlands and approximately \$5 million related to one-time charges for store closures and other provisions in Asia. Interest expense for 2020 is expected to be approximately \$9 million.

In terms of income taxes, excluding the utilization of any discrete tax benefit, we expect a tax rate of approximately 17% in 2020. With respect to CapEx, we expect to invest between \$50 million to \$60 million in 2020, which includes expenditures related to our new distribution facility in the Netherlands scheduled to open in 2021 as well as some investments that shifted from last year into this year.

In summary, although we are experiencing near-term challenges with the disruption in our Asia business, the Crocs brand and our fundamentals are strong. And we believe this disruption to be temporary. I remain very excited about our plans for 2020 as we continue to drive top and bottom line growth, while making important investments to fuel the business over the long-term.

At this time, I'll turn the call back over to Andrew for his final thoughts.

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Thank you, Anne. As our 2019 performance indicates, we have great momentum in our business and our brand heat has never been stronger. While we decreased our 2020 guidance as a result of challenges created by the coronavirus, our positive outlook for Crocs remains unchanged. We are confident there is a long runway of growth ahead of us and numerous opportunities to drive increased shareholder value for years to come.

Operator, please open the call for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question comes from the line of Erinn Murphy with Piper Sandler. Go ahead, please. Your line is open.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Q

Great, thanks. Good morning. I guess my question maybe just starting with the coronavirus and what you've embedded in your guidance of the \$46 million for the full year. It sounds like you're already assuming kind of the broader impact you're seeing in outside of the Asian market, outside of China. But what's your assumption how long this pressure continues?

And then, maybe if we can just understand a bit more on the supply chain side. Can you talk about kind of what's being produced in China, their specific packaging or other input costs or inputs that go into maybe production lines elsewhere in Asia and as you've seen any disruption on the supply side at this point?

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

A

Yes, thanks, Erinn. So, firstly, I think I would like to say that our first focus is around health and well-being of our employees, our partners and our suppliers throughout the Asia region. So, that's kind of how we've approached this.

As we look at the business impacts, I think they're on three levels. Firstly, we've got direct impact in China which I think is pretty clear to everybody. So, stores are still substantially closed. Our e-commerce was not operating through most of February because our distribution partner was closed at the request of the local government. They are now operating. But, obviously, your business is at a reduced level.

Almost as important as that is the impact in rest of Asia. So if you look at the 130 million-plus Chinese tourists that travel globally, eight of their top destinations are in Asia, and we're seeing significant drops in traffic in Japan, in Korea, in Singapore. And as we look at our distributor businesses in Thailand and other parts of Southeast Asia, we're seeing big drops in traffic there. And then on top of that, you've got the supply disruption. So, there's really three levels of impact that we're managing and monitoring.

Part of your question was how long that we assume this goes on? Our assumption is essentially what we've built into the guidance that we have provided at this stage is that this goes on through first and second quarter. So, we've got impact in first quarter and second quarter, and we recover in the back half. In terms of the supply disruptions, again, the way to think about it is we're a little over 10% of our finished good production comes out of China, a little over 70% of our finished good production comes out of Vietnam. So, that kind of gives you kind of where we're orientated.

But, as you rightly pointed out, Vietnam is not free from impacts, right? So we do get components that go into the products that we make in Vietnam out of China. Some of that is dual-sourced so we can switch to a Vietnam-only source, and some of it comes – and some of it's sole-sourced out of China. So, we'll have to look for different sources around that. And you also see other impacts in terms of just the productivity of Vietnam facilities because many of these manufacturing groups are Chinese or Taiwanese-owned.

So, we are seeing supply disruption. I think if you kind of look at February, for example, coming back from Chinese New Year, look, a lot of facilities came back very, very slowly or came back at far less productivity than they would have done. And that is getting better. But there's definitely disruption going forward.

I don't know if there's anything else you'd add, Anne.

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

Yeah. I would just say that all of our factories have restarted in China...

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Okay.

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

...just at varying levels of productivity.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Okay. That's helped. But then in terms of the disruption, just I make sure I understand how you're kind of framing the guidance. You're not assuming any further disruption from here on the supply chain side and really the impact is on kind of the cooler demand across APAC in the first half. Am I understanding that right, or you have included supply chain?

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Yeah. We...

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

Yeah. Sure.

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Yeah. Yeah. Yes. Correct.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Okay. Got it. And then, maybe just...

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

So, just to put a finer point on that. If we see...

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Yeah.

Q

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

...significant delays going into Q3 and Q4 deliveries, that would be a larger impact than we've outlined.

A

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Got it. And then in terms of like inventory on hand, particularly into the North American market, how comfortable are you as you look out for the first half just given that this is the region where you've been seeing the most significant piece of your growth?

Q

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

Yeah. I would say from the US perspective a couple things, right, our inventory is up approximately 37% year-over-year. And most of that is in our US market because we did bring about 50% of that is because we brought it in ahead of Chinese New Year which proved prudent just because the Chinese New Year and the timing of that. And then, the rest of it is because we were obviously light on supply last year and going into US growth, we wanted to make sure we had enough inventory. So, we're less – I would say we're less impacted at this point in the US right now because of our inventory.

A

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Got it. Okay. And then just last question for me just on the collaboration pipeline. Can you talk a little bit more about how we should be thinking about the phasing of that here in 2020? And then, what is the international opportunity on the collabs that you guys have been introducing to the market? Thank you very much.

Q

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Yeah. Thank, Erinn. So, collabs, you've probably seen we've started to ramp up – the way to think about phasing is they are sort of now through summer and then we have another pulse in late Q3, Q4. That's basically how we phase it. So, through the summer and then leading up to holiday are our two periods that we focus on for collabs. I think we've seen that those work most effectively in the past. In terms of kicking off 2020 collabs, you saw we did KFC a couple of weeks ago, which I'd have to say that was not really oriented around selling a lot of pairs. The pairs that we sell will actually be in March, and we delayed that because we wanted to have access to the Chinese market for that, because obviously KFC is very important in that marketplace. But I would say the media attention, the PR and the earned media we got from that was probably one of the best we've ever done, to be quite honest. It was – that was really impactful. You also saw us tease one this week, which, if you haven't figured it out, that will be coming out at the weekend.

A

And then from an international perspective, absolutely. I would say today, we probably have on the schedule more than double what we did last year from an international perspective. And that's probably one of the key focuses is getting more international collabs, which would be China, Asia, and Europe.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Got it. Thank you, guys, and all the best.

Q

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Thank you.

A

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

Thank you, Erinn.

A

Operator: Our next question comes from the line of Jonathan Komp from Baird. Go ahead, please. Your line is open.

Jonathan Robert Komp

Analyst, Robert W. Baird & Co., Inc.

Yeah. Hi. Great. Thank you. Just, I mean, first, following up on the coronavirus impact and the guidance. Could you just remind us the size of China today? Is it still kind of 7% or 8% of sales? And then, when you look at the trend in the rest of your Asia business, it's pretty clear that China saw a sharp falloff. Can you maybe just talk about kind of the direct share and the recent trend you're seeing, and is it intensifying in terms of the traffic declines or how do you think about kind of the rest of the Asia business?

Q

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

Sure. So, we don't normally disclose China because it's not a disposable segment, but for purposes of this, it was about 5 % of revenue in 2018, is the right way to think about it. And so, obviously, we're seeing the impact in China.

A

And then, I would say from our direct markets, the biggest impact market that we're seeing are really Singapore, Korea, and Japan. And that's really on mostly the retail side and pretty large drop off of traffic.

And then as far as the Southeast Asia market, we know that Thailand, as Andrew mentioned, is very exposed to from a tourism perspective. So, we are also hearing from our distributor partners that certain of our markets in Southeast Asia are experiencing large drops in traffic.

Jonathan Robert Komp

Analyst, Robert W. Baird & Co., Inc.

Okay. That's really helpful. And then, more broadly on the earnings guidance. Just two questions there. I think, first, excluding kind of the coronavirus impact, looks like very strong growth still. So, I wanted to ask maybe what's driving, especially kind of gross margin and what you're seeing for the year.

Q

And then just, also when you look at the range, you have pretty wide range, obviously implied high end versus the low end. So what's – like what are the major moving parts or assumptions that you embedded in the range?

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

A

Yeah. So, Jonathan, let me give you kind of sort of what's the sort of flavor as to what's driving it and what we're assuming, and then Anne will dig into some of the components that you are alluding to there in terms of margin and SG&A.

So if you think about, yes, we still got underlying growth. So despite the coronavirus impact that we called out, our full year guidance still directs you towards strong growth. That growth is coming from the Americas and EMEA. And if you kind of look back at Q4, you really start and I would say 2019 for the full year and certainly the latter period of the year, you start to see growth accelerating in EMEA. So, we think Americas and EMEA are strong drivers of our growth.

The causation of that growth is kind of what we've been talking about. So product, marketing, connecting with our consumer, driving brand relevance and awareness, I think that's working extremely well, and we're seeing really clear evidence of that spreading. So, we feel good about that. You know, obviously, without these impacts, we think that we would have started to see that in Asia and we'll start to see that in the future in Asia. But I think we've got a clear game plan to drive growth.

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

A

Yeah. Just to reiterate what Andrew said, the underlying business is strong and we wouldn't be updating guidance if it wasn't for the coronavirus. Taking that into account, when you think about gross margin directionally for the year, we do expect adjusted gross margins to be up as we continue to have stronger product margins and tailwinds from higher prices and mix.

And then, as discussed in our prepared remarks, we have \$3 million of charges associated with our new Netherlands DC that we expect to open in 2021. But we had \$12 million in charges last year associated with our US DC. And then, we expect continued improvement throughout the year. And our US DC and that ramping up, we don't expect the full impact this year from the 100 basis points, but we will get that on an ongoing basis, on an annualized basis as soon as we're at full productivity level.

Jonathan Robert Komp

Analyst, Robert W. Baird & Co., Inc.

Q

Okay. And any chance of quantifying just kind of how much you think gross margin will be up or any more detail there? Thanks for taking the questions.

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

A

I think the way that I would think about that is that it's embedded in our overall EBIT margin guidance of 11% to 13%. So, I would say gross margins going to be up, SG&A, when we planned SG&A, we planned investments in marketing, China, and capabilities and certain functions, obviously planning a pretty big growth year. And we also plan to invest an incremental \$20 million in marketing. So, even though we have the impact of coronavirus on 2020, we really don't want to jeopardize our long-term growth and still expect to invest. So, we only expect modest leverage in SG&A. So, with those pieces, you can get to the overall guidance.

Jonathan Robert Komp

Analyst, Robert W. Baird & Co., Inc.

Okay. Understood. Thank you.

Q

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Thanks, Jonathan.

A

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

Thank you.

A

Operator: Our next question comes from the line of Mitch Kummetz with Pivotal Research. Go ahead, please. Your line is open.

Mitch Kummetz

Analyst, Pivotal Research Group

Yeah. Thanks for taking my questions. Just maybe a couple on coronavirus and then I got another one. So, just to be clear, your \$40 million to \$60 million, that's just Asia. You're not assuming anything for Europe, even though if it always – it is a problem now.

Q

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Yeah. I mean, that's broadly true. I think the thing that we're conscious of is potential supply disruption in the future. But we don't see that in the first half significantly. And as Anne alluded to earlier, I think we have some inventory buffer in the US. So, that's really predominantly Asia.

A

Mitch Kummetz

Analyst, Pivotal Research Group

And then on the EBIT margin guidance for both Q1 and the full year, actually, maybe just at the full year, the 11% to 13%. In the press release, you kind of talk about provisions in Asia as a [Technical Difficulty] (00:37:11-00:37:20) for the year is like 50 basis points, 100 basis points that you factored in...

Q

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Mitch, could you...

A

Mitch Kummetz

Analyst, Pivotal Research Group

...for coronavirus?

Q

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

The line went dead in the middle of your second question.

A

Mitch Kummetz

Analyst, Pivotal Research Group

Oh, sorry, yeah, I think I've got a bad line. How much are you factoring in the EBIT margin on coronavirus?

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

The flow-through of our revenue, plus I would say the one-time charges that we outlined of approximately \$5 million, and that's really related to some things around stores that we may want to take some store closures early just based on traffic level.

Mitch Kummetz

Analyst, Pivotal Research Group

Okay. And then just last question. As you think about this explorer consumer that I think is driving a lot of your incremental revenue growth. Have you started to see much demand outside of classic clogs yet? I know that like the Brooklyn wedge collection is new, I think you're going to be focusing more on – I think you said on the call that some of the celebrities and collabs outside of just clogs. So, are you starting to see demand pick up in other areas outside of clogs, particularly with that consumer?

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

I would say the majority of the interest from that consumer is probably still on the core clog at this stage. And I think it's really early in our 2020 product introduction plans. And as you rightly pointed out, we have focused a set of products and a set of marketing strategies on engaging that consumer in a wider set of product strategies. I think it's really too early to say.

I would say sandals that we have planned for this year I think we are really optimistic about, and obviously very, very early. But where we see performance of some of those sandals on some of our DTC channels, I think we're feeling good about where we are.

Mitch Kummetz

Analyst, Pivotal Research Group

Got it. All right. Thanks.

Our next question comes from the line of James Chartier with Monness, Crespi. Go ahead please. Your line is open.

James Chartier

Analyst, Monness, Crespi, Hardt & Co., Inc.

Good morning. Thanks for taking my questions. So Andrew, earlier, I think you said that you expect recovery in the second half of 2020. Is that just the coronavirus impact goes away or do you expect some of the demand that's impacted related to the coronavirus to shift into third or fourth quarter?

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

I think it's mostly that we expect the lack of commercial activity, commerce activity, shopping and being in malls to subside in Q3 and Q4. People will be back out in the malls. I think most of the demand in the Asian countries is

lost. I don't think it just pushes out. There's no reason to believe that they would buy more in the back half of the year because they didn't buy in the first half of the year.

James Chartier

Analyst, Monness, Crespi, Hardt & Co., Inc.

Q

Okay. And then Anne, on the non-recurring store closing cost, you quantified \$3 million in the first quarter but you didn't quantify it for the year. Is there additional cost beyond first quarter related to those store closings?

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

A

Yes. So what we've talked about related to Asia, mostly charges related to Asia, one-time charges for the year is \$5 million, \$3 million being in Q1.

James Chartier

Analyst, Monness, Crespi, Hardt & Co., Inc.

Q

Okay. And then just by my math, the \$40 million to \$60 million impact is 3% to 5%. Would you add that to your sales guidance for the year comes out to 13% to 15% which is 1% above your previous guidance? Is there an implicit raise to the underlying business or is that math off?

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

A

Yeah, I think within very close to our original range. Obviously, we continue to see strength in our underlying business as we talk about, and we feel really good about the underlying business excluding kind of the extraordinary events with the coronavirus.

James Chartier

Analyst, Monness, Crespi, Hardt & Co., Inc.

Q

Okay. That's all I have. Thanks. And best of luck.

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

A

Yeah.

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

A

Thanks, Jim.

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

A

Thanks.

Operator: [Operator Instructions] And our next question comes from the line of Sam Poser with Susquehanna. Go ahead, please. Your line is open.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

Thank you for taking my question. Most of the stuff that I wanted to know about has been asked. But I guess the question is this, in the fourth quarter, was Asia Pac – how did Asia Pac do relative to your internal expectation from both say sales and margin perspective?

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

A

Yeah. Our Asia growth in the fourth quarter was 15%. So, we were pleased with that growth. Some of it we're starting to see the pickup in wholesale. And then, we had extremely strong e-commerce growth which was in line with our strategy of opening marketplaces and really focusing on digital. So, we were pleased with our Asia growth in the fourth quarter.

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

A

Yeah. Consistent with our plans, Sam.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

And so, there's – so if we think ahead a year, I mean, once the dust settles and you're not going to make – may not make up the sales this year, but you should make – you should run a very healthy increase at the end – at the beginning of next year theoretically as if the brand momentum continues as you have planned. Is that a fair statement?

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

A

Yeah. I mean, Sam, I'm not going to comment on – sort of on long range growth expectations. I think we've highlighted we will definitely do that in the later this year when we plan to hold an investor conference. But, yeah, I think as we've talked about repeatedly, we definitely see Asia as our largest long-term growth opportunity based on the size of the markets that we are participating in, the direct markets where we participate and also the indirect markets, the distributors that we have in those marketplaces. So, it was important to us that we were able to achieve the growth that we did in Q4. And in the future once the dust settles from coronavirus, we will be – we are focused and we will continue to be very focused on driving growth in Asia.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

And then just a follow-up on that. Other brands have talked about how business – how their business was, let's say, for the first three weeks of January. Can you give us some idea of the trend prior to the advent of the coronavirus?

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

A

Yeah. So we don't – thanks, Sam. We don't talk about trends within the quarter. But just going back to Q4, because I think that's relevant, with our 15% sales increase, we saw really strong growth within our Southeast Asia distributor markets in India especially and in e-comm. And you know I think that's the best way to think about it.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

Okay. And then just to follow up on somebody else's questions. I mean are you for – are you seeing or do you foresee any impact of the coronavirus in, let's say, Europe, Australia or the Americas within your – is there any impact in markets other than in Asia baked into the sales reduction that you provided?

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

A

Yeah. So, look, it's a very fluid situation, Sam. As you're aware of, from what you've highlighted, look, Australia, absolutely. I mean, clearly, we're already seeing that. It's a strong tourist destination out of China. And so, you can see that impact already. I don't know about Europe, to be quite honest. Obviously, the explosion in cases in northern Italy and potentially that spread in Europe is something that's very recent. It's really this week. And it's very hard to contemplate what that would have. And really, any impact in Europe is not built into our expectations.

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

A

Yeah. And if I could just elaborate just to clarify one thing, Australia is actually considered part of our Asia region.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

Yeah.

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

A

So, that would be included in our guidance. It's actually pretty small for us, but that Australia is included in our Asia region in your guidance, whereas Europe is not.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

And then lastly, I promise you, can you talk about like sort of the evolution of the management of the brand and the – and what's really sort of besides the product and maybe it's the manner by which you're marketing them, the way you're segmenting the products and so on. In North – in the Americas, how that's working and how – and where that is, all other things being equal, in Europe and Asia?

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

A

Yeah. That's a very good question, Sam. So, I would say as we kind of look at our marketplaces, obviously, the Americas – the US market is by far the most sophisticated. And I think what you're alluding to is we've definitely instituted and are focused on a marketplace management strategy, which allows us to manage which products go to which channels, how much they are allocated, if you like, and make sure that we have the right products in the right places for the right consumers. Clearly, it's different consumers going to different channels and we are working actively on that. We're pleased with where we are on that. And I would say the vast majority of our retail partners are also pleased with that to see it's very proactively managing the marketplace.

That need is also – there's also a need in Europe, and we're transposing some of those marketplace management techniques to Europe. It's less relevant in other markets which are far less sophisticated. But it is a

key element of our ongoing strategy, and we think it's an important element because it drives – it will drive longevity and sustain our growth strategy – our growth over time.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Thank you. And good luck with all that.

Q

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Thank you, Sam.

A

Operator: Our next question comes from the line of Jim Duffy with Stifel. Go ahead, please. Your line is open.

Jim Duffy

Analyst, Stifel, Nicolaus & Co., Inc.

Thank you. Good morning. First, congratulations to the team on a terrific year in 2019.

Q

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

Thanks, Jim.

A

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Thanks, Jim.

A

Jim Duffy

Analyst, Stifel, Nicolaus & Co., Inc.

And I wanted to ask, with respect to the 2020 guidance, can you guys speak to the wholesale growth rates and B2C comps assumed in the guide? And I'm specifically curious what's assumed for North American B2C comps.

Q

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

Yeah. We don't break out the pieces. I would say that it's encompassed in our overall guidance, but we – from the American standpoint, we expect B2C comps to be positive and we expect good wholesale growth as well.

A

Jim Duffy

Analyst, Stifel, Nicolaus & Co., Inc.

Okay. And one of the reasons I ask, I'm curious expectations for mix and the influence there on ASP. Would you expect ASPs to increase on a year-to-year basis?

Q

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

Yeah. I would say all things being equal and ex-currency, because obviously that's a fluid situation, I would say, yes.

A

Jim Duffy

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah. Okay. And then, I wanted to ask some about inventories and the complexities of inventory management, given the virus disruptions. What are some of the considerations and the differences as it relates to inventory management in Asia that you see in between distributor markets and direct markets? Had you yet sold into the distributors when the virus came about for direct markets? What are the considerations for channel inventories? Can you guys speak through that a little bit, please?

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

A

Yeah, I think this is one of the areas that internally we're incredibly focused on, because it's going to be extremely fluid. I mean I think the broad dynamics that factories came back slower than we would have expected out of Chinese New Year because of the coronavirus. So, you've got some delays coming out of those factories.

You've also got reduction in demand, particularly in some of the Asian markets. So, you've got future supply that's not going to be consumed. So I would say we're very focused on kind of rescheduling supply, that's coming out of the factories that are producing and also redirecting supply that was intended for China and some of those other markets.

As Anne alluded to earlier, I think it's fortuitous that we improve, that we brought in a good amount of inventory into our North America marketplace ahead of an early Chinese New Year because that puts us in a better position there. But this is going to be a very fluid situation and we're going to be working very closely with our distributors and our wholesale accounts to manage this over the coming months.

Jim Duffy

Analyst, Stifel, Nicolaus & Co., Inc.

Q

And Andrew with respect to those distributors, had you yet sold into them for the spring summer season, or is that something that happens generally after the Chinese New Year?

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

A

No, I would say it's different in different parts of the world, but in Asia, they've taken – I think as Anne mentioned, they've taken quite a lot of supply in Q4 and very early Q1. In Latin America and EMEA, it's flowing as we speak. But so, it's different in different parts of the world.

Jim Duffy

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. And then last one for me, I'm curious how you're phasing marketing investments in Asia. You've made some investments in ambassadors for Asia. Can you talk about how you're leveraging those relationships, and have you delayed any programs or anything like that? You mentioned the KFC launch was delayed. Just how are you thinking about marketing investments in Asia? Are you able to delay that till later in the year when it may be more impactful?

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

A

Yeah. So, I mean, I think that obviously China was a really big focus for us, it was I think a very big coup for the brand to be able to land Yang Mi as a – as our brand ambassador. And as we revealed her and launched that, really pre-coronavirus, it had a great impact. We saw a tremendous social media engagement and we saw a nice impact from that so, but obviously with stores being closed, we have pulled back on some of that activity and we'll push it into later in the year.

Jim Duffy

Analyst, Stifel, Nicolaus & Co., Inc.

Thank you.

Q

Anne Mehlman

Chief Financial Officer & Executive Vice President, Crocs, Inc.

Thank you.

A

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Thank you.

A

Operator: And there are no further questions at this time. I'd like to turn the call back over to our presenters.

Andrew Rees

President, Chief Executive Officer and Director, Crocs, Inc.

Thank you very much. I appreciate everybody's interest in the company. Obviously, a difficult – an interesting time and difficult time for all of those impacted by the coronavirus. But as a company, we're very much focused on the well-being of our employees and managing the situation go forward. So, we appreciate everybody's ongoing interest in the company.

Operator: And this does conclude today's conference call. You may now disconnect.

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