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Crocs, Inc. (CROX)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day welcome to the Crocs, Inc. Quarter and Full Year 2022 Earnings Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, today's event is being recorded.

I would like to turn the conference over to Cori Lin, Vice President, Corporate Finance. Please go ahead.

Cori Lin
Vice President-Corporate Finance, Crocs, Inc.

Good morning, everyone, and thank you for joining us today for the Crocs fourth quarter and full year 2022 earnings call. Earlier this morning, we announced our latest quarterly and annual results and a copy of the press release may be found on our website at Cox.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 provisions of the federal securities laws. These statements include, but are not limited to statements regarding the acquisition of HEYDUDE and the benefits thereof Crocs's strategy, plans, objectives, expectations, financial or otherwise, and intentions. Future financial results and growth potential, anticipated product portfolio, our ability to create and deliver shareholder value and statements regarding potential impacts to our business related to the COVID-19 pandemic. These statements involve known and unknown risks, uncertainties, and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performance, or achievements expressed or implied by the forward-looking statements. Crocs is not obligated to update these forward-looking statements to reflect the impact of future events except as required by applicable law 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 and our subsequent filings with the SEC. Accordingly, actual results could differ materially from those described on this call. Please refer to the Crocs Annual Report on Form 10-K as well as other documents filed with the SEC for more information relating to the risk factors. Adjusted gross profit, adjusted gross margin, adjusted selling general and administrative expenses, adjusted income from operations

and operating margin, adjusted income tax benefit and effective tax rate, adjusted basic and diluted earnings per common share are non-GAAP measures. 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, Chief Executive Officer and Anne Mehlman, Executive Vice President and Chief Financial Officer. Following their prepared remarks, we'll open the call for your questions. At this time, I'll turn the call over to Andrew.

Unverified Participant

Thank you, Cori. And good morning, everyone. As you saw in our press release issued this morning, we delivered extraordinary 2022 results, including record $3.5 billion in sales and industry leading adjusted operating margins of 27.7%. These results underscore the high consumer demand globally for the Crocs brand, the growing momentum of the HEYDUDE brand. And our ability to consistently deliver strong profitability while investing for the future. Looking forward to 2023, we expect another year of robust revenue growth, top tier margins and significant cash flow generation.

Now let me share a few highlights from the full year of 2022. Total revenues grew 54% as we added a second fast growing brand, HEYDUDE. Crocs brand revenues were $2.7 billion, increasing 19% on a constant-currency basis. Crocs brand increasing 19% on a constant currency basis. Crocs brand international growth was exceptional at 47% constant currency for 2022 and accelerating to 75% constant currency growth for Q4 in both Asia and EMEALA. HEYDUDE brand revenues exceeded initial expectations and reached nearly $1 billion on a pro forma basis and delivered over $275 million in adjusted operating income.

Consolidated digital revenues grew 58% to represent 37.8% of 2022 revenues. Exceptional adjusted gross margins of 54%, even with significant freight and inflationary pressures. Adjusted income from operations increased 42% to nearly $1 billion and adjusted operating margins of nearly 28%.

Adjusted diluted earnings per share increased 31% to $10.92, and strong cash flow allowed us to reduce gross leverage from 3.1 times upon the acquisition of HEYDUDE to 2.25 times at year end. As we transition to 2023, I want to give you an additional insight into three of our long-term growth drivers for the Crocs brand, sandals, international and innovation in both product and marketing, as well as provide an update on HEYDUDE.

Sandals an important growth initiative for Crocs, allowing us to expand into the adjacent $30 billion global sandal category where we believe our molded technologies, accessible price points, strong go to market, will allow us to compete effectively in a relatively fragmented market. The category also provides an additional entry point to the Crocs brand for consumers who may not choose to engage with the clock. We know our sandals resonate with consumers, since our consideration is now on par with that of Crocs and we already have a sizable $310 million sandal business. Within sandals, we refined our focus on four subcategories, every day, style, street/sport and adventure. The everyday category offers broad reaching classics for everyone and includes a personalizable slides, two straps and flips. Our Style category is female centric, trend driven and includes styles such as the Brooklyn, Crush and Mega Crush. Our street/sport category is rooted in street style, with a focus on hip but inclusive of her, and includes only echo and mellow franchises. Finally, our adventure category has functional design for the whole family and includes our all terrain and swiftwater franchises. 2022 for the Crocs brand sandals was a year of two halves. In the first half, sandals revenues declined due to the lack of newness following the Vietnam factory shutdowns in 2021. In the second half of 2022, sandals grew by 31% as we introduced a strong cadence of newness, such as the Crush, Mallow and Echo, supported by effective sandals, specific

marketing. We're incredibly confident in sandal growth in 2023, given planned newness and a significant increase in marketing allocated to sandals and the strong Crocs brand trajectory in important sandal markets such as India and South East Asia. With respect to newness in our style category, we're planning additional height and new uppers in our popular Brooklyn franchise in our street / sport category. We continue to use innovative technology in a Mallow franchise and will launch a new flip during the year. With the new product introductions, marketing investments and regional brand momentum, we expect sandals to be our fastest growing product category in 2023 marketing investments and regional brand momentum, we expect sandals to be the fastest growing product category in 2023, reaching approximately $400 million in sales.

Moving to another important growth driver for the Crocs brand, our international markets. We have now seen eight consecutive quarters of strong double-digit growth outside of North America. We anticipate even greater growth as the Crocs brand has approximately one-third the penetration internationally that it has here in the US. The drivers of this growth are in essence, the same drivers of growth that we saw in the US. First, focusing on our iconic clock and driving relevance with innovation and collaborations.

Second, leveraging Jibbitz for personalization and consumer engagement. Third, expanding our addressable market with sandals. And finally, always on social and digital marketing to continuously engage our existing and new consumers. A unique playbook for Crocs has been successful in the US and across all of our key focus markets. In EMEA, Western Europe grew revenues by 38% constant currency with the United Kingdom, up 105% constant currency. In Asia, South Korea grew over 30% constant currency, despite having an already high level of penetration. India grew 91% constant currency. Additionally, we see our global brand building activities having a halo in many of our distributor markets, resulting in triple-digit revenue growth in Latin America, the Middle East and Southeast Asia.

China has been a unique case. As you know, we completed the repositioning of our China business in 2021. Since then, China has been constrained by COVID lockdowns. Yet we still invested in our team and in marketing to build brand relevance. We've seen green shoots in the second half of 2022. Revenues grew 35% constant currency.

As China reopens and the consumer returns to more normalize shopping, we're excited about the prospect of building significant Crocs brand presence in 2023 and beyond. Well, still a smaller base than we would like. We expect China to grow approximately 30% in 2023.

Products and marketing innovations is another important driver of the Crocs brand. Our marketing calendar is extremely robust as we look to put more Crocs on more consumers. In 2023, we expect to have record new product introductions, some of which I mentioned when discussing sandals. Product newness will be critical to our always on brand drumbeat, as well as a strong pipeline of more than 60 global brand partnerships across a healthy mix of celebrities, megabrands and licenses, of which 25% will be regionally led.

We will invest in a record amount of marketing dollars over $200 million to drive the Crocs brand relevance, amplifying our products and engaging new and existing consumers. This will be achieved by maintaining our digitally led and social first approach to engage consumers through digital first drops social innovation and brand ambassadors.

Turning now to HEYDUDE, today represents our first full year of ownership, and we've accomplished a lot. The integration is on track. Although there is still much work to be done. We've developed a clear plan for the brand and the future is bright. With respect to recent accomplishments, there are many. We have updated the brand identity and clarified its purpose and meaning. We've expanded the line with several new icons to be trialed in

2023. Staff, the entire leadership team and hired over 150 roles. Stabilized and expanded the manufacturing footprint, developed a business systems roadmap, expanded distribution capabilities to handle the immediate throughput needs, turned over many international distributors and spent nearly $60 million of marketing in the second half alone, which on an annualized basis was almost 4x the amount spent in 2021.

We've also seen great initial results exceeding our expectations. Brand revenues in 2022 grew 70% on a pro forma basis, driven by wholesale partner expansion in the United States. DTC revenues were approximately 36% of sales. Gross margins have been lower than anticipated due to channel mix, unfavorable pre acquisition freight contracts and higher inventory handling costs as we work to expand the HEYDUDE distribution center to support the $1 billion and growing brand.

Even with this, HEYDUDE generated over $275 million and adjusted operating income a 31% adjusted operating margin. Well, we have more to do. We are incredibly excited about our results thus far. The potential for the HEYDUDE brand and the value this acquisition will generate for shareholders.

The addition of HEYDUDE has brought other benefits as well. It enables us to access a larger addressable market, which is now approximately $160 billion on a global basis versus $40 billion prior to the acquisition. We are now far more diversified from a product perspective with casual HEYDUDE silhouettes representing 27% of 2022 revenues on a pro forma basis, Crocs representing 57% of consolidated revenues.

Finally, we substantially leverage our shared services across the two brands, further supporting our industry leading operating margins.

Before I turn the call over to Anne, I'm incredibly proud that our five year annualized TSR of 54% would have placed Crocs Inc..

As a number two best performing company in the S&P 500. This exceptional performance is a testament to our strategy, our execution and our talented team. I want to express my gratitude to the entire Crocs, Inc. organization for the hard work and commitment to delivering best-in-class growth and profitability. 2022 was a transformational year as we integrated HEYDUDE. But the Crocs and HEYDUDE brands enter 2023 with incredible strength and momentum. I'm confident in our brands, our team and a demonstrated ability to deliver sustainable growth, profitability and shareholder value.

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

Anne Mehlman

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

Thank you, Andrew. And good morning, everyone. I'll begin with a recap of our fourth quarter results. All revenue growth rates will be cited on a constant currency basis unless otherwise stated. For reconciliation of non-GAAP amounts mentioned to their equivalent GAAP amounts please refer to our press release.

Our fourth quarter results were outstanding $945 million in consolidated revenues, a 64.8% increase to prior year, aided by the addition of HEYDUDE. We continued to deliver top tier profitability with adjusted gross margin of 53.3%, adjusted operating margin of 26%, and adjusted earnings per share of $2.65 up 23% to fourth quarter of last year. Strong profitability and tight working capital management enabled us to repay $300 million on our term loan B facility in the quarter.

I will now detail our revenue highlights by brand, beginning with the Crocs brand. During the quarter we sold 27 million pairs of shoes, an increase of 20.8% over last year. Our average selling price in Q4 was $23.95, a 6.8% decline on a reported basis and a 3.6% decline on a constant currency basis. It's a slight decline in North America associated with higher DTC promotions, offset constant currency ASP increases internationally. Importantly, while the North American markets became more promotional in the second half of the year and helped drive those channel inventories to a healthy level, the Crocs brand was still less promotional in the fourth quarter and for the full year than pre-pandemic. From a product perspective for the fourth quarter, results continue to be driven by our key product pillars. Clocks, Sandals and Jibbitz. Sales of Clocks increased 9% to become 79% of Crocs Brand revenues with growth of our profitable classic clock franchise outpacing that of other clocks. Sandals grew 53% in the quarter to represent 10% of brand revenues. Jibbitz continued to drive consumer engagement and grew 13% to become 8% of brand revenues.

For the full year, clocks were 77% of brand revenues, sandals were 12%, and Jibbitz grew 27% to become 8% of brand revenues. Now let's review Crocs brand highlights by region for the quarter. North America revenues of $457 million were relatively flat from 2021 as strong DTC growth of 18%, an indicator of underlying consumer demand was largely offset by a 25% decline in wholesale. DTC comparable sales for North America increased 13% on top of 53% DTC comparable sales growth in the fourth quarter of 2021. Digital led the growth driven by brand strength and newness. [indiscernible] declined as we continued to proactively manage market health with our partners in the fourth quarter. Brick and mortar channel inventory in North America is very healthy with on-hand inventory levels down double digits versus prior year. Similar to the third quarter, Crocs Brand growth was led by International with both Asia and EMEALA revenues up 75% in the quarter. Asia Q4 revenues were $91 million, up 74.8% from last year. As Andrew mentioned we saw broad-based growth across all channels and all of our key focus markets. South Korea and India continue to outperform and grew strong double digits during the quarter in the year. China faced periodic COVID lockdowns. However, it grew 38% for the quarter following 34% growth in Q3. EMEALA revenues increased an exceptional 75.6% over Q4 2021, despite our exit of direct Russia operations. Momentum has been building over the last two years and resulted in broad-based growth in our direct and distributor markets. Overall, we are extremely pleased with the underlying strength of the Crocks brand internationally.

Turning to HEYDUDE, revenues were $279 million, growing 36.6% from Q4 of 2021. Digital sales were particularly strong during holiday and constituted 51.6% of brand sales in the quarter. We remain confident in the potential of the brand and look forward to sharing our growth strategies and plans in the future. From a channel perspective, digital remains are top priority for both brands as it enables us to meet our consumers in their preferred channel. During Q4 2022 our consolidated digital business, which combines e-commerce and e-tail, grew 80% on top of 41% growth in Q4 of 2021.

Digital penetration for the quarter was 45.1%, up from 40.3% last year and 34.2% in 2019. Our digital growth benefited from product newness, refined user experience, and additional marketing activities that drove strong traffic. Consolidated adjusted gross margin for the quarter was 53.3%, down approximately 1,000 basis points from last year. About half of the compression to consolidated adjusted gross margin is related to the addition of the compression to consolidated adjusted growth margin as related to the addition of the HEYDUDE brand. Crocs brand adjusted gross margin was 56.1% or 760 basis points lower than prior year, which was an atypical year as we took price ahead of inflation and had an overall lack of promotions in the industry. The decline in adjusted gross margin is attributable to approximately 340 basis points of promotions, 180 basis points of inflationary costs and a 180 basis points of higher freight and inventory handling costs. Currency negatively impacted gross margins by 70 basis points. HEYDUDE brand gross margin for the quarter was 46.4% with positive channel mix was offset by the continued effect of legacy freight contract costs, higher inventory storage costs as we work to expand distribution center capabilities to support the larger business and holiday promotional activity.

Our Q4 adjusted SG&A at 27.3% of revenues improved by 780 basis points compared to prior year. This excludes $18 million of cost in Q4, primarily related to the shutdown of our Russia direct operations and the HEYDUDE acquisition and integration. For full year 2022 adjusted SG&A leveraged 490 basis points to 26.7%. The significant decrease in adjusted SG&A area for the quarter and the full year is due to leverage of shared services across both brands even as we invested over $215 million this year in additional marketing, talent and infrastructure to support future growth. Our fourth quarter adjusted operating margin declined 260 basis points to 26%, compared to 28.6% for the same period last year as gross margin pressures offset SG&A leverage. Fourth quarter adjusted diluted earnings per share increased 23.3% to $2.65. For the full year 2022, let me recap a few highlights. Total revenues grew 54% to $3.55 billion, with Crocs brand revenues increasing 19% on a constant currency basis on top of 65% growth in 2021. And HEYDUDE brand revenues reaching nearly $1 billion on a pro forma basis. Crocs brand international growth was exceptional at 47% constant currency. Adjusted income from operations decreased 42% to $986 million, and adjusted operating margin of 27.7% remains industry leading.

Full year adjusted diluted earnings per share increased 31% to $10.92. We concluded 2022 with a strong liquidity position comprised of $192 million of cash and cash equivalents and $749 million of borrowing capacity on our revolver. Through strong cash flow generation and tight working capital management, we prepaid $300 million on a term loan B during Q4, reducing total borrowings to $2.3 billion and gross leverage of 2.25 times and net leverage to approximately 2.1 times.

We remain focused on deleveraging to under 2 times gross leverage by the middle of 2023. Our inventory balance at December 31, 2022 was $472 million increase of $169 million of HEYDUDE inventory. The Crocs brand inventory balance was $303 million, a 42% increase over prior year and continues to decline sequentially, down 7% versus the third quarter. Our higher inventory reflects revenue growth, higher cost in inventory and a very low level of inventory last year due to limited availability with the factory closures, well-headed inventory slightly elevated from pre-acquisition purchases. Crocs brand inventories very healthy. Our entire team is extremely focused on inventory health Crocs brand inventory is very healthy. Our entire team is extremely focused on inventory health, especially as we grow. In 2022, capital expenditures were $104 million. A little over half of this investment was in our distribution centers as we expand and automate our facilities. The balance of the investment was in our information technology, retail fleet and corporate offices. All of these investments support future growth. And as I mentioned, we will continue to invest in the business to fuel and sustain growth.

Now, turning to the future, I would like to share our current outlook for Q1 and then full year 2023. For Q1, we expect consolidated revenues to grow approximately 27% to 30% at current currency rates, with the Crocs brand growing double digits. We expect adjusted operating margin to be between 24% and 25% and adjusted diluted earnings per share of $2.06 to $2.19.

For the full year 2023. Our guidance contemplates some conservatism as we are cautious about the impact of macroeconomic events, particularly on the US and European consumer as the year progresses. Even with this, we continue to expect revenue growth of 10% to 13%. Assuming current currency rates. For Crocs brand revenues, we expect to grow 6% to 8% and 9% to 11% in constant currency, with growth in all regions and all channels. For HEYDUDE brand revenues we expect growth to be in the mid-20s on a reported basis.

We expect consolidated adjusted operating profit margins of approximately 26%. This includes an anticipated benefit to Crocs brand gross margin associated with lower inbound freight rates and the clawback of airfreight, slightly offset by channel mix and the growth in sandals. For the full year 2023, we expect our underlying non-GAAP tax rate, which approximates cash tax paid to be approximately 20%. Our GAAP tax rate will be approximately 24%.

We anticipate non-GAAP earnings per share to be approximately $11 to $11.31 in 2023, which does not assume any impact from potential future share repurchases. It also incorporates increased interest expense on a floating rate debt associated with the current rate environment. To support growth for both brands, we expect to invest approximately $165 million to $180 million in capital expenditures. Investments include expansion of our distribution capabilities, including our new HEYDUDE and DC in Las Vegas implementation of new technology systems for HEYDUDE, an expansion of our corporate facilities to support our growth.

In 2023, we estimate approximately $30 million of one-time charges, primarily related to the aforementioned capital investments and are fairly balanced across COGS and SG&A. We expect the combined brands to generate significant cash flow, allowing us to achieve two times less gross leverage by the middle of this year. Our capital allocation priorities are first to invest in the business and second to balance deleveraging with the ultimate goal of reaching 1 to 1.5 times net leverage and resuming our historically successful share repurchase program.

In summary, throughout 2022, we delivered strong revenue growth, profitability and cash flow. With the underlying strength of the core Crocs business and the addition of HEYDUDE, we are confident we have positioned ourselves for sustained profitable growth, strong cash flow generation and significant value creation for our shareholders.

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

Andrew Rees

Chief Executive Officer & Director, Crocs, Inc.

Thank you, Anne. Crocs, Inc. had an exceptional year in 2022. The Crocs brand is resonating strongly with consumers throughout the world and we are confident in continued growth led by Sandals and International. The HEYDUDE acquisition is exceeding expectations. Integration is going well and we have a clear plan for growth. I could not be more excited for the future and the tremendous value creation opportunity for shareholders.

Operator, Please open the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. And we will now begin the question-and-answer session. [Operator Instructions] At this time we will pause for a moment to assemble our roster. And our first question today will come from Jonathan Komp of Baird. Please go ahead.

Q

Yeah. Hi. Thank you. Good morning. Anne can I ask a follow-up on the first quarter guidance? I believe you said the Crocs brand should grow double digits. Can you give a little more color how that might look geographically? And then a bigger picture question for 2023 for the Crocs brand, are you expecting North America to grow for the full year? And could you comment on some of the drivers, across some of the product initiatives and the channel performance you're expecting?

A

Sure. Hi, Jonathan. Morning. So, let me start with the full year and then I'll talk about Q1. So for full year, I shared we expect the Crocs brand to go 6% to 8%, which is about 9% to 11% at given constant currency. And growth is really going to be powered by international, but the US will grow. I think we're currently cautious about the consumer in the US, especially in the back half, but we're still interested in growth over last year driven. And that growth is really going to be driven by sandals and newness. And we do expect North America to have good growth in Q1 as well.

And then from just an overall channel perspective, we still expect DTC to lead the growth in our North America region for this year that we know we continue to focus, especially at our e-com side.

A

Yeah. And just about maybe a tie to color to that, John. I think one of the reasons that DTC is leading the growth that's where we have the newness, the fastest, right. We were able to bring a lot of our new sandals and new styles to our DTC environments in Q4 and they're showing up faster, as you'd expect in our DTC environments, both e-commerce and store in Q1. You know, we're extremely pleased at this at this point with the performance we're seeing and we're excited as those new products are supported by our social digital marketing flows to also.

Q

That's great. And then one follow up on the outlook for the Crocs brand gross margin. It looks like you quantified a little over 400 basis points from airfreight investment and then higher freight and inventory handling in 2022. So as we think about some of those costs coming back into the business as a benefit, would you expect Crocs brand gross margin to be back to the 58% level? Or could you maybe just give some color on the puts and takes you see there? Thank you.

A

Yeah. Let me, yeah, that's a great question. So let me just take a minute to recap. So 2022, obviously were anniversary and a high point for 2021. So our Crocs brand adjusted gross margin finished at 56.7%, which is about a 500 basis point decline to 2021. And as you mentioned, we had about 220 basis points of airfreight that will come back and then about 190 basis points of higher freight inventory handling costs that we talked about coming back over the year. And then the rest is really related to inflationary costs. We had promotions for about 90 basis points in in currency. For 2023 we do believe that Crocs brand will be largely in line with our long term expectations of about 58% gross margin. And then HEYDUDE is expected to increase year-over-year, but will ramp slowly or slower throughout the year because we need to continue to work through this subscale P&L network. So our consolidated adjusted gross margins for this year were projecting to be about 55% to 55.5%, including obviously the impact of HEYDUDE and we will continue, just one side note, we will continue to provide gross margin color by brands for the remainder of the year.

Q

That's all really helpful. Thank you.

A

Thank you.

A

Thank you.

Operator: Our next question today will come from Tom Nikic of Wedbuk, I'm sorry, Wedbush Securities. Please go ahead.

Tom Nikic
Analyst, Wedbush Securities, Inc.

Q

Hey, Andrew. Hey, Anne. Thanks for taking my question. I want to ask, so I believe you said North America Wholesale was down 25% in Q4. And I think on the Q3 call, you know, you kind of gave us like, you know the wholesale sell through that's going to give us a better indication of the demand for the brand in the wholesale channel. How did the sell throughs look in North America wholesale for Q4?

A

Yeah, I would say, Tom we were very happy with the performance of North American Wholesale in Q4. We ended the year with inventories in channel down double digits and that was one of our kind of primary goals was to make sure that we took, you know, is obviously going to be a promotional quarter. We anticipated that and we took advantage of that promotional quarter to make sure we're clearing out of, you know, end of season goods and also, you know, enabling our wholesale partners to effectively compete in what would be a promotional [indiscernible] it, and so we were very happy with the performance of the wholesale business was important to

keep our inventories in line. And as we kind of look at our end channel inventories, we think they are, we're very well positioned for 2023.

Q

Okay. If I can also ask on the inventory growth for the core Crocs brand guys I realize it's coming down sequentially, but, optically, it's still, it's a pretty big number plus I believe it's low-40s. How should we kind of think about that working its way down over the course of 2023 and do you see any risk that you're potentially over inventoried with core Crocs brand?

A

Yeah. I would Tom, I think there's a couple of ways, a couple of things to think about. One is, yes, it's a – it's a 40% growth over the same period last year. But if you remember, that same period last year was an exceptional low because it was immediately after the Vietnam factory closures, right. So, on a normalized basis, we actually think the Crocs inventories is very well positioned relative to our future growth plans. So on a normalized basis, it puts us at approximately a four turn, which is where we'd like to be from an inventory to sales ratio. We think that's kind of one of the best in the industry as best-in-class in terms of working capital management. And it allows us to have healthy core inventories and fill up once demand. It allows us to bring in new products at the rate we want to but not have access inventories on that. So we think it's about where we want it to be given what we expect for future growth.

Q

Understood. Thanks Andrew. And if I could just sneak one more in for you. The $30 million of one-time charges that you're expecting for 2023, can you give us a little bit more color as to what that comes from? I guess the description in the press release was, kind of investments for growth, which normally are kind of included in the adjusted numbers. But I'm just kind of curious, like what, what those will The numbers, but I'm just kind of curious like what those – target were.

A

Sure, there are kind of three buckets, but the majority of those are things that, were just consistent in how we talk about it. So distribution center overlap where we might be transitioning distribution center. So it's kind of overlap on as we're bringing up the [ph] Hadoop distribution center costs where we're playing duplicate rent and things like that. Also, same with we're making some changes as we talked about some investments in some corporate headquarters to expand and we're paying some duplicate rent there. So those are the majority of the charges. And then the other one is we're implementing a new ERP system for Hey dude. And those costs, we typically call out a one time as we don't typically implement ERP systems.

Q

That's helpful. Thank you. Thanks, Sam. And best of luck in 2023.

A

Thank you.

Operator: Our next question today will come from [ph] Abby Skeptic's from Piper Sandler. Please go ahead.

Q

Again. Thanks so much for taking my question. So how should we think about the cadence of gross margin in terms of tailwinds from lapping airfreight versus the promotions and the greater mix of Hey Dude revenue? And then just on the Hey Dude inventory competition, I think, it's a bit elevated, can you just talk about the reasons for this. Is this due to changes in wholesale partner behavior or more so on logistics? Just any color there would be helpful. Thanks.

A

Yes. Thank you. I mean, let me start with gross margins and I'll let Andrew talk about Hey Dude inventory. So from a gross margin perspective from Crocs brand expected to be a pretty normal cadence throughout the year. So a return to seasonal pattern, Q1 tends to be low just given the wholesale channel mix in the quarter. So I would just model that out as kind of normal, normal kind of, you know, pattern given the guidance. I think from a Hey Dude perspective, we do expect, as I mentioned earlier, to be lower in the first half as we're still rolling through some of those higher freight and storage costs. And then as we get into rolling off those costs, as well as into a better sized distribution center, we expect that to increase into the back half of the year. And that plays into our overall gross margin that we talked about from $55 million to $55.5 million.

A

Yeah. And I think on the second part of your question Abbie around HEYDUDE inventories, yeah, we feel that HEYDUDE inventories are heavier than we would want to be on a go forward basis. And I would say it's principally related to a number of factors. One is are inbound receipts that were ordered pre our acquisition that were probably not the right composition that we would have liked in terms of we know there was probably heavier on things that haven't sold as quickly, so we're going to have to work our way through those. There was also just the process of getting the whole planning function up and running effectively so that we can match demand with supply effectively. And we've been pretty good at that historically. On the Crocs brand, we have not been as good at that on HEYDUDE over the last year, but I think we're confident we'll get there. We I think we have plenty of opportunities to sell this inventory over the coming year. We're not panicked about it, but it's a little bit heavier than we'd like at this point.

Q

Perfect. I think...

A

[indiscernible] inventory just if I can voice over...

A

Yeah.

A

...one just quick note that that's our own inventory. We're actually very satisfied with inventory that we have in channel from a HEYDUDE perspective.

Q

Got it.

A

Yeah.

Q

Got it. And then on the on promotions, should we think about this as like more of a normalized level, especially as you guys are bringing in more and more newness and more like fashion risk or how are you thinking about the go forward promotional environment?

A

Yeah. So from a promotional standpoint, I mean, I think Q4 played out exactly as we anticipated from promotions on the Crocs side especially I think for this year, we expect it to be normalized promotion environment again I think for this year, we expect it to be, you know, normalized promotional environment. Again, I don't think it has to do with more of our product mix. I think it has more of a just a return to the norm of a promotional environment against, you know, very low promotional environment, 2021. As we said in our prepared remarks, we're still actually less promotional than we were pre-pandemic. So I do expect, you know, promotions to, you know, to maintain and pretty much be aligned from this point going forward.

Q

Got it. Thank you so much.

A

Thank you.

A

Thank you.

Operator: Our next question today will come from Laura Champine of Loop. Please go ahead.

Q

Thanks for taking my question. And congratulations on the international growth in Q4. If growth continues to be mixed towards international, how is that likely to impact gross margins if the mix continues to shift in that direction in 2023?

A

Yeah. Hi, Laura. It does depend a little bit on where that growth occurs. So if it occurs, you know, in our direct to consumer channels like anywhere else in the world, then that's obviously helpful from a gross margin standpoint. If, you know, obviously we've had really strong distributor growth, which is a headwind to gross margin, but carries no SG&A. So the higher the distributor growth have outperformed, it will impact gross margins a little bit, but it can be accretive overall because there's no SG&A associated with it.

And that would be embedded. Obviously, we've embedded, you know, good international growth into our guidance. So that would be embedded in our current margin guidance from a Crocs perspective.

Q

And you're incorporating sort of a stable mix of distributor versus DTC? Or do you think the outsized growth in distributors continues through this year?

A

I know it's a pretty stable mix. Actually, I think last year we had really strong distributor growth as we saw tourism returned to a lot of markets and we saw some restock. I think this year it's actually a much more balanced mix between some restart. I think this year is actually a much more balance mix between TGC and distributor.

Q

Got it. Thank you.

A

Yeah.

Operator: Our next question today will come from Sam Poser of Williams Trading. Please go ahead.

Sam Poser
Analyst, Williams Trading LLC

Q

Thank you for taking my questions. I have a, yeah small handful. Number one, you mentioned that you're going to increase the marketing, I would assume for both brands pretty aggressively. What kind of ROI are you assuming on those increased investments?

A

So, yeah I think I would say we're going to increase our dollar spent, Sam but we're expanding, we're investing at about the same rate that we have invested historically. So if you remember, we've run the Crocs brand at between kind of 7% and 8% of sales in terms of marketing. That includes both our brand marketing and a lot of our digital marketing and our social marketing and we're maintaining that rate, but obviously, as the brand has grown over the last several years, that dollar amount is a lot more significant. And that's one of the important factors around scale in this business. If you have scale and you invest as a percentage of sales, you know, you can reach a lot more consumers. From a HEYDUDE perspective, it will be an increase over last year because we underinvested in the first half of the year as we were, you know, digesting the brand. We did invest at rate at about a similar rate in the back half of the year for the HEYDUDE brand. So it will be an increase in the first half and then similar in the back half. But of course, we're also getting growth there as well. So the dollar amount will be larger.

Q

Well, let me follow up on that. The, when you, when you went into 2022 and you said we're going to invest X, was the return on your investment higher than what you anticipated?

A

The return on investment was consistent with our expectations.

Q

Thank you. Then what – and what is either one? What is the expectation for 1Q North American wholesale? Is it going to look like Q4? Just going to look like Q4 more similar and then DTC similar as well. Is that sort of how to think about it? In North America, given the peers retailer's hesitancy to step up at the moment?

A

Yeah. I mean, so I'll take that. We don't guide, you know, by channel, by region. We never have. But what I would say is I think the way to think about it. I think what you're trying to get at is how healthy is the wholesale channel. And do we expect sell and to kind of normalize with sell through, right. And as we kind of think about the first half of 2023, we're pretty confident that selling will normalize. We'll sell through because we've got our kind of in channel inventories down double-digits at year-end. We're very confident that we're kind of well positioned within channel inventories. The only challenge is that we could expect our – you know, some of our partners are still heavy. Some are not, but happy with other brands and trying to manage, you know, constrained DCs and open to

buy constraints. So we are focused, you know, we are dealing with that and that's a little bit of an unknown. We are starting to deliver substantial newness to our North American wholesale. I think we're confident in that at this point. But some of that is been unknown. So but I think, you know, in the first half of 2023, we'll definitely see a normalization of North American wholesale, sell in and sell out.

Q

And then – and can you tell me the influence, what is your assumed like, sort of, you know, growth interest expense, the interest expense you're expecting for the full year.

A

Yeah. Sure. So from an interest rate perspective, so our guidance obviously assumes higher interest rate expense in last year, driven by the four-year debt-related to HEYDUDE in the rate environment. So as a reminder, we walked in $700 million of fixed rate debt, at an average rate of 4.2%. And then the balance of our debt is the $1.7 billion term loan B that's floating rate, which is over plus $350 million. So on average it's like 7.7%. If you want to model the interest rate and then, obviously we paid out $550 million of debt in 2022 and we anticipate really strong cash flow this year and significant paid out against this year, which will, offset some. But interest will be higher this year than it was last year.

Q

All right. Thanks very much. Continue the success.

A

Thanks, Tom.

Operator: And our next question is from Jim Duffy of Stifel. Please go ahead. And Jim, your line is now live. You may be muted.

Q

Sorry about that. Yeah, it was on mute.

A

Good morning Jim.

Q

Good morning Anne, Good morning, Andrew. I have a couple of questions around margins for the brands and the regions. First on HEYDUDE had some unforeseen challenges that HEYDUDE margins however still running at

31%, which is above your original objective of 26%, 27%. I guess I'm curious, does that make you rethink the margin opportunity for the HEYDUDE brand?

A

Yeah. Hi, Jim. Thank you so much. I do believe that the HEYDUDE margins we're very pleased with overall the operating margins. One thing when we originally guided HEYDUDE to operating margins, we hadn't pulled out the shared service cost from both brands and now we've pulled that out. And so both brands are running higher operating margins. And then we have obviously pulled out the shared service cost to get to our overall operating margin guide of 26%. So obviously, you know, last year we ran higher. We delivered 27.7% but our long term guidance around 26% as we continue to invest in both brands to support the growth.

Q

Helpful. Thank you. And Anne I know you don't want to get into regional margin guidance, but for the Crocs brand, can you speak to the next direction in the regional profit pools? Will you see a meaningful shift towards international or does planned investment and growth for international keep the margin mix of the regions or excuse me, the profit mix of the regions relatively consistent.

A

Yeah. So a couple of things there. Obviously, from an operating margin perspective, all of our regions are very profitable. As we continue to scale international markets, we will continue to see that profitability expand in Asia. We've been investing significantly in China to support that growth. And so as those Asia markets scale, then obviously it drives leverage and continues to expand our profit margin. So I don't expect a significant operating margin change based on our international mix.

Q

Okay. Thank you very much.

A

Thank you.

Operator: Our next question is from Mitch Kummetz of Seaport Research. Please go ahead.

Q

Yes. Thanks for taking my questions. Just first question on HEYDUDE. So you gave the guide and reported. I think by my math, the pro forma works out to be kind of mid-teens growth year-over-year. I'm curious to know if you expect that to be kind of a straight line cadence over the quarters. I know that the growth has been moderating a little bit. I think as you're lapping larger numbers. And, you know, I would think that as you go

through the year, you continue to kind of lap larger numbers. So I'm wondering if we should be thinking of that sort of mid-teens on a straight line basis, pro forma, or do you expect that to kind of moderate as the year goes by?

Q

Yeah. Good morning, [ph] Mitch. I think, you know obviously Q1 sales growth just as we didn't own them for a full year. So as you mentioned, on a reported basis, you know, we haven't guided by quarter. I think we see good growth, you know, throughout the year. As Andrew also mentioned, we're cautious in the back half of the year. Just given, you know, cautious on the Crocs brand, but also just cautious overall on the consumer. So we've incorporated that into our guidance for the back half of the year.

Q

Okay. And then on the Crocs business, just a couple of questions. You mentioned [indiscernible] growth in the quarter. And I think it was said that the classic kind of outperformed the Clogs category overall. I'm curious to know how lined the Clogs performed in the quarter. I believe that was a pretty healthy business for you guys last year in Q4. And I'm curious how that lapped this year. And then I guess secondly, on sandals, you referenced kind of four kind of big sandal segments there. I'm kind of curious if you know how that -- how that kind of performed by segment in the back half and sort of the outlook for 2023. I assume that the kind of the everyday pieces, the biggest of those segments and I'm wondering if you're seeing kind of outsized growth there versus the others and if that would be expected to continue in 2023.

A

Okay. Good. That's a lot of questions. So Classic has performed extremely well in Q4. It performed extremely well all year long. Right. And as kind of we mentioned extremely well all year along, right. And as kind of we mentioned in our prepared remarks, as we look to gain share in a lot of international markets, it's important that we really submit and land the classic and we've been doing an exceptional job of that. So that's being driving strong class growth, classics also continue to do online classic continues to do extremely well in the US. From a line perspective, lined, I would say the line business in the US peaked last year, so that was probably a high watermark of consumer takeaway of lined that moderated a little bit this year and we expect that to moderate in the future. Right. We think we're going to reset the line business at a little bit of a lower level, that's a very important component for our, our fourth quarter business. We think, you know, we've got some really strong innovation coming into that area. I would say international for lined is a completely different story. So on an international basis, line still has a lot of incremental penetration opportunities in in those markets to kind of demand a winter line product. So think Northern Europe, think, you know, northern parts of Asia, right. So a bit, a bit of different story in line in different parts of the world. And from a sandals perspective, yeah, we talked about H2 for sandals, 30% plus growth and you're right that if you think about Q4 growth in sandals, it was 50 plus percent, so 50 plus percent growth rate for Q4 in sandals really driven by a lot of those new styles that we brought to market as well as strong sell in of sandals to our distributor markets and you know, some of those distributor markets are sandal heavy if you think about Southeast Asia.

Q

Okay. That's helpful. Thanks and good luck.

A

Thank you.

A

Thank you.

Operator: Our next question is from Jay Sole of UBS. Please go ahead.

Q

Hi, good morning. This is [ph] Maurice Iemma on behalf of Jay Sole. Thanks for taking our questions and congratulations on the results. Maybe I wanted to ask a little bit more if you could provide more details on the European business. How's that performing and what are your expectations for this year in that particular business? You know, when we look at it from a wholesale and DTC perspective. Also as we think about the gross margin outlook for 2023, when do you think we lap return to more normalized promotional levels?

And lastly, on you know, the health of the balance sheet, you know, it seems that you're on track to getting to your target leverage ratio. Should we expect the company to resume buyback activity, you know as soon as second half of 2023 and at a similar rate to what you were doing prior to the HEYDUDE acquisition? Thanks.

A

So Maurice, I'll give you a little color on EU. And then Anne will talk about gross margin and balance sheet. So look at the EMEALA business, EMEALA segments which obviously Europe, Middle East, Africa and LATAM performed extremely well in the fourth quarter. 75% growth is obviously, you know, exceptional. If we kind of isolate down to Europe, we're seeing very strong trajectory for the Crocs brand in the European market. I think in our prepared remarks, we called out as an example of that 105% growth in the UK, which is obviously an important market in Europe. So we're seeing very strong trajectory for the brand that's showing up, both in our DTC business, which in Europe is primarily digital and is also showing up in our wholesale business.

As we look to 2023, I don't think we're going to allow 75% growth, but we still see very strong trends in our European business. So we're very confident. And that's really about the brand trajectory. The brand is getting traction and, you know, we're not seeing significant pull back from the consumer for our brand. I'm not saying that's not true across broader product categories, but they still have – they're still buying Crocs.

Q

Yeah. And then, I think your second question was on gross margin outlook. And so, as you mentioned, I think, you know, from a margin perspective, Q4 played out exactly as we anticipated with margins as well as the promotional environment. I think, you know, our seasonal promotions and liquidation of each inventory was very successful. And you know, that continues. You know, Q1, January tends to be your cycling through liquidation period and then you get to more normalized throughout the quarter.

You know, I think from a return of the promotional environment, we're still less promotional than we were pre-pandemic. And so we feel like we're at a pretty normalized level this year. I don't see anything that's out of the ordinary. And then, your second question on capital allocation, you know, we're you know, we paid down $550 million of debt in 2022, which we're really pleased with. And our priority during 2023 is to continue to pay down debt to get to that two times gross leverage and then continue past that. Then we have some options of how we want to allocate. So at current interest rates, we would, you know, equally pay down debt that would be a priority as we target to get 1 times to 1.5 times net leverage. And then we will also look at resuming our share repurchases at that point.

Q

Great. Thank you so much.

A

Thank you.

Operator: [Operator Instructions] Our next question is from [indiscernible] with BNP Paribas. Please go ahead.

Our next question is from Aubrey Tianello with BNP Paribas. Please go ahead.

Q

Good morning. Thanks so much for taking my question. I wanted to start out with the SG&A outlook for 2023. Just given, you know, you're being a little more cautious with your view on the revenue guide for this year, a little lower than the long term algo. Can you just you know, any more detail on where you're able to pull back on SG&A to preserve the 26% unit margin.

A

Yeah, sure. So in 2023, we plan to invest principally in marketing and talent. And that's as we mentioned earlier on the call, we for marketing, we invest as a percentage of sales of 7% to 8%. So obviously if revenue was to significantly decline with that's an area we would look at pulling back on, although it's usually we try not to because we want to really preserve the brand. So I don't think it's necessary for us to pull back from an SG&A standpoint to hit the 26%. Obviously, we're investing more year over year because this year in 2022, we were over the 26%. But if business doesn't turn out as expected, we can pull SG&A levers and pretty quickly deleverage given the flexibility of our cost structure.

Q

Yeah.

A

Yeah, I think yeah. I really I emphasize already our perspective is the opposite of your question, which is with growth in the business and expansion in gross margins, we're actually able to continue to invest to drive future growth from an SG&A.

Q

Okay. got it. Yeah, got it. And then maybe just one on HEYDUDE just given the amount of growth in the last couple of years has been so impressive. Can you help us understand how much more room there is domestically for the brand in terms of wholesale door penetration? So how far along you are with that with that process and how much -- how much opportunity is left in the US? Yeah, the great question. So we've made really good progress in our first year of ownership in sort of wholesale door penetration in the US, right. So we're really pleased with the progress we've made. And as you kind of implied in your question, that has fueled our growth. As we look at 2023, we do feel like there is incremental door penetration and there's still long term door penetration available in the US. There are still a number of key and significant customers that we have not yet penetrated that we're obviously working on. And I think in addition to that, there's a lot of share by door opportunity, right? So as we continue to bring new styles to market, as we continue to drive greater brand awareness for the Hey Dude brand consistently across the US, if you remember when we purchased the brand, it was its awareness was regional. I would describe it as so as we invest in marketing drive awareness, we will see both door penetration, we'll share -- expansion of share by door and we will see, we believe in rates of sell through. So that will be somewhat constrained in 2023, because we're dealing with a constrained distribution network where our -- and our capabilities are not consistent with our growth potential. So but over a long run, we see lots of runway for North American growth in Hey Dude.

Q

Great. And then maybe if I could just follow up quickly on that. Any update on the timeframe for expanding internationally with Hey Dude? And is there -- is any of that reflected in the guide for the year?

A

Yeah. I think actually one point, I just want to go back to my last answer and add yeah, I think actually one point I just want to go back in my last answer and, and add to that. I think PD released an information just recently and indicated that HEYDUDE was, I think one of if not the fastest growing brand in the US in Q4, so in dollar terms, so that's obviously exceptional. From an international perspective, yeah, we're super clear, right. So our game plan for 2023 is to continue to test the brand internationally that will involve direct distribution with some select wholesale customers and a digital presence in the UK and Germany that will come up, you know, later sort of in the second to third quarter. It will also involve distribution with some key wholesale partners in sort of Middle East, sorry, in Southern Europe, in the Middle East. So we've been you know, that's our plan for HEYDUDE international. We think it's critically important that we get, you know, really strong feedback from these important markets. We've done a lot of research associated with kind of brand receptivity, but that's our plan. It's relatively modest in terms of dollars in 2023. It's all about testing and positioning for the future.

Q

Thank you so much.

A

Yeah.

A

Thank you.

Operator: At this time, we will conclude our question-and-answer session. I'd like to turn the conference back over to Andrew Rees for any closing remarks.

Unverified Participant

Thank you very much, everybody. Appreciate everybody's interest and, and great questions this morning. And as you can tell from our prepared remarks and also the answers to your questions, we're incredibly confident in terms of how our brand is positioned or brands are positioned for another exciting year in 2023. Thank you.

Operator: The conference has now concluded. We thank you for attending today's presentation. You may now disconnect your lines.