07-May-2019

Crocs, Inc. (CROX)

Q1 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Sharon, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Crocs First Quarter 2019 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. [Operator Instructions] Thank you.

At this time, I will turn the call over to Marisa Jacobs, Global Head of Investor Relations to begin the conference.

Marisa Jacobs
Global Head of Investor Relations, Crocs, Inc.

Good morning, everyone, and thank you for joining us today for the Crocs first quarter 2019 earnings call. Earlier this morning, we announced our first quarter 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 provisions of the federal securities laws. These statements include, but are not limited to, statements regarding future revenues, gross margin, SG&A as a percent of revenues, operating margins, CapEx, and our product pipeline. Crocs is not obligated to update these forward-looking statements to reflect the impact of future events.

Adjusted gross margin, SG&A, income from operations, net income and earnings per diluted common share are non-GAAP measures. A reconciliation of these amounts to their GAAP counterparts are contained in the press

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release issued earlier this morning. 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.

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, Marisa, and good morning, everyone. I'm particularly pleased with the strong first quarter growth we delivered, as demand for our brand continues to accelerate. Our priority for 2019 is to drive sustainable, profitable topline growth by delivering great products and by growing our business across our three channels and our three geographic segments, just as we did in Q1.

On a constant-currency basis and excluding the $6 million impact of store closures, we grew global revenues more than 11% with gains in all channels and geographies. The geographic standout was EMEA where we had a truly remarkable growth. Our Global retail comp of 8.7% was exceptionally strong, especially when you take into account the Easter shift to later in the second quarter. Our e-commerce business once again delivered double-digit increases, and our wholesale business grew mid-single digits even as demand for Classic clogs in Americas exceeded supply.

Higher-than-expected revenue growth in combination with a higher-than-expected gross margin and lower-than-expected SG&A enabled us to grow our non-GAAP income from operations by 22% and deliver adjusted EPS of $0.36, up from $0.23 in the first quarter of last year.

Consumers clearly like our spring summer 2019 collection, and our impactful marketing is resonating. As a result, our brand continues to strengthen.

In 2018, we rolled out a number of new collaborations and ended the year with two incredibly successful Post Malone collaborations. This year, we have another great line-up, and importantly, we are expanding our reach by partnering with key regional brands and personalities that are prominent in our five core markets. In Q1, we focused on influential L.A. streetwear brands. Our collaborations with Pleasures, Left Hand LA, Chinatown Market, and PizzaSlime brought us great visibility with their fans.

Moving into Q2, we directed our focus to Asia, the region with the greatest long-term growth potential. In China, we were thrilled with the buzz surrounding our appearance at Shanghai Fashion Week. Custom-designed Classic clogs made their way down the runway at the Vivienne Tam show. Vivienne is an internationally recognized Chinese-American designer known for her culture-bridging East-meets-West designs.

Last month, we delivered a new collaboration with BEAMS in Japan, a leading specialty retailer there and it has received incredible worldwide attention. We have a great roster of additional collaborations that will stretch over the next couple of years to extend our reach and increase interest in the brand. So stay tuned!

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We officially unveiled our 2019 marketing campaign in April with a declaration that you should "Come As You Are", and the response has been excellent. The five exciting new brand ambassadors selected for their relevance in our five key markets, the U.S., China, Japan, Korea, and Germany illustrate our global approach to brand expansion. We will be unveiling new content from each of them throughout the year. The extensive reach of this campaign is being supported by additional marketing investments with the biggest increase taking place right now in the second quarter. As we have elevated our product to marketing over the last couple of years, we've seen a clear impact with accelerating rates of brand relevance and engagement.

In terms of product, we are continuing to focus on our four most important growth drivers, clog relevance, sandal awareness, visible comfort technology and personalization. The response to our Spring/Summer 2019 collection has been terrific.

Clogs continue to be in high demand. First quarter clog revenues grew approximately 12% and represented 56% of our footwear sales. The excitement that now surrounds our classic icons started in the U.S. and spread to EMEA, and we're confident that we can ignite this trend in the rest of the world. In fact, rapidly accelerating demand for Classic clogs outpaced supply, particularly of certain core colors. Our supply chain teams have been working hard to increase capacity at existing factories and bring new factories online. Classic clog inventories will be back to appropriate levels by the end of this quarter.

Sandals remain a key area of focus. We estimate the annual addressable market for casual sandals to be approximately $23 billion globally, and it's highly fragmented. We see casual sandals a natural growth area for Crocs, and consumers are responding favorably to our Spring/Summer 2019 collection.

In Q1, sandal revenues grew approximately 12%, and generated 27% of our footwear revenues, up from approximately 26% in the first quarter of 2018. It's our eighth consecutive quarter of double-digit growth. Existing styles have been refreshed with the addition of new colors and embellishments. The new Serena style, available in plain and embellished sandals and flips makes a nice new addition to our line. We're building on our heritage of continuing to innovate around comfort technology, an important consumer purchase criteria.

In March of 2018, we unveiled LiteRide, a premium offering distinguished by enhanced comfort and streamlined modern styling. It has been a tremendous success. For 2019, we expect LiteRide sales to more than double from 2018.

Reviva is new to our spring/summer 2019 sandal collection. It's the latest example of how we're incorporating comfort technology into our design process. We launched Reviva with flips and slides. The collection incorporates strategically placed bubbles in the footbed that massage with every step. It's just getting into the market, and we're pleased with the early response.

Personalization is a trend that keeps growing in relevance, and our expanding collection of Jibbitz Charms is an important part of our brand proposition. The charms may provide consumers with a fun and unique way to make each pair of clogs their very own, and are contributing to the growth of our clog sales. Consumers are responding enthusiastically to our expanded assortment while allowing the brand to lean into the global mega-trend of personalization.

Turning briefly to our distribution channels, we continue to see growth across the board. Our DTC comp, which combines our retail and e-commerce results, was approximately 12%. We grew our e-commerce business

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approximately 17%, our eighth consecutive quarter of double-digit e-commerce growth. In the Americas and EMEA, growth topped 20%.

Our growing brand heat is continuing to drive traffic to our sites. We are upgrading the technology we use to analyze and manage our customer data. This is enabling us to deliver a more targeted message to our consumers, which is boosting the effectiveness of our marketing spend. During the quarter, we added three new marketplaces, and we are very pleased with the early results.

Our retail comp was approximately 9%, which was the seventh consecutive quarter of positive comps.

First quarter wholesale revenues grew approximately 5%, as customers refreshed their assortment for spring. We saw the highest growth in our e-tail accounts followed by distributors. With respect to brick-and-mortar accounts, we continue to add new customers and grow existing accounts through door and SKU expansion.

On our last call, I laid out how we are driving sustainable profitable revenue growth through the lens of product, channel and region supported by marketing.

From a product perspective, we are continuing to prioritize clogs, sandals, visible comfort technology and personalization through our Jibbitz charms.

From a channel perspective, we expect e-commerce to remain our fastest-growing channel. At wholesale, our e-tailers and distributors represent the greatest opportunity. And at retail, our decision to right-size our store fleet and prioritize outlets is boosting productivity.

From a regional perspective, we expect the positive momentum in the Americas and EMEA to continue while we believe that the most significant long-term growth potential is in Asia.

Lastly, under the umbrella of our "Come As You Are" campaign, we will be unveiling new content and collaborations throughout the year, designed to further boost consumer awareness and engagement, particularly in our five key markets.

2019 is off to a strong start. And with that, we are reiterating our full-year guidance despite the fact that currency headwinds have continued to increase. Our excellent Q1 results are directly attributable to all the great work being done by our global team, and I want to say thank you to each team member for their contribution.

With a successful Q1 behind us and clear evidence that our brand momentum is accelerating, I'm even more confident in our prospects for continued long-term growth and increased shareholder value.

At this time, I'll turn the call over to Anne to review our first quarter results and guidance.

Anne Mehlman

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

Thank you, Andrew, and good morning, everyone. I'll begin with a short recap of our first quarter 2019 non-GAAP results. For reconciliation of all non-GAAP amounts to their equivalent GAAP amounts, please refer to our press release.

I'm very pleased with our Q1 results. We exceeded our guidance with outstanding performance in all channels. This sets us up well for the rest of the year.

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First quarter revenues were $295.9 million, up 4.5% from $283.1 million in the first quarter of 2018, and well above our guidance of $280 million to $290 million. Currency negatively impacted our results by $12.7 million, about $3 million more than we had anticipated. Store closures and business model changes reduced revenues by approximately $6 million in the quarter. Absent these impacts, revenues would have grown 11.1%.

We sold 18.4 million pairs of shoes, an increase of 8.2% over last year's first quarter. Our average selling price for footwear during Q1 decreased 3.4% to $15.73, as a result of currency.

In an effort to streamline our prepared remarks, I'm going to limit my segment commentary to key drivers of the business. Details of our sales by channel and comp performance are laid out in the tables found in our press release.

In the Americas, first quarter revenues grew by 4.3% to $129.1 million, which included a negative currency impact of $1.3 million. Our wholesale sales results were bifurcated. We grew nicely in North America, despite limited Classic clog availability as demand for that product continued to accelerate. In Latin America, wholesale revenues declined as a result of the negative currency impact and ongoing economic disruptions.

Our DTC business had another superb quarter, and I'm pleased to note that we generated a 21% e-commerce growth and a 12% retail comp even without the benefit of Easter-related sales.

In Asia, revenues for the first quarter were $91 million, just about flat with last year's first quarter. This includes a $4.3 million headwind from currency. Mid-single-digit increases in our wholesale and e-commerce channels were offset by the decline in retail, primarily due to the store closures and business model changes.

In EMEA, revenues grew 11.6% over last year's first quarter to $75.7 million. This exceptional growth also occurred despite the fact that currency reduced reported revenues by $7.1 million. In constant currency, revenues grew more than 22%. The brand heat we are experiencing in the U.S. is spreading to EMEA, driving revenues and sell-throughs.

Moving on to the rest of our P&L, our adjusted gross margin was 46.9%, above our guidance of 46%, but down 250 basis points to prior year. There were a number of contributing factors. So, let me walk you through them.

Currency negatively impacted the quarter by 140 basis points, coming in worse than we had anticipated. Consistent with my remarks last quarter, the negative impact from currency move will be much more pronounced in the first and second quarters of this year, before moderating in the back half.

Two other items also depressed our Q1 adjusted gross margin. First is higher freight rates associated with inflation and the use of air shipments to speed up deliveries of Classic clogs. By relocating the Americas DC to Ohio, we will mitigate some of these freight pressures. And as we restore Classic clog inventory to appropriate levels, we will eliminate the use of air freight.

Second, costs at our L.A. distribution center rose as we operated above maximum capacity. The move to Dayton, Ohio will help to mitigate these pressures and translate into gross margin gains next year. We are making good progress on the build-out of the new DC and have already successfully shifted fulfillment for the Americas retail business from L.A. to Dayton.

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Our adjusted SG&A expense was $104.4 million or 35.3% of revenues, better than our guidance primarily as a result of higher revenues, effectively leveraging our cost base, as well as the shift of some spend from Q1 into Q2.

As a percent of revenues, our adjusted SG&A improved by 410 basis points over the first quarter of 2018, reflecting savings, resulting from our recently-completed SG&A reduction plan. Our adjusted income from operations was $34.5 million, up 21.5% compared to the first quarter of 2018.

Our adjusted earnings per share increased 57% to $0.36 compared to $0.23 in the first quarter of 2018.

Our balance sheet continues to be very strong.

Inventory at the end of the quarter was 6% lower than at the same time last year, as we continue to carefully manage inventories across our various channels and replenish our Classic clogs.

During Q1, we repurchased approximately 2.1 million shares of our common stock on the open market for $53.5 million at an average share price of $25.07. That left us with approximately $102 million available under the plan for future share repurchases.

This morning, we announced that the Board of Directors has approved an increase of $500 million to our existing share repurchase program. Under the expanded plan, we have approximately $600 million available for future share repurchases.

We ended the quarter with $86.3 million in cash and outstanding borrowings of $215 million. During the quarter, we amended our credit facility to raise our borrowing capacity from $250 million to $300 million.

On January 1st, 2019, we adopted new GAAP lease accounting rules, which resulted in a significant increase in our reported assets and liabilities associated with our leases. The recognition of rent expense and payments associated with these lease asset, and liabilities will not result in material differences to operating income or cash flows compared to the previous accounting rules, nor does it impact our banking covenants.

As we turn to guidance, I want to remind you that our guidance is based on current currency rates.

For 2019, we are reiterating the full-year guidance we provided in February, despite currency erosion. That guidance is contained in this morning's press release.

With respect to the second quarter, we expect revenues to be between $350 million and $360 million compared to $328 million in last year's second quarter.

Our guidance incorporates the loss of approximately $10 million of negative currency impact and $6 million of revenues associated with our reduced store count. At the mid-point of our guidance, adjusting for currency and store closures, this represents underlying growth of approximately 13%.

Adjusted gross margin for the second quarter is expected to be approximately 52.2% compared to 55.3% in last year's second quarter. The variance reflects the negative impacts of approximately 150 basis points resulting from the strengthening of the U.S. dollar as well as the negative impact of approximately 160 basis points from higher freight and distribution center cost in the Americas. As I mentioned earlier, the negative impact from currencies will be more pronounced in the first half and will diminish over the back half. Furthermore, the headwinds resulting

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from higher DC and freight costs will be partially mitigated as we ramp up operations in the new Ohio facility later this year. In 2020, we anticipate realizing approximately 100 basis points of improvement in our adjusted gross margin resulting from our move into the new facility.

SG&A is expected to be approximately 40% of revenues compared to 44% in last year's second quarter. This includes a significant increase in our marketing spend over last year's second quarter, resulting from the shift of some spend from Q1 into Q2, as well as incremental investments we are making to support and accelerate our growing brand momentum. Also included is approximately $2 million of non-recurring charges relating to various cost reduction initiatives.

Given our strong performance in Q1 and our expectations for achieving our interim target of a double-digit adjusted operating margin, I feel very good about the balance of the year.

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 you heard this morning, 2019 is off to a great start, and I'm confident in our ability to maintain the positive trajectory of our business. Our brand is continuing to strengthen. We are continuing to build on our strong clog tradition to expand our sandal business and to build our comfort technology offerings and to give consumers more opportunities to personalize their Crocs. Upgrades to our supply chain will allow us to maximize the growth potential of each of our channels and geographic segments.

We have a clear strategy for moving forward. And by executing against that vision, we will continue to accelerate growth on both our top and bottom line.

Operator, please open the call for questions.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Jonathan Komp with Baird.

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

Q

Yes. Hi. Thank you. I want to follow up first just the commentary around Europe and starting to see the brand heat. Can you give a few more examples of what you're seeing there and maybe what you think is driving the improved momentum in the outlook ahead?

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

A

Yes. Thank you, Jonathan. I'd say a couple of things. One is, I think, EMEA was particularly strong. Obviously, we had very strong currency headwinds in EMEA. So, they kind of hit that numbers despite $7 million of FX drag as the euro, I think, is down around €1.11, €1.12. I think what we saw is strong performance across all channels, so wholesale, e-com, and retail.

As we look at the shape of the business, we can see very strong traffic to our e-com sites and also to our e-tailer sites. We see very strong interest in the brand coming through digitally. We see very strong interest in our stores and from a wholesale perspective, we've been able to sign new accounts and extend reach in existing accounts. So, I would say it's working on all dimensions.

And not mentioned in our remarks, we also opened a pop-up store today featuring just our Classic clog and featuring Jibbitz in Boxpark in Shoreditch, England. So, we're also investing a lot in marketing to continue to heat up the brand in Europe.

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

Q

Yes, great. Maybe a different subject then for Anne. When you look at the gross margin outlook and the implied improvement at least on a year-over-year basis relative to the first half when you look into the implied second half, can you just walk through the various puts and takes that are impacting the first two quarters that you expect to subside later in the year?

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

A

Absolutely. So, just starting with Q1, our adjusted gross margin was 46.9%, which actually was better than guidance by about 90 basis points, even as FX moved against us even stronger than what we expected.

So, from a first quarter perspective, FX was – drove margins down about 140 basis points. And then the remainder was higher freight and DC costs. But when you think about – from a guidance perspective, DTC outperformed, which has higher margins.

Our promotions were lower because of that strong outperformance. And then we did move a little bit of airfreight from Q1 and Q2. So, walking to Q2, our adjusted gross margin guidance is 52.2%. That includes – so that's down 310 basis points when you exclude the one-times for the DC of 120 basis points. And that decline again is very

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similar, as we talked about on the call last quarter, that FX would be a really strong headwind in the first half of the year.

So in second quarter, FX is about 150 basis points. And then, the remainder is higher freight, including air and DC costs. All of those pressures start to mitigate throughout the year. In Q3, we expect gross margins to be down slightly. And, in Q4, we expect gross margins to be up. And then, overall, for the full-year, we expect our adjusted gross margin, as we reiterated our full-year guidance, to be at 50.5%, which is down about 100 basis points on an adjusted basis from prior year.

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

Okay. Great. Very helpful. And maybe last one just for me. When you look at the wholesale channel opportunities, especially in the Americas, and seeing some of the success with partners that are newer like Journeys recently, could you just talk more broadly about where you see distribution going and whether or not the brand heat, once you get the Classic clog supply back in line, whether or not there's any additional distribution opportunity to be had here.

Andrew Rees
President, Chief Executive Officer and Director, Crocs, Inc.
A

Yes. So, I think priority number one for us in the Americas is fulfilling demand, particularly for Classic, as clearly our demand from our wholesale partners is outstripping supply. As we indicated, we will be in line by the end of the quarter as we've worked really hard to bring on additional capacity. So, that's priority number one.

And then, I think priority number two, it will be obviously to leverage that brand heat to further extend the brand. I think as we look at all of our points of just distribution, we have a lot of points of distribution. We've probably got a, I would say, a short list of incremental accounts where we'd like to be. We think it would be good for the brand. We think it's the right way to reach our consumers.

I think our biggest dollar volume growth will come from door expansion and SKU penetration in major existing accounts. So, I think the door growth with new accounts is really not the big driver. The big driver is SKU penetration and door penetration in existing accounts.

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

Okay. That's great to hear. Thank you very much.

Andrew Rees
President, Chief Executive Officer and Director, Crocs, Inc.
A

Thanks, Jonathan.

Operator: Your next question comes from Jim Chartier with Monness, Crespi.

Jim A. Chartier
Analyst, Monness, Crespi, Hardt & Co., Inc.
Q

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Good morning. Thanks for taking my question. First, could you just talk about, as you've attracted new customers with the Classic clog, are you seeing them buy other categories or are you being able to convert these new customers into sandals or other categories?

Andrew Rees
President, Chief Executive Officer and Director, Crocs, Inc.
A

Yeah I think, the very strong growth of Classic is driven by, I would say, new and existing customers. A lot of our marketing work, a lot of our collaboration work is obviously appealing to customer groups that may not have had a natural affinity to Crocs in the past, which has been great.

We've seen great resonance with teen. Obviously, we're going through prom season right now, and we see lots of exciting things happening in with teens at prom. So, we see new customers coming. But I would also say the same marketing and social media activity is also encouraging existing customers to buy new colors, to buy additional styles. So, we see the growth on both dimensions.

And in terms of penetration of other silhouettes, obviously we're very focused on sandals. We continue to grow sandals. We grew sandals at double-digits in Q1 and we're very optimistic for sandal growth going through the summer, obviously.

Right now, we're seeing, particularly in the U.S., some cold and rainy weather which is not helping sandals for us or really many other brands. But we're very optimistic about sandals through the rest of the year. So, we feel really good about the combination of clogs, sandals comfort and our personalization as a broad-based attack that's allowing us to really engage consumers across multiple dimensions.

Jim A. Chartier
Analyst, Monness, Crespi, Hardt & Co., Inc.
Q

Great. And then, on the ad spend you mentioned a big increase in second quarter. How is that allocated by region? And then, how do you balance the increased spending versus some of the inventory constraints that you're seeing?

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

Yes. So, from an ad spend increase, we're spending a lot of our increase in Asia, particularly in Q2. I would say that we do have increases in all regions, but it is heavily directed at Asia as we work to extend the brand heat of Americas and Europe over to Asia. So that's the first part. The second part, can you repeat or what was your second part of your question, Jim?

Jim A. Chartier
Analyst, Monness, Crespi, Hardt & Co., Inc.
Q

Just spending on increasing ad spend, when you're constrained by inventory in certain regions.

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

Oh, yes. Sure. So, obviously, the Classic clogs in the U.S., it's really a U.S. Classic clogs wholesale constraint. So, it doesn't – we really haven't seen an inventory constraint impact in Asia at all. It's been less in Europe.

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So, again, we think that ad spend is just as important to create brand heat, and we do expect our Classics to be back in stock by the end of Q2. So, we'll continue to spend to continue that journey. And we have been able to successfully drive our consumers to different products in our direct-to-consumer in the U.S. And you can see that in our Q1 results.

Jim A. Chartier
Analyst, Monness, Crespi, Hardt & Co., Inc.

Q

Okay. And then lastly, you're moving from a single brand ambassador for Asia last year to three country-specific ambassadors this year. What's the early read on that change?

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

A

Yes. I think we're really happy with that change, Jim. We've seen great resonance last year. Our ambassador was really career-centric. We've seen great presence with Suzu in Japan and also with our ambassador in China. So, I think that was a really good move, and we're pleased with that.

Jim A. Chartier
Analyst, Monness, Crespi, Hardt & Co., Inc.

Q

Great. Thanks and best of luck for the rest of the year.

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

A

Thank you.

Operator: Your next question comes from Mitch Kummetz with Pivotal Research Group.

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Yes. Thanks for taking my questions. Andrew, you mentioned the Easter shift a couple times in your prepared remarks. I was hoping you could quantify that impact for us.

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

A

Yes. So, the way we thought about it is we were definitely worried about the Easter shift. Obviously, it moved from the first week in April last year to well into April. So, it put both our DTC business solidly into Q2 and also shifted back a little bit of your wholesale deliveries by a couple of weeks.

But I have to say at the end of the day we frankly we comped it, right. We comped it from a DTC perspective. We had in Americas incredible comps in Q1 both in store and online. So, we were able to make all those dollars up. And as we look at Q2 and having Easter suddenly in Q2, that's obviously embedded in our guidance. So we feel really good about where our guidance is.

Mitch Kummetz
Analyst, Pivotal Research Group

Q

I'm going to push you a little bit on that. I mean is it a few million dollars do you think? I mean you comped it in the quarter. But, obviously, it's accretive in the second quarter or so.

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Andrew Rees
President, Chief Executive Officer and Director, Crocs, Inc.
A

Yes. We don't think it's a very large number.

Mitch Kummetz
Analyst, Pivotal Research Group
Q

Okay.

Andrew Rees
President, Chief Executive Officer and Director, Crocs, Inc.
A

So, the best way to think about it, it's in our guidance.

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

Yes.

Mitch Kummetz
Analyst, Pivotal Research Group
Q

Got it.

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

I mean it's mostly U.S., right, a little bit in Europe.

Mitch Kummetz
Analyst, Pivotal Research Group
Q

Yes.

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

It doesn't really impact Asia at all.

Andrew Rees
President, Chief Executive Officer and Director, Crocs, Inc.
A

Yes.

Mitch Kummetz
Analyst, Pivotal Research Group
Q

Okay. And then Anne, on the SG&A, you mentioned that there was a shift in some expenses from Q1 to Q2. Can you quantify that?

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

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Yes, I would say it's less than $1 million. So, when you think about what we did from an SG&A perspective, if you think about how we over-performed our guidance, it was really about leveraging our cost base and that drove about 140 basis points to the favorability to guidance. And then the rest was a little bit FX and a little bit of expense shift into Q2.

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Okay. And then, I guess lastly on the adjusted gross margin for the year, I come up with 50.5% if you adjust back the 100 basis points of the DC. I think that's down about 100 BPS from last year on the adjusted basis. Can you say how much of that is freight and FX, and is there any way, I know you're not giving 2020 guidance here, but is there any way you can talk about how much of that freight you might give, I mean get back or expect to get back next year?

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

A

Yes. So, at current currency rates right now for the full-year, FX is about 130 basis points. So, we do have some things going the other way with mix and that are pulling that back.

If you think about what we've talked about for 2020, on an adjusted basis, we're down 100 basis points. Next year, because of the U.S. DC relocation, we have said we'll get our 100 basis points back. So that's the best way to think about it, is that we're still expect to clawback a 100 basis points from lower DC and better freight from where we're positioned in the country.

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Is that 100 basis point clawback, that's on an adjusted basis, that's not...

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

A

On an adjusted basis.

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Okay.

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

A

So on a full basis, it would be 200 basis points...

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Got it. Yes.

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

A

...because you get back the 100 basis points one times and the 100 adjusted.

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Mitch Kummetz
Analyst, Pivotal Research Group

Q

Yes. Yes. I just want to clarify it. All right. Thank you. Good luck.

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

A

Thank you.

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

A

Thanks, Mitch.

Operator: Your next question comes from Erinn Murphy with Piper Jaffray.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Great. Thanks. Good morning. A quick question on the second quarter sales guide, super strong, up 9% at the midpoint, which would be a good acceleration from the 5% in the first quarter.

So, I'm just curious what you're seeing out there, just given this is the heavier at-once kind of reorder quarter, if you could just talk about what you're seeing in the environment that gives you that confidence?

And then, Andrew, specifically, you mentioned a little bit of rainier, colder weather in the Americas in particular. Is that what you're seeing currently out there post-Easter? Or has anything picked up post-Easter? Thank you.

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

A

Great. Yes. So let me address the weather first. Yes. Obviously, the weather has been in the last couple of weeks in terms of impacting the U.S. So, we're seeing a little bit of an impact from that, but nothing that concerns us relative to our guidance at all.

In terms of what's driving the overall guidance, I think there's a few things. We're expecting continued strong performance in EMEA. We have a very good revenue book, and we're seeing very strong continued at-once performance in EMEA, so we feel really good about EMEA, although we don't expect currency to mitigate, so that continues to be a pretty healthy headwind in EMEA.

In Americas, we're particularly enthusiastic about our wholesale business. Again, we've got strong book of deliveries in Q2 and, again, we're seeing more at-once performance than we can satisfy. And then, so we anticipate as we go through the quarter being able to satisfy more and more of that, so we see pent-up demand in Americas.

And then, from an Asia perspective, we see several key markets in Asia performing well. So, it's really kind of across the board. I'd say from a product perspective, it's number one clog-driven as it was in Q2, but we see sandal performance probably accelerating over what it did in Q1.

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Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Okay. That's actually very helpful. Thank you. And then, can you talk about how the Work category is performing for you guys currently? And where do you see the opportunity for that business longer-term?

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

A

Yes. That's a pretty good question. We like that business. It's a smaller business for us today, but it's very, very stable. It's very high margin. There's quite a small SKU base, and we think our product works really well.

Almost all of our Work shoes are clogs, so they are embedded in that clog performance. It was up double-digits in quarter one. And we see that being kind of continuing to build. It just doesn't move the needle a ton on the topline, but over time, we think it will, and it's a strong margin contributor.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Okay. That's helpful. And then, Anne, just a housekeeping question for you, you talked about ASPs being down in the quarter, but that was really led by currency. What would ASPs have been ex the currency impact in the quarter?

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

A

I think they would've been slightly up.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Okay. Got it. Thank you, guys.

Operator: Your next question comes from Sam Poser with Susquehanna.

Samuel Poser
Analyst, Susquehanna International Group, LLP

Q

Good morning. Thank you for taking my question. For both Anne and Andrew, you talked about the demand for clogs despite the shortage of product. How much of that shortage of product may have helped the demand for clogs? And how much of the actual demand do you think you've missed? And how much of the demand do you want to actually satisfy as you bring inventories into better shape?

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

A

Yes. Okay. There's a lot to that, Sam. So, I think, look, we haven't really played the game of trying to figure out how much we missed. Obviously, we know we're getting at-once orders and requests for products that we are not able to satisfy in the immediate timeframe, and we defer in those some weeks out and, in some cases, some months out.

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So, we can see business that we would have been able to book that would be is now getting booked in the future. And I think underlying your question is do you want to satisfy all the demand? I think for a lot of our core colors, and we're seeing – you can see it on our website. You can see the shortages are in black and white and in a number of core colors that are I think you frankly want to be able to satisfy that demand.

Our approach to creating demand for clogs, essentially using a lot of our collaborations and marketing to create interest in the category, but when it comes to core colors, we really feel like we want to satisfy that demand.

Samuel Poser
Analyst, Susquehanna International Group, LLP

Q

And then I mean that's a good transition to my next question. You've had some very strong responses to a number of – almost all of these corroborations you've done recently. The question is this. How are you going to scale that? I mean, clearly, your supply was well below the demand. I guess do you see opportunities to scale these collaborations, but still leave people wanting for more, so they can become more material to your business?

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

A

Yes. We do. We see different collaborations with different partners Sam. I think you've seen a number this year that have been very meaningful from a PR perspective, but clearly are small. And that was their intent. You will see others later this year that are much larger in scale.

And as we move into – frankly, we're booking collaborations through 2020 and 2021 at this stage. So, as you look in the future, we have a blend depending what audience we're trying to reach of smaller-scale, PR-orientated, brand-heat orientated, and enticing new customers and on larger scale collaborations that will drive both volume in that collaboration.

I would have to say, I think even the small scale collaborations are really impactful and driving just volume to the brand and to the core product.

Samuel Poser
Analyst, Susquehanna International Group, LLP

Q

Just a quick follow-up, I mean, let's just take Post Malone. The pairs weren't huge. The pro-pairs (sic) [pairs] sold out. He's got an exceptionally large following, so Post Malone, could that be scaled or with whatever you're planning on doing more with, is it more towards your whoever you're partnering with more towards your core, what you view as your core Crocs customer?

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

A

I think, Sam, I would say I'm not anxious to be drawn on this, because that's a little bit of the secret sauce. But there are some of these high profile collaborations that can scale. There are some that can't. And there are more core-orientated collaborations that can scale. So it will be a combination of both.

Samuel Poser
Analyst, Susquehanna International Group, LLP

Q

All right. Thanks so much and continued success.

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Andrew Rees
President, Chief Executive Officer and Director, Crocs, Inc.
A

Thank you, Sam.

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

Thanks, Sam.

Operator: Your next question comes from Steve Marotta with C.L. King & Associates.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.
Q

Good morning, Andrew, Anne and Marisa. Andrew, you mentioned in Asia, it's the market with the largest growth opportunity, though it was the weakest DTC comp in the first quarter. Could you talk a little bit about that dislocation within the period and when you would expect that dynamic to reverse?

Andrew Rees
President, Chief Executive Officer and Director, Crocs, Inc.
A

Yes, I think as we look at Asia, we strongly believe it's our market with the greatest long-term growth potential. Obviously, we're direct in a number of countries that have very large populations. We're indirect in other countries where we use distributors that, again, have large and growing populations, and we have the strongest, generally, GDP growth in that region.

We don't break out our results by country. But I can say that a few countries, so Japan, Southeast Asia and India, we're seeing really encouraging results. We see China as our greatest opportunity long-term.

And you might have noticed in our proxy, we've formed a committee with our Board of Directors to really accelerate growth in China. And that's the place where we're investing in marketing, we're investing in celebs, we're investing in collabs to really recalibrate the market in terms of our merchandising.

As we looked at our merchandising strategy in China, historically, it wasn't entirely in sync with our global merchandising strategy of clogs and sandals. It was led with loafers for a long time. So, we're recalibrating that so we're retooling our merchandising strategy in China.

So, some of our drag on DTC comes from some of that recalibration, and that will take us a few quarters to work through, but we see really encouraging signs in some of our core markets. And we think over the long-term, Asia will drive the greatest growth for the brand.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.
Q

That's very helpful. If you can comment a little bit on – Q1 and Q2 have historically been the seasonally strongest periods. But you've also mentioned that, obviously, there's a resurgence from a new standpoint and the popularity of the brand amongst school-aged kids.

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Can you talk a little bit about – maybe give a sneak peek into this current back-to-school season, what your order book says, and if the third quarter might become significantly more important to you in the near-term in this year, next year than it has been historically.

Andrew Rees
President, Chief Executive Officer and Director, Crocs, Inc.
A

So, yes, we're excited about Q3. I think as a number of you pointed out, we had a very strong Q3 last year, which was super encouraging. And we've been really pushing really hard to get our supply constraints back in line in time for Q3 because we think that's critically important, especially related to Classic clog in North America.

So, we don't disclose order book. We haven't done that for many years. But I can say we're optimistic about Q3, and we're doing a lot of the work associated with allowing us to comp Q3 performance very nicely.

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

Yes. I think from the overall shape of the business, as Andrew just mentioned, we do expect Q3 to be much more of a material quarter than what's happened in the past and much more in line with Q1 and Q2.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.
Q

That's very helpful. I'll take the balance of my questions off line. Thanks.

Operator: Your next question comes from Jim Duffy with Stifel.

James Vincent Duffy
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Thank you. Good morning. Hope you guys are doing well.

Andrew Rees
President, Chief Executive Officer and Director, Crocs, Inc.
A

Thanks, Jim.

James Vincent Duffy
Analyst, Stifel, Nicolaus & Co., Inc.
Q

I'm trying to better understand the supply constraints and clog availability limitations, $6 million upside to the higher end of the guidance for the first quarter doesn't seem like a huge disconnect relative to expectations. What was the clog growth rate in the quarter? Was the mix of clog business higher than you expected in 1Q?

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

Yes. So, clogs grew 11.5% in Q1. Now, obviously, that's all clogs, not just the Classic, but the Classic results were up strongly. And it was pretty strong. I think it was 56% of our overall footwear revenues in Q1. What we were able to do – the beat in Q1 was really direct-to-consumer, so e-commerce and retail both in Americas and EMEA had very strong comp even with the Easter shift.

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And part of that was shifting the consumer into Classics that either Classics that we weren't constrained on colors, so different colors, or different silhouettes altogether from – or different styles. So, I would say in the direct-to-consumer business, we were able to do that. Obviously, you can't do that from a wholesale perspective as easily. So, that's really where the outperformance came and that's really how the clogs showed up in Q1.

James Vincent Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Got it. And with an eye towards alleviating constraints as you get into that third quarter, where do you expect 2Q inventory balances at quarter-end?

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

A

So, from a Q2 inventory perspective, I'll just talk about kind of the full year where we think we're at. So we think from an inventory perspective, about four turns is right for our business. We're turning a little bit faster than that right now, and again, that reflects the constraint of clogs. So, we do expect to be a little bit more back in stock in Q2. And essentially, what we're going to do this year is we're going to reshape our inventory a little bit in Q4. We're going to bring in some inventory earlier than what we had in the past in order to be ready for Q1, so we don't run into the same type of issues that we had this year. So, you will see a little bit of a heavier inventory balance in Q4.

James Vincent Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. Shifting gears a little bit, last question, can you speak to the capital structure strategy in the context of the repurchases and the new authorization? What do you see as target leverage ratio? How do you think about borrowing for utilization of the share repurchase authorization? Is that opportunistic or something you expect to do fairly consistently across the year?

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

A

Yes. So, we're really excited that our Board is very confident in our strategy and our business overall and increased – obviously, our share repurchase authorization was $500 million, it's now $1 billion, which leaves us about $600 million available for future share repurchases.

In Q1, as we talked about in our prepared remarks, we repurchased 2.1 million shares for $53.5 million at an average cost of $25.07. And we are going to be very opportunistic about it. We have a $300 million revolver which we increased earlier this year.

And Q1 is our highest working capital quarter. So, we'll continue to look at our capital structure and we'll continue to invest in where we think we get the best return, whether that's in the business, whether that's buying back shares or paying down debt.

James Vincent Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you.

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

A

Thank you.

Operator: Your next question comes from Erinn Murphy with Piper Jaffray.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Great. Thanks for taking my follow-up. I just had one follow-up on the LiteRide business. I am curious how it's performing generally in the second year. We have seen a little bit more promotional activity there into and out of the Easter season, both online and as well as on Amazon. So, I'm just curious if that was planned or what you're seeing generally as that business gets into year two. Thank you.

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

A

Yes. We're really thrilled with LiteRide businesses in year two. As we think about LiteRide in year two, we think it will end up being at double what it was in 2018. So, 2018 was obviously the launch year. We launched March 1st, so we're confident in the overall business very well, and we see it strengthening through the year.

I think the promotional activity you've seen is largely been around closing out colors. We're kind of moving. We continue to refresh in terms of new colors, fashion colors, etcetera. And obviously, we generally close out the old colors to make way for the new. So, we're generally we're very pleased with the business, and I would say it's mostly non-promotional.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Okay. Thank you.

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

A

Thanks.

Operator: At this time, I would...

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

Okay. Sorry. I was going to thank everybody for their continued interest in the company, and we're really thrilled with where we are and excited for the future.

Operator: This concludes today's conference call. You may now disconnect.

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