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Crocs, Inc. (CROX)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

Marisa Jacobs, Global Head of Investor Relations, you may begin your conference.

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

Good morning, everyone, and thank you for joining us today for the Crocs second quarter 2019 earnings call. Earlier this morning, we announced our latest quarterly results and a copy of the press release can be found on our website at crocs.com.

We would like to remind you that some of the information provided on this call is forward-looking and accordingly is subject to the Safe Harbor provisions of the federal securities laws. These statements include, but are not limited to, statements regarding future revenues, gross margins, 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

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reflect the impact of future events. We caution you that all forward-looking statements are subject to risks and uncertainties described in the Risk Factors section of our Annual Report on Form 10-K.

Accordingly, actual results could differ materially from those described on this call. Please refer to Crocs Annual Report on Form 10-K, as well as other documents filed with the SEC for more information relating to these risk factors. Adjusted gross margin, income from operations, operating margin, net income and earnings per diluted common share are non-GAAP measures. A reconciliation of these amounts to their GAAP counterpart is contained in the press release we issued earlier this morning.

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

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

Andrew Rees

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

Thank you, Marisa, and good morning, everyone. I'm thrilled with our year-to-date performance and we expect to grow at an even faster pace in the back half of 2019. We are raising our full year revenue growth expectations for the second time and now anticipate growth of 9% to 11% reflecting the strength of our business.

We are successfully executing against our strategic priorities, particularly those focused on driving revenue growth by prioritizing clogs, sandals, visible comfort technology and personalization while also driving overall profitability. Demand for our product is strong and our brand heat is rising. Given our consistent track record over the past two years, I'm more confident than ever that we will continue to drive top and bottom-line growth for years to come.

During Q2, we grew global revenues 9.4% and 12.5% on a constant currency basis. Excluding the combined impact of currency and store closures, second quarter revenues grew approximately 14%, making it our fourth consecutive quarter of double-digit organic revenue growth. Our operating margin rose 200 basis points to approximately 13%, while our EPS rose 57% to $0.55.

Our marketing and product teams did a tremendous job last quarter as we rolled out an unprecedented number of collaborations and marketing activities, and the response was phenomenal. As we have discussed on previous calls, collaborations are a great way to reach new consumers and build brand heat. Our diverse slate of collaborations speak to different audiences reflecting the democratic nature of our brand. We recently did targeted launches with edgier brands like Chinatown market in partnership with Urban Outfitters at ComplexCon, a punk Classic clog for Barneys New York and a clog styled for country musician Luke Combs at the CMA Fest.

Representing a larger commercial opportunity was the Vera Bradley x Crocs collection, which engaged a lot of our core fans. It was sold in our direct to consumer channels and also in Vera Bradley stores and their dotcom site. We're starting to use the same playbook in our international markets.

We're raising our profile and spreading awareness of the brand through regional collaborations with designers and retailers like Vivienne Tam and BEAMS.

The increasing pace of our international collaborations and marketing investments is consistent with our belief that Asia represents our greatest long-term growth opportunity. In terms of product, our focus remains on our key

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growth drivers, clogs, sandals, visible comfort technology and personalization. During Q2, clogs continued to be in high demand. Clog revenues grew approximately 18% and made up 57% of our footwear sales, up from 52% during last year's second quarter. The biggest uptick in demand has been for our Classic clog, and we've more than doubled our production capacity this year.

Demand for a few core colors is continuing to exceed supply. We're working closely with our suppliers to further boost production levels and are confident in our ability to meet the demand contemplated in our guidance.

Sandals remained a key area of focus during Q2, and consumers continued to respond favorably to our Spring /Summer 2019 collection. Sandal revenues grew approximately 11%, even as weather in North America and Europe caused the sandal season to get up to a later start on last year. Sandal revenues generated 27% of our footwear revenues compared to 26% in the second quarter of 2018. It's a ninth consecutive quarter of double-digit sandal revenue growth as we continue to grow global awareness of Crocs sandals.

Visible comfort technology continues to be an important consumer purchase criteria. The Reviva franchise which focuses on flips and slides has been well-received and we recently rolled out kids LiteRide.
For 2019, we expect LiteRide sales to be at least double 2018 levels.

I've spoken before about the importance of personalization, a global trend that keeps growing in relevance. Over the past few quarters, we've steadily increased the size of our Jibbitz Charms collection.

We're rolling out new charms monthly to stay on top of emerging trends, and testing different ways to further enable personalization. Our consumers are clearly embracing Jibbitz Charms collection to personalize the Crocs, which is driving brand engagement higher.

I'm going to turn briefly to our sales channels, where we continue to turn in strong results across the board.

Second quarter wholesale growth exceeded 9% as customers continue to place at once orders for Spring/Summer 2019 product to meet expanding consumer demand. This growth came on top of the 7% wholesale growth we delivered in Q2 of 2018.

Our DTC comp, which combines our retail and e-commerce results was approximately 14%. We grew our e-commerce business 18%, a great result coming on top of almost 24% growth during last year's second quarter. This represents our ninth consecutive quarter of double-digit e-commerce growth with brand heat continuing to drive more traffic to our site.

Retail comps were approximately 12%, our eighth consecutive quarter of positive comps, and our total retail sales rose 4% even while continuing to absorb the impact of last year's store closures.

In terms of our outlook for the year, we now see growth accelerating in the back half of the year, particularly, North America. In response, we're raising our full-year guidance for the second time, to levels that are significantly higher than those we outlined last November and in February of this year.

Our growth algorithm drives sustainable profitable revenue growth through the lens of product, channel and, region, supported by impactful marketing.

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From a channel perspective, our plans anticipate that e-commerce will remain our fastest growing channel. That e-tailers and distributors will deliver the most significant wholesale growth and that retail will continue to benefit from the shifting to outlets and right-sizing our store fleet.

Our regional perspective is unchanged. We expect the positive momentum in the Americas and EMEA to continue and, over the long-term, our most significant growth potential is in Asia. In Korea and Japan, our business grew nicely. As we discussed on our last call, we have formed a China growth committee. Our focus there is on elevating clogs and sandals and creating the same brand heat around the Classic Clog that is driving our business in Americas. In addition, we are updating our store design to drive consumer engagement and investing in more marketing in China. We are confident that these actions similar in nature to those that we have already executed elsewhere around the world, will ignite long-term growth in China.

Lastly, from a marketing perspective, our Come As You Are campaign will continue to unveil exciting new content and collaborations throughout the year to further boost consumer awareness and engagement.

The year is off to a terrific start. Our great results are a testament to the enormous dedication of our extraordinary team, and I want to thank them for everything they have done and continue to do.

At this time, I'll turn the call over to Anne to review our second 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 second quarter 2019 performance. For a reconciliation of any non-GAAP amounts to their equivalent GAAP amounts, please refer to our press release.

We had a very good second quarter, coming in at the high end of our revenue guidance, exceeding both our gross margin and SG&A guidance and growing EPS by 57%. Starting with the fourth quarter of 2016, we now have met or exceeded our revenue and gross margin guidance for 11 consecutive quarters.

During the second quarter, revenues were $358.9 million compared to $328.0 million in the second quarter of 2018. This represented an increase of 9.4%, or 12.5% on a constant currency basis. Currency negatively impacted our results by approximately $10 million, while store closures reduced revenues by approximately $6 million in the quarter.

We sold 19 million pairs of shoes, an increase of 6.7% over last year's second quarter. Our average selling price for footwear during Q2 increased 1.9% to $18.39, with higher prices on certain products and less discounting more than offsetting the negative impact of currency.

The Americas had a phenomenal quarter. We grew revenues to 23.7% to $170.4 million with minimal impact from currency. Every channel grew at double digit rates, with wholesale and e-commerce approaching 30% growth. Our retail comp was 17.6%. Clog demand continued to climb particularly for Classics. Revenues from high margin Jibbitz sales rose significantly, driven by an uptick in unit sales and a price increase. In Asia, revenues for the second quarter were a $118.4 million down 3.2% compared to last year's second quarter. Excluding $5.4 million of negative impact from currency, Asia revenues grew 1.3%.

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Our e-commerce channel delivered mid-single digit increases and our retail comp was approximately 1%. Wholesale growth throughout much of the region was offset by China where we continue laying the foundation for future growth.

In EMEA, revenues grew 3.4% over last year's second quarter to $7 million. Excluding $3.8 million of negative impact from currency, EMEA revenues grew 9.1%. This growth came on top of the 17.6% growth last year. E-commerce had another great quarter, growing almost 25%. Our retail comps were up more than 8% and our wholesale business after turning in an excellent first quarter, continued to grow.

Moving on to the rest of our P&L, our adjusted gross margin for the second quarter was 53.6%, well above our guidance of 52.2%. A higher margin in the Americas and lower than expected air and general freight costs contributed to the stronger than expected adjusted gross margin.

On a year-over-year basis, reduced purchasing power associated with the strengthening of the U.S. dollar drove 150 basis points of the 170 basis point decline. Additional freight and distribution costs were somewhat offset by increased pricing and reduced promotions.

Our second quarter SG&A expense was $141.5 million. By continuing to drive leverage across the business, we beat our guidance and reduced SG&A as a percent of revenue by 460 basis points, down to 39.4% from 44%.

Non-recurring charges in this year's Q2 were immaterial compared to $8.4 million in last year's second quarter.

Our operating margin rose 200 basis points to 13.3% while our adjusted operating margin improved 40 basis points to 14.3%.

Our diluted earnings per share increased 57% to $0.55 compared to $0.35 in the second quarter of 2018. Our adjusted diluted earnings per share increased 9% to $0.59 compared to $0.54 last year.

During Q2, we repurchased approximately 2.5 million shares of our common stock on the open market for $55 million, at an average share price of $21.89. That left us with approximately $547 million available under our plan for future share repurchases. Year-to-date, we have repurchased 4.6 million shares for approximately $108 million, or an average of $23.35 per share.

Our balance sheet continues to be very strong.

We ended the quarter with $107.8 million in cash. Our outstanding borrowings are at $215 million, and are unchanged from the end of Q1. In July, we entered into a new $450 million credit facility, which replaces our $300 million facility. This new facility carries lower borrowing rates and contains less restrictive covenants, so that we will have more flexibility in terms of managing our capital structure.

Inventory at the end of the quarter was 3.6% higher than at the same time last year and our inventory turns are running above 4 times, as demand continues to steadily rise.

In summary, we feel great about the quarter and there are few milestones worth noting. Growth in the Americas was almost 24%, with wholesale and e-commerce growth almost 30%, and our retail comp approached 18%. On top of that, our overall performance resulted in our operating margin rising 200 basis points to 13.3%.

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

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For 2019, we are increasing our guidance as follows.

Revenues are now expected to grow 9% to 11%, compared to our prior guidance of 5% to 7% growth. We continue to anticipate that 2019 revenues will be negatively impacted by approximately $25 million of currency changes and approximately $20 million resulting from store closures.

Our gross margin guidance is unchanged. We continue to expect an adjusted gross margin of 50.5% and GAAP gross margin of 49.5%. The flow through from raising our full-year revenue guidance is expected to be offset in the back half of the year by reduced purchasing power associated with the strength of the U.S. dollar and the strengthening of our wholesale revenues which carry a lower gross margin.

We now expect that SG&A will be approximately 40% of revenues. This represents a 100-basis-point improvement over our prior guidance reflecting the success we're having leveraging top-line growth including strong wholesale growth which carries lower SG&A than other channels. Our updated guidance now contemplates non-recurring charges of $2 million. In 2018, SG&A was 45.7% of revenues and included $21.1 million of non-recurring charges.
We now anticipate that our adjusted operating margin will exceed 10%, which achieves our interim target of returning to a low double-digit operating margin. Our GAAP operating margin is now expected to be approximately 9% including non-recurring charges associated with our new distribution center and certain SG&A costs. This is up from our prior GAAP operating margin guidance of 8.5%.

Our tax rate is now expected to be approximately 15% down from our prior guidance of 25%. The decrease in our anticipated effective annual tax rate relates to higher than anticipated U.S. profits for 2019, giving rise to an ability to use various tax benefits accumulated during prior years.

With respect to the third quarter, we expect revenues to be between $295 million and $305 million compared to $261.1 million in last year's third quarter.

Our guidance incorporates the loss of approximately $2 million from negative currency impact and $3 million from revenues associated with our reduced store count. At the midpoint of our guidance, this represents growth of approximately 15%.

Adjusted gross margin for the third quarter is expected to be approximately 51.5% compared to 53.3% in last year's third quarter. Reduced purchasing power is expected to account for approximately 150 basis points of the decline. The balance reflects higher freight and distribution costs as well as our expectations for strong wholesale growth, which carries a lower gross margin. This decline will be partially offset by gains from pricing and reduced promotions, along with efficiencies from closing our owned manufacturing facilities.

Our gross margin is expected to be approximately 50%, with non-recurring charges relating to our new distribution center accounting for the 150-basis-point differential between GAAP and adjusted gross margin. Q3 will be our largest quarter of non-recurring charges relating to our new distribution center.

SG&A is expected to be approximately 40% of revenues, compared to 47.9% in last year's third quarter as we continue to leverage top line growth, including strong wholesale growth which carries lower SG&A than our other channels. This guidance also includes an increase in our marketing spend over last year resulting from incremental investments we are making to support and accelerate our growing brand momentum.

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We had a great spring/summer season, executing well on all fronts. That set us up well for a strong second half in which we are anticipating accelerated growth leading to excellent 2019 financial results.

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. Year-to-date, our business has performed very well, and I'm confident that this performance will accelerate through the second half of the year. The product and brand-building work of the past few years has been transformational. Our product is in great demand and our brand is hotter than ever. Combined with the strong SG&A controls, our growth is driving strong operating leverage and higher levels of profitability. By adhering to our strategic priorities, we believe we will drive top and bottom-line growth and increase shareholder value in the future.

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 from Baird. Go ahead please. Your line is open.

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

Q

Yeah. Hi. Thank you. I wanted to start off asking a little bit more about the brand hit that you're seeing and I know you raised the full-year outlook for revenue by a pretty significant amount and that's all implied from the second half. So could you just talk more about what that implies about the response to some of your ongoing brand actions and then also related to how you're viewing the sustainability of some of the hit that you've driven?

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

A

Yeah. Thank you, Jonathan. I think what we've seen in the first half of the year is really a very, very strong traction on our product and marketing strategy, and I would say particularly in the U.S. and EMEA where we've had a really excellent first half and we've seen that across channels. We've seen that in our DTC channels, we've seen that very strongly in wholesale and we're feeling really confident about the trajectory of the business.

I think this is a result of a lot of the hard work we've done in the last several years, repositioning our product and brand and as we look at the back half, we are really seeing that continue. We're seeing that continue from a whole sale perspective. We're seeing that continue from a DTC perspective. I would say a lot of it is pivoted around clogs, sandals, personalization are really driving that growth. And as we look at our traffic to our websites, we look at traffic to our stores, we're really seeing very significant and continued interest in the brand.

I think a part of your question was sustainability, and we also feel very confident about that. We feel confident about the diversity of consumers that we're attracting to the brand. We think about our consumers in two big buckets are “Feel Good” and ”Explorers”. Feel Goods are more traditional and among all the consumers, we're seeing traction with that group. Explorers are a little bit more urban, younger, and we're seeing traction with that group. So, we really see the traction is pretty broad-based which is what gives us the confidence in the [indiscernible] (00:22:26).

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

Q

Okay, great. And maybe as a follow-up more specifically related to some of the channel callouts that you've had, I know the DTC business has been strong for a while, but I just wanted to ask more about the strengthening of the wholesale business that you've signaled, and maybe if you could talk a little bit more specifically anymore color where you're seeing the strength and then also how much support you have in terms of order book and forward indications for that business?

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

A

Yeah. I think so, maybe I break that down into a few pieces. So I'd say, in Q2, the real strength that we saw in wholesale was in the Americas, and as we look at where that comes from, we see that as pretty broad sales as we talked about before, as we think about that particularly in Americas, we're focused on three key channels,

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we're focused on our digital channel, the broad-based e-tailers. We're focused on family, and we're focused on sporting goods, and we saw strength across all of those three major channels, both in terms of pre-orders for the product, but also fill-in orders through the quarter and we see that continuing. If we talk about EMEA, EMEA had a really strong Q1, driven a lot by pre-books, a little bit flatter growth from a wholesale perspective, but if you look at H1 in EMEA, it was very, very, strong. If we look at Asia, we really see strength in our wholesale business in Japan, Korea and to some degree in our Southeast Asia distributor business. So, we see it as pretty broad based in terms of wholesale.

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

Q

Okay. Great. Thank you.

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

A

Thank you.

Operator: Your next question comes from the line of Erinn Murphy with Piper Jaffray. Go ahead please. Your line is open.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Great. Thanks. Good morning and nice quarter. I guess, my question, Andrew, for you is on the Jibbitz business. You talked about that really driving significant results and just bringing in more monthly newness. Can you talk more about the purchasing behavior behind that consumer, are you seeing consumers come in and co-incidentally buy Jibbitz rather buying clogs or you think consumers come more frequently just to look at the newness. Just would love to hear how you're thinking about that opportunity and the behavior today. And then can you talk about potentially looking at wholesale as a channel for Jibbitz; I think you sell on a few of the dotcoms partners, but just curious on what that could look like? Thank you.

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

A

Yeah. I think so – Jibbitz is, as you said Erinn, it's very important to us, right. What we're doing there is tapping into a global megatrend. There's a global megatrend customization. You can see it in footwear categories, you can see it across many other categories and, particularly, your younger consumer is very focused on buying not necessarily a generic product but are looking to buy a product that's personalized for them. Our way of enabling that and I think it's a very compelling way is Jibbitz. It allows the consumer to make that purchase, a unique purchase to them. It allows them to express key attributes that they want to express about themselves to others and frankly to change that over time. So, what we're seeing in terms of purchasing dynamics, we're seeing that evolve. So, I think initially – you've been following the company for a long period of time, so initially this was a very child-orientated add-on. We've evolved that dramatically to be much more child and adult in terms of the types of Jibbitz that we're producing. So we are appealing to a much, much wider audience.

I think initially we saw it more as an add-on to purchases as you kind of alluded to, so their customers would purchase a clog or an increasingly wider range of jibbitable product, that's a phrase, product that is being specifically designed to allow that personalization. I think we are starting to see that evolve with consumers coming particularly through our DTC environment actually to purchase new Jibbitz specifically to change up,

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maybe a, product that they already have. As you know, we really like this because it drives a lot of brand engagement. It is also a very highly profitable product category and for our customers the price is low and we can get a lot of value for it and the consumer sees a lot of value in it.

You also alluded in your question to wholesale. Historically, it's been a challenging category for wholesale because it's very hard to manage, right, it's a lot of small items, but we work closely with a range of wholesalers to produce options for them and formulations for them that allow them to manage it and I think they were really pushing us to do that for them because they saw the consumer engagement that was taking place in our DTC environment and they wanted to participate in that. So, we are increasingly working with a range of wholesalers to allow them to sell and showcase Jibbitz in their stores.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Got it. Thank you. And then just a couple of follow-ups, just in terms of the model, maybe the second quarter revenue. How inventory or style constrained were you still in the Classic clog and did that impact your revenue growth at all? And then, I guess, the second modeling question, Anne, for you on the gross margin, you maintained your full year. So that implies roughly 300 basis points for the fourth quarter in terms of a bump in gross margin on an adjusted basis. Just curious with the building blocks are there?

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

A

Okay. Yeah, let me talk about the Classic clogs and then I'll pass it over to Anne, Erinn. I would say, we continue to be constrained through the quarter in terms of Classic clog. It's mainly in a few core colors, probably two to three core colors. And I would say out of stocks were sporadic through the quarter. The underlying situation that we're experiencing is the growth in demand continues to exceed our growth in supply. I note that in my prepared remarks we have more than double supply but obviously, there's a little bit of a lag in terms of some of that supply reaching the U.S. And we continue to add supply to make sure that we can keep up with future demand.

I would say we anticipate continuing to experience sporadic constraints for the Classic clog and this is really only in the Americas through Q3. But we're very confident that the amount of supply that we have meets the guidance that we provided. So, I think this is a really high-class problem and one that we're proactively addressing and can understand what the opportunity is. I think, your question was also did it constrain revenue in Q2. Yeah, I would say somewhat, but we're working diligently on this and are positive over time. I'll pass it over to Anne.

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

A

Yeah. Hi Erinn. From a currency perspective, we will see gross margins get a pickup in Q4 from less currency pressures. So why we still expect to have negative currency pressure if you think through our overall currency guidance, it's going to impact our margins by 130 basis points. First half is 140 basis points, H2 is 110 basis points, with Q3 having 150 basis points. So there's some piece of Q4 that currency and then the other piece of Q4 is really we're driving a lot more volume in Q4. So, we're driving a lot more leverage on our fixed gross margin cost structure. Those are the pieces that drive Q4 margin.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Okay. And Anne, just the last question for you on tax rate. Obviously, it was significantly lower than we anticipated for the year and I think you guys referenced in your prepared remarks some tax benefits are pulling forward given

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the profitability in the Americas. Does that continue into 2020 or would you expect the tax rate to bounce back to the mid-20s that you had seen before? I'm just trying to understand that because it does move our models pretty significantly.

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

Yeah. It's a good question. So our tax rate, we guided 15% down from 25%, which as you mentioned reflects higher than anticipated U.S. profits, which give rise for us to use various tax benefits accumulated during prior years. Well, we do expect that our tax rate will continue to decline from the 25%. We're not going to provide long-term guidance yet on tax rate, but we will guide for tax rate when we give 2020 guidance.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.
Q

Okay. But those should be above 15% but below 25%? I mean it does move our model so significantly [ph] given in 1000 ….

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

I think that's the right way to think about it. Yeah.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.
Q

Okay. Okay. Fair enough. Thank you guys and all the best.

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

Thanks, Erinn.

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

Thank you, Erinn.

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

Mitch Kummetz
Analyst, Pivotal Research Group
Q

Yeah. Thanks for taking my questions. In Q3, you guys are obviously looking for some strong growth in the quarter. You're up against a pretty tough comparison. I know back to school was very strong last year. So I'm just hoping you could tell us what gives you the confidence in that outlook and obviously at this point, you've got one month in the books. I'm just wondering if there's anything you could say about what you're seeing for early back to school and to what extent, you're kind of extrapolating that over the balance of the back to school season?

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

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Yeah. I would say Mitch, we're very confident in the guidance that we've provided. I know the external investor community have been concerned about our back to school compare. I would say we are not at all concerned about our back to school compare. We think our opportunity to grow in this timeframe is very significant frankly this year and for years to come. We have a very good player – a good role in that back to school business where we haven't in the past and that will continue.

What we're seeing, I would say, supports that as you rightly point out, we're a month into the quarter and back to school is in full flight in many channels and we continue to see very strong sales growth in all of our core channels of the product that we have on the shelf. And I would say healthy reorders for that product. So...

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Okay. That's helpful.

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

A

... we're very confident.

Mitch Kummetz
Analyst, Pivotal Research Group

Q

And then you referenced Vera Bradley collab in your prepared remarks, can you speak to how the pairs compare that to like a Post Malone, I assume it's a lot more pairs, and do you have any kind of similar collabs in the pipeline for the back half or you're doing maybe more pairs than in things you've done in the past?

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

A

We're not going to talk about the pairs on our different collabs, it was obviously bigger, right. So, we sold it in our stores, we sold it online. Vera Bradley sold it in their stores and online. I think Vera Bradley's own retail and e-comm environments sold out very quickly. We have sold out essentially on our e-comm site, we still have pairs in store. And I would say the sell through rates, if you look at the weekly sell through rates are very, very good. So, I feel like it was a great collab, it really hit our core consumer. We weren't really reaching out to new consumers. It really hit our core consumer, and we know we had high overlap between our core consumer and Vera Bradley's core consumer. So it was really very well done. And I would say our strategy against collabs is to appeal to our very democratic and diverse consumer base. So they'll be at the high end, they'll be with designers, they'll be with musicians, they'll be with other brands, they'll be with retailers. And we think that portfolio is a very powerful portfolio and there will be others that are more significant in the future, absolutely, but they will be mixed in with others that are very focused and niche.

Mitch Kummetz
Analyst, Pivotal Research Group

Q

And then lastly on Europe, you had another nice quarter in Europe, particularly e-comm and wholesale. Could you speak a little bit to where you're seeing the most growth or maybe on a country-by-country basis, are there certain countries that stand out and others that are maybe still lagging that you still need to bring along?

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

A

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Yeah. I mean I think so as we think about Europe or EMEA, it's tricky, right. So, as Americans, we think about that as an amalgamous environment but it's not at all, right. You really have to focus your sales and marketing efforts country-by-country. Germany is a particular focus for us. It's our biggest part of that business. So, we do focus very hard on Germany for a lot of our marketing and sales efforts into Germany. So, I would say that has grown nicely. I would say, also in our EMEA business, is a pretty significant distributor business where we serve as distributors in the Middle East, in Southern Europe, and in Eastern Europe. And I say we've seen good growth in that. So, if you were to take away our headline, I would say distributors, I would say Germany and also in that business is our Russia business. And we've seen very good digital and e-com growth in Russia.

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Okay. Great. All right. Thanks. Good luck.

Operator: And your next question comes from the line of Sam Poser from Susquehanna. Go ahead please. Your line is open.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

Thank you for taking my question. Good morning. And you talked about the 11 quarters of beating on sales and gross margin guidance, why wouldn't Q3 be another one of those quarters? Are you adjusting the manner by which you're guiding that?

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

A

Hi, Sam. Thanks for the question. Yeah, we're very confident in our Q3 guidance. As you pointed out, we've consistently met our guidance or exceeded our guidance expectations and we continue to guide what we see at the time that we have visibility, so we're confident in our Q3 and full-year guidance.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

As you were before in Q2 and it sounds like the momentum especially in clogs is improving which is your highest margin business, and you got additional air freight. I just want to walk through the components of it?

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

A

Yeah you want to walk through the components of gross margin just to understand?

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

I want to get the puts and takes off of this improved demand, the acceleration in the overall sales especially in the wholesale business, which should give you leverage on your fixed costs and so you're saying that your headwind on gross margin in Q3 is going to be worse than it was in Q2. I'm just trying to understand how this whole thing holds together.

[indiscernible] (00:38:25)

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

A

Yeah, let me walk you through it. So our gross margin for Q2 was 53.6%, which was higher than our guidance by a 140 basis points. And really what that came down to is we had better than expected gross margins from the Americas. As you mentioned, we had strong pricing and strong sell-through of clogs, which is high margin and we had less discounting and promotions associated with the strength in the Americas business.

In addition, we had a little bit less freight than we expected. We use less air and our underlying and inbound freight rates were, we've seen them come back in the line a little bit. So even though they're still impacting year-over-year, they are a little bit lower than what we had initially projected. From a Q3 perspective, we have that currency of 150 basis points, which is a little bit stronger than what we had anticipated originally. And the balance of really why it's getting worse is higher wholesale which carries a lower gross margin, so it's very accretive overall for the bottom line, because it allows us to leverage our SG&A and that's why we were able to take down our expectations for SG&A rates, so that – it's great, but it does mix out a little bit negative on the gross margin line.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

Okay. Okay. Thank you. And were there any impacts on revenue due to the Easter shift? Does that help second quarter at all? [indiscernible] (00:39:57) did it help?

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

A

Yeah, I would say look we had a really good Easter, so we were really pleased with particularly our DTC performance during Easter. So, I would say, it was a strong, but I would also say it continued to be strong throughout the quarter. So I wouldn't interpret our comps in Q2 as Easter driven. I would say they were strong during Easter, but they were stronger rest of the quarter also.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

Thank you. And then one last thing, you said in the investor presentation about the Americas that you wanted to maximize clog growth. Is there a maximum level that you – is that possible – is there a maximum level, is there a ceiling or was that verbiage?

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

A

Yeah, I think what we're trying to say there Sam is we want to get our supply to catch up with – the growth and supply to catch up with our growth and demand. I think what you're alluding to a little bit, so the way we think about it is – core colors we frankly want everybody to be in stock at all times. There's no reason to be out of black, out of white, that's not a strategy whereas I would say fashion or seasonable colors, we do see that there is a limited supply that we want to provide on those and we want those to sell through and sell out, and then be replaced by the next seasonal color or graphic. And where we are right now, is we are seeing periodic out of stocks in our core colors which we don't think is the right way to treat our consumer, or the right way to maximize our business. But, we're also seeing very strong sell through on our seasonal colors and sell out of our seasonal colors which is intentional.

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Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

Okay. Thank you. And one last thing, are you seeing any concessions from your Chinese suppliers, given that you've increased the manufacturing there; it's a little bit higher now than it was planned originally?

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

A

I would say concessions. I would say, look I think we have a very strong partnership with our sourcing base. We work with a handful of very large and multi-country suppliers. So the Chinese suppliers that we work with are the same suppliers we work with in Vietnam and other places, you know the same groups, and the benefit of working with those large and pretty sophisticated groups is that you can move production around and get incremental capacity when you need it.

Sam Poser
Analyst, Susquehanna Financial Group LLLP

Q

Thank you very much, [ph] and (00:42:50) continued success.

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

A

Thank you, Sam.

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

A

Thank you, Sam.

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

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

Q

Yeah. Hi. Thank you. Just wanted to ask a couple of follow-ups. First on the margin outlook, I just wanted to clarify since you have the table in the back [indiscernible] (00:43:10), but on a GAAP basis for the year, you're saying 49.5% gross margin and 40% SG&A, but a 9.0% operating margin. So I just wanted to clarify that?

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

A

Yeah, so on a GAAP basis in the back of the release, we walk it, right, so we have – on a GAAP basis, we're projecting our gross margins at 49.5%. Then you add back in the one-time recurring charges, which is about a 100 basis points associated with our new DTC location which just takes us to about 50.5%. We didn't walk non-GAAP SG&A rate. So when you take that out, it's about 40% and we just took it at the mid-range of where we get to our GAAP operating margin.

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

Q

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Okay. I guess I was just asking. So 49.5% gross margin and you subtracted out 40% G&A and I think it'd be more like 9.5% GAAP operating margin versus 9%. So just wanted to make sure I wasn't missing anything.

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

Yeah, we just did “approximately” in the non-GAAP reconciliation, so you are correct.

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

Okay. And then so you add in 120 basis points and you'd be more in the mid-10% range than the 10.2% listed?

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

Correct.

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

Okay. And then I wanted to follow up since you're above 10% now on a non-GAAP basis. How are you thinking ultimately about the direction or the longer-term opportunity from a margin expansion opportunity?

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

Yeah. So as you pointed out, for some time, we've been focused on achieving our double-digit operating margin and we're thrilled to achieve it in 2019, and we're confident that we can drive revenue growth to continue to drive leverage and we'll give more color when we provide 2020 guidance.

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

Okay. And the last follow-up I had was on the revolver. I’m not sure if you mentioned it, sorry if you did, but just the recent increase in the capacity there, could you share any thoughts on the motivation for that especially since we’re buying back stocks still, fairly aggressively in the first half?

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

Yeah. From a capital structure perspective, we're focused on maximum flexibility, so the market was very good for us to get a refinance. We got a lot more flexibility and we got a better rate and the ability to borrow more which allows us to invest in our business, buy back shares, and do a number of different things. And so it was really focused around maximum possibility and then also simplified our overall revolver structure.

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

Okay. Great. Appreciate it. Thank you.

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

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Thank you.

Operator: Your next question comes from the line of Steve Marotta from C.L. King & Associates. Go ahead please. Your line is open.

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

Good morning, Andrew, Anne and Marisa. Andrew, I know that you do not disclose backlogs or talk about next year, but given the acceleration in the back half of this year and going up against the order book last year and I'm sure being better anticipated in stocks for the first half of next year, can you talk at all about how the bookings are at least early on for the first half of next year. Again, without specificity, you're giving away something competitive. Can you talk a little bit about how things are being received next year in the wholesale channels?

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

Yeah. So you're right Steve, we don't disclose backlog and we are certainly not going to start. But I can give you a little color. I think the very strong sell-throughs that we're seeing at wholesale today and the clear opportunity our wholesale partners see to increase order quantities to drive in stocks and drive improved sell-through in the future is playing well to our future order book, right. I would also say that some of the new product that we have in our pipeline for spring 2020 is also being well received. So the sell-through that we're really seeing is on our core clog and our core business. So those things did give, I would say, a high level of confidence and an optimism associated with future orders.

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

That's really helpful. And could you, I know you don't guide, of course, the EPS for the quarters, but can you talk a little bit about what you're anticipate average shares outstanding would be in the third quarter and year-end given what the share repurchase activity has been for the year?

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

Yeah. So as you mentioned we purchased 2.5 million shares during the quarter for $55 million at $21.89 a share. So that takes our diluted weighted average share count in the quarter to 71.9 million shares and we ended at 69.6 million shares. So you can take that and model that through adding in any dilution from the fully diluted basis.

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

That's terrific, thank you very much. I appreciate it.

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

Thanks.

Operator: Your next question comes from the line of Jim Chartier from Monness, Crespi, Hardt. Go ahead please. Your line is open.

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

Q

Good morning. Thanks for taking my question. As you mentioned in your remarks, here you're still sowing seeds for growth in China and I believe you said that China was still a drag on the Asia business. So is there anything you're seeing that gives you confidence that that business is stabilizing and potentially set to inflect in the near-term? And then in terms of distributors, anything on the horizon in terms of adding some new distributors there? Thanks.

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

A

Yeah, great question, yes. If we look at Asia, the way we think about Asia as we have the three key markets, Japan, Korea, and China. So Japan and Korea are growing nicely, and we feel really good about the trajectory around that.

And as you also said, it's clear that China in this quarter was a bit of a drag. I would say, we are putting in place all of the same strategies that we had put in place in the Americas, in EMEA and our other Asian markets around focusing on clogs and sandals, on working with our distributors to clean up their inventories and reposition their store base. I would say we put a lot of effort into this during the last six months, and we are seeing, I think, we believe we're starting to see, real traction with those distributors.

And as you alluded to, we also have the opportunity to add some new distributors to reach some territories that we are currently not penetrated into. So I think we feel really good about the work that we've done. We feel really good about how we're positioned, and we think that will yield growth in the future. I think we also have confidence that the playbook has worked pretty much everywhere else. So we have no reason to believe that it will not work in China; it's just taken us a little time to get around to having the resources to devote to this in a very focused way.

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

Q

Okay. Thank you.

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

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

Q

Thank you. Good morning. So guys, clog demand remained strong. I'm curious within clogs, have you seen any change in consumer demand patterns, or are people buying the same colors and styles? Is it really the core colors or is its new products and colors that's driving the business here?

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

A

So I would say there's two things to talk about, Jim. One is Classic, so on Classic, we're seeing very strong demand in clogs. So just think black, white, blue, brown, core colors and real growth in those clogs. We're also seeing very rapid sell-throughs on seasonals. So, Melon, Lemon, Tie-Dye, et cetera where we're hitting seasonal colors, where we're hitting things that are kind of current in the season or in the fashion world. And so we're seeing very rapid sell-through on those.

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So it's really a combo effect which is, I guess, I would say is the strategy, is the plan. You bring excitement and newness to the clog through the seasonal and the graphics and the marquee product. And then the second piece of clog is also LiteRide. So I don't want to lose focus on LiteRide. LiteRide was introduced last year, it will more than double this year. There are two big components, the LiteRide Clog is also a very big. Pacer is also doing well, and we introduced kids LiteRide this last quarter both in clog and pacer and I would say that's doing very well. So the LiteRide is – think about LiteRide as double last year, so that is also providing growth. It is also a higher priced product, so it drives that piece to it. So it's both Classic and LiteRide that are driving a lot of clog relevance and traction.

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

Q

Great. And then Andrew, you saw nice progress in the sandals, up double digits year-to-year. Is that geographically diverse in terms of the strength or is it concentrated in one particular region?

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

A

I would say that is geographically diverse. So we are seeing double-digit growth across all regions. I think the growth in Americas and Europe was a little muted in the quarter, the spring season for sandals, because good weather didn't get started until later in the quarter. So we felt like we missed a little bit of traction earlier in the quarter. I think it was less to do with what we were offering and more to do with the overall sandal business. But even given that, it is geographically diverse. We're seeing traction against sandals in all regions.

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

Q

Great. And then a last one from me. Still on product mix, new clogs and sandals have been the point of strategic emphasis. The remainder of the business is about 16% of the mix now, things that are neither clogs nor sandals. How do you think about that going forward, Andrew, is that about the right contribution to mix or do you see that continuing to mix down?

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

A

I would say in the short-term, it'll probably continue to mix down a tad. There are a couple of key franchises in that other business, I would say, loafers and flats. I think we're much more optimistic about the long-term prospects of flats as the fashion cycle potentially returns. We think Crocs is very relevant in flats, molded is very relevant in flats, but it has been out of cycle from a fashion perspective for some time now. So if that was to come back, that would be an opportunity to drive that component of the other. I think the loafer business is a less distinctive business for Crocs, I think we have some ideas and points of view on how to develop that in the future, but it's really not a focus at this stage.

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

Q

Thank you.

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

A

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Thank you.

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

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Yeah. Thanks. I just have a quick follow-up on one of Duffy's questions who was asking about the clog feed. And Andrew, you talked about rapid sell-throughs in seasonal, and I think you mentioned the Kadee there, it seems to me that you guys are doing a lot more prints, selling Vera Bradley is a great example, where you're capable of there. So I was just trying to understand how much of that – how much is like prints and incremental driver to the clog business. Do you feel like you're still in early innings on that? Is that something that you do more of in the back half and then also into next year?

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

A

Yeah. We've always done a good amount of prints. The beauty of the clog and the beauty particularly of the Classic clog is it's a great vehicle. It can carry lots of things, right. It can carry color, it can carry print, it can carry Jibbitz, whatever you give it. So I think this is a very versatile chassis – so that's really appealing.

I think we'll continue to do prints and I think they will grow; I think we will also continue to make sure that they do sell through, right. They have a life cycle. We sort of also highlighted in one sense that we have a core print that has sold for a long, long time in terms of our Realtree franchise where we printed product in designated channels that is always in stock and does extremely well. But so I wouldn't say it's going to mix up, but I think it's an important component of the overall mix.

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

A

Great. And we do see seasonal colors and prints drive purchase frequency, that's important.

Mitch Kummetz
Analyst, Pivotal Research Group

Q

Thank you.

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

A

Great. Thanks.

Operator: It looks like we have time for one last question. The last question comes from the line of Erinn Murphy with Piper Jaffray. Go ahead please. Your line is open.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Great, thanks for letting me follow-up. Just two small follow ups. One, Andrew for you on the Blackstone share lock-up, I believe that's coming to you this month. Just any thoughts around that? And then the second question is

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on price increases. You've done price increases I believe in North America, the last two years as you've gone into the next coming year. Do you see any opportunity to take further price increase within the Classic, or is $39.99 the right place to be? Thank you.

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

A

Yeah, hi, Erinn, I'll start with the Blackstone lock up. As you remember, we converted the preferred Series A shares back in December and about half of those are 6.9 million shares. The lock-up expires this month shortly. And Blackstone has been a great partner. They remain on our board and it's a small piece of our overall float. And we're excited about what the future holds for our tax structure but we don't comment specifically on Blackstone plans.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Fair enough. And then anything on the price increases like how we should think about if there's more opportunity, or are you guys at the sweet spot now just being slightly shy of $40 on your Croc Classics?

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

A

Yeah no, I think the way to think about this, Erinn, is look, as we think about, when we look at pricing, we really focus on our consumer and making sure that we're giving great value to our consumer but we're also capturing the value that we deserved for the brand. I think the price increases that we've executed historically have worked really well and we've captured incremental value for the brand and frankly the rate of sales has accelerated. So, I think the consumer is telling us in the space they still see great value in the product. As a strategy, we look at pricing on a market-by-market basis. So we look to understand where we sit relative to competitive brands and competitive products, and are we positioned in an appropriate way, given that market. So you do see – for example, the Classic and LiteRide key franchise is priced slightly differently in different markets, and we'll continue that, and we'll continue to evaluate select price changes market-by-market. I would say if you currently look at the North America market, we've talked to our customers and we've talked to a number of you all about we are anticipating a price increase in Classic for early next year.

Erinn E. Murphy
Analyst, Piper Jaffray & Co.

Q

Okay. Thank you.

Operator: And with that, I'd like to turn the call back over to Andrew Rees.

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

Great. So I just want to wrap up by thanking everybody for their ongoing interest in the company and thank you very much.

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

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