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Crocs, Inc. (CROX)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to Crocs' Second Quarter 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Cori Lin, VP, Corporate Finance. Thank you. Please go ahead.

Corinne Lin

Vice President-Corporate Finance, Crocs, Inc.

Good morning, everyone, and thank you for joining us today for the Crocs' second quarter 2020 earnings call. Earlier this morning, we announced our latest quarterly results, and a copy of the press release may 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 potential impacts to our business related to the COVID-19 pandemic. Crocs is not obligated to update these forward-looking statements to reflect the impact of future events. We caution you that all forward-looking statements are subject to risks and uncertainties described in the risk factors section of our annual report on Form 10-K. Accordingly, actual results could differ materially from those described on this call. Please refer to Crocs' annual report on Form 10-K as well as other documents filed with the SEC for more information relating to these risk factors.

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

Joining us today on the call 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 & Director, Crocs, Inc.

Thank you, Cori, and good morning, everyone. As you saw from our release issued this morning, our business, both from a top and bottom line perspective, performed exceptionally well during the second quarter of 2020 despite the worldwide challenges presented by the COVID-19 pandemic. Our extraordinary performance in the midst of the most difficult business environment many of us have faced in our lifetimes demonstrate our ability to deliver increased profitability and underscores the work we've done expanding the desirability, relevance and consideration of our brand and product offering globally.

Anne will review our financial results in more detail shortly, but here are a few highlights from the second quarter of 2020. Our global revenue for the second quarter declined by only 6% on a constant currency basis and revenue grew in four of our top five markets, the US, China, Korea and Germany. Our Americas business had a strong second quarter revenue of \$172 million as the US business delivered high single-digit revenue growth despite stores being closed for half of the quarter. Americas retail comp store sales increased 18% after reopening.

While Asia Q2 revenue declined, two of our most important markets in the region, China and Korea, each delivered modest revenue growth. Also, e-commerce revenue increased by 68% with strong performance across all three regions. E-commerce revenues for the Americas grew triple digits while Asia and EMEA each grew strong double digits.

Adjusted operating margins increased by 800 basis points to 22%. Adjusted diluted earnings per share grew 71% to \$1.01. We nearly doubled the amount of cash generated from operations relative to last year and we completed our free pair for healthcare donation program, giving over 860,000 pairs of Crocs to frontline healthcare workers.

Let's start by reviewing our performance for the quarter and the impact of COVID-19. Of course, it continues to be nurses who have been directly impacted as well as the many heroes on the frontline that continue to battle this pandemic. Our top priority throughout continues to be ensuring the wellbeing of our employees, our consumers and our partners.

As we shared in our last earnings call, we focused on positioning our business for both short and long-term success. Our defensive playbook that we began to implement in early March is complete, and our offensive playbook is beginning to show results as evidenced by our strong Q2 performance. We've previously outlined that the second quarter will be the most difficult one. While we hope the worst is behind us, we remain prudent and cautious.

During Q2, most retail locations across the globe, including our wholesale customers, our own stores and partner stores will close at some point. In the Americas, our company-operated stores closed at mid-March and began reopening in mid-May. Many of our wholesale customers' brick-and-mortar stores were also closed during these times. Despite these closures, the Americas region grew 1% on a constant currency basis, benefiting from triple-

digit e-commerce growth. We're particularly pleased by our continued momentum in the United States which delivered a high single-digit revenue growth. When our stores reopened, we saw declines in traffic but increases in both conversion and average transaction value. As a result, we saw 18% comps with softness in tourist markets such as Hawaii and Orlando, but strength in markets reliant on local consumers.

In Asia, the landscape was mixed and Q2 revenues declined 19% on a constant currency basis as growth in China and Korea was offset by declines in Japan, India and much of Southeast Asia. Outside of China and Korea, many stores were closed for the majority of Q2, and we continue to expect a slow recovery in our distributor markets. China and Korea were bright spots, each growth second quarter revenue and delivering positive comps. Korea stores were open throughout the quarter and we saw significant outperformance in retail. In China, our stores and the approximately 350 partner stores reopened in April and remained open throughout the quarter.

We continue to improve brand relevance in China with an all-star livestream event with Yang Mi on Tmall which exceeded our expectations. In June, we were pleased with our brand performance during mid-season festival, and we also opened our first energy store in Shanghai. The energy store features our new store concept and showcases both Classic and Jibbitz, with a large Jibbitz zone in front of the store allowing for consumers in-store personalization. As a result of these activities, our reach and engagement increased 50% month-over-month in June. We remain optimistic about our growth acceleration plan in China and the positive momentum we're driving.

EMEA performed better than expected in light of retail closures. [indiscernible] (00:07:40) direct markets experienced revenue growth with strong digital performance offset by weakness in our distributor markets. Revenue declined roughly 2% on a constant currency basis.

While many brick-and-mortar stores were closed for part of Q2, crocs.com and our third party digital e-commerce platforms remained open. The Americas delivered triple digit e-commerce growth while Asia and EMEA grew double digits, resulting in 68% global growth. We also saw strong sell-through at our e-tailers which show up in our wholesale revenues. Our digital business which combines e-commerce and e-tail represented 56% of our Q2 sales compared to 33% for the comparable period last year. While these strong growth rates have recently started to temper, it is clear that the pandemic has accelerated the shift to digital and that digital has been and will remain a high priority channel going forward.

From a product perspective, our results continue to be driven by our focus on our four key product pillars, clogs, sandals, Jibbitz and visible comfort technology. Sales of our iconic clogs were particularly strong this quarter, increasing 10% year-over-year to represent 68% total footwear revenues compared versus 56% last year. As anticipated, sandal performance was impacted by limited inventory and stores being closed for a good part of the sandal season. In Q2, sandal revenues declined 33% and represented 22% of sales versus 30% of sales last year. We did see encouraging sell-through on our new sandal programs Brooklyn, Tulum and the classic slide. We are very optimistic that we'll be able to take full advantage of these programs in 2021.

Profitability was very strong driven by improved gross margin. Our strong brand management resulted in high sell-through rates that significantly reduced discounting and clean inventories. The Crocs brand entered this crisis with incredible management and our brand involvement increased even further during the pandemic. We continue to fuel brand heat with collaborations throughout the world. In addition to the event I mentioned with Yang Mi, we teamed up with Ruby Rose to create a colorful, one-of-a-kind classic Bae clog to celebrate Pride Month. During Q2, we executed a number of collaborations in Japan and Korea. We have an exciting collaboration pipeline for the second half of the year which kicked off with Luke Combs last week showcasing our new classic slide.

We believe brand momentum was also aided by our free pair for healthcare program which helped to generate more than 29 million new visits to crocs.com. More importantly, in just 45 days we donated more than 860,000 pairs of Crocs at a retail value of nearly \$40 million to frontline healthcare workers in need. On July 1, we launched our newest partnership with Feeding America, the largest [indiscernible] (00:10:59) hunger relief organizations. This is an important step in our effort to continue to support our communities.

I've seen the power of our organization when we come together for good, and I know that together we will continue to make a meaningful impact globally. Crocs' vision is everyone comfortable in their own shoes. We are activating our vision through these donation programs and our Come As You Are campaign, now in its fourth year, which celebrates one-of-a-kind and reflects that we stand together with all different kinds. While it goes without saying that 2020 has been anything but predictable, I'm tremendously proud of how we responded as a team and the results we have delivered for our employees, our customers, our communities and our shareholders.

Now let's turn to the future. We're even more optimistic now about the Crocs brand and our long-term growth potential than we were coming into the pandemic. Our brand has proven resilient through the crisis and we've demonstrated that we can deliver best-in-class profitability. While we are confident on the long-term, we're managing the business cautiously for the balance of 2020. Global uncertainties remain with both the pandemic and the consumer as stimulus programs potentially expire and unemployment persists. Specifically relating to Crocs, we have constrained our inventory levels which will limit our revenue upside in the back half of the year.

These inventory constraints are deliberate. In March, we dramatically cut orders for summer deliveries, proactively managed working capital and preserved all holiday units. We sold through more than anticipated in Q2. And while we were reacting to shortages in core inventory, we feel that it's more important to keep inventory lazy and to turn up the majority of our focus to 2021. We're incredibly optimistic about 2021 and we will continue to execute our growth plans that are clearly working. Our four key product pillars, clogs, sandals, Jibbitz and comfort technology, and our powerful social and digital marketing are clearly creating consumer engagement. From a channel and regional perspective, our digital-focused strategy and our growth focus in Asia will lead our future growth. We believe we have a clear path to return to revenue growth in 2021.

Before I turn the call over to Anne, I want to express my gratitude to the entire Crocs organization for the hard work and commitment to delivering exceptionally strong results in the face of such adversity. A special thanks to those in our distribution centers and retail stores. Without you, it would not have been possible to serve our consumers and perhaps more importantly our frontline healthcare community for much of Q2.

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

Anne Mehlman

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

Thank you, Andrew, and good morning, everyone. I'll begin with a short recap of our second quarter results. For a reconciliation of the non-GAAP amounts mentioned to their [indiscernible] (00:14:08) GAAP amount, please refer to our press release.

We had exceptional profit in the second quarter. The Americas delivered revenue growth even with retail stores closed in the region for half the quarter. Growth in Americas was offset by COVID-19-driven weakness in Asia and EMEA, resulting in softer top line results versus the second quarter of 2019. Bottom line results were outstanding as we grew operating margin and EPS versus the second quarter of 2019. Second quarter revenues

came in at \$331.5 million compared to \$358.9 million in the second quarter of 2019, a 7.6% decrease or 6% on a constant currency basis. Currency negatively impacted our revenues by approximately \$5.9 million.

We sold 16.3 million pairs of shoes, a decrease of 14.6% over last year's second quarter. Our average footwear selling price during Q2 increased 10.3% to \$20.29 with the increase attributable to higher prices, lower discounting, increased sales of charms for shoe and channel mix. Second quarter wholesale channel revenues fell 19.5% following last year's reported growth of 9.4%. The Q2 softness was primarily driven by our Asia business with the largest declines in Japan, India and our Southeast Asia distributor market. The declines in Americas and EMEA wholesale were less than anticipated as strong e-tail performance helped offset store closures of our brick-and-mortar partners and weakness in distributor markets.

Second quarter retail sales fell 41.8% globally driven by COVID-19 closures in all regions. However, retail comp store growth which excludes store closures of more than three days in a given month was an increase of 10.5% on top of 11.8% comp growth in prior year. We saw record-breaking e-commerce sales growth of 67.7% on top of 18% growth last year. As Andrew noted, Americas e-commerce sales grew triple digit or 102.2% while Asia and EMEA each grew strong double digits. This represents our 13th consecutive quarter of double-digit e-commerce growth.

Digital revenue as a percentage of total revenue which includes crocs.com and marketplaces reported in e-commerce and our e-tail revenue included in our wholesale channel was 56.1% in the second quarter as compared with 32.6% in the same period last year. Our strong digital sales were aided by brick-and-mortar closures. The pandemic accelerated digital penetration, though it's not clear yet if that trend will continue.

Now let's review our results by region. As I mentioned earlier, the Americas had another strong quarter with revenues up 0.7% to \$171.6 million and minimal impact from currency. High single-digit growth in the US was somewhat offset by weakness in our Latin American distributor business. Retail comps increased 18.2% upon reopening. Growth was phenomenal in e-commerce and stronger than anticipated in wholesale led by e-tail and the dotcom side of our brick-and-mortar partners. Our performance in the US is the direct result of our commitment to driving relevance with the consumer through great products and marketing.

In Asia, Q2 revenues were \$93.6 million, down 21% from last year's second quarter. Strong e-commerce growth of 31.7% was offset by a 44.8% decline in wholesale. We're encouraged by the growth we saw in China and Korea and the more recent improvement we're seeing in Japan. All three markets had positive regional comps. And overall, Asia delivered 8.5% retail comp growth versus last year's comp growth of 0.7%.

EMEA revenues declined 5.1% or 2% on a constant currency basis versus last year's second quarter to \$66.4 million. Revenue growth in all of our direct markets was offset by declines in our distributor markets. Declines of 60.8% in retail were partially offset by double-digit e-commerce sales, up 52.4% versus prior year and strong e-tail sell-through. Our EMEA business is exiting from growing brand heat and are continuing to focus on digital commerce.

Our second quarter adjusted gross margin was 55.2%, up 160 basis points from last year's 53.6% driven by product mix, higher prices on certain products and lower levels of promotions and discounts in the Americas. One-time items that impacted reported gross margin by 100 basis points are largely attributable to COVID-related inventory and impairment charges in Asia.

Our adjusted SG&A fell to 33% of revenues versus 39.4% in last year's second quarter. The decrease in adjusted SG&A were a result of the immediate actions we took to reduce cost in anticipation of lower revenue as the

pandemic worsened. Some costs were added back when we reopened stores, so we expect more normalized SG&A levels going forward. Second quarter GAAP SG&A included \$14 million of charges, most of which were recognized as a result of COVID-19 including donations of inventory of \$8.2 million, employee separation costs and restructuring of \$3 million and bad debt reserves of \$1.7 million.

Our second quarter operating income increased 18.3% to \$56.6 million, and operating margin increased 380 basis points to 17.1%. Adjusted operating margin increased 800 basis points to 22.3% as cost savings added to the positive leverage in gross margin. For Q2, we recorded a tax benefit of \$1.9 million as we accrued more tax than necessary in Q1 in anticipation of weaker profitability than realized. Second quarter diluted earnings per share rose 50.9% to \$0.83 compared to \$0.55 last year. Excluding non-GAAP adjustments, diluted earnings per share increased 71.2% to \$1.01 compared to non-GAAP earnings per diluted share of \$0.59 a year ago.

We significantly strengthened our balance sheet in the second quarter. We ended this quarter with \$151.4 million in cash and \$275 million in outstanding borrowings. Our strong performance and cash flow allowed us to reduce our borrowings by \$75 million during the quarter. We did not repurchase any shares during the quarter as we sought to maximize liquidity and profitability. We ended the quarter with over \$375 million of liquidity between cash and available borrowings. Inventory at June 30, 2020 was \$146.8 million, down from \$195.8 million in the first quarter but up from \$134.6 million in the second quarter last year. The decrease versus first quarter was aided by sell-through as well as cancellations of delivery that were scheduled to arrive in mid-June.

As Andrew touched on earlier, there are many uncertainties throughout the world and we obviously lack visibility. As a result, we will not be providing full third quarter 2020 guidance. However, I would like to share our current high-level outlook. Barring significant additional closures in the second half of 2020, we expect revenue to be approximately flat. We anticipate the sharpest revenue decline to be behind us in Q2. Our normalized tax rate is approximately 17%. However, we expect our tax rate to be 11% for 2020 as we project to utilize deferred tax assets that were subject to a valuation allowance.

We now expect capital expenditures to be approximately \$50 million. This reflects investments to support long-term growth that we had initially deferred. As we have shared, we are relocating and expanding our EMEA distribution center in the Netherlands. We are also opening a facility adjacent to our Ohio distribution center that will significantly increase our capacity in the Americas. This new facility will be dedicated to e-commerce and will open later this year. We expect to generate strong positive cash flow throughout the remainder of the year.

In summary, in spite of the COVID-19 disruption globally, the Crocs brand and our fundamentals are impressively strong. At this time, I'll turn the call back over to Andrew for his final thoughts.

Andrew Rees

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

Thank you, Anne. As our 2019 performance indicated, we have great momentum in our business. The Crocs brand has never been stronger with iconic products at moderate price points, with great storytelling and global distribution. Our company quickly adapted to the COVID-19 crisis and has delivered exceptional Q2 top and bottom line performance in unprecedented times. We remain cautious for the second half of 2020 but incredibly optimistic about continuing to deliver long-term profitable growth.

Operator, please open the call for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Erinn Murphy from Piper Sandler. Your line is open.

Erinn E. Murphy

Analyst, Piper Sandler Companies

Q

Great. Thanks. Good morning and congratulations on the solid results. I guess Andrew, my question is really around inventory and the constraints that you're seeing. Just how are you thinking about prioritizing inventory between your partner doors as well as your own stores into the back half and how quickly can you get back into style?

Andrew Rees

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

A

Yeah. Great question, Erinn. So, look, we just finished an incredible second quarter, and clearly we exceeded both our expectations and the expectations of the external community. So we sold through more inventory than we anticipated selling through and planned for. So we are in a constrained position. I would say we are chasing pretty rapidly core inventory. So our core styles, think of our classic styles which you can see on our website is stocked out at this point in certain colors, and we're hopeful that we will get more inventory in a short period of time.

In terms of how we are portioning that inventory, we're trying to be practical about that. We want to support our wholesale partners as well as make sure that we're representing the brand in the right way both in our stores and on our website. So from time to time, we are stocked out on our own website but we also think it's important to honor the commitments that we made to our wholesale partners as well. So we're trying to balance that, so I think – I'd much rather been in this position frankly. I would hate to be in a position where we had piles of excess inventory and discounting it. Obviously, the position we're in has allowed us to ensure that our gross margins remain up.

Erinn E. Murphy

Analyst, Piper Sandler Companies

Q

Okay. And just to maybe pile onto that, you said a short period of time. Can you clarify is that two months, is that four months? And then have you needed or do you need to airfreight any product to keep up with where the demand has been?

Andrew Rees

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

A

Yeah. In terms of timing, it's probably later in the third quarter instead of fourth quarter is when we will get into a much better position. And I would say at this point in time, airfreight is just not a practical option with all of the passenger flights not operating which is where a lot of the airfreight actually resides, below deck. Airfreight rates are through the roof and for our price of product that's just not an option.

Erinn E. Murphy

*Analyst, Piper Sandler
Companies*

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Okay. And then my second question is just around digital, clearly very strong in the quarter. When you look longer-term, where do you think digital should be as a percent of the mix? And then maybe for Anne. As you think about the expansion that you see here in the United States, any puts and takes that we need to be aware of for the model if you think about that in the third quarter in particular? Thank you.

Andrew Rees

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

A

Yeah. Let me just hit the digital point then I'll pass it over to Anne to talk about the DC expansion. So firstly, I would say I think our strength in digital and our commitment to digital over many years at this point is one of the really core factors that has allowed us to have such a great Q2 and really flourish in the environment that we're in today. We intend to continue to make that commitment. And as we look at the way we define digital which is both our own e-commerce and our e-tail partners, obviously that was a very large percentage of our sales, over 50% of our sales in Q2. I think it has that potential in the long-term. I don't think it will be – it won't be that high as we go forward because we're obviously hoping our stores and our other wholesale partners have opened up. But I think over the long-term, we have that kind of potential and I think that is very much in sync with how the consumer wishes to shop in the future. So I'll leave it to Anne to talk about our DC expansion both here and in the Netherlands.

Anne Mehlman

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

A

Yeah. So from the perspective of the US, we're really excited about expanding our DC in Ohio that we opened last year. I think what you've seen was the increased growth in our e-commerce business. Even last year as you remember, we experienced delays through Cyber Monday and just that huge ramp of volumes was difficult to satisfy the consumers in a reasonable SLA. And so while they're not going to build to the peak of our business, we do think that e-commerce continues to become a bigger and bigger part of our mix and we need to support that. And so it made sense to buildout additional capacity just dedicated to our e-commerce business. As far as margin impact, I wouldn't say that it really is going to impact margin in a significant way because it's really going to be absorbed by additional e-commerce volume if you think about it in that way.

Erinn E. Murphy

Analyst, Piper Sandler Companies

Q

Great. Thank you both. All the best.

Andrew Rees

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

A

Thanks, Erinn.

Anne Mehlman

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

A

Thanks, Erinn.

Operator: Your next question comes from the line of Laura Champine from Loop Capital. Your line is open.

Laura Champine

Analyst, Loop Capital Markets LLC

Q

Thanks for taking my question this morning. It's really to dig a little deeper into your revenue guide for the back half. How does that square with your current sales run rate? And maybe if you can comment in more detail about the percentage of stores that are closing again or what's your total because your press release says almost all stores were open at the end of June but now the majority are in the Americas? So I just want to get a sense of are you being conservative about a potential resurgence, closing some of your partner stores and your own stores, or is this just a reflection of where the trend for top line is right now?

Anne Mehlman

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

A

Yeah. Hi, Laura. So I think just starting with – we don't really give commentary within the month. But just stepping back and thinking about our stores, I think we have less than [ph] 15 (00:29:46) stores closed at this point. Some of them are closed in the US just having to do with the resurgence of the virus, and we expect that to continue, just ongoing throughout small closures. We're not anticipating any large-scale closures, and that was pretty consistent with where we ended June. I think at the end of June, we had all of our stores open and, as I said, we closed [ph] 15 stores (00:30:08).

From a run rate perspective and how we're thinking about the back half, the best way to think about it is we do believe that we'll continue to see e-commerce continue to outperform and we're a little more conservative on the retail front. And then from a wholesale perspective as we talked about, we'll continue to see our e-tail of our wholesale business outperform while our distributors will take a little bit longer to recover. And then just on a follow-up to Andrew when he was talking about chasing replenishment inventory, we are chasing replenishment inventory for core styles. So if we can secure that a little bit earlier than what we're thinking now, and the timing works, we know that there's additional demand and that could actually lead to some revenue upside versus the flat back half we guided.

Laura Champine

Analyst, Loop Capital Markets LLC

Q

Got it. So does that entail your guidance for flat in the back half, would that still equate to Crocs gaining share in footwear overall? So you're saying the industry is going to be down but we're going to be flat? Or what's happening from a share standpoint? I'm just trying to square the long-term growth outlook with the outlook for the back half.

Andrew Rees

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

A

Yeah. Laura, I can say unequivocally we are gaining share. We see that in the marketplace, we hear that from all of our wholesale partners. We're absolutely gaining share in the marketplace. I think we'll see over the next weeks or 10 days the Q2 results from many of our competitors, and I highly doubt any of them will be close to our trajectory, so I think we're absolutely gaining share. In the back half of this year, demand will certainly exceed supply, so we will manage that carefully. Once again, I would much rather be in that situation than the opposite situation. And then as we look to 2021, we think we're very, very optimistic about continuing our growth trajectory in 2021.

Laura Champine

Analyst, Loop Capital Markets LLC

Q

Got it. Thank you.

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

Jonathan Robert Komp

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

Q

Yeah. Hi. Thank you. Andrew, maybe a bigger picture question. I mean, it looks like Crocs' momentum into the crisis and is regaining some momentum coming out. I'm curious just how you think about the duration of this broader trend you're seeing for the brand, if anything's changed or – and you shift back to offense, if anything will look different than you might have expected several quarters ago before this all started.

Andrew Rees

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

A

Yeah. I think the way we think about it, Jonathan, is a few things. Number one, I think our defensive and offensive plans, our defensive playbook is really largely complete at this point and I think has served us very well in terms of making sure we have the right liquidity and we could get on the offense as soon as possible. As we think about the offensive playbook, I think we're seeing some of that play out. But a lot of that really leverages our core strategy, it really leverages that core strategy around cost, around personalization, around sandals, etcetera. And I think just – I actually think that the pandemic and how the consumer is trending puts us in an even stronger position than we might have thought we were in before, right?

I think it's pushing the consumer to a very casual place. I think we see casual rapidly taking share from dress or formal attire. So I think the consumer is becoming more casual, they're looking for comfort, they're looking for value, they're looking for great storytelling, they're looking for personalization and inspiration. And I think as a brand, and perhaps uniquely amongst the footwear space, we provide a lot of those aspects. So I think – and the consumer is coming in our direction, and I think all the work we've done on the company over the last several years puts us in a fantastic position to take advantage of that. So we think that provides a runway for sustainable growth over a significant period of time.

Jonathan Robert Komp

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

Q

Okay. Great. That's very helpful. Maybe a follow-up then on margin. Just curious if anything has changed in your outlook for SG&A that you outlined the last quarter for this year and in some of the cuts there. And then Anne, I know you mentioned the return to top line growth next year. I don't think you commented on margin at all. So just any broader thoughts on how the margin outlook longer-term may be impacted by some of the shifts you see?

Anne Mehlman

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

A

Sure. So just starting with the short-term, from an SG&A standpoint we have previously guided \$440 million to \$460 million. And given that revenue was stronger than what we had originally anticipated, and we did have number of short-term reductions really in Q2 just related to our stores being closed and defensive actions we took, so we do think that SG&A will return to more historical percentages in Q3 and Q4 of this year. And then from an operating margin standpoint, we're really pleased with the way that the quarter shaped out from an operating margin perspective. I think it really showed all the work that we've done on the business, in particular scaling both SG&A and gross margin. So last year, we were excited to hit our double-digit operating margin and we certainly think long-term there's further expansion to be had in margins.

Jonathan Robert Komp

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

Q

Okay. And just to clarify, do you still expect to be within \$440 million to \$460? Just to clarify that comment.

Anne Mehlman

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

So \$440 million to \$460 million was our previous guide and we're now just saying that we think the back half will be in line with historical SG&A percentages.

Jonathan Robert Komp

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

Okay. All right. Thanks for all the perspective.

Anne Mehlman

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

Thank you.

Andrew Rees

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

Thanks, Jonathan.

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

Mitch Kummetz

Analyst, Pivotal Research

Yeah. Thanks for taking my questions. You may have addressed it; I had to step away from my phone for a couple seconds ago to chase a squirrel off my bird feeder. But when Laura was asking about back half growth, I was curious if you talked a little bit about Q3 versus Q4 because, Andrew, as it relates to your inventory comments, it sounds like, I mean, you'll be better-positioned with inventory in the fourth quarter than the third quarter. And then as it relates to Q3, I'm just wondering how you guys are thinking about back to school and potentially schools being online versus in person and if that has any impact on your business.

Andrew Rees

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

Yeah. Thanks, Mitch. So we didn't actually give any specifics when you were chasing the squirrel, but I think your assumption is correct, right? So we think the back half flat but, yeah, and we'll get back in inventory position later in Q3, into Q4 and we feel much better about that. That would indicate that probably Q4 will be a little stronger than Q3.

Mitch Kummetz

Analyst, Pivotal Research

And how are you thinking about, yeah, back to school? Yeah.

Andrew Rees

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

Yeah. So from a back to school perspective, look, it's incredibly kind of uncertain as we – I think we're all experiencing right now, a kid, they don't what's going on and it's incredibly uncertain. I do think what we're – in certain categories that it's still, even if kids don't go back to school in person, it is still a pivot point that requires – that will not necessarily require, but there is renewal of wardrobe that goes on, right? And I still think, we still think

that we will see a strong back to school period in terms of consumer shopping. So we're not overly concerned about whether kids go back or kids don't go back. We don't think that's a huge driver for us. It could be a little bit better if they didn't to go back, but it's incredibly uncertain and I think, look, school districts are frankly changing their minds on a daily and weekly basis right now.

Andrew Rees

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

[indiscernible] (00:38:37)

A

Operator: Your next question comes from the line of Susan Anderson from B. Riley FBR. Your line is open.

Susan Anderson

Analyst, B. Riley FBR, Inc.

Hi, good morning. Thanks for taking my question. Nice job on the quarter. I guess just a follow-up on that last question. Have you guys talked about how much of your third quarter business historically came from back to school? And then I have a follow-up after that.

Q

Andrew Rees

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

Yeah. I think so the way we think about that and what we've seen over time is last year was probably the first year we saw a very kind of significant back to school [indiscernible] (00:39:17). Historically, it hasn't been a critical shopping occasion for Crocs but it has become certainly more important. And so I think it's really become more important for us which is great because it gives us another critical shopping occasion. Certainly, it was instrumental in improving our Q3 last year. So we think it's an important shopping occasion for us and we're very confident in terms of what we like at this point in time.

A

Susan Anderson

Analyst, B. Riley FBR, Inc.

Great. And can you talk about the variances to the wholesale performance across the regions? And I guess if you're not – if you were not chasing product right now, would you say that orders have returned to normal or how should we think about that?

Q

Andrew Rees

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

Yeah. I think orders – yeah. So I think there's a few things I would call out in terms of the variance across regions then I'll get into kind of order cadence. One of the biggest things that you see in terms of variance across regions is the amount of distributor business that shows up in our wholesale sales across regions. Greatest impact in Asia where we serve a lot of wholesale distributors, particularly in Southeast Asia which tend to be highly tourist-orientated markets; think about Thailand, think about Philippines, etcetera. Obviously, tourists are not travelling to those markets and those distributors have been severely impacted.

A

We took a very deliberate decision do not ship to those distributors, right? So we took cancellations and proactive – in some cases, proactively cancelled their orders because, frankly, we could use the inventory elsewhere and we didn't want them to be overstocked in inventory; we wanted them to be in a strong position going into 2021 where we think the markets will start to recover, although some of the tourist markets I think will recover slowly. So that's the biggest delta you see across the regions in terms of wholesale business. I think we highlighted in

prepared remarks we have seen our business grow in four of our top five markets, so those are our direct markets.

In terms of order cadence, I would say as we look at particularly our direct markets and our traditional e-tail and brick-and-mortar wholesalers, I think we're seeing a strong order book, we're seeing both orders for future seasons, we're looking into future seasons right now and replenishment orders. So I would say that's a return to a pretty traditional relationship; the biggest challenge frankly is our own availability of supply.

Susan Anderson

Analyst, B. Riley FBR, Inc.

Great. That's very helpful. Thank you so much. Good luck next quarter.

Andrew Rees

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

Thank you.

Operator: There are no further questions. I'll turn the call to the presenters for any closing comments.

Andrew Rees

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

All I'd like to say is we're thrilled that we had such an incredible quarter two and I want to thank everybody for their continued interest in the company.

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

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