INVESTMENT THESIS

Crocs, Inc. (CROX: $101.00; $6.2B market cap) is a business that specializes in the design, development, distribution, marketing, and sale of lightweight footwear products for men, women, and children. In recent years, CROX has successfully executed an aggressive turnaround plan designed to create a more efficient organization that can sustain profitable multi-channel global growth, benefitting from larger trends in casualization and personalization. The corporation recently acquired HeyDude for $2.5B, Crocs' largest acquisition in the firm's history. The upstart loafer company was poorly understood by investors and the deal was widely panned at the time. However, we believe the acquisition will be highly accretive for the company and adds another complementary product offering to a management team that has demonstrated strong acumen in marketing, distribution, and brand-building.

Today trading at 9.5x PE and an 8.4x EV/EBITDA, we believe shares offer a highly attractive risk/reward dynamic as current valuation incorporates little value for the company's credible growth prospects that suggest earnings CAGRs well into mid-teens annualized rates or better are quite achievable. In an upside case we find surprisingly defensible, one could envision the company earning $33 per share or more in three to four years' time with shares approaching $500 at a 15x EPS multiple.

REASON FOR OPPORTUNITY

Many consumer goods companies have come to be regarded as one-time pandemic beneficiaries with investors viewing current margins and recent growth trajectories as unsustainable. Croc's acquisition of HeyDude likely exacerbated these fears, as the company paid $2.5B for a company most investors hadn't heard of the time. The payment, made mostly in cash and supported with debt financing alongside ~3M in common shares, was a sizeable one for a company that at the time that was anticipated to generate ~$700M in EBITDA that year. The change in capital allocation strategy and capital structure further necessitated the company pause their existing share repurchase plans. In the midst of a meaningful market selloff, shares were punished, subsequently declining nearly 65% at one point from the beginning of this year.

VARIANT PERCEPTION

Despite some investors holding a stigmatized view of the brand given a prior boom/bust cycle from the 2006/2009 time period, we believe the brand remains quite strong. Over the last ten years, Croc's legacy brand volumes have grown subsequently each year, with only a modest contraction in one year in 2016. More recently and like many of its peers in the consumer space, today's low valuation implies the company is a one-time pandemic beneficiary and business prospects offer little growth beyond this year. While it would be ill-advised to suggest the company did not benefit from the pandemic's effects on consumer spending on goods, we believe this view is incomplete and neglects to incorporate the success the management team has achieved since they arrived five years ago.

Management's successful plan has reinvigorated the brand and enabled growth across multiple channels prior to the pandemic. Since becoming CEO in 2017, Andrew Rees implemented a strategic plan focused on taking costs out, shrinking SKUs, increasing operating margins, and reallocating capital away from stores to enable greater investments in digital marketing initiatives to drive improved brand awareness. This strategy has been successful, with operating margins up from flat in 2016 to 12% in 2019 and 19% in 2020 on a top-line CAGR of 6% in the three years leading up to 2020.

Importantly, looking forward the legacy Croc's brand is now positioned with four young growth vectors alongside a strong brand in its more mature market (the US clog) that is still growing at a healthy clip. The four major growth drivers currently for its legacy brand are across underpenetrated geographies in both AsiaPac and EMEALA and across underpenetrated product lines in Sandals and Jibbitz. Lastly, the recent HeyDude acquisition offers meaningful promise moving forward. CROX has just begun to integrate this brand using the same formula that drove its legacy brand's growth over the last few years. We believe that HeyDude has the potential to eventually become an even bigger brand than its legacy products.

THE BUSINESS

What it is - CROX is a leading designer, manufacturer, and marketer of a distinctive line of casual footwear and accessories for men, women, and children. The company's Crocs brand is well known for its unique line of molded footwear that is focused on fun, comfort, color, and functionality as key brand attributes. The products utilize a proprietary closed-cell resin ("Croslite") that enables the footwear to be lightweight, non-marking, and odor resistant. CROX also allows consumers to personalize their shoes with Jibbitz. Jibbitz are a smaller add-on item that comes in the form of letters, numbers, characters, or images that attach to the clog. CROX also now owns the HeyDude company, a high-growth, young brand focused on comfortable and casual loafers.

Market dynamics – CROX is best known for its classic clog shoes. The company's products are sold across more than 65 countries globally via a network of third-party wholesale partners and distributors as well as the company's direct channels that include retail stores, outlets, E-Commerce channels, and kiosks. The company has smaller businesses in sandals, personalized Jibbitz, and comfort technology. Crocs sell its products in more than 125 countries, through three distribution channels: wholesale, retail, and e-commerce.

Corporate history – Most recall Croc's original success as having come pretty much out of the blue, as the funny-looking but comfortable clogs sent the stock on a meteoric rise shortly after its IPO in 2006. Many also conflate the stock chart with a fad-driven boom and bust cycle, even though a closer look at clog volumes actually shows fairly consistent growth over the last twenty years. Even so, the company was not without its problems, primarily from management missteps as an overburdened cost structure created profit headwinds. Accordingly, when Andrew Rees became CEO in 2017, he initially focused his efforts on taking costs out and making the operation more efficient. He shrunk the store count by more than a third and began optimizing their go-to-market strategy by emphasizing sales through the direct-to-consumer digital channel and through wholesaler channel partners. This enabled the company to devote greater resources to product innovation and marketing, a smart reallocation of corporate resources that offered great payoffs for the branded consumer products company.

INVESTMENT CONSIDERATIONS

Strategic initiatives have driven strong results – In recent years, CROX has implemented a strategic turnaround plan intended to create a more resourceful business that can maintain profitable multi-channel global growth for the long term. Over the years CROX has been successful in streamlining the global product portfolio, prioritizing direct investment towards larger geographic markets, reorganizing the business structure, and rationalizing underperforming retail units. Today and prior, the progress has been most evident in the domestic market but has been gaining momentum within Europe and is being applied within China, which is expected to accelerate in 2023. Looking ahead, CROX has outlined plans as a stand-alone company (prior to announced plans to acquire HeyDude) to reach $5B+ in annual revenue by 2026 (17% CAGR).

Distinctive product placement – The core Crocs formed footgear style and the iconic clog outline is widely familiar universally as comfortable, functional, and fun given the versatility of the company's proprietary Croslite material that allows for many different color and design variations. The current global strategies have aligned around driving enhanced relevance for classic clogs, which is currently an estimated $8B total addressable market (~71% of 2020 CROX sales), driving awareness for sandals, roughly a $30B+ global market (~16% of 2020 CROX sales), and enhancing visible cushioning technology such as LiteRide & Reviva. Over the last few years, the company has expanded brand awareness with distinctive digital marketing campaigns, partnered with celebrities & influencers, and perpetuated the shoe's relevance by collaborating with popular household brands, while also increasing the opportunities for personalization.

Becoming a two-brand organization– In late 2021 CROX announced plans to acquire HeyDude for $2.5 billion in a deal that closed in February of this year. HeyDude is a casual footwear brand founded in Italy in 2008 that focuses on comfortable and lightweight footwear that is versatile enough to be worn for multiple occasions. The company is digitally-led with online sales accounting for roughly 30% of sales, while still largely a domestic brand with >95% of revenues from the U.S. To date, the brand is most popular in the South and Midwest regions. Current brand awareness remains low at just ~20% and CROX sees the opportunity to apply a similar playbook that has proven successful to drive HeyDude awareness closer to Croc's current levels of ~92%. The brand is expected to generate Pro-forma revenue of $850-890 million in 2022E and to grow 20%+ over time, with an operating margin expected to sustain 26% after incremental investment.

Expanding margin structure – Management expects sales increases over time along with targeted cost reductions associated with its performance improvement plan to lead to higher operating margins over time. The company recently released long-term targets of 26%+ adjusted operating margin seen by 2026.

Improving the DTC segment and enhancing distribution – DTC operations reached 50% of total revenue in recent years with total digital penetration across owned E-Commerce and third-party e-tailers reaching 41.5% in 2020.

Balance Sheet / Capital Allocation – CROX currently has $143 million in cash & short-term investments, along with $2.62 billion in debt. Recent increases in the company's debt load are attributable to the borrowings used to finance a portion of the HeyDude acquisition earlier this year. Management has stated that they are committed to quickly deleveraging and targeting to be below 2.0x gross leverage by mid-year 2023. Once the firm has reached this stated goal, the company plans to reengage in its existing share repurchase program.

Ownership / Management – CEO Andrew Rees took over the top job in the middle of 2017. Previously, Rees was a consultant working on a growth plan assignment for Crocs and soon thereafter moved to the company in the Role of President in 2014, before ascending to the CEO position. As CEO, he has refocused the company on core lines, slimmed down the company-owned store portfolio, and done an impressive job on the marketing and branding front.

GROWTH PROSPECTS

We view the legacy Croc's brand as having five critical growth vectors, four of which are just hitting their stride. Additionally, the HeyDude acquisition offers the company an entry into a significantly broader category with one of the fastest-growing brands the space has seen in quite some time.

Americas **–** Even though the CROX legacy brand is no longer in its nascent growth phase within the Americas, management has proven adept at driving continued engagement with customers through consistent product innovation. The company is continuing to create new silhouettes to reach new consumers and increase its overall margin profile. CROX plans to remain committed to doing collaborations and to license out popular influencers or trends to keep their products within the mainstream realm of pop culture. One of the biggest potential growth drivers for the CROX legacy brands is its product innovation and its expansion into the sandals category. Sandals currently represent a very large total addressable market as previously mentioned and can appeal to a different subset of consumers that don't favor the traditional Crocs clog silhouette. Management has stated their goal is to grow the sandals business by 4x to $1.2B+ in annual revenues in coming years.

AsiaPac **–** Management's goal within the region is to see a long-term growth rate of ~25% through 2026. For context, during the most recent quarter revenue growth in this region was +82% on a constant currency basis. This strong growth was broad-based across India, Southeast Asia, Japan, and South Korea. Over the past few quarters, the South Korean market has been particularly strong. Typically, consumer brand preferences within the region can be made or broken in South Korea and tend to be a trendsetter. We are encouraged to see that this market has shown strength thus far. Management has also stated on its most recent earnings call that they expect this region to be a large growth driver as consumer demand trends (particularly in sandals) are projected to accelerate in the next few years. China also continues to be underpenetrated and could provide an additional boost in increased revenues. The country is currently the second-largest footwear market behind the United States. As of last quarter, less than 5% of CROX revenue is derived from China. CROX expects to execute this plan by increasing brand awareness with brand ambassadors and key opinion leaders, while also making investments in brand relevance, digital capabilities, and talent. The company also has strategic initiatives to augment its distribution network within the region, while also opening up stores throughout the geography tactically. The board of directors views this segment as a priority for growth as the latest management incentive plans specifically highlight growth for its sales in China.

EMELEA **–** Within Europe, Middle East, Africa, and Latin America, consumer demand trends continue to increase. Last quarter, revenues increased by ~$132M on a revenue growth rate of 45.6% on a constant currency basis and now represent roughly 19% of Croc's legacy brand sales. Based on our recent conversation with management, CROX is seeing very strong momentum in the UK and France. Its most mature market within the segment is Germany. Currently, operating margins are lower in this region in comparison vs. the more mature Americas division. This has been due to a function of scale, timing in volume increases, and the more recent go-to-market strategy. As this region matures, the profitability metrics should start to close the gap with the figures seen in the Americas segment. Within these regions, CROX will also have the opportunity to take pricing in the next few years and to increase its Jibbitz sales significantly.

Jibbitz **-** Another large area of growth potential for the company is to increase its personalization opportunities through Jibbitz. CROX has seen Jibbitz grow from $35M in 2019 to $65M in 2020 and to $162 in 2021. The company expects that Jibbitz should double in revenue by 2026. Jibbitz charms range in price from $5 to $20 for more complex sets and drive high levels of engagement and frequency of purchase because they allow the shoe to be transformed depending on the contexts and moods of the buyer. Based on our recent discussion with management, Jibbitz costs cents on the dollar to manufacture. CROX enjoys licensed partnerships with Disney (Marvel and Lucasfilm) Warner Bros, Nintendo, and Nickelodeon and have recently participated in collaborations with brands such as Vineyard Vines and KFC. Jibbitz has assisted CROX in accelerating its operating margins and helps keep current footwear owners engaged with the brand. Jibbitz remains underpenetrated in markets abroad like Europe and Asia and has a large opportunity to generate outsized growth in markets outside of the United States.

HeyDude – The company's December 2021 purchase of HeyDude was initially unwelcome by investors. Despite the initial share price reaction, the HeyDude acquisition looks quite promising, particularly when considering the company catapulted to half a billion dollars in sales and a low 30s EBITDA margin in just over a decade's time. Over the last three years, sales have grown from $191M in 2020, $580M in 2021, and will grow to $960M in 2022, while achieving 30%+ EBITDA margins in that same time frame. During the most recent quarter, HeyDude's revenues exceeded expectations with $269M in sales last quarter with adjusted operating margins of 29.3%. Over the next few years, CROX believes that the brand will generate $1B+ in annual revenues with an annualized growth rate of 20% through 2026. Management plans on investing in industry-leading marketing to build brand awareness, enhance digital capabilities for further acceleration, and leverage the existing CROX network. The company has brought in industry veteran and former President of Sperry, Rick Blackshaw, to lead the new division. Mr. Blackshaw is a well-regarded industry veteran with over 25 years of experience in the business. The brand only has 20% awareness and is popular in the Midwest and Southern regions. The shoe has yet to hit the East and West coasts in a meaningful way and has no international presence. With an estimated $120B TAM loafer market, the HeyDude brand has a long runway for continued outperformance.

VALUATION

Analyst coverage is robust, with 11 different bank analysts currently covering CROX. The stock is trading below its category peers on a P/E basis, though we believe current multiples reflect little of the anticipated EPS growth.

	Price	**EV**	**EV/Sales FY23**	**P/E FY23**	**EV/FY23 EBITDA**
SHOO	$34.53	$2.55B	1.2x	12.3x	8.7x
DECK	$399.02	$10.14B	2.6x	18.5x	13.1x
SKX	$42.18	$6.61B	0.8x	11.0x	7.8x
NKE	$109.53	$168.93B	3.2x	29.1x	21.9x
CROX	$101.00	$8.71B	2.2x	9.5x	8.4x

PROSPECTIVE RETURNS

Overall, we believe that CROX presents a compelling upside over the next 3-5 years as their business continues to grow due to their recent HeyDude acquisition and the natural growth of their core brand. Over the recent six to eight quarters, gross margins have increased due to a lack of discounting because of supply chain constraints the company experienced. For our estimates, we are assuming a normal pace of discounting will return, however, we also believe this can be somewhat offset by the airfreight costs that were incurred over recent months because of limited containership availability.

In our projections, the base case assumes that in 2026 CROX can produce revenues of just over $7.4B, with an EBITDA margin of 26% by 2026, along with an annualized top-line growth rate of 21% over 2023 through 2026. Our base case for CROX legacy product revenue growth includes 2023-2026 CAGRs of 14%, 18%, and 27% in North America, EMEALA, and Asia Pacific. In addition, we break down these assumptions further and estimate that clogs will grow at a CAGRs of 15%, 26% for sandals, and 19% for Jibbitz. Lastly, in our base case assumption, we estimate that HeyDude will reach $2.4B in sales by 2026.

We note all our projections exclude potential share repurchases. However, in the past the company has been an active acquiror of their own shares and has stated they will likely resume purchases once their gross leverage again falls below 2x. From 2.5x currently, management estimates their leverage ratio will approach these levels within a quarter or two, sometime next spring/summer. In the upside case we alluded to in the summary introduction, a ~20% shrink in the share count would produce EPS at or above $33 per share in 2026. At a 15x PE multiple, we find this to be a surprisingly defensible upside scenario for shares to approach the $500 level.

Case	Description	FY23-26 Assumptions
Bull	Market growth is faster than expected, with operating margins approaching to the levels better than management guided.	24.6% CAGR - 21% CAGR on legacy brand - 25.5% CAGR for HEYDUDE 57% gross margin

	FY 2023 E	FY 2024 E	FY 2025 E	FY 2026 E
Sales	$4,225.9	$5,308.1	$6,699.7	$8,363.5
growth	*21.6%*	*25.6%*	*26.2%*	*24.8%*
EBITDA	$1,204.4	$1,560.6	$1,808.9	$2,258.1
margin	*28.5%*	*29.4%*	*27.0%*	*27.0%*
growth	*32.3%*	*29.6%*	*15.9%*	*24.8%*
Incr margin	*24.9%*	*32.9%*	*17.8%*	*27.0%*
EPS	$12.95	$16.07	$19.34	$24.56
growth	*20.6%*	*24.1%*	*49.3%*	*52.8%*

PE	EPS	Target Price	Return
7.0x	$24.56	$171.89	70%
9.0x	$24.56	$221.00	119%
11.0x	$24.56	$270.11	167%
13.0x	$24.56	$319.22	216%
15.0x	$24.56	$368.33	265%

Case	Description	FY23-26 Assumptions
Base	Market growth continues as expected, with operating margins approaching to the levels in which the company guided.	21.2% CAGR - 17.5% CAGR on legacy brand - 21.5% CAGR for HEYDUDE 56.5% gross margin

	FY 2023 E	FY 2024 E	FY 2025 E	FY 2026 E
Sales	$4,096.9	$5,019.4	$6,119.8	$7,430.7
growth	*18.9%*	*22.5%*	*21.9%*	*21.4%*
EBITDA	$1,106.2	$1,405.4	$1,615.6	$1,979.9
margin	*27.0%*	*28.0%*	*26.4%*	*26.6%*
growth	*28.4%*	*27.1%*	*15.0%*	*22.6%*
Incr margin	*21.2%*	*32.4%*	*19.1%*	*27.8%*
EPS	$12.23	$14.68	$17.43	$21.28
growth	*10.7%*	*20.0%*	*42.5%*	*45.0%*

PE	EPS	Target Price	Return
7.0x	$21.28	$148.96	47%
9.0x	$21.28	$191.52	90%
11.0x	$21.28	$234.08	132%
13.0x	$21.28	$276.64	174%
15.0x	$21.28	$319.20	216%

Case	Description	FY23-26 Assumptions
Bear	Market growth is slower than expected, with operating margins approaching to the levels under expectations.	17.2% CAGR - 15% CAGR on legacy brand - 18.1% CAGR for HEYDUDE 56% gross margin

	FY 2023 E	FY 2024 E	FY 2025 E	FY 2026 E
Sales	$3,884.0	$4,623.6	$5,455.9	$6,407.3
growth	*14.2%*	*19.0%*	*18.0%*	*17.4%*
EBITDA	$1,021.5	$1,216.0	$1,391.2	$1,633.9
margin	*26.3%*	*26.3%*	*25.5%*	*25.5%*
growth	*18.1%*	*19.0%*	*14.4%*	*17.4%*
Incr margin	*18.7%*	*26.3%*	*21.1%*	*25.5%*
EPS	$10.09	$11.99	$14.66	$17.78
growth	*2.8%*	*18.7%*	*45.2%*	*48.3%*

PE	EPS	Target Price	Return
7.0x	$17.78	$124.44	23%
9.0x	$17.78	$159.99	58%
11.0x	$17.78	$195.55	94%
13.0x	$17.78	$231.10	129%
15.0x	$17.78	$266.65	164%

Our Base case price target assumes a P/E multiple of 11x on 2026 projections based on the similar levels where its peers currently trade. Based on the assumptions above, we project a four-year price target of $232.

Our Bull case price target assumes a P/E multiple of 13x on 2026 projections based on an additional valuation increase as execution is better than expected. Based on the assumptions above, we project a four-year price target of $319.

Finally, our Bear case price target assumes a P/E multiple of 7x in 2026 under the assumption consumer trends and purchasing habits of CROX consumers have been negatively altered. Based on the assumptions above, we currently have a four-year price target of $124.

RISKS

- Global consumer slowdown: CROX's sales slowed during the 2008-2009 recession and the company could remain vulnerable to future swings in the overall economic position of its core customers.
- Competition: CROX operates in a highly competitive environment and must produce differentiated products at competitive price points to maintain and grow its market position.
- Fashion preferences: Changing fashion trends and consumer preferences can have a substantial impact on the CROX brand and the ability of the company to generate sales.
- Managing input costs: Fluctuations in key input costs, including raw materials, labor, and transportation could adversely impact profitability.
- Integration: CROX needs to continue successfully integrating the HeyDude brand including hiring to support key functions required to drive the financial projections for the business.

CATALYSTS

- China reopening: If China were to experience a snapback to a pre-covid environment, this could help accelerate CROX's expansion plan within the region.
- Reinstatement of the buyback: Should the HeyDude integration come to fruition quicker than anticipated, this will allow the company to reach its targeted debt levels and reinstate the stock repurchase program.
- Increases in consumer confidence: One of the worries hanging over CROX is that customers may be feeling pressure from external inflationary forces. Should the macroeconomic situation change, this may be a positive catalyst for the company.