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CROX - Q1 2018 Crocs Inc Earnings Call

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OVERVIEW:

Co. reported 1Q18 revenues of $283.1m, net income attributable to common stockholders, after preferred share dividends and equivalents of $3.9m, of $12.5m and diluted EPS attributable to common stockholders of $0.15. Expects 2018 revenues to increase by low single-digits vs. 2017. Also, expects 2Q18 revenue to be $315-325m.

CORPORATE PARTICIPANTS

Andrew Rees *Crocs, Inc. - President, CEO & Director*

Carrie W. Teffner *Crocs, Inc. - Executive VP & CFO*

Marisa Jacobs *Crocs, Inc. - Senior Director, Investor Relations*

CONFERENCE CALL PARTICIPANTS

Eric Thomas Johnson *Piper Jaffray Companies, Research Division - Research Analyst*

James Vincent Duffy *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Jonathan Robert Komp *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Mitchel John Kummetz *Pivotal Research Group LLC - Senior Analyst of Footwear, Apparel Vendors and Retailers*

Samuel Marc Poser *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Steven Louis Marotta *CL King & Associates, Inc., Research Division - Senior VP of Equity Research & Senior Research Analyst*

PRESENTATION

Operator

Welcome to the Crocs first quarter earnings call. My name is Hilda, and I will be your operator for today. (Operator Instructions) Please note that this conference is being recorded.

I will now turn the call over to Ms. Marisa Jacobs, Senior Director of Investor Relations at Crocs, Inc. Ms. Jacobs, you may begin.

Marisa Jacobs - *Crocs, Inc. - Senior Director, Investor Relations*

Good morning, everyone, and thank you for joining us today for the Crocs First Quarter 2018 Earnings Call. Earlier this morning, we announced our first quarter results and a copy of the press release can be found on our website at crocs.com. We would like to remind you that some of the information provided on this call is forward-looking and accordingly, is subject to the safe harbor provisions of the federal securities laws. These statements include, but are not limited to, statements regarding future revenues, gross margin, SG&A expenses, income from operations, adjusted EBITDA and our product pipeline. Crocs is not obligated to update these forward-looking statements to reflect the impact of future events. Adjusted EBITDA is a non-GAAP measure. A reconciliation of this amount to income from operations is contained in the Crocs investor presentation posted on our website.

We caution you that all forward-looking statements are subject to risks and uncertainties, described in the Risk Factors section of our annual report on Form 10-K. Accordingly, actual results could differ materially from those described on this call. Please refer to Crocs annual report on Form 10-K as well as other documents filed with the SEC for more information relating to these risk factors. Joining us on the call today are Andrew Reese, President and Chief Executive Officer; and Carrie Teffner, 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 - *Crocs, Inc. - President, CEO & Director*

Thank you, Marisa, and good morning, everyone.

2018 is off to a strong start. We delivered great product, including launching our new LiteRide collection. We continued to enhance the Crocs brand with the second year of a highly successful COME AS YOU ARE campaign. And by executing against our strategic priorities, we once again delivered financial results that exceeded our guidance.

This morning, I will speak to you about our brand building and product success and update you on our three strategic priorities. I also want to provide you with additional details regarding our decision to close our Mexico manufacturing and distribution facilities, as we continue to simplify our business to enhance profitability. Carrie will then review our first quarter financial results and our latest guidance.

As a refresher, our three overarching strategic priorities are: one, driving sustainable profitable revenue growth; two, improving the quality of our revenues so that we generate annualized gross margins in the low 50s; and three, simplifying our business to reduce costs so that we can bring our annualized SG&A, as a percentage of revenues, down to the low 40s.

This is our road map for delivering double-digit EBIT margins.

Driving sustainable profitable revenue growth is our first priority. Strengthening our brand and delivering relevant product across our distribution channels is critical. I'll begin with our brand and product and then discuss the progress being made across our three distribution channels.

In 2017, brand perception improved dramatically. As I've discussed on our prior calls, we generated double-digit improvements in brand desirability, relevance and esteem in year one of our campaign, and engagement continues to grow as consumers increased their interaction with our brand, socially, online and in-store.

We are now in year two of our COME AS YOU ARE campaign, and it continues to exceed our expectations. As part of the campaign, we launched Crocs: The Musical and the response has been phenomenal. Between the time of the launch in March and late April, the number of impressions across our global social media channels grew approximately 90% and engagement rates increased approximately 250%.

In terms of product, we've prioritized molded footwear, particularly clog and sandal silhouettes. We have also streamlined our portfolio and achieved our targeted global product alignment of 60% across our three regions.

We estimate that the annual global market for clogs is approximately $4 billion and Crocs is a clear market leader. We expect to grow this business as the category grows and by taking share, as we continue to drive clog relevancy. In our largest clog franchises, Classic and Crocband, we are driving continuous innovation and growth by introducing new seasonal colors, graphics, licenses and on-trend embellishments. In addition, our CROCS AT WORK business is being revitalized. We launched two new styles in the second half of 2017, and are regularly refreshing the line with new graphics. In this year's first quarter, total clog revenues grew by 12%, and the clog category represented 53% of our footwear sales, up from 49% in last year's first quarter.

The sandal category represents our largest growth opportunity. The relevant sandal market is estimated to be $23 billion globally and is growing more quickly than clogs. Furthermore, with less than a 1% market share in a highly fragmented market, we have the opportunity for meaningful growth. This season, we increased our sandal offering to address additional wearing occasions for our consumers. Examples include the introduction of fresh colors and graphics and the addition of a new flip to our highly successful Swiftwater outdoor franchise. For dressier occasions, we updated our women's Capri, with new sequins and novelty embellishments to give it a dressier touch. In the first quarter, sandals represented 26% of our footwear sales, up from 22% in last year's first quarter. And in total, our sandal revenues grew 21% in the quarter. This was on top of growing 26% in 2017, more evidence that sandals are a category where we can take share.

We launched our innovative LiteRide collection on March 1. LiteRide is one of our most significant new product introductions in years. It combines a revolutionary new material with Croslite to produce extremely lightweight shoes with a highly cushioned footbed. The collection includes clogs, sandals and casual athletic silhouettes. We launched LiteRide with a globally coordinated campaign, which has exceeded our expectations. And as anticipated, it's bringing new consumers to the brand and is generating incremental demand, thanks to its comfort technology and clean modern silhouette.

The strength of our product, growing brand relevance and compelling marketing underlie the progress being made across our distribution channels. As we look at our three channels, we continue to expect e-commerce and wholesale to be our revenue growth drivers, while we right-size our retail channel by completing our previously announced store closure plan later this year.

We expect continued double-digit growth in our e-commerce channel, which includes our own e-commerce sites as well as the business we do on third-party marketplaces, as shoppers increasingly migrate from brick-and-mortar stores to the convenience of online shopping.

Within the wholesale channel, approximately 1/2 of our revenues will be generated by e-tail accounts and distributors. This portion of our wholesale business is expected to grow in the high single-digit range. We'll benefit from consumer adoption of online shopping and from being well-positioned with strong partners in underpenetrated rapidly growing distributor markets. The remaining half of our wholesale business is generated from our traditional multi-brand brick-and-mortar accounts and partner stores, where we expect, on a combined basis, more moderate growth.

E-tail represents the fastest-growing portion of our wholesale channel, and one we continue to prioritize by working closely with key accounts on merchandising, marketing and the consumer experience. Tighter coordination among our respective merchant teams is improving inventory availability to the consumers, and by co-investing in marketing with our e-tail accounts, we're driving more traffic to Crocs branded products on their sites. The result is an enhanced consumer experience that is fueling robust e-tail growth.

We're also well positioned for growth with our distributor partners. Over the past few years, we've transitioned multiple markets to large, experienced distributors with the depth of talent and resources needed to grow our brand in these under-penetrated markets. These best-in-class distributors are expanding within their respective markets by opening new single-branded locations and increasing the placement of Crocs within multi-branded retailers.

For these reasons, we are confident in our ability to drive sustainable, profitable top line growth.

And now, I'll touch briefly on our two other strategic priorities where we've also made meaningful progress.

Our second strategic priority is to improve the quality of our revenues. As discussed previously, we significantly reduced sales to low-margin discount channels. We improved the quality of our inventory and reduced obsolete inventory across each of our distribution channels. We've also shifted our focus to higher-margin molded footwear. As a result of these changes, we delivered meaningful margin gains over the past two years that resulted in gross margin of 50.5% last year. We expect to deliver further gross margin expansion in 2018.

Our third strategic priority is to simplify our business, to operate more efficiently and to reduce costs so that we can bring our SG&A, as a percent of revenue, down to the 40% range. We're in year two of our SG&A reduction plan, and are on track to deliver more than half of the $75 million to $85 million of annual expense reduction by the end of this year. We're also on track to deliver the full amount by 2019.

A key component of our SG&A reduction plan is to reduce our retail fleet to under 400 stores. Since the end of 2016, we've lowered our store count from 558 to 425, including 22 store closures in the first quarter of this year.

I am very pleased to announce that we just entered into an agreement to assign the lease on our SoHo store in Manhattan. We will close the store this week to prepare for the handover to the new tenant. The impact of this transaction is incorporated in our updated guidance.

As part of our ongoing effort to simplify our business and improve profitability, we have made the decision to close our manufacturing and distribution facilities in Mexico. Manufacturing has ceased, and the distribution center will be closed by the end of the third quarter. We have operated our Mexico manufacturing facility for over 13 years, thanks to our tremendous team of talented associates. I want to thank each and every one of them for their dedication and commitment. I'm deeply grateful for their contributions to the Company. Carrie will take you through the financial implications of this transaction.

In closing, 2018 is off to a great start, and as a result, we're raising our full year guidance. We have the right product, the right marketing and the right channel strategy, and I'm confident in our ability to drive top and bottom line growth.

At this time, let me turn the call over to Carrie to speak to you about our first quarter financial results, and our second quarter and updated 2018 guidance.

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Thank you, Andrew. First quarter revenues were $283.1 million, up $15.2 million or 5.7% from a year ago. This exceeded our guidance of $265 million to $275 million. We delivered solid results across all channels, despite store closures and business model changes, which reduced revenues by approximately $12 million. Our DTC comp was a positive 11.2% and currency positively impacted first quarter revenues by $13.4 million.

We sold approximately 17 million pairs of shoes in the quarter, an increase of 3.9% over last year's first quarter. Our average selling price for footwear was $16.28, a 1.1% increase compared to the $16.11 in last year's first quarter.

The positive reception to our spring/summer 2018 collection drove strong results across each of our three channels.

Global wholesale sales increased by 6.5%. Success with last year's fall holiday line and an enthusiastic response to our spring/summer 2018 collection led many of our accounts to increase their pre-books over last year's first quarter, particularly in the Americas. And as Andrew touched on earlier, the LiteRide introduction drove incremental sales as account added the LiteRide franchise to their Crocs lineup.

Our retail comp was 7.6%, our third consecutive quarter of positive comps. While the Easter shift had a modest impact, our strong retail comp was driven by higher traffic due to the strength of our product, more impactful marketing and improved retail operations. Global retail sales were down 3.7%, as we operated 117 fewer stores compared to the end of the first quarter of 2017.

Our e-commerce business grew 24.1% during the quarter, and we generated double-digit growth in every region. This was our fourth consecutive quarter of double-digit e-commerce growth. Strong product was central to this progress. In addition, the digital marketing and social media activations that took place in Q1 relating to LiteRide, Drew Loves Crocs and our latest Come As You Are campaign materials, including Crocs: The Musical, all helped drive traffic to our sites.

From a regional perspective, the following revenue amounts are as reported.

The Americas generated revenues of $123.8 million in the first quarter, an increase of 5.2% over last year's first quarter, with each channel growing as we benefited from increasing demand for Crocs across our largest region. Currency had minimal impact on the region. Wholesale revenues grew 2.3%, reflecting continued strength in the clogs silhouette. Our Americas DTC comp was a positive 13.1%; our retail comp was a positive 10.9%; and total retail sales grew by 5.7%, despite having 12 fewer stores than in last year's quarter. E-commerce sales increased 18.5% on strong traffic gains and an increase in units per transaction.

Turning to Asia, first quarter revenues of $97.2 million decreased 1.2% compared to last year's first quarter, primarily reflecting the lower store count in the region. Currency favorably impacted the region by $5.9 million. Wholesale revenues increased 1.1%. Our Asia DTC comp was a positive 10.4%. Our retail comp for Asia was a positive 4.7%, driven primarily by higher conversion. Retail sales declined 18.2% as we operated 83 fewer stores compared to the first quarter of 2017. E-commerce sales increased 33%. We grew our business in each country and turned in particularly strong results in China, Korea and Japan, our key markets in the region.

In Europe, our revenues grew 19.7% to $61.8 million over last year's first quarter, reflecting strong double-digit wholesale and e-commerce results. Currency positively impacted the quarter by $7.5 million. Wholesale revenues grew 22.9% due to strong pre-books and at-once sales. Our Europe DTC comp was a positive 4.2%. Our retail comp was a negative 2.6% and total retail sales decreased 3.3% due to operating 22 fewer stores. High street and mall traffic fell in January and February due to the harsh winter, however, traffic rebounded sharply and turned positive in March as conditions improved. Our e-commerce business grew by 31.2%, as we benefited from a double-digit increase in traffic to our sites.

Turning to other items on our P&L. Our gross margin at 49.4% came in 40 basis points above expectations and 50 basis points below last year's 49.9% rate. As I mentioned on our last call, our first quarter's gross margin was impacted by the shift of our inventory costing methodology to FIFO.

This reduced our gross margin by approximately 80 basis points in the quarter, but will have no impact on the full year. Adjusting for this, gross margin for the first quarter would have been 50.2%.

Our SG&A expenses were lower than projected, coming in at $114 million. Non-recurring charges associated with our SG&A reduction plan were $2.5 million this year, compared to $2.2 million in last year's first quarter. SG&A, as a percentage of revenues, improved by 380 basis points, declining to 40.2% from 44.0% in last year's first quarter as we benefit from our SG&A reduction efforts.

Our income from operations was $25.9 million, growing 66.4% compared to last year's first quarter.

Net income attributable to common stockholders after preferred share dividends and equivalents of $3.9 million was $12.5 million. After adjusting for the preferred share participation rights of $2.1 million, adjusted net income available to common stockholders comes to $10.4 million. Our diluted EPS attributable to common stockholders was $0.15 compared to $0.08 in last year's first quarter. The weighted average diluted common share count we used to calculate EPS was 71.7 million shares compared to 74.6 million shares at the end of last year's first quarter.

Turning to the balance sheet, we ended the quarter with $102 million in cash and no outstanding borrowings on our credit facility. This compares to $88.9 million in cash and $3.5 million of outstanding borrowings at the end of Q1 2017.

During Q1, we repurchased approximately 1.4 million shares of our common stock for approximately $20 million, at an average price per share of $14.32. This leaves just under $200 million available for future repurchases.

Inventory at the end of the first quarter was $148.2 million, a $30.3 million or 17% decrease compared to last year's first quarter ending inventory. This reduction reflects our continued focus on improving the quality of our revenues as well as our lower store count.

Cash used in operating activities was $46.6 million, an improvement of 6.6% compared to the first quarter of 2017.

Before providing our guidance for Q2 and the full year, I want to remind you that our guidance is on an as-reported basis.

For the second quarter of 2018, we expect revenues of $315 million to $325 million compared to $313.2 million in last year's second quarter. This includes the loss of approximately $23 million of revenue associated with our reduced store count and business model changes.

Gross margin for the second quarter is expected to be slightly above last year's 54.2% rate.

Our second quarter SG&A is expected to be essentially flat to last year's $140.4 million. This includes approximately $6 million of non-recurring charges, consisting of approximately $1 million associated with our SG&A reduction plan and approximately $5 million relating to the closure of our Mexico manufacturing operation. Nonrecurring charges in last year's second quarter were $1.8 million. Absent the approximately $6 million in nonrecurring charges and approximately $4 million of negative currency impact, our second quarter SG&A would be approximately $10 million lower than the prior year.

In total, we will incur approximately $10 million in non-recurring charges to close our Mexico manufacturing operation, split pretty evenly between Q2 and Q3. Approximately half of the nonrecurring charges will be noncash.

Let me now turn to our full year guidance. With respect to revenues, we now expect revenues to increase by low single digits compared to 2017. Double-digit e-commerce growth and moderate wholesale growth are expected to more than offset declining retail revenues. Previously, we had guided to flat revenues year-over-year. Store closures and business model changes will reduce 2018 revenues by approximately $60 million compared to 2017. Absent those, we would expect revenues to be up high single digits for the year.

We continue to expect our gross margin to increase by 70 to 100 basis points over last year's 50.5% rate. On an annual basis, the closure of our Mexico operations is expected to improve gross margins by approximately 30 basis points. This benefit will be reflected in our 2019 results.

SG&A for the full year is now expected to be approximately $485 million compared to our prior guidance of $475 million. We now anticipate incurring approximately $15 million of nonrecurring charges. Approximately $5 million of this relates to the implementation of our SG&A reduction plan and $10 million relates to the closure of our Mexico manufacturing operation. As I noted before, approximately half of the Mexico-related charges are noncash. After adjusting for the nonrecurring charges and the currency impact, our full year 2018 SG&A reduction would be approximately $45 million against our 2019 SG&A reduction goal of $75 million to $85 million.

We are maintaining our guidance with respect to income from operations at approximately $50 million, up from $17.3 million last year. The higher revenues we now anticipate will offset the increase in non-recurring charges.

We now expect our adjusted EBITDA to be approximately $95 million, compared to $67 million last year and our earlier guidance of $85 million. We define adjusted EBITDA as income from operations plus depreciation, amortization and nonrecurring charges. 2018 adjusted EBITDA is expected to include approximately $30 million of depreciation and amortization and $15 million of non-recurring charges.

2018 income tax expense is now expected to be approximately $17 million, compared to $7.9 million in 2017.

Looking beyond 2018, I want to reiterate my belief that we are on a clear path to double-digit EBIT margins, which based on our current level of depreciation and amortization, would translate into a 13% adjusted EBITDA margin.

In summary, I continue to be pleased with our ongoing progress, and I am confident that the ongoing benefits we are realizing from successfully executing against our strategic priorities will continue to result in increased shareholder value.

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

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

Thank you, Carrie. As I mentioned at the start of today's call, I'm very pleased with our first quarter results.

I want to acknowledge the hard work of our associates throughout the world. Without them, we wouldn't be making such great progress.

The response to our spring/summer 2018 collection has been very positive, and we are extremely encouraged by the LiteRide launch. Year 2 of our Come As You Are marketing campaign is also performing very well as it continues to drive engagement, build our brand and drive sales. We believe that our strategic priorities have us focused on what is important to consumers and customers, and our success in driving growth more quickly than previously anticipated is reflected in our increased guidance for 2018.

Operator, please open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We have a question from Mitch Kummetz from Pivotal Research.

Mitchel John Kummetz - *Pivotal Research Group LLC - Senior Analyst of Footwear, Apparel Vendors and Retailers*

So, I'm just trying to have a better understanding as to kind of what assumptions are embedded in your Q2 outlook? Can you say what percent of your wholesale business is at-once? And how you're thinking about at-once in the quarter? And then, also what your DTC comp assumption is for Q2? And then I have a follow-up.

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

Right. Thank you, Mitch. So Q2 is a slightly bigger at-once quarter than the average quarter. So as we, kind of, look at our business in Q2, it's roughly 70-30 from a pre-book to at-once blend. As we look at our DTC channels, we're really excited and pleased by our comp performance in retail in Q1. But frankly, we see the significant consumer shift out of brick-and-mortar into e-commerce, so we continue to plan our retail business conservatively from a comp perspective. But we are gaining confidence and are confident in our e-commerce business and plan that at a double-digit growth rate.

Mitchel John Kummetz - *Pivotal Research Group LLC - Senior Analyst of Footwear, Apparel Vendors and Retailers*

Okay. And then I know that you report a lot of metrics around channel and geography. Is there anything that you can say about the performance that you're experiencing by gender, let's say, men's, women's, kids? Are you seeing strength more in one area versus the other?

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

Yes. I think we do see a few trends there, Mitch. I think you saw in Q1 that clogs performed better than they have in recent quarters and 12% growth was really strong. So clogs generally go to market, not all of them, but most of them go to market as unisex, which we see as a competitive advantage. They're sized that way and then we blend the colors so that they appeal to men and women. So -- and I think that part of the business biases towards men. The sandal business biases heavily towards women. So different parts of the business, respond to different genders. And I would say our kids business has been pretty stable. We're one of the few brands that have a robust business across men, women and kids.

Mitchel John Kummetz - *Pivotal Research Group LLC - Senior Analyst of Footwear, Apparel Vendors and Retailers*

Let me ask that question a different way and then I'll get off. But in terms of some of the better brand perception, engagement, all those things, a lot of those metrics are way up. Are you seeing any differences across gender with that feedback?

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

Yes. I would say we are seeing higher female engagement. I think that's what you're driving at. And as we look at our marketing campaign, Come As You Are, we look at the product we have in the marketplace, we are driving higher female engagement.

Operator

We have a question from Jim Duffy from Stifel.

James Vincent Duffy - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

My first question, can you speak to the pricing influence on the quarter? The 1.1% ASP increase on a year-to-year basis was maybe not as much I might've thought given the introduction of LiteRide and some of the pricing action that you've taken?

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Yes. Keep in mind, the pricing action that we took on clogs was primarily the Classic and the Crocband and predominantly it was just a North America price increase. So obviously, not impacting all of the revenue in the marketplace. The other thing impacting the overall ASP is the mix of sandals. So given that sandals grew 21% in the quarter and are now 26% of the footwear sales, that's going to bring the average ASP down. And you'll see when you look at the 10-Q, that on a constant currency basis, we're actually down a little bit in ASP. And that's really the product mix.

James Vincent Duffy - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay. So the sandal has a lower ASP than the clog?

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Yes. But again it's high margin like clogs as well.

James Vincent Duffy - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay. And then can you speak to the AUR trends that you're seeing in the stores? Are you still seeing a good attach rate on the Charms? And is that helping the AUR?

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Yes, so AUR -- definitely we're seeing progress. It varies by market, obviously. But we're seeing good conversion rates and higher units per transaction. I would say predominantly North America, in retail, is where we're having the most success, and really the most focus right now in building out the Charm business. And that's continued to generate a lot of excitement about the brand. It's also driving increased UPT, and we're continuing to build that out here. And then ideally, we transport that into the European and Asia markets.

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

Yes. We're definitely leaning into a pretty significant trend around personalization. So Charms is our way of helping our consumers personalize the product and we think that has a nice impact on AUR, but frankly, also has a very nice impact on brand engagement.

James Vincent Duffy - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Great. And then last question for me, and perhaps you addressed this and I missed it, but can you speak to the disconnect between the direct to consumer trends that you're seeing in Asia and the wholesale trends that you're seeing in Asia?

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

Yes. As we look at our Asia business and first as we look at the marketplace, we see e-commerce, whether it be single-branded e-commerce, whether it be marketplaces, whether it be multi-branded e-commerce websites, really accelerating in Asia. And we've leaned into that trend. So we're putting a lot of time, effort and resources into that making sure that we can capitalize on that. And as we look at our wholesale business, there's still a number of transitions going on in the marketplace. We can see strong growth in our distributor business as we talked about, which is predominantly in Southeast Asia. We see strong growth in some of our other marketplaces. But we do have marketplaces, as we've talked about on prior quarters, where we're going through a wholesale transition. That's particularly in Japan, where we're transitioning more from a mono-brand distributor business to a multi-brand retail business. So we planned that business down. It is meeting our expectations. It's exactly what we thought it was going to be. But that is a shrinking of our wholesale business in that marketplace.

Operator

We have a question from Jonathan Komp from Baird.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Carrie, the first question I have, just the revenue guidance increase for the year. Can you give a little more color by geography and by channel, what's driving the increase versus the prior guidance for about flat?

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Yes. So obviously, as we outperformed Q1 versus our expectations, and with our view now on Q2, and calling Q2 a $315 million to $325 million quarter, which is an increase over prior year as well, that's translating essentially into our perspective on the full year being up low single digits. Relative to channel, I would say it's really a little bit stronger in the retail. We've planned that fairly modestly, and we certainly came out strong in Q1. Continued double-digit e-commerce performance and moderate wholesale growth. So that's kind of consistent, and it's really consistent across the regions.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. Great and then a follow-up question on the gross margin outlook. For Q2, I think you said up slightly. I thought you'd be getting the accounting benefit in Q2, the inverse of what you saw in the first quarter from the inventory costing change. So I just want to clarify that, what you're seeing on an underlying basis for Q2? And then also, what you're seeing in the back half of the year that gives you confidence in the growing gross margin you're projecting for the full year?

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Sure. So when we look at the full year, let me just reiterate, full year guidance is the same, at up 70 to 100 basis points. And as I mentioned on the Q1 call, the change to accounting methodology to FIFO has no impact on the full year. And you're right, we took about an 80 basis point hit in the first quarter related to that, it's a little bit less than what we had originally expected. And so, less of a flip as we go through the Q2 portion of the year. That said, the other element that is impacting Q2 is we are heavily impacted in Q2 by the store closings. It's one of our biggest quarterly impacts thus far, with about $23 million in retail revenue losses associated with the store closures. So that's kind of creating a drag on that. And then the other part of your question is the back half of the year. Again, it's trending the same way, slight improvement over the prior year, which gets us to the 70 to 100 basis points on a full year. And it's really product mix as we move through the balance of the year.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay, great. And one last one for me. On the SG&A, it sounds like the underlying improvement, now $45 million, is increased slightly for the year. I just want to ask if that's reflective of achieving some savings quicker? And if so where? Or, are you seeing even deeper cost savings as you work through some of the actions?

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Yes. So it is a little bit goes a long way against the SG&A base. So as we continue to really focus on control over spending, I think we're tracking right essentially where we had projected to be in terms of store closures at this point. And so, the additional savings are really dips across a number of things, less traveling expense, less -- it's a variety of discretionary spend that we're able to tighten up on.

Operator

The next question comes from Steve Marotta from CL King & Associates.

Steven Louis Marotta - *CL King & Associates, Inc., Research Division - Senior VP of Equity Research & Senior Research Analyst*

Carrie, you mentioned that the goal for SG&A, as a percent of total sales, is 40%, and that the SG&A program that you have in place to reduce costs is expected to be complete in fiscal '19. Can we assume that fiscal '20 on a full year basis would be 40% or less SG&A cost as a percent of sales?

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

So to clarify, our expectation in terms of our model to get to the double-digit EBIT margin, is gross margins in the low-50s and SG&A in the low-40s. So I'm not committing to 40%. So definitely the low-40s. And we're tracking along those lines to be able to get to those levels in the time frame that you outlined.

Steven Louis Marotta - *CL King & Associates, Inc., Research Division - Senior VP of Equity Research & Senior Research Analyst*

Okay. All right. So without offering fiscal '20 guidance, do you assume based on the fact that the SG&A reduction program will be completed next year, that SG&A in the low-40s in fiscal '20 is a reasonable assumption?

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Yes.

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

Yes. That's a reasonable assumption, Steve.

Steven Louis Marotta - *CL King & Associates, Inc., Research Division - Senior VP of Equity Research & Senior Research Analyst*

The other question I had is, I know that for years, Crocs has knocked on the door of fall/winter product. And I don't think anyone has answered, unfortunately. Is there anything that is in the research and development stages that makes you a little bit more optimistic for heavier-weight product in the back half of the year to reduce seasonality a little bit, particularly from an earnings standpoint and obviously by extension, from a sales point as well?

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

Yes. So thank you. As we look at the business strategically, the first thing that we're focused on is driving growth where we can most reliably and with the highest probability to drive growth. And frankly, that's in the summer season, that's where we can see the biggest gains, that's where the brand is well positioned. So that's our primary focus. And we're focused, as you know, on clogs and sandals. And as you see in our Q1 results, and frankly as you also saw in Q4 of last year, those initiatives are working. And so in terms of -- that does lead us to have a seasonal business. And so, we're accommodating that as best as we can. As we look at fall/winter, we're not developing specific fall/winter product. But we do believe clogs, lined clogs and sandals can sell well and they sold well in the back end of last year in that season. And we have a lot of business outside the United States in warm weather parts of the world. As you look at South East Asia or as you look at the southern hemisphere, we really rely on those markets to counteract slower business in the northern hemisphere.

Operator

We have a question from Erinn Murphy from Piper Jaffray.

Eric Thomas Johnson - *Piper Jaffray Companies, Research Division - Research Analyst*

This is Eric on for Erinn. I have two. First, can you guys comment a little bit more on what you're seeing with LiteRide, how that's trending across age buckets, genders or the three kind of core styles you've launched with? Has it been more or less cannibalistic than you originally thought?

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

Yes. We are really pleased with the LiteRide launch. That was launched March 1, so you're seeing a pretty small amount of it in Q1. I would say it's exceeded our expectations across the board, from a sell-through perspective, from a regional performance perspective and also from a channel performance perspective. I think what you can see is what's resonating with consumers is the comfort technology, the visible comfort technology, plus also the updated styling. And so we do actually see it bringing new consumers to the brand. We think -- the analysis we've done is the cannibalization is very, very modest. Obviously, it does impact a couple of styles that we have in the marketplace, but it's really modest. And at this point, we're really chasing product so that we can maximize its success. And in terms of styles that are selling, I think that was part of your question, the clogs and the sandals, right? So it's really big -- there are three parts to LiteRide, there's a clog, there's a number of sandals and then there are some athletic silhouettes. I would say the clog is driving the largest portion of the revenue. And the athletic silhouettes that we have, we planned them to be pretty small. They are dramatically exceeding expectations, but that's a relatively small expectation.

Eric Thomas Johnson - *Piper Jaffray Companies, Research Division - Research Analyst*

Great. And then second, on Mexico production, how important was that to the overall mix? And if it was, where is this volume going to be diverted? And then is there any risk that it compromises your ability to fulfill in-season demand in the Americas region?

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

So, as you look in our K, Mexico was about 11% of our overall production, that's what we call out. We're shifting that volume largely to Asia. As you are aware, we have a series of large partners in Asia that we outsource our manufacturing to, both in China and Vietnam. This obviously has been planned over some period of time, so that we don't anticipate any supply risk from this shift. And obviously, as Carrie outlined, we see a future financial benefit in terms of lower cost of goods and higher gross margin. So we think this is a positive shift for the company. Obviously, we are extremely appreciative of the work that our associates in Mexico have done and the contribution they've made to the company. But we think this is the right move as we continue to simplify the business.

Operator

We have a question from Sam Poser with Susquehanna.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

I just have a question about the way you're reporting the numbers. I mean, you have these nonrecurring charges built in. But the underlying business on a go-forward, why not give us just non-GAAP numbers and give us the adjusted SG&A and everything else? That way, everybody will be thinking about it the same way, because I know we're thinking about it differently when we look at around $0.16 of earnings in the quarter, not $0.15 when you take out the $2.5 million -- or the SG&A adjustment in the quarter for the non-recurring charges?

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Sure, Sam. Obviously, it's a choice. But I would say we're much more biased to GAAP measures to comply with SEC requirements. And so we want to make sure that as we convey our numbers in our script, it aligns pretty well to what we're putting forward in terms of our 10-Q, as well as our earnings release. So it's really a choice and I think we're doing a really good job of actually breaking out the pieces so that we can make it very clear what the amount is, what the one-time charges are, and the non-recurring charges are as well as the total. So, we're trying to make it as easy as we can. I know some would prefer we would do adjusted, but we've made the decision to try to do as much as we can according to GAAP.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Okay. And then the tax rate, it looks like the tax rate -- can you explain -- the tax rate seems to be a little bit higher than we what would have anticipated. Can you give us what that underlying tax rate is and why it is what it is?

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Sure. So the tax rate in the quarter, and the Q is out and the detail is in there as well, but the tax rate in the quarter was a little bit higher than what we had originally anticipated. And that was really associated with the new tax regimes, specifically around the GILTI tax, which is essentially a global tax that's designed to tax global intangible low tax income. And we've made an election to take that as a period expense. So we kind of have a higher impact in Q1, which will dissipate as we go through the year. So when you get to the differential of the tax rate, we had about a 31% tax rate last year in Q1, I think we're at about a 39% tax rate this year. The differential is approximately $2 million, it's really, essentially, tied to that GILTI tax.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

And then when we think about, you said you would have $17 million of taxes for the full year based on -- I mean, I guess, let's say what's your go-forward tax rate when you make money? I mean, you meant still Q4 but it'd still be an issue?

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Yes. It's a fair question, Sam. I just think it's not as easy an answer just because we are working through the impact of the tax act. And then it does matter significantly in terms of the geography of where our earnings occur. So we've guided this year at $17 million. And so we're in that 30%, low 30% range right now. And as we get additional information, we will be happy to provide it.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

And then so basically though, next year it should be lower just made up for that additional adjustment in the quarter and so on and so forth.

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

I think it will depend on how the GILTI -- I think there are some unintended consequences associated with the tax act that everyone is trying to work through in the first half of the year. And as that fleshes out, we'll get better line of sight to what that means for the next year.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

All right. And again, following up on somebody else's question earlier, 2020 will be the first clean year. There should not be any headwinds or other sort of non-recurring charges related to SG&A reduction and other things like that. That should be the first clean year of numbers without various adjustments for our closings, and so on and so forth. Am I thinking about that correctly?

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

I don't think we said that. I think what we said is, that by the end of '18 we would have completed our SG&A reduction plan. We're confident that itwill yield the SG&A reductions that were outlined within that. And that we've outlined our model associated with double-digit EBIT margins, which is gross margins in the low 50s, SG&A in the low 40s. We think that's how this company can operate. What happens in the world between now and 2020, that's another matter, Sam.

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

Yes. But to be clear, I think maybe it will be helpful. Based on the SG&A reduction plan that we have outlined, those costs will all be completed in 2018. There will be no additional non-recurring charges associated with the SG&A reduction plan that we've announced that will linger into 2019. In addition, as we think about the store closures and business model changes we will have that impact in 2019 based on the closures that occur in '18 as well as the shifts like we had with the Swire Group earlier this year, we'll have that lap in 2019, but then beyond that right now, that should be clean in 2020. That would all have worked its way through. But hopefully that provides a little more specificity.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Just confirming. As of now, it looks like it will be apples to apples, 2020 to 2019, of course, things could change.

Carrie W. Teffner - *Crocs, Inc. - Executive VP & CFO*

That seems reasonable. Yes.

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

Yes.

Operator

We have a question from Mitch Kummetz from Pivotal Research.

Mitchel John Kummetz - *Pivotal Research Group LLC - Senior Analyst of Footwear, Apparel Vendors and Retailers*

I just had a follow-up question regarding broader market dynamics. I know a year or two ago, you spoke about the negative impact of growing athletic penetration across your wholesale accounts, I think particularly in the family channel, that was stealing open-to-buy dollars away from nonathletic brands. I'm just wondering how you're viewing that dynamic today. Is that still happening? Is it still hurting the nonathletic segment? Or at this point, those dollars aren't coming from you guys because you guys have had the resurgence and things are better? Maybe you can go into that little bit.

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

That's a good question. I think the way we see it is that we feel like the overall market has firmed up a little bit. So when we look at '16 into '17, I think the overall footwear market was going through some big shifts and was frankly soft. As you look across the industry during the back end of last year into the early part of this year, we feel like the market has firmed here in the U.S., and frankly, overseas as well. Athletic is still a major trend. So, as you can see from some very strong results from some of the large athletic players, athletic is still a strong trend. And the portion of open-to-buy available to casual brands is -- I don't think it's shrinking as it was, but certainly, we are very much aware, we need to have great product, great marketing and be aggressive to get our product placed, which is I think, what we're doing, and that's why we're showing success.

Andrew Rees - *Crocs, Inc. - President, CEO & Director*

Great. And since there are no more questions, thank you very much for joining us on our call today and your continued interest in Crocs. Thank you.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.
