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CROX - Q4 2017 Crocs Inc Earnings Call

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OVERVIEW:

Co. reported 4Q17 revenues of $199.1m, net loss attributable to common stockholders, after preferred share dividends and equivalents of $3.9m, of $28.3m and loss per diluted share of $0.41. Expects 2018 revenues to be relatively flat with 2017 and 1Q18 revenues to be $265-275m.

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PRESENTATION

Operator

Welcome to the Fourth Quarter 2017 Crocs Inc. Earnings Conference Call. My name is Jackie, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded. And now I would like to turn the call over to Marisa Jacobs, Senior Director of Investor Relations. 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 Fourth Quarter 2017 Earnings Call. Earlier this morning, we announced our fourth quarter results, and a copy of the press release can be found on our website at Crocs.com. We would like to remind everyone that some of the information provided on this call is forward-looking and accordingly, is subject to the safe harbor provision of the federal securities laws. These statements include, but are not limited to, statements regarding future revenues, gross margins, SG&A expenses, income from operations, adjusted EBITDA, interest expense and our product pipeline, some of which are non-GAAP financial measures. 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 a number of risks and uncertainties described in the Risk Factors section of the company's annual report on Form 10-K. Accordingly, actual results could differ materially from those described on this call. Please refer to Crocs' annual report on Form 10-K as well as other documents filed with the SEC for more information relating to these risk factors.

Joining us on the call today are Andrew Rees, President and Chief Executive Officer; and 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.

I'm pleased to share that our fourth quarter results demonstrate that we finished 2017 on a high note. Throughout 2017, our ongoing initiatives resulted in improved product, more impactful marketing and a stronger brand.

We centralized our focus around three strategic objectives: firstly, simplifying our business to reduce cost; secondly, improving the quality of our revenues; and thirdly, positioning ourselves to drive sustainable, profitable growth. I'm happy to report that we made meaningful progress in each area and furthermore, we expect additional progress in 2018.

In our most recent quarter, we exceeded our revenue and gross margin guidance making this the fourth consecutive quarter in which we met or exceeded these metrics. A big driver of our performances is the work we've done to eliminate a large number of unproductive stores along with the related infrastructure and overhead and to pursue operational efficiencies that advance our SG&A reduction plan. We also improved processes and leveraged systems to significantly reduce inventory and improve the quality of that inventory. Through better working capital management and improved profitability, we increased our cash generated from operations and resumed our buyback activity. These actions contributed to meaningful improvements in shareholder value.

During the call this morning, I'm going to review the three strategic objectives that underlie all of this activity, recap the progress made against them in 2017 and touch on our plans to further advance them in 2018. I'll then turn the call over to Carrie, who will give you an update on our fourth quarter financial results and present our 2018 guidance.

Our first strategic objective is to simplify the business so we can operate more efficiently and reduce cost. At the beginning of 2017, we announced our SG&A reduction plan calling for the elimination of between $75 million and $85 million of annual expenses by 2019. A major component of this program involves reducing our company-operated store fleet by 160 stores between 2017 and 2018 and eliminating the related infrastructure and overhead. When this plan is complete, we will be operating less than 400 stores compared to 558 stores at the end of 2016.

We began 2017 with a plan to reduce our store count by approximately 70 stores. In fact, we substantially accelerated our efforts and achieved a net reduction of 111 stores, so that we ended 2017 with 447 stores. At this point, the heavy lifting associated with the store reduction plan is behind us, and we are on track to complete the remaining SG&A reduction activities this year.

The second objective is to improve the quality of our revenues. Over the past few years, we have taken deliberate steps to accomplish this, notwithstanding the impact on our top line. For example, we reduced our European discount channel sales, which generated poor margins and had a detrimental impact on our brand perception. We shifted from a sell-in to a sell-through wholesale and distributed culture. We aggressively cleared through obsolete and end-of-life product. As a result, we are investing more in our newest, fastest-turning and highest-margin products. And we shifted our focus to clogs and sandals, silhouettes that best reflect Crocs' DNA and have the highest product margins in our portfolio. Based on those actions, we've increased our gross margin by almost 400 basis points since 2015, including a 230 basis point increase in 2017. As significant as this progress has been, we're continuing to drive further gross margin improvements, although at a more modest level than last year.

Our third strategic objective is to position ourselves to drive sustainable profitable growth. We will do this by continuing to strengthen our relationship with the consumer through great product and marketing. The key to this is clogs and sandals where we have a strong positioning, a distinctive offering that is in demand, supported by our marketing investments in our "Come As You Are" campaign, which has been extremely successful in driving engagement and sales since its launch this past April. Geographically, our marketing efforts focus on our most important markets: the U.S., China, Japan, South Korea and Germany.

Collectively, our efforts resulted in meaningful improvements across the board in 2017. For the full year, revenues were down approximately 1% on an as-reported basis, but up mid-single digits, excluding business model changes and store closures. We improved our gross margin by 230 basis points, and we substantially reduced our underlying SG&A run rate as we worked towards the completion of our SG&A reduction plan. Lastly, we more than doubled our adjusted EBITDA. Overall, I would characterize 2017 as a highly productive year that began to reflect the financial improvements associated with this successful execution of our strategy. And as you can see from the guidance we issued this morning, we anticipate that we will continue to deliver further financial improvements in 2018.

As I mentioned previously, one of our most important initiatives is to connect deeply with our consumers through great product and marketing. From a product perspective, we're excited about the kickoff of our Spring/Summer 2018 line. We're particularly excited about our March LiteRide launch. LiteRide is an innovative and premium-priced collection of clogs and sandals with a clean, modern silhouette. It combines a proprietary new material with Croslite to produce extremely lightweight shoes with a highly-cushioned footbed.

In terms of categories, clogs continue to be our most in-demand silhouette. Clogs represented approximately 57% of our fourth quarter footwear sales and 51% of our full year sales, reflecting growth in both periods compared to the prior year. In our 2018 assortment, we have great new colors, graphics and styles to boost clog relevancy even further.

We're continuing to grow our sandal business. Sandal revenues increased 44% in the fourth quarter and represented 15% of our total footwear sales, up from 11% in 2016's fourth quarter. For the full year, sandals grew 26% and represented approximately 20% of our footwear sales compared to 16% in 2016. For spring/summer 2018, we expanded the number of sandal SKUs in our collection by approximately 15%, adding greater variety to address additional wearing occasions.

Our marketing strategy continues to reflect our focus on clogs and sandals. As we enter year two of our "Come As You Are" campaign, Drew Barrymore, Yoona Lim and Henry Lau will continue as brand ambassadors and we have a lot of exciting, impactful new content to roll out during the year. The Drew Barrymore Loves Crocs collection launched early this month, and we are pleased with the excitement of positive brand coverage we've seen both here and abroad.

We expect our fastest growth to be driven by digital commerce, which involves our own e-commerce sites, fast-growing e-tailers and third-party marketplaces. Rapidly expanding third-party marketplaces such as Rakutan in Japan, Coupang in South Korea and Zalando in Europe, are one of our highest priorities for 2018. We intend to play a much more active role in the marketing of Crocs on those sites.

Finally, I'm pleased to announce that we recently entered into a new agreement with Swire Resources, a subsidiary of the Hong Kong-listed conglomerate Swire Pacific, which is taking over our wholesale and retail businesses in Hong Kong. The transfer of our wholesale business took place in January and the retail stores transfer should be completed in April. The revenues associated with the 15 retail stores we operated in Hong Kong in 2017 were approximately $15 million.

This transaction is similar to the South Africa, Taiwan and Middle East transactions we entered into between 2016 and 2017. Each one simplified our business. And by transitioning subscale markets to strong partners, we enabled growth while improving our own profitability.

We tackled a number of significant initiatives in 2017 and while that work is now complete, I'm pleased with the progress we have made. Our product is now more focused, more relevant and more in-demand. Our brand is on an upswing, our financial performance improved and shareholder value increased. This sets us up well for 2018, and I'm very encouraged about our prospects for the year.

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

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

Thank you, Andrew.

Fourth quarter revenues were $199.1 million, up $11.7 million or 6.2% from a year ago. This exceeded our original guidance of $180 million to $190 million, as well as our updated January guidance of $195 million to $198 million. It was great to deliver topline growth while closing stores and absorbing the impact of the sale of our Taiwan business at the end of 2016 and our Middle East business during the second quarter of 2017. Those activities reduced our revenues by approximately $14 million in the quarter.

From a channel perspective, we also saw strong results in all channels, with wholesale up 15.2% and a positive DTC comp of 6.2%. Let me provide additional color around these channels.

As just noted, consolidated wholesale sales increased by 15.2%. Our customers and distributor partners are encouraged by the success they have been having with our brands, particularly by embracing our "Always Summer" philosophy and de-emphasizing winter product. As a result, accounts are expanding their assortment, placing product in additional doors and keeping our product on shelves longer.

Our retail comp was a positive 3.7% while retail sales declined 6.3% as we operated 111 fewer stores at the end of 2017 compared to the same time in 2016. Customers embraced our fall/holiday 2017 collection, which emphasized clogs and sandals, and we continued to improve execution resulting in higher conversion rates. Retail is benefiting from the strength of our product, better in stock positions and impactful marketing. And because we are reducing the number of full-line stores, outlets, which are the more profitable format, now make up almost half of our store portfolio as compared to approximately 40% at the end of 2016.

Our e-commerce business grew 11.6% during the quarter with strong growth in the Americas and Europe. We managed inventories well improving our in-stock position, especially around key shopping periods and benefited from the global adoption of best practices in a variety of areas including product presentation and the structuring of promotions to strike the right balance between driving sales and preserving gross margin.

We sold approximately 11 million pairs of shoes in the quarter, an increase of 10.3% from last year's fourth quarter. Our average selling price on footwear declined 5.6% to $17.54. The lower ASP is a function of prioritizing molded product over more expensive cut-and-sew styles, and of having fewer retail stores.

From a regional perspective, the following revenue amounts are as reported. Currency had a positive $4.5 million impact on the quarter's revenues, which I'll note by region.

I'll begin with the Americas where we had another terrific quarter with growth across all three channels. Revenues of $105.8 million increased 13.6% over Q4 last year with minimal currency impact.

Wholesale revenues grew 29.1%, driven by at-once sales, which came in higher than expected as consumers continued to purchase clogs and sandals despite winter weather and vendors looked to restock their shelves.

Our DTC comp was a positive 8.9%. Our retail and e-commerce businesses both benefited from our decision to capitalize on the clog and sandal momentum from summer. A price increase on key styles put into place shortly before Thanksgiving did not slow that momentum. The price increase impacted approximately 20% of our revenue base and most notably included our Classic and Crocband styles. We also expanded our focus on our Jibbitz Charm collection to encourage personalization among teens and adults in addition to children and this contributed to the increase in clog sales. Lastly, by structuring promotions effectively, we drove incremental sales while preserving strong margins.

As a result of these activities, our retail comp was a positive 7%. This was our best comp quarter of the year and the third quarter in a row of positive comps. Furthermore, total retail sales grew by 2% despite having 15 fewer stores than in last year's fourth quarter.

E-commerce sales increased 13% for the reasons previously denoted combined with increased marketing investments.

Turning to Asia, revenues of $66.6 million declined 3.2% compared to last year's fourth quarter. Currency favorably impacted Asia revenues by approximately $2 million.

Our wholesale business delivered strong growth, partially mitigating the impact of business model changes and retail store closures in the region. Wholesale revenues increased 9.9% driven by higher at-once as we continued to build up our business with distributors and leading multi-brand wholesale customers.

Our Asia fourth quarter DTC comp was a negative 1.3%.

Retail sales declined 23.1% as we had 84 fewer stores compared to the prior year. Our comp was a negative 2.9% due to traffic declines and lower ASPs, which resulted from the shift to more molded product.

E-commerce sales declined by 1.4%. In general, we saw strong e-commerce growth across Asia with the exception of China on 11/11 or Singles' Day.

Europe delivered a solid fourth quarter. Revenues grew 3.7% to $26.3 million over last year's fourth quarter. Currency positively impacted the quarter by $2.3 million. Our heightened focus on clogs and sandals worked and we successfully capitalized on Europe's growing enthusiasm for Black Friday and Cyber Monday. Russia also returned to growth as it moved beyond the aftermath of last quarter's terrorist activity.

Wholesale revenues declined approximately $600,000 or 4.4% as we continued to focus on higher-quality revenue.

Our DTC comp for the fourth quarter was a positive 10.5%.

Our retail comp was a positive 1.7% and total retail sales increased 0.8% despite operating 12 fewer stores. Both of these results were driven by the strength of the business in Russia where Crocs continued to perform extremely well.

Our e-commerce business grew by 36.1% making this the third consecutive quarter of growth.

Turning to other items on our P&L. Our gross margin was 45.4%, an increase of 340 basis points as compared to last year's fourth quarter gross margin of 42%. These results exceeded both our initial and updated guidance. Favorable currency rates accounted for approximately 1/3 of the improvement and the balance was driven by the increasing penetration of molded product, our focus on improving the quality of our revenues as we steadily refine our go-to-market capabilities, disciplined inventory management and disciplined management of our promotional activity.

Our SG&A expenses were $120.7 million, $2.2 million higher than in the fourth quarter of 2016 and slightly above our most recent guidance. The nonrecurring charges associated with our SG&A reduction plan came in at approximately $3 million compared to the $2 million we had guided to. We also incurred approximately $6 million of nonrecurring expenses involving a noncash impairment charge and a contract termination charge, which accounts for the increase in SG&A relative to our guidance.

As Andrew previously mentioned, in early 2017, we announced a plan to reduce our SG&A between $75 million and $85 million by 2019. A significant driver of this reduction comes from our plan to reduce our store count to less than 400 from 558 at the end of 2016. Our store reduction plan is ahead of schedule and will be concluded this year.

Overall, our SG&A reduction plan is also on track. SG&A for 2017 was approximately $500 million. This includes $17 million of nonrecurring charges. When compared against our 2016 SG&A of approximately $506 million, we delivered approximately $23 million of SG&A reductions as we realized the partial year benefit of store closures and related overhead reductions. I also want to point out that during 2017, we reset our variable compensation, which increased our SG&A by $10 million.

Our loss from operations in the quarter was $30.4 million compared to last year's operating loss of $39.8 million. The loss from operations would have been approximately $17 million better absent the nonrecurring SG&A charges.

The net loss attributable to common stockholders after preferred share dividends and equivalents of $3.9 million was $28.3 million. Our loss per diluted share was $0.41 compared to last year's loss of $0.60. The weighted average diluted common share count used to calculate EPS was 69.5 million shares.

Turning to the balance sheet. We ended the quarter with $172.1 million in cash and no outstanding borrowings on our credit facility. This is up almost $25 million from $147.6 million at the end of last year, despite having repurchased $50 million of common stock during the year.

During the fourth quarter, we repurchased approximately 2.2 million shares of our common stock for $23 million at an average price per share of $10.22. For the full year, we repurchased approximately 5.7 million shares for $50 million at an average price per share of $8.82. As of year-end, $69 million remained available under our $350 million share repurchase plan.

The Board of Directors recently amended our share repurchase plan to increase its size to $500 million. We now have the ability to repurchase $219 million of our common stock under this increased authorization.

Inventory at the end of the fourth quarter was $130.3 million, a $16.7 million or 11.3% decrease as compared to last year's ending inventory. We drove this improvement while growing revenues 6.2%, which speaks to the success of our ongoing inventory management initiatives.

During 2017, cash provided by operating activities was $98.3 million, an increase of $58.5 million, or 147%, compared to $39.8 million in 2016.

Let me now turn to our guidance.

Regarding currency, I want to note that our guidance is on an as-reported basis. Given the volatility of the U.S. dollar, I want to point out that our guidance is based on currency rates as of today. To the extent that the U.S. dollar strengthens or weakens, this will impact our reported results.

With respect to the first quarter of 2018, we expect revenues to be between $265 million and $275 million compared to $267.9 million in last year's first quarter. This includes the loss of approximately $13 million of revenue associated with the reduced store count and business model changes.

We expect first quarter gross margins to be approximately 49% as compared to last year's 49.9% rate. At the beginning of the first quarter of 2018, we changed our inventory costing methodology from average cost to FIFO or standard cost, which is the more widely used footwear and apparel methodology. This change results in timing-related charges to cost of goods sold during the quarter. Our full year gross margin rate is not impacted since the Q1 charges to cost of goods sold will be offset by a favorable impact to cost of goods sold in the following months, as that inventory is sold. Absent these charges to cost of goods sold, our first quarter gross margin would be up modestly to prior year, reflecting our focus on quality revenue and favorable foreign exchange rates compared to Q1 last year.

Our SG&A for the first quarter is expected to be approximately $115 million. This is approximately $3 million lower than last year's first quarter SG&A and includes approximately $2 million of nonrecurring charges associated with our SG&A reduction plan, which is the same amount as in Q1 last year.

For the full year, as previously noted, we expect revenues to be relatively flat with 2017. This guidance reflects our stronger performance in Q4, the accelerated store closures, our just announced deal with Swire Resources, as well as the benefit of foreign currency rates. Store closures and business model changes will reduce our revenues by approximately $60 million compared to 2017. Moderate wholesale growth and double-digit e-commerce growth are projected to offset the loss of retail revenue. Absent the store closures and business model changes, revenues would be up mid-single digits.

Our gross margin is expected to increase approximately 70 to 100 basis point over last year's 50.5% rate, as we continue to improve the quality of our revenues.

SG&A for the full year is expected to be approximately $475 million. This includes approximately $5 million of nonrecurring charges associated with the implementation of our SG&A reduction plan and approximately $5 million of incremental cost due to the weakening of the U.S. dollar compared to 2017. After adjusting for those items, our SG&A would be reduced by approximately $40 million against the $506 million of SG&A we incurred in 2016, reflecting our continued progress against our SG&A reduction plan.

Our income from operations, which includes approximately $5 million of nonrecurring charges, is expected to be approximately $50 million compared to $17.3 million in 2017. Please keep in mind that the 2017 income from operations includes $17 million of nonrecurring charges.

We expect our adjusted EBITDA to be approximately $85 million. We define adjusted EBITDA as income from operations plus depreciation and amortization and nonrecurring charges. 2018 adjusted EBITDA includes approximately $30 million of depreciation and amortization and $5 million of nonrecurring charges. Our 2017 adjusted EBITDA was approximately $67 million, including $33.1 million of depreciation and amortization and $17 million of nonrecurring charges.

We are projecting our 2018 income tax expense to be approximately $13 million, compared to $7.9 million in 2017. We will update this guidance as we continue our analysis of the new tax legislation in the upcoming months.

As it relates to our mid-term objectives, let me reiterate my continued belief that a return to double-digit EBIT margins is achievable. Based on our current level of depreciation and amortization, a 10% EBIT margin translates into a 13% adjusted EBITDA margin. We have made great strides shedding unprofitable revenues and reducing our cost structure. As a result, additional revenues will carry a much lower cost structure allowing for a more meaningful flow through to the bottom line.

In summary, I'm extremely pleased with our progress in 2017. Our strategic roadmap is driving the intended improvements in our business and now those improvements are becoming evident in our financial results.

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.

Like Carrie, I'm very pleased with our results. We've made significant progress in our product and marketing efforts, as well as our strategic initiatives to simplify the business and generate cost savings. As we look forward, we'll focus on sustainable, profitable revenue growth. We are confident that our product, marketing and distribution channel initiatives will deliver that growth and that the benefits from this work will drive meaningful EBITDA increases in the future.

The progress we are making could not have happened without the hard work of our incredible associates. I want to thank each one of them for their efforts last year and their commitment to the future success of Crocs. We are all aligned in our commitment to deliver topline growth, greater profitability and increased shareholder value.

Now operator, I will open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Jonathan Komp.

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

I wanted to start off and ask if you have any more color around the Americas' wholesale performance. It was quite strong, up nearly 30%, and I'm wondering if you can just give more color around any kind of timing shifts there or not, And then, when you look across channels, where are you seeing the most momentum for that business?

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

Yes, Jonathan, I apologize for my voice upfront. You may have heard on the earlier prepared remarks, I'm suffering from a cold. So I'll do my best, but yes, we're really pleased with the Q4 wholesale performance, particularly in the Americas, but also across the business. I would say from a channel perspective, the thing that really stood out was e-tail. We saw particularly strong performance in our e-tail channel, and by that I mean our wholesale sales to our e-tail wholesale customers, where we saw very strong at-once business that we had underestimated frankly. So that was on the plus side, but overall, I also think, it was due to how we positioned ourselves from a clogs, sandal and lined clog perspective. I think that worked really well. So we are really pleased with that. From a timing impact, I think what you're alluding to, was whether any of that was pull-forward from Q1 or what was shifting between Q4 of '17 and Q1 of '18. There was almost no shift between the quarters. So from our perspective, it was completely clean.

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

And just as a follow-up, Andrew, I know back in early 2016, you started very strong from a wholesale perspective and then saw a couple of more challenging quarters after that. Is there any wy you can give comfort that, what you're seeing with sell-throughs and the product pipeline that you have, that you wouldn't see any givebacks there in terms of the strength in the wholesale?

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

Yes, I understand your question. So I think what we saw -- we did see that in the early part of '16, as you alluded to. But I think what we saw throughout '17, frankly, for pretty much four quarters now in a row, is improving wholesale sell-through of the product. And that's really related to two big things, I think, our product focus, clogs and sandals is where the DNA of Crocs is most apparent. It's what the consumers are looking for from us. And, it is due to our effective marketing, which has been driving sell-through. And, it's also due to a lot of work that was done over the last couple of years to improve relationships with key wholesale customers and clean up the channel, to make sure that they are positioning and marketing the brand in the way we want to be positioned at market, and then buying the appropriate amount of inventory to support that business. And we're doing the appropriate activities to ensure that we can supply that inventory as it's required. So I think the channel's an awful lot cleaner, the brand's better-positioned and the product's right.

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

Yes, and I just add to that, you remember back in 2016, especially as we got into second, third quarter, that what we were dealing with was retailers essentially scaling back significantly their open-to-buy in order to right-size their inventory levels given a lot of the challenges that the retailers were facing. So I think that has shifted already. That took place in '16, and hence the results that Andrew mentioned in terms of our performance in 2017.

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

Okay, great. And just one last one for Carrie, I want to follow up on your comments about the SG&A. I think you referenced underlying reductions of about $40 million so far baked into the 2018 guidance. I'm just wondering if you'll get the remaining $40 million or so that you're targeting at the midpoint in 2019, which I think, would get you down to the mid-$430 million range, but I just wanted to clarify that.

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

Yes, absolutely. I think what you're seeing is, you've got partially the benefits of these store closures and the activity that's going on, and so we will get to the full run rate. And certainly, we have other things that we're executing against in 2018 as well, that will give the full year benefit in 2019. So we absolutely feel very confident in our ability to deliver the full $75 million to $85 million by 2019.

Operator

Our next question comes from Scott Krasik.

Scott David Krasik - *The Buckingham Research Group Incorporated - Analyst*

Just a question on the margins. Obviously, ex-FX, you're still seeing the benefits of fewer promos and favorable mix. So just wondering, how you think about the molded business? What can you grow that to as a percentage of sales? And then where are you in terms of your promo close-out reductions? And then I have another follow-up.

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

Okay, so as we think about gross margin, we've seen pretty significant improvements in '16 and '17. And a lot of the benefit that we've seen in those years has been driven by that cleanup of our promotional activity, the cleanup of our inventory and having less excess and obsolete product being sold at lower margins. The other benefit that we've definitely seen and probably more of the shift to that benefit in 2017, was the shift to more molded product. We will continue to see that shift occur, but not necessarily at the same levels, given that we took a big step forward in 2017. So as we think about gross margin going into 2018, we do have a little bit of headwind associated with the regional and channel mix, especially as we have significant number of the retail stores closing, but that is being offset by the currency benefit that we're seeing based on currency rates right now, as well as some of the product mix moving more to the molded product, as well as some supply chain efficiency. So we think that we still have gross margin rate improvement ahead of us, but we think it's more modest than what we've certainly seen in '16 and '17.

Scott David Krasik - *The Buckingham Research Group Incorporated - Analyst*

And without giving guidance, is that a multiyear comment? Or that's strictly just about '18?

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

Yes, what we said, as we think about our framework to deliver our double-digit EBIT margins, is really having gross margins in the low 50s. So for sure, we see that improvement in 2018, but I'd like to continue to see that improvement as we move into 2019.

Scott David Krasik - *The Buckingham Research Group Incorporated - Analyst*

Okay, Carrie. And then the Hong Kong distributor shift, when and how did this come about? And then when does that start to hit the P&L? And lastly, are there any other meaningful markets where you would consider that?

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

Yes, Scott. So let me take that. Obviously, the Hong Kong distributor shift is the 4th of these business-modeled transitions that we've completed, and all of those have been in Asia. So Hong Kong is the most recent one. But also to recap, Taiwan, South Africa and the Middle East, and those are all captured in our Asia region as we report it. It came about, as I think we've talked about historically, as we've targeted a number of small businesses where we don't think we're particularly efficient. The cost structure to support those businesses is in excess of the size of the business and the potential for the business. And we think our partners are better equipped to run those businesses for us and to grow them in the future. As we look back at all of those transitions, I think, we're really satisfied with how they've gone. We've selected really strong partners, and we feel that way obviously about Swire in Hong Kong, which is a major presence in that marketplace. And in terms of others in the future, I think, we will continue to look very selectively at places that meet those characteristics, which are small, probably low potential or highly complex markets where other partners may be more advantaged. But obviously, we can't say more at this stage.

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

And then the one thing that I'll add to that is essentially, we transferred the wholesale business to Swire Group in January, and the retail stores will be transferred in April.

Scott David Krasik - *The Buckingham Research Group Incorporated - Analyst*

So start up of when in 1Q?

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

Yes, the wholesale in 1Q. The retail starts in Q2 and then the other call-out that I think was important that we made in the prepared remarks was we operated in 2017, 15 retail stores in the Hong Kong market. The annual revenue for those retail stores was approximately $15 million.

Scott David Krasik - *The Buckingham Research Group Incorporated - Analyst*

And your comment to get below the 500 stores -- or 400 stores, sorry, by the end of this year? Did that already contemplate those 15 stores? Or is that incremental?

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

Yes , that contemplated those 15 stores. Our opportunity has really been can we do some of this sooner than what we expected, and so we really have an acceleration in terms of the timing of this transaction.

Operator

Our next question comes from Erinn Murphy.

Erinn Elisabeth Murphy - *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

I guess, I wanted to go back to the first question just about the Americas business and your comment on the at-once strength that you saw. Bigger picture, how are you seeing retailers in this market just balancing between -- for your business, obviously, balancing between prebooks versus what they are leaving for at-once business inter-quarter?

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

Yes, good question, Erinn. For our business, we don't see a material shift. I think every retailer would like to place fewer prebooks and do more at-once business, but as we look at the proportion of our business today, it's not materially different than it was last year or the year before. So we kind of see that in the same way. So it's kind of a risk mitigation strategy. I think, as we looked at '17 and we are able to see relatively strong sell-throughs in our wholesale business, particularly in North America, we were able to capitalize on a growing at-once business. And I think, as you see some of the e-tailers in particular are very dynamic in terms of chasing inventory and chasing opportunities. So we don't see it as materially different, but obviously, it represents an opportunity for '18.

Erinn Elisabeth Murphy - *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

And then you've obviously come off a number of trade shows recently, whether its Platform or Outdoor Retailer, and there's a couple of others you've attended. Can you talk about how fall is shaping up right now? What are you seeing in those prebooks and any kind of qualitative commentary you can provide us?

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

Yes, I think, we've been very pleased with the activity that we've seen at those shows. I think we've seen a lot of interest in the brand. We've seen a lot of traffic in our booths. We've been getting very strong feedback around the consistency of line, the logical evolution of the line, the innovation that we're bringing to the table particularly with LiteRide and some new styling and graphic treatment. So we're seeing a real understanding from our wholesale customers about where we're taking the product and a reinforcement of that's the right direction to take it. In terms of absolute bookings, we don't talk about that and it's a little early for that, but we feel really good about how we're positioned in fall.

Erinn Elisabeth Murphy - *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

Okay. And then maybe for Carrie, you gave a lot of good details on the guidance components for 2018 to get us to EBIT, but I'm curious if you're embedding in, sorry if I missed it, any buyback in how you're thinking about 2018, just given you've beefed up that authorization this morning?

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

Yes, so, obviously, we don't comment on future plans for buyback, but what I would say in that regard is as we look at the $50 million that we did buyback in 2017, I think, that's a result of the fact that we've made significant progress in the strategic transformation, which has resulted in strong cash generated from operations, almost $100 million in 2017. And based on this performance, we feel confident. The Board feels confident in the business, and we believe that share buybacks are an appropriate way to create shareholder value. And our goal is to continue to be a strong cash flow generating company and then to use that cash to continue to improve the value of the business.

Operator

Our next question comes from Mitch Kummetz with Pivotal Research.

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

I guess I have a few. Let me start with Asia where the DTC comp was down. I think you talked about Singles' Day in China not going that well. Can you elaborate on that? Or can you talk about what the impact of that was on your comp in the quarter?

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

Yes, so you're absolutely right, Mitch, we did highlight that. I think, our DTC comp in China is a standout, right? If you look at the global DTC comp, it was particularly strong during the quarter, driven by the Americas and Europe. And as we look at Asia in particular, a couple of things I'll point out. One is, our overall e-commerce comp in Asia was strong in all other countries outside China. So our overall e-commerce comp in Asia was strong in all countries outside of China and strong in China, other than Singles' Day. So we feel really good about the overall e-commerce performance. What we saw on Singles' Day, is we've been a strong participant in the Singles' Day, historically. And as we looked at this year, we saw dramatic increases in both the number of companies participating in our category and in broader categories. And we saw a very significant increase in the cost of driving traffic and driving customer acquisition. And frankly, we chose to protect our profitability and not to continue to pay for that traffic. So it was really a profit orientation that caused us to pull back on that. So it had an overall impact on the e-commerce performance for the region in this quarter, but if we look at our e-commerce performance in Asia through the year, we achieved the 23% comp for the year, which included that. So we feel really good about where we are there. And I think the other piece you referenced, from a retail perspective, it was also our weakest comp in Asia. And this is the market where we've been going through the most significant transition in terms of our store portfolios, where we've closed the most stores, 84 stores. We feel good about where we're getting to in that transition, but we're not satisfied with the comp performance and we'll focus on improving that in the future.

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

Got it. And then on Europe, I know, you're going through kind of a transition there as well in terms of making some channel adjustments and that put a little pressure on the wholesale. When does that normalize? When do you lap those changes there?

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

Yes, so as we move into 2018, we've lapped those business model changes as it relates to the discount channel business. So it's essentially clean in 2018. So as we think about, Q4 for Europe wholesale was down $600,000, so certainly not significantly, but for 2018, we expect solid European wholesale growth. And in fact, embedded in our '18 wholesale channel expectations is wholesale growth in all regions.

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

Got it. And then lastly on the stores, I know you guys are ahead of plan in terms of closing stores, you've talked about getting to under 400 or just thereabouts. Has anything changed there? I mean, is there opportunity to do more with that or now that the business has picked up a little bit in terms of your transformation initiatives, is there any thoughts in terms of, maybe, rethinking that and opening some stores? What are your views on that?

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

So as we think about the store closures embedded in those numbers are openings. So we're really being clear about the net reduction, because to your point there are places where adding a store makes a whole lot of sense. The key for us has really been shifting our overall portfolio mix more to an outlet portfolio mix, with the reductions that we're doing. So we're at about 40% outlet stores at this point, at the end of 2017. So our announced SG&A reduction plan is the net 160 store reduction. Certainly to the extent that we have opportunity to reduce that store count further basically by closing other stores that we see as not driving the right form of profitability, we will continue to do so. But we're evaluating that on an ongoing profitability and exit cost basis. And there definitely are some stores left in our portfolio by the time we finish the SG&A reduction plan that we wish we could exit, and we'll certainly pursue those avenues.

Operator

Our next question comes from Jim Duffy with Stifel.

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

In the fourth quarter, the comp strength really stands out. Can you -- particularly in North America, can you speak to the split you're seeing between traffic and ticket within that? And then what are you looking for, for the assumptions of comps built into the first quarter and fiscal year guide?

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

Yes, Jim. We're very pleased with the Q4 performance both in North America and Europe. As you think about DTC, obviously, it was stronger in our e-commerce channels, which is where we see the consumer transition. And in terms of your question around ticket and traffic, I think the best way to characterize it, I would say, it was broadly flat in terms of traffic to slightly down in traffic, but that's better than it has been historically. I think if we look at early parts of '17 and '16, we were frankly fighting double-digit traffic declines. And so therefore, you're seeing some improvement in terms of average ticket. Obviously, our overall ASP continues to be trending slightly down so the ticket was more around units per transaction.

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

Yes. And I'll just make the comment that the ASP is actually for the fourth quarter because of the price increases that we took on essentially the clog and the Classic Crocband was up for the quarter as well to Andrew's point, the -- in North America, specifically as well as the transaction value, which was also driven by some additional UPT. So really good underlying fundamentals as we look at that comp performance.

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

Yes. And as we look at what we see is driving that in-stores, it was, I think inventory mix: how we were positioning our clogs, lined clogs and sandals in that season and selling fewer boots, as well as some significant initiatives, particularly in North America, that we put behind Charms and personalization products, which has driven a higher level of engagement and excitement in stores.

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

Great. And then the assumptions in the guide on comps?

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

Yes. So as we look at the 2018 guidance, from a retail standpoint, we are still being relatively, I guess I won't say conservative, but we're assuming relatively flat comps, similar to what we assumed in 2017. We think that's the right approach given the traffic challenges across the regions.

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

Very good. And then Carrie, a technical question. The change from average costing to FIFO, the drag in the first quarter and then the reversal as the year unfolds, that implies you're seeing improvement in cost of goods in 2018 over 2017? Is that accurate?

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

Yes, so on the full year, the change in accounting methodology for inventory has no impact on the full year. So there's a little bit of a bump impacting Q1, which essentially reverses in Q2 and then we're past it. And then on a full year, there is no impact. And to give a little color on why we changed the accounting methodology, it's really that as we've evolved over the last couple of years and shifted our ERP system, our moving average costing methodology was actually quite cumbersome and labor-intensive to operate effectively. And so we decided to move to the more simplified approach that's very consistent with our goal to simplify the business. And quite frankly, it is more in line with the industry standards. But I think, as you guys think about the gross margin, I think, it's important to keep the full year in mind and not let this Q1 really factor in, because it washes out pretty quickly.

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

Makes sense. And then the $60 million headwind from store closures anticipated in the year, I believe, that was $50 million prior, is the Swire business transition the difference there?

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

Yes. That's absolutely right. It's really the timing of assumed business model changes in that number, correct.

Operator

Our next question comes from Sam Poser with Susquehanna.

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

I guess, just to confirm, you're aiming at around 398 stores by the end of the year. Am I stating that correctly?

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

It's about that number, Sam, yes, less than 400...

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

And then, can you give us some kind of the flow of those store closings?

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

We haven't issued than kind of detail Sam. But they're not all at the end of the year, they are scattered throughout the year. That's the best way to think about it.

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

With a good chunk in the first quarter, because of that 15 stores...

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

Certainly, because of the Swire Group, for sure.

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

Yes, exactly.

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

And then secondly, in the press release you commented that you expected to be able to return to growth in 2019. Can you give us some color as to what that means as far as, what kind of growth you're going to see, because you've had some underlying growth ex the store closures for quite some time now. And so you're going to be up against slightly more difficult comparisons when you get to '19. So I mean, how should we think about the longer-term top line situation here?

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

Yes, good question, Sam. So I'll first off, highlight exactly what you said, which is, if you look at '18, our guidance incorporates an embedded mid-single-digits growth for the underlying business to overcome those $60 million of headwinds from business model changes in store closings, right? And if you look at '17, we've had underlying growth in '17 as well. And so your question is, essentially, does that continue? Or does that potentially accelerate? Or decelerate? Right? So we're not...

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

And I guess, how do you have visibility on any of that at this point?

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

Right, so we fundamentally believe that we have the right strategy in place to continue to grow this brand on a global basis, okay? And so we are confident that beyond the immediate period that we've guided for, we have the opportunity to continue to grow the brand. And we think, we can grow the brand based on a number of critical product, marketing and distribution strategies we put in place. The first is to focus on clogs and sandals. Clogs represents about a half of our business. We are the market share leader on a global basis. I think we've demonstrated that we can grow our business in that category and that category is in fact growing if you look at North American NPD data. So we think we can grow half of our business, probably at more moderate rates, but certainly at low to mid-single digits. Then if you look at the sandals pieces of our business, which is our secondary focus, we think that represents a pretty significant upside on a long-term basis for the company. It's a $23 billion global category. It's highly fragmented from a competitive perspective. There are no other competitors that own big pieces of that market on a global basis. Our product has proven to be successful in that arena and we believe that we can continue to build out a stronger and stronger product assortment within the sandals arena. So we think that represents a long-term growth strategy for the brand. Secondly, as we look at our focus and emphasis on digital commerce, we think that's absolutely critical. It's very, very clear, on a global basis, the consumer is shifting from shopping in physical stores to shopping online. We can capitalize on that, both through our own e-commerce activities and our own sites, which we have 11 around the world and potential to grow. We can also capitalize on that based on participating more directly in global marketplaces, and that's a major initiative we're putting in place in '18. And the third element we capitalize on that is with large wholesale customers that are e-tailers that are growing rapidly and taking market share. And as a brand and as a company, we think our product works really well in that environment. As a company, we've built the knowledge and technology and capabilities to exploit that. And then lastly, we've seen very significant improvements in the desirability, relevance and consideration for the brand. Our "Come As You Are" marketing campaign, kicked off really, really well in '17. We'll be continuing that in '18 and have plans beyond that, as we continue to raise the profile of the brand and the desirability of the brand relative to consumers. So you're absolutely right. We can't have,- we don't have complete visibility, but we think we have, we are confident we have, the right strategies in place that will drive growth for the brand in the future.

Operator

Our next question comes from Jim Chartier with Monness, Crespi, Hardt.

James Andrew Chartier - *Monness, Crespi, Hardt & Co., Inc., Research Division - Security Analyst*

I want to talk about the Asia wholesale business, which inflected positive for the first time in a number of quarters. Can you just discuss what drove that improvement? Do you think it's sustainable? And then, where are you in rebuilding the wholesale distribution in China?

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

We're definitely optimistic that it is sustainable. You referenced wholesale distribution in China, as really the drag that we've been seeing overall in Asia. That's the place where we've been going through the most business model transitions. The four that we highlighted have all taken place within what we call our Asia region over the last two and a bit years. And if we look at China, we feel like the transition that we've gone through there has been completed, and we're well positioned for future growth. We did see double-digit wholesale growth in China during the quarter, and we feel really good about our wholesale customer mix, the investments those wholesale customers in China are making relative to their own store base and distribution, and our ability to grow that business in the future. And so I think, as we look at Asia, it has been a drag on our overall performance for the last year due primarily to the business model transitions, but we think we're well positioned for growth in the future.

Operator

Thank you. I'll now turn the call back over to Andrew Rees for closing remarks.

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

Good, thank you. Let me just close by thanking everybody, for joining us and the continued interest in the company. We appreciate it. Have a good day.

Operator

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