Crocs (CROX)

November 19, 2024

Ribeiro Capital

Overview

Crocs Inc (CROX)	
Current Share Price:	$97.98
Market Cap	$5,710 MM
Free Cash Flow (TTM)	$940 MM
EBITDA (TTM)	$1,097 MM
PEG Ratio (5 years)	1.1 (5 yr)
Recommendation	Buy

Company overview

Crocs Inc operates two main business segments: Crocs and Heydude, a company acquired by Crocs in 2022. Both segments operate mainly by selling footwear through wholesale and direct to consumer. The company has a solid grasp on the market and great fan base, operating mainly in the US but growing strongly in markets such as China and Western Europe

Investment Thesis

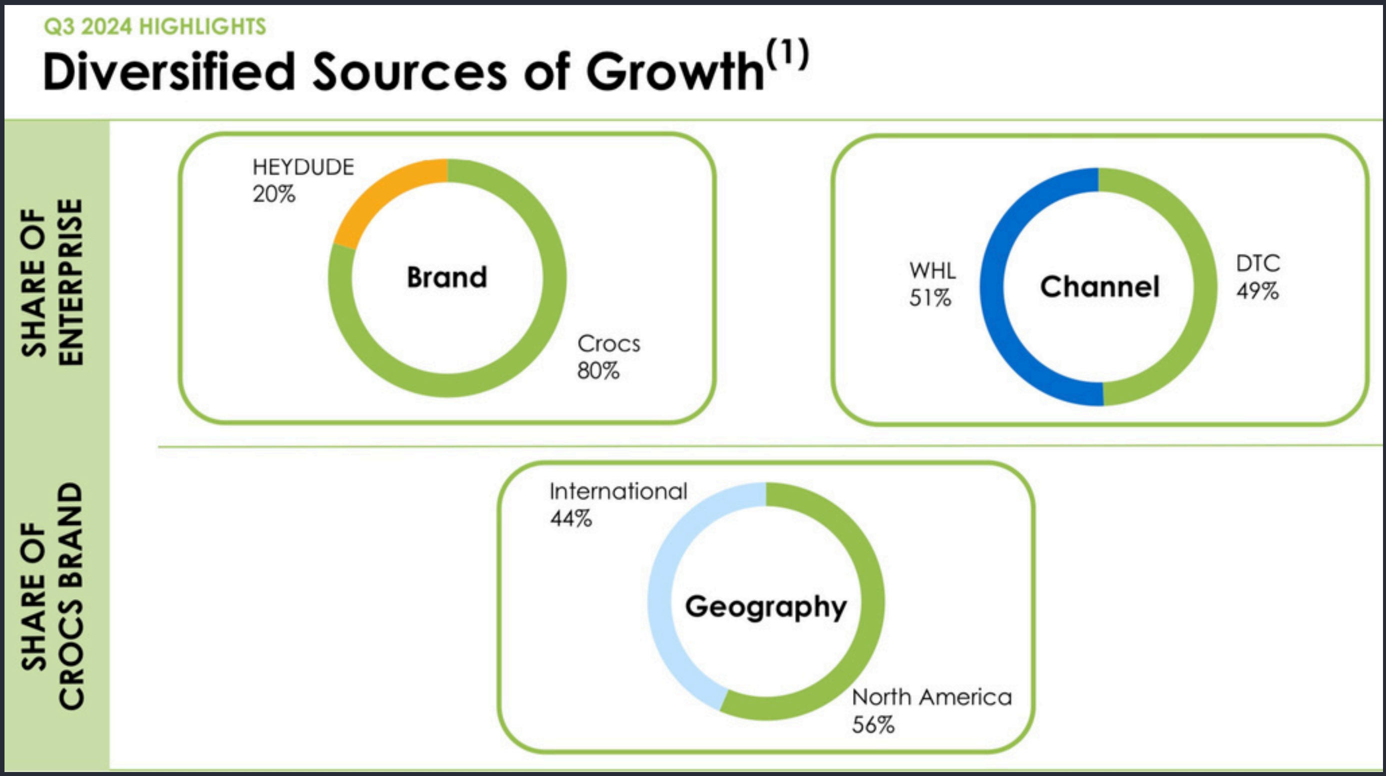
Crocs offers a quality product that has been around for years and producing stable cash flow for the company. The brand has been very successful as a whole but the market is overseeing this because of an overpriced acquisition of Heydude, creating a great buy opportunity

Outcomes and Opportunities

The company has consistently improved its revenue over the past years, going from $1.3 Billion in 2020 to around $4 Billion in the trailing 12 months. This revenue had a large bump in 2022 with the acquisition of Heydude but even as revenues normalized after, growth continued steadily, averaging a Revenue growth of 41.9% CAGR and EPS growth of 55% CAGR over the last 3 years

Crocs has seen great growth, specially internationally. Overall revenues have increased 8% and the company expects this to be sustained by a broader DTC sales share and increasing the occasions that people use crocs by offering different designs and product offerings

International revenues, however, have grown 17% YoY, signaling an opportunity for long term growth outside the US where the brand is still virgin and has room for growth with its same old product. This growth will come specially from Western Europe, China and India, where a large part of the goods are produced



Outcomes and Opportunities

Heydude was considered an extremely overpaid transaction by market analysts, as its popularity failed to gain traction for as long as Crocs's management thought. The revenue for the segment has been dropping. The company's revenue has declined -17% YoY. Margins for the brand have increased 5.1p.p YoY.

Management has started to implement a change in direction for Heydude, assuming fault for over estimating inventory in 2022 and 2023. The focus now is cleaning up the already big inventory by displaying Heydude in premium outlets and shifting the brand marketing.

Marketing for HeyDude will change from a performance-based one to a brand-based one, which management hopes will create a strong consumer base for the brand in the long run, even if this means lower returns in the short term. The company will do that through strategic celebrity partnerships and social media presence to increase brand awareness.

These operational expenses with Heydude have been responsible for an overall decrease in the company's operating margin, compressed by -2.9% YoY. Management hopes that after stabilizing Heydude the margins will be improved again.

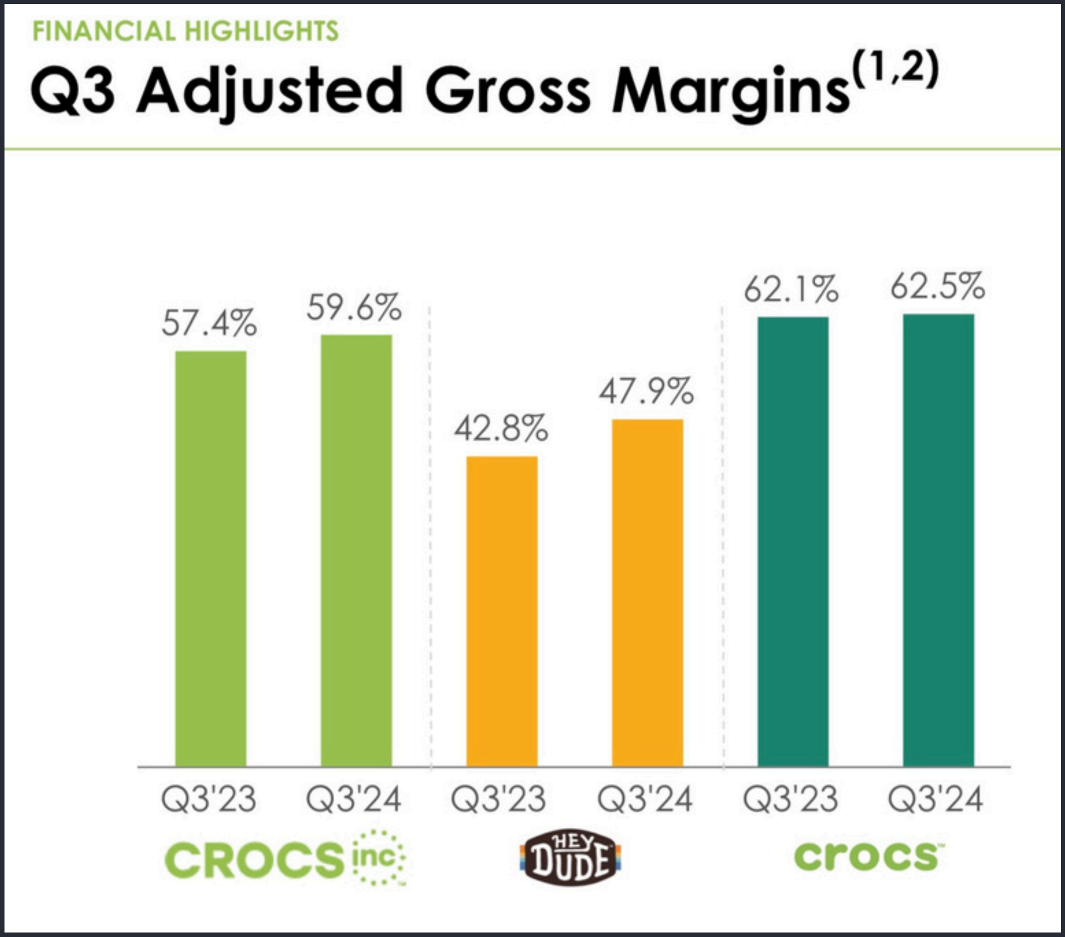
Another management focus is paying down its debt. The company acquired a substantial amount of debt over the past few years, specially during the acquisition of Heydude. The company repaid $110 Million of the debt, which now amounts to $1.4 Billion.

The other main use for FCF is share repurchasing. The company bought back 1.1M shares outstanding over the last quarter and still has $550M to go (amounting to around 5M shares at the current share price)

Competitive Position and Industry

The Footwear industry is estimated to be worth around $400 Billion and to grow around 3 or 4% over the next 5 years. However, the industry itself is very segmented, with products ranging from sports footwear, dominated by Nike, for example, to social/everyday shoes and casual/comfort shoes one wears, a segment that is dominated by Crocs. The company seems to want to evolve to other segments and have its products be worn in more occasions, but even if that doesn't happen, their dominance over their niche is enough to keep them growing.

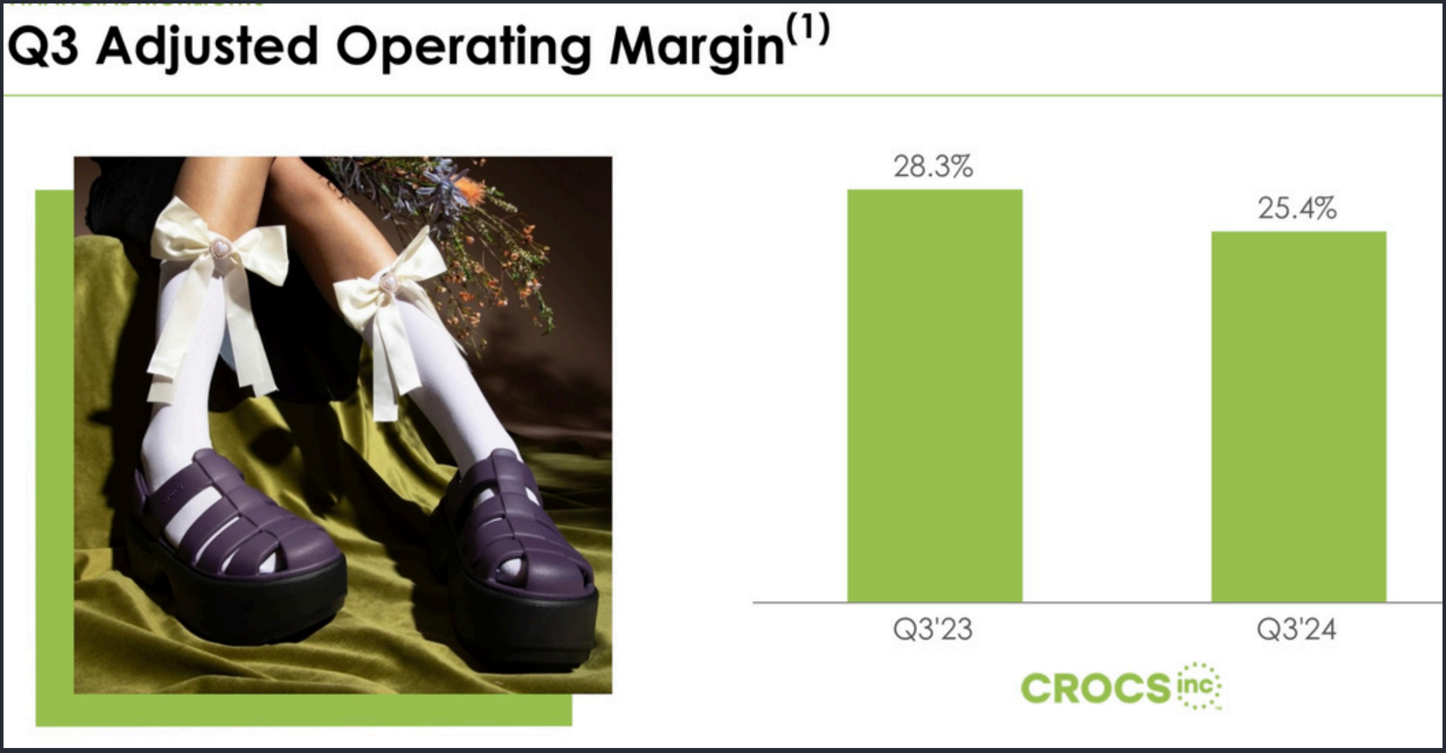
Crocs already has a very strong brand and name recognition, which comes with a loyal fanbase of a varied demographic. With its proprietary design and material usage, it offers a unique and comfortable product, which guarantees them great presence worldwide and an economic MOAT in the industry.



Risks

The investments towards the Heydude segment have been significant and have offsetting Crocs’ success, trying to turn around the brand. If the management direction shift doesn’t work out in the long term and if the brand doesn’t manage to improve on their previous success, the acquisition will prove to be a mistake. In that case, the sale of the business wouldn’t be a bad idea, which would take away the burden from the profitable Crocs segment

The unitary price of a pair of crocs is considerably high for a pair of shoes, and this customers may look unfavorably towards the product in the long term. This will require them to spend significantly more on SG&A to improve the brand awareness and make sure people keep paying top dollar for the product. If this happens, margins will shrink. But considering that their gross margin has been improving YoY, that’s a manageable risk



Earnings Overview

Income Statement Overview

Revenue for First 9M2023 x 9M2024: 3,002M x 3,112M. Driven mainly by international markets sales growth

- EBITDA 9M2023 x Q3 2024: 827M x 821M, driven by a lower operating margin caused by higher SG&A

- Net Income 9M2023 x 9M2024: $538M x 581M, driven mainly by lower interest expenses

Balance Sheet Overview:

Current Ratio: 1.43, healthy for a retail company

- Debt to Equity Ratio: 102%, driven mainly by the acquisition of Heydude. This is expected to go down as management focuses on repayment

Debt to FCF: 1.69, meaning that it would take less than 2 years if the company used its FCF to pay off their debt. Considering that is one of their priorities, this is healthy

Statement of Cash Flows Overview

Cash Provided by operating activities: 9M2023 x 9M2024: $580M v $670M, driven mainly by a higher net income and lower accounts receivable

- Free Cash Flow: 9M2023 x 9M2024: $494M x $620M (*see “valuation” point 3 for more),

- FCF in the TTM = $940M
- Analysts’ expectation for FCF in FY 2025: $755M

Valuation

EV/FCF analysis: CROX: 8 /// NKE: 17 /// DECK: 16 /// SKX: 8

Method Used: Reverse DCF and DCF valuation

Assuming it's FCF in the TTM of 940Billion USD, a 0% FCF growth over the next 10 years, a terminal growth rate of 1.5% and an conservative discount rate of 15% per year (average of market being 10%), the stock should be trading at $110.92, implying an upside from today's price

- Using its current share price and assuming the same stats for WACC, and TGR but applying next year's expected FCF of $755M, the share price should be trading at around $89.09, below the current share price

- Using these conservative assumptions, the company is currently valued in a FCF increase of around -2% CAGR for the next 10 years, which seems very pessimistic, specially when considering their growth opportunities internationally, a strong performance from Crocs and a less worse performance from Heydude long-term

- Using these same assumptions and assuming a very conservative FCF growth of 2% CAGR, the company should be valued at around $125.00

Conclusion: Buy

With a strong brand presence, and a reliable cash flow generation capability, CROX seems like a company that the market has been looking overly harsh upon because of the Heydude acquisition. This presents a great buy opportunity at current prices even if growth stays in the mid single digits.