

Crocs

Second Quarter 2024 Earnings

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CORPORATE PARTICIPANTS

Erinn Murphy - *Senior Vice President of Investor Relations and Corporate Strategy*

Andrew Rees - *Chief Executive Officer*

Susan Healy - *Chief Financial Officer*

PRESENTATION

Operator

Good day, and welcome to the Crocs Second Quarter 2024 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on the touchtone phone. To withdraw your question, please press "*" "2." Please limit yourself to one question. And please note, this event is being recorded. I would now like to turn the conference over to Erinn Murphy, Senior Vice President of Investor Relations and Corporate Strategy of Crocs. Please go ahead.

Erinn Murphy

Good morning, and thank you for joining us to discuss Crocs, Inc. second quarter results. With me today are Andrew Rees, Chief Executive Officer, and Susan Healy, Chief Financial Officer. Following their prepared remarks, we will open the call for your questions, which we ask that you limit to one per caller.

Before we begin, I 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 our strategy, plans, objectives, expectations and intentions, including our financial outlook. These statements involve known and unknown risks, uncertainties, and other factors, which may cause our actual results, performance, or achievements to differ materially.

Please refer to our quarterly report on Form 10-Q and other reports filed with the SEC for more information on these risks and uncertainties, certain financial metrics that we refer to as adjusted or non-GAAP are non-GAAP measures. A reconciliation of these amounts to their GAAP counterparts is contained in the press release we issued earlier this morning. All revenue growth rates will be cited on a constant currency basis, unless otherwise stated. At this time, I'll turn the call over to Andrew Rees, Crocs Inc. Chief Executive Officer.

Andrew Rees

Thank you, Erinn, and good morning, everyone. Thank you for joining us today. Before we discuss the quarter, I'd like to start by welcoming Susan Healy to her first Crocs Inc. Earnings Call. We reported second quarter revenue of more than \$1.1 billion, which represents the highest quarterly achievement in the company's history and exceeded our guidance. Coupled with robust adjusted gross margin expansion of 330 basis points adjusted earnings per share grew by 12% to \$4.01, even as we accelerated strategic investments.

This performance resulted in record free cash flow for Crocs Inc. which we utilized to pay down \$200 million in debt and repurchased \$175 million of our common stock. Our enterprise initiatives remain consistent, and we've focused on three primary levers to fuel durable long-term growth: one, ignite icons across both of our brands to drive awareness and global relevance for new and existing consumers; two, drive market share gains across our Tier 1 markets through strategic investment behind talent, marketing, digital and retail; and three, attract new consumers to our brands through methodically diversifying our product range and usage occasions.

Starting with the Crocs brand, the investments we are making in product and marketing are enabling us to win with consumers around the world. During the quarter, we saw further growth

in global brand awareness and desirability. We have continued to evolve our partnership model with a clear intent to drive engagement, build consumer love, and ultimately fuel brand heat.

During the second quarter, we celebrated SpongeBob's 25th anniversary by creating a SpongeBob and Patrick Clog with the official announcement unveiled on the Las Vegas Sphere. Along with this, we released a number of partnerships that range from Pringles to Naruto, to Treasures, a K-pop band, and Minions. We continue to push into sneaker and lifestyle opportunities as exemplified through our Salehe Juniper sneaker release was sold out within minutes at \$140 and we've seen on secondary shopping platforms for multiples of the original price, a testament to the strong consumer response.

Looking at product overall, growth in the second quarter was once again led by our icon, the Classic Clog. As we prioritize durable growth, we have built several successful franchises that aim at expanding into new usage occasions to drive new and repeat purchases. The sandal category strengthened in the quarter as the consumer reacted favorably to the newness that we have brought to the market this year.

In particular, our style sandals are performing well across both new franchises like the Getaway and Miami, as well as established franchises like the Brooklyn. We introduced a Jibbitable (sp) version of the classic Brooklyn as well as a woven style, leveraging our molded DNA. The growth of our Jibbitz business during the quarter was led by strong double-digit growth in Asia, which was also our highest penetration by geography.

Our Jibbitz consumer continues to be one of our most valuable consumers, and we see them purchasing with higher frequency and average order value. Our strategic priorities within Jibbitz are centered around driving higher penetration in digital and wholesale channels, enhancing speed to market, and continually introducing product freshness.

Moving to a review of our business by geography. We saw broad-based strength led by our Tier 1 markets. The North America market performed ahead of our expectations and gained market share with revenue growth of 3% versus the prior year. Strength was driven by better at-once demand from our retail partners and solid DTC channel growth. For the first half, our North American revenues grew 6% against a broader market that was essentially flat.

International revenue grew 22% versus prior year supported by exceptional growth in China and Australia. China grew over 70% on top of triple-digit growth last year. While there is evidence in the market that the Chinese consumer is becoming more cautious, we see our accessible, authentic, and personalizable brand position as a clear competitive advantage.

Coming off the strength of our Super Brand Day in the first quarter, we have emerged as the #1 women's footwear brand on Tmall in the days that followed. This momentum drove outsized strength in the midsummer festival where Crocs led the conversation and took notable share on Tmall and Douyin, despite more promotional period for the industry at large.

For the first time ever, Crocs emerge as a top 10 overall fashion brand on Tmall during the festival and was one of only two footwear brands mentioned in the top 10 fashion rankings. Our direct markets within Europe registered double-digit growth in the quarter led by the U.K. and Germany and we continue to see ample opportunity for growth in the future.

Turning to the HEYDUDE brand. We remain focused on solidifying the business in North America and establishing the Wendy and Wally as iconic franchises for the consumer. We have made

progress in improving the health of our underlying business in North America, exemplified by pricing on digital up versus prior year, solid recovery in gross margins, and our inventories turning in excess of 4x. That said, our wholesale business HEYDUDE remains challenging, and we expect that to continue through the second half of the year. As we shared in the first quarter earnings call, sell-in and sell-out are down versus last year, and we'll focus on energizing the brand through improved marketing effectiveness and new product introductions.

During the quarter, we brought new HEYDUDE partnerships to the market, including Corona, a four-piece collection with the iconic beverage brand featuring our Wally, Wendy and Hudson styles. Our lead partnership, Denim & Dudes, marked the first HEYDUDE collaboration with international reach.

From a product perspective, we're bringing more focus around our core across the Wendy and Wally and we're leaning into three primary offerings: Stretch Subs, Stretch Canvas, and Funk Mono. While leading from the core is our focus, we'll make calculated bets with key sneaker and boot styles that the brand is also known for. As we look into 2025, we see an opportunity to optimize our SKU count while still improving our channel segmentation and bringing new innovations to market. For example, we introduced the comp this quarter, leveraging our Wendy and Wally DNA and added cushion and height retailing for \$85. We initially tested this product in DTC and will bring it to wholesale in time for back-to-school.

From a distribution perspective, we opened 13 new HEYDUDE outlet locations in the quarter, bringing our total year-to-date openings to 19. We are pleased with our new stores and see growing consumer engagement and shopping across genders and ages as consumers can experience the full breadth of the line. During the quarter, we also introduced HeyMakerz, our personalization proposition within our direct channels. These stations are creating buzz in our stores as consumers explore self-expression with the brand. For the year, we plan to open approximately 30 outlet stores. On the wholesale side, we will continue to optimize our account base and focus on improving customer segmentation.

Internationally, we're making progress in our direct markets in Europe as we build the brand in the U.K. and Germany. We're also introducing the HEYDUDE brand in Australia this quarter. and have plans to expand into select distributor markets in 2025. We're working on elevating our reach and effectiveness of our marketing to drive bigger brand moments, geared at accelerating awareness and creating community.

We plan to introduce the brand in a methodical and consistent way and get more shoes on feet. In addition to igniting our icons and focusing on the core, we're bringing her to the center of the conversation. We believe female youth culture is one driver of influence and brand connectivity and plan to accelerate our influence opportunity as we move into the fall. We plan to significantly accelerate our marketing investment and effectiveness in the second half of this year to drive more brand heat for HEYDUDE.

Before turning the call over to Susan to review our financial results, I want to call out the publication of our 2023 Crocs, Inc. company report released in June. This annual report highlights our commitment to and progress on our purpose: to create a more comfortable world for all through action-orientated ambitions of inclusivity, climate stability, circularity and community. I encourage you to check out the report for more information against these initiatives. I will now turn the call over to Susan to walk through our financials for the quarter.

Susan Healy

Thank you, Andrew, and good morning, everyone. Before I review the quarter, I'd like to say what an honor it is to have the opportunity to serve as the CFO of Crocs, Inc. This is a company with strong financial performance brought to life by its culture, brands, people and purpose. I look forward to working with Andrew and our talented management team to further advance the company's strategic and financial goals as well as to get to know many of you in the investment community in the weeks ahead.

Now for a review of our second quarter financial performance. We generated over \$1.1 billion in consolidated revenues in the quarter, growing 5% over last year, led by the Crocs brand. Adjusted gross margin improved 330 basis points from prior year to 61.4% and adjusted operating margin was 29.3%, resulting in adjusted earnings per share of \$4.01. Our second quarter results exceeded the high end of our guidance for the enterprise.

For the Crocs brand, revenues were \$914 million, growing 11% to prior year driven by DTC growth of 14% and wholesale growth of 9%. The growth came from a mix of volume in ASP with units increasing 6% versus last year to a total of 35 million pairs of shoes sold and brand ASP increasing 4% to \$25.96. As Andrew noted, North America revenues came in ahead of our expectations, growing 3% versus the prior year to \$489 million.

Growth was led by DTC, which was up 7%, while wholesale was down 4%. Underlying North American brick-and-mortar growth was up mid-single digits. International revenue of \$425 million was up 22% from prior year, led by DTC growth of 28% and wholesale growth of 18%. China led the way, growing over 70% on top of triple-digit revenue growth last year, and we also saw exceptional growth in Australia. In addition, our direct European markets grew by strong double digits.

Turning to HEYDUDE. Revenues were \$198 million, down 17.5% from last year and within our guidance range. Consistent with our strategy to strengthen the HEYDUDE brand for the long term, brand ASPs were up 7% to \$30.76, while volumes were lower. We sold 6 million pairs of shoes, 23% below last year. Wholesale revenues were down 24% from last year, since which time we have strategically reduced our account base and rightsized channel inventories.

The DTC channel was down 8% supported by retail contribution, offset by digital contraction as a result of prioritizing brand health through higher ASPs. Consolidated adjusted gross margin for the second quarter was 61.4%, up 330 basis points from last year. Crocs brand adjusted gross margin was 64.1% or 210 basis points higher than the prior year. The primary drivers of margin expansion were favorable product costs, lower freight costs, and higher international pricing.

HEYDUDE brand gross margin was 49.1% and 200 basis points higher than prior year, driven by lower freight costs, channel mix, and higher ASPs partially offset by investments in infrastructure. Our second quarter adjusted SG&A dollars increased 19% to prior year. Our SG&A rate was 32% up 420 basis points compared to prior year, driven by continued investment in talent, marketing, and DTC to support long-term market share gains.

Our second quarter adjusted operating margin declined 100 basis points to 29.3% compared to 30.3% for the same period last year but was favorable to our expectations on higher gross margin and revenue. Second quarter adjusted diluted earnings per share increased 12% to \$4.01. Our non-GAAP effective tax rate was 17.8%.

Our inventory balance as of June 30 was \$377 million, a decline of 14% versus this time last year. Both of our brands achieved inventory turns above our goal of 4x on an annualized basis.

Our liquidity position remains strong, comprised of \$168 million of cash and cash equivalents and \$559 million of borrowing capacity on our revolver.

During the quarter, we repaid approximately \$200 million of debt, reducing borrowings to approximately \$1.5 billion. We ended the quarter within our long-term net leverage target range of 1 to 1.5x. We completed \$175 million of share buybacks during the quarter repurchasing 1.2 million shares at an average price of \$149.53 per share. We currently have \$700 million remaining on our share repurchase authorization. In the second half of 2024, we plan to continue to buy back stock and pay down debt, enabled by our best-in-class free cash flow generation.

Now turning to 2024 guidance. We are reaffirming our full year top line guidance range and raising our operating margin and EPS expectations to reflect the beat in Q2, partially offset by continuing investment in talent and marketing in the back half of the year. We are maintaining our full year revenue outlook of 3% to 5% growth, despite \$11 million of incremental FX headwind underscoring the underlying strength of our business. Our guidance assumes currency rates as of June 30.

For the Crocs brand, we continue to expect revenue growth between 7% and 9%, led by international. For HEYDUDE, we continue to expect revenues to contract between 8% to 10% and expect wholesale to be negative for the year and DTC trends to be better than wholesale as we communicated last quarter.

We are raising our guidance for consolidated adjusted operating margins from approximately 25% to more than 25% for the year. We are maintaining our guidance for enterprise gross margin as well as Crocs and HEYDUDE brand gross margins to be up for the year versus 2023. We remain focused on investing behind brand accretive and strategic SG&A initiatives which we believe will drive second half SG&A dollar growth to be above the first half.

We are raising our 2024 adjusted diluted earnings per share guidance from a range of \$12.25 to \$12.73 to a range of \$12.45 to \$12.90. Our updated full year range balances the strength we saw in Q2, along with appropriate caution around consumer spending trends and the geopolitical landscape as well as the timing of our SG&A investments. Consistent with our previous guidance policy, this range reflects future debt repayment, but does not assume any impact from future share repurchases.

We are maintaining our expectations of underlying non-GAAP effective tax rate, which approximates cash taxes paid to be approximately 18% and the GAAP effective tax rate to be 21.5%. Our annual capital expenditures are now planned between \$100 million to \$110 million, down from \$120 million to \$130 million tied to the cash timing of select operational projects.

Turning to our guidance for Q3. We expect consolidated revenues to be in the range of down 1.5% to up 0.5% at currency rates as of June 30, with the Crocs brand growing 3% to 5%, led almost entirely by international growth. We expect HEYDUDE revenue to be down between 14% to 16% in the quarter, showing modest sequential improvement versus Q2. Embedded in our HEYDUDE guidance is the impact of lapping significant discounting on our marketplace for most of Q3 last year as well as timing of wholesale orders. We expect SG&A spend to be up in the low to mid-20% range in Q3. With talent and marketing investments elevated versus the year-to-date trend. We expect adjusted operating margin to be approximately 24.5% and adjusted diluted earnings per share to be between \$2.95 and \$3.10.

As we look to the fourth quarter for the HEYDUDE brand, we expect revenue growth to be supported by: one, easing comparisons; two, the timing of wholesale shipments; three, the contribution from new retail stores; four, sell-in to new international distributors; and five, lapping last year's pricing reset on digital late in Q3. In summary, we had a record second quarter. We have clear plans to invest further in our business to fuel long-term profitable growth, and I am confident in our ability to achieve our 2024 objectives. I will now turn the call back over to Andrew for his final thoughts.

Andrew Rees

Thank you, Susan. We are pleased by the results our teams have delivered through the first half, including our ability to pay down debt and return significant capital to shareholders. We believe the strategic investments that we are making in talent and marketing will set our brands up for durable long-term share gains. At this time, we'll open the call for questions.

QUESTION AND ANSWER

Operator

We will now begin the question and answer session. To ask a question, you may press "*" "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw it, please press "*" then "2." At this time, we ask that you please limit yourself to one question only. I will pause momentarily so we may assemble our roster. Our first question comes from Jonathan Komp of Baird. Please go ahead.

Jonathan Komp

Yeah, hi. Thank you. Good morning. I want to ask about the second half revenue outlook. Could you maybe talk, Andrew, about your assumptions and what you're seeing in terms of the core North America Crocs sell-throughs and how you're expecting that to trend? And then, Susan, just to follow up on the fourth quarter HEYDUDE outlook. I know you highlighted, I think it was four or five reasons for the inflection in year-over-year performance. Could you maybe just talk about the underlying assumptions in terms of the sell-through rates or the consumer and demand that's needed to hit the guidance in Q4 for HEYDUDE.

Andrew Rees

Yeah. Thank you, Jonathan. So look, before I start, obviously, we're really thrilled we had an exceptional Q2. We're thrilled to announce those results today. In terms of the back half, Crocs. We're obviously not adjusting our overall expectations for the Crocs brand. But -- and we had an exceptional first half for the Crocs brand. As we look at the back half in North America, I think we're very satisfied with the share gains that we've achieved in the first half. We've grown about 6% on -- through the first half. That's against a market that is approximately flat. So substantial share gains.

In the back half, we are more cautious, right? I think we definitely see the U.S. consumer behaving cautiously. We think our brand is well positioned relative to a cautious consumer environment, we accelerate exceptional value, we give the consumer exceptional value, but we are planning the back half in North America from a Crocs revenue perspective, approximately flat. And I'll let Susan talk about HEYDUDE and I'll maybe add something at the end.

Susan Healy

Yeah. Hello, Jonathan. So when you think about HEYDUDE in the back half of the year, you've got to really think about Q3 and Q4 in tandem. So we expect Q3 wholesale to be down to last

year and below Q2 versus last year, and we anticipate Q4 sell-in to be up. Part of what's driving that is the fact that last year, we had some orders that we shipped in Q3, and we deliberately did that to get them ahead of our planned ERP implementation just to avoid any potential disruption.

And so when you look at Q4 then, you're going to see one is you're going to see more normalized wholesale flow between Q3 and Q4. And then there's also some other sort of non-comp compares, things like our rollout of retail stores, which are ramping up this year, our sell into new international distributors, and then you're also lapping last year's pricing reset in digital, which took place late in Q3.

Jonathan Komp

Yeah, thank you.

Operator

The next question comes from Adrienne Yih of Barclays. Please go ahead.

Adrienne Yih-Tennant

Yes, thank you very much, and congrats on the nice quarter. I guess my question is on the SG&A, the talent and brand accretive marketing. Can you give us examples of what has worked thus far in the year-to-date period, where you're placing those incremental investments in the third quarter, and when you do you see the type of payback, the return on that ad spend and the talent investment? Thank you very much.

Andrew Rees

Yeah. Yeah, Adrienne, I would say these are long-term investments we're making. Our company, as it stands today, is exceptionally profitable. Our full year guide for EBIT is now 25.5%. This is an exceptional number. And we've grown extremely rapidly over the last several years, both organically and across that and also through the acquisition of HEYDUDE. At this time, we are making a series of investments in talent to enable us to grow in the future. Some examples around that would be enhancing our international teams for Crocs where we're growing very rapidly in Asia and also in Europe, investing in our marketing functions for both Crocs and HEYDUDE in terms of talent.

We've historically made some meaningful investments in terms of distribution infrastructure, and we're actually seeing some nice benefits from efficiency of our distribution infrastructure. And I think that really the big one is really marketing, right? We see a consumer that's obviously, I think, somewhat cautious here in the United States. We're a little concerned about the cautiousness of the consumer in China as well. And we believe it's extremely important in these environments to engage the consumer. So we're upping our marketing investment I guess, Crocs, but we're also meaningfully upping our marketing investment against HEYDUDE, where we've obviously got new talent in place in terms of HEYDUDE leadership and I think we've got some really great ideas and a strong point of view about how we can bring that brand to life.

Operator

Our next question comes from Jim Duffy of Stifel. Please go ahead.

Jim Duffy

Thank you. Hi, Andrew. Welcome, Susan. Susan, looking forward to working with you. With respect to the guide for the remainder of the year, the fiscal third quarter guide, I think, more cautious than most had expected. Can you, Andrew, speak to what you saw across July and key

considerations in your outlook for the back-to-school season, and then also perhaps speak to tactical strategies, product flow and considerations as it relates to holiday?

Andrew Rees

Yeah. Thanks, Jim. In terms of sort of inter-quarter, we don't really give any perspective on that. We never have. But what I would say, the consumer is behaving cautiously. We anticipated that. We expected that as we kind of thought about this year, and that is definitely true. So we think it's definitely prudent to plan the rest of our year that way, and we've done that from a Crocs perspective.

And then obviously, there's a lot going on with the HEYDUDE guide between Q3 and Q4. I think Susan thoroughly elucidated what that looks like. So it's not really inter-quarter trends that we're calling out because I note that we really haven't changed our full-year perspective. We expected this and have planned accordingly.

Operator

Our next question comes from Rick Patel of Raymond James. Please go ahead.

Rakesh Patel

Thank you, good morning, and great to have you on the call, Susan. For the Crocs brand, can you talk about how the B2C strategy on Amazon may be affecting how results are being reported as you think about wholesale versus direct-to-consumer? And just given the lumpiness of the results implied for the third quarter, can you provide additional color on what you might be seeing in terms of changes in the trend line for the wholesale channel versus three months ago?

Andrew Rees

Yeah. So I think maybe I'll hit the second bit first, right? So -- and I think there's a couple of times. But what I would say, and I'm not sure we -- in terms of lumpiness, what are you referring to, Rick?

Rakesh Patel

I'm just talking about the sequential slowing that's embedded in the third quarter guidance.

Andrew Rees

Yeah. So I think that's pretty simple, right? So as we think about the first half for the Crocs brand in North America with 6% growth, right, against a market that was approximately flat to significant market share gains. In the back half, we're guiding the Crocs spend to be approximately flat. So I don't think that's lumpiness, but that's a distinct change in first half to second half, and that is due to anticipated consumer softness.

So I think that's the piece. And I think that's only prudent, right? We want to plan our business that way to ensure that we keep inventories clean and fresh in the channel. We want to make sure that we don't get over inventoried and not pouring our cash into inventory versus returning it to shareholders. So that's, I think, just prudent planning.

And then your first part of the question was the Amazon trajectory. Look, I think Amazon continues to be a really important global partner perspective associated with. We want to be on the marketplaces where the customer shops. That is Amazon in the U.S. and in fact, in many parts around the world. And we have -- we are shifting sometimes how we manage the marketplace in terms of 1P versus 3P, I don't think that changes -- that change in terms of where it shows up in our P&L will be phasing out as we go through the back half of this year.

Operator

The next question comes from Chris Nardone of Bank of America. Please go ahead.

Christopher Nardone

Thanks, guys. Good morning. So regarding your Crocs brand international business, can you discuss where you're seeing some of the momentum and what countries are driving the biggest impact to your back half growth expectations? Then quickly on HEYDUDE International, if you could also remind us what percentage of your business this year will come from outside of the U.S.? And then Andrew, what gives you confidence that you can avoid some of the gray market issues that impacted the brand previously with this newer international rollout?

Andrew Rees

All right. So three questions there, right? So international for Crocs, right? So obviously, that is a key driver of our growth has been for the past couple of years at this point. And that's really the fundamental thing that we're doing there is penetrating underpenetrated markets like China, for example, like in Australia, for example, and also in parts of Western Europe.

So the fundamental driver is that we've got markets around the world that are large and substantive where the brand is underpenetrated, and we're now able to invest talent, invest marketing, and drive that penetration. The key markets that have been driving growth like China is our number one and probably our greatest long-term potential, and we've made substantial investments to enable that growth.

Australia has been also a very strong driver of growth. We called that out a couple of times. I think in the prepared remarks, we referenced China is up 70% during quarter two, which is on triple-digit growth last year. We continue to expect strong growth in China, but we are also calling out the fact that the Chinese consumer is clearly more conservative than they have been in the past. We think our brand is well positioned against that.

In terms of other important markets, I would say at some of our key Western European direct markets, the U.K., Germany, et cetera, have also performed well, yielding strong double-digit growth. And if we look longer term, we're also super excited about our potential in India, which we think is a rapidly emerging market. We're making also very coherent investments in that marketplace.

All right. So the other parts of your question are HEYDUDE international. We don't break out the percentage that is HEYDUDE international in terms of percent of the business. But I think, and I have talked about it before, what I would say is our model internationally is essentially going to be mirror Crocs. So we're going to be direct where Crocs is direct, and we're going to use distributors where distributors -- where Crocs uses distributors. In terms of where we put I would say, planted flags for HEYDUDE, right, and bear in mind, from a HEYDUDE perspective, we're starting off with brand awareness that is essentially 0 in these international countries.

We've planted flags in the U.K., we're planting flags in Germany. We're planting a new flag in Australia. We think that's going to be a nice market for HEYDUDE. So those are direct markets. And that means that we're opening e-commerce, we're selling wholesale and we're participating in the market directly leveraging our Crocs team. The second thing we've done is we've initiated new distribution agreements with a range of distributors. And Susan called out part of our Q4 benefit is we'll be doing some initial shipments to a range of new international distributors, which will get up and running in 2025. Hopefully, that gives you everything you need, Chris.

Operator

The next question comes from Tom Nikic of Wedbush. Please go ahead.

Tom Nikic

Hey. Good morning, everyone. Thanks for taking my question. And Susan, welcome aboard and looking forward to working with you. I wanted to ask on the HEYDUDE side. I know, obviously, it's got a new brand President, Terence, who obviously, is very familiar with the enterprise overall. Can you just talk a little bit about what -- I guess, what Terence brings to the table for the HEYDUDE brand, like how he can help rejuvenate and reinvigorate the brand and essentially like what part he'll play in getting HEYDUDE back to a growth trajectory. Thank you.

Andrew Rees

Great. Thank you, Tom. Yeah, look, we're thrilled to have Terence back. I would say it's only been 90 days at this point. So -- but we're thrilled to have him back. We all love working with him when he was here initially and we're very impressed by the trajectory he was able to drive it at Stanley, where he was for a period of time while he was not with us. So we're thrilled to have him back.

We're also -- I would also emphasize he's leading what we believe is a strong management team within our HEYDUDE business. So we think we've got sit all of the pieces in place. And in terms of, I think, what he's able to do, he's driving really, I think, three or four key things. One is definitely sharpening the brand's focus on their icon, the Wendy and the Wally. So driving investment, focus, energy, and innovation into the Wendy and Wally. He is focusing our attention on North America, which is obviously the biggest market.

But if we can leverage brand heat in North America around the world, it also gives us opportunities internationally and he's really shifting the marketing energy and the focus to the female consumer. If we can drive -- we believe the younger female consumer derives youth culture. If we can engage and energize a female, younger female consumer, we know that's going to spread passion for the brand to a much broader range of consumers and drive the brand overall.

And I would say, lastly, we're also arming with significant firepower, right? Embedded in our guidance in the back half is an increase in our marketing investment that's substantial. So we will support Terence and the innovation he's able to bring to the HEYDUDE brand and really be able to drive that in the future.

Operator

The next question comes from Sam Poser of Williams Trading. Please go ahead.

Samuel Poser

Good morning. Thank you for taking my questions. I have three that I'm going to merge into one since we're only allowed to ask one. Number one, Walmart, how long have you been selling to walmart.com or what's going on there? Number two, can you just talk about promotional activities you saw in the quarter and then promotional activity you're anticipating in the back half of the year for both brands? And then lastly, how much is lapping Barbie affecting the domestic guidance in North American guidance for the Crocs brand for the back half of the year?

Andrew Rees

Got it. Okay, three questions. Number one, we have been present on walmart.com for several years now. And our philosophy is unchanged on this, which is we believe our brands, particularly

the Crocs brand, which is a highly democratic brand, should be represented where the consumer is shopping.

Walmart.com is the second largest marketplace in the U.S. market relative to Amazon as Flipkart is in India. So we think those are important platforms for the brand to be represented on. But obviously, the product needs to be appropriately segmented relative to the consumer that's shopping on those marketplaces. So hopefully, that kind of answers that question. In terms of promotional activity, what are you getting at that Sam? What are you trying to elucidate?

Samuel Poser

Well, I'm just asking, really, it's more about the U.S. guidance, but I mean, are you seeing -- you talk about a weaker consumer. So I'm wondering if you need to get -- if you're anticipating needing to get more promotional, or I'm just -- how you're looking at the marketplace and then how do you look towards Crocs and HEYDUDE responding to that?

Andrew Rees

Yeah, I think -- so what I would say is, look, the market is more promotional than it was sort of last year, I would say, and certainly more promotional than it was coming out of the pandemic. I would say it's kind of returning, from my perspective, to what it was pre pandemic, which is key promotional periods is super important, and the marketplace gets pretty down and dirty during those key promotional periods.

As we've talked about with an accessible brand, we believe you have to participate in those promotional periods to get your fair share of consumer spending. And we've been doing that and we'll continue to do that. I'm not sure at this point we're anticipating an increasing trajectory of promotions in the back half. That is not the reason for the difference in terms of anticipated growth rate first half to back half. So I think we kind of see it as status quo and we see our strategy as status quo. Hope that helps.

In terms of your specific question about Barbie, Look, it was a nice performing product, and we really enjoyed the advent of pink being a really great color last year, and we have a lot of color in our brands. It was great. But the specific Barbie collab and comping that or not comping that is not driving any impact on our business.

Operator

The next question comes from Laura Champine of Loop. Please go ahead.

Laura Champine

Thanks for taking my question. It's really about the long-term prospects for HEYDUDE with kind of a short-term kicker of when do you think your new leadership there should be able to make a material impact in the growth trajectory of HEYDUDE, but also how has your experience with HEYDUDE over the last nine months, call it, influence your thoughts on the long-term growth potential of the brand?

Andrew Rees

Yeah, great question, Laura. So what I would say is we are extremely bullish against long-term perspective or projections for HEYDUDE, and as bullish as we were when we bought the brand. Obviously, over the last several months, it has not performed as we had hoped it would, particularly here in the U.S. marketplace. And I think we've talked at some length about some of the things that I think we did wrong associated with that.

That does not change our long-term perspective on the brand. We think the value proposition that the brand brings to the table, lightweight, comfortable, easy on and off product that is extremely compelling from a -- to the consumer that we can make in many different colors, fabrications, flavors, et cetera with a really effective consumer engagement strategy and marketing strategy, we think, has a lot of potential against today's consumers.

And really, everything we continue to kind of learn about the brand and the innovation we can bring in certain areas in the product line is reinforcing that. So I would also note, despite the brand not meeting our current ambitions, it's making an extremely solid contribution to our overall financial picture in terms of revenues, margin, and profitability, but not reaching our ambition for the brand. And I think we're very confident in the team we have in place, the strategy we have in place that we will be able to reach full ambition for the brand. So I think we're as -- in a nutshell, we're as confident and is enthusiastic about the brand as we were when we bought it.

Operator

The next question comes from Ashley Owens of KeyBanc Capital Markets. Please go ahead.

Ashley Owens

Hi. Thanks for taking the question. I just want to touch on gross margins a bit. We've seen some pretty solid expansion in both brands for the first half of the year. Just how should we be thinking about modeling that for the balance if we're still seeing similar levels of expansion in the back half as we did in the first half? Just any puts and takes you could provide color on would be helpful. Thanks.

Andrew Rees

Yeah, Susan will answer that.

Susan Healy

Hello, Ashley. So at the enterprise level, we expect gross margins to be up for the year-end for the second half, but not at the same rate as the first half, basically due to the harder compares. So if we kind of look at it brand by brand, for Crocs, we expect it to be up slightly year-over-year as we start to anniversary some bigger freight gains from last year. And on the HEYDUDE side, we're expecting Q3 margins to fully recover when we compare it to two years ago.

Operator

The next question comes from Mitch Kummetz of Seaport. Please go ahead.

Mitchel Kummetz

Yeah, thanks for taking my question. Andrew, how is the Spring '25 order book coming together? And do you expect HEYDUDE North America spring orders to be up or down? And then just as a follow-up to Jonathan's question earlier. Susan, you mentioned the wholesale order shift. Can you quantify that, perhaps? Thank you.

Andrew Rees

Yeah, thanks, Mitch. I think, look, we don't comment consistently on future order books. But I would say, look, we're satisfied with, obviously, as you're well aware, we're out selling Spring '25 currently. I would say, retailers, as you would expect, are buying somewhat cautiously given that the current trajectory of the business and what they see for the remainder of the year. That's really a domestic comment. As we look at our Crocs order book, domestically and globally and the strength of our Spring '25 line, we're happy with where it's at, and we'll obviously get into '25, and we'll tell you more about that in the future.

From a HEYDUDE perspective, we're excited about the line that we're bringing to the table in Spring '25. And we're getting a lot of positive feedback against some of the innovation that's embedded within our product strategy, and we plan to support that with really compelling marketing and drive consumer engagement.

Susan Healy

And on the specifics about the orders that we shipped earlier last year in Q3, we don't break that out specifically, but that is definitely embedded in our guidance of being down 14% to 15%. And when you think about the impact that has on the year-over-year compares for Q4, that's part of what's providing that lift that the implied guidance gives you for the full year.

Operator

Our next question comes from Jay Sole of UBS. Please go ahead.

Jay Sole

Great. Thank you. Andrew, I'm just wondering if you can elaborate a little bit on the China business. You made a few comments, but China for Crocs brand being up 70% on top of triple digit growth last year. Can you just talk about your progress in that market, where you're pleased, maybe whether there's more opportunity, and what kind of growth do you expect going forward? Thank you.

Andrew Rees

Yeah. I think we're really -- we talked a lot about it over the last 18 months. We're really excited by the trajectory that we're seeing in China. At the heart of it is we've driven brand relevance. We've made the Crocs brand, and particularly the Clog and personalization of the Clog, relevant to the Chinese consumer. We've done that mostly through, I would say, digital and social marketing, and we've really established a very strong platform in the Chinese market.

That's driven strong growth across our channels, right? That's driven strong growth -- very strong growth in triple-digit growth last year and 70% in Q2, as you highlighted in your question, across channels. So that's been both digital. So it's a Tmall, Douyin, and all the other digital platforms. It's what we book as wholesale, which is two franchise partners that then sell through mono-branded stores.

So those mono-branded stores are seeing comp store gains, those franchise partners are also opening more stores. So that's been driving the wholesale growth and we've had some modest incremental growth in our retail fleet, where we're focusing on both what we call energy stores in the major metropolitan areas, China -- sorry, Shanghai and Beijing and a couple of other Tier 1 cities and also Tier 1 outlets, which we think are also important in the Chinese market. So growth across all channels.

As we look forward, while we're not quantifying kind of future growth expectations, our anticipation is we will see sustained growth over multiple years in the Chinese market. We're still very much underpenetrated relative to the size of the market. And we think that growth will come across all channels. But I think the largest component of the growth will come from our wholesale sales as our partners open more stores and we drive more store penetration across the Chinese market. Our anticipation is we'll penetrate sort of Tier 1, Tier 2 cities in the next two to three years. We're not anticipating a lot of business below 2 Tier cities. We want to really keep the quality of our business high and focused on the higher demographic portion of the market.

Operator

Our next question comes from Jim Duffy of Stifel. Please go ahead.

Jim Duffy

Well, thanks for taking the follow up. Two quick ones, if I may. With sandals in the more sneaker like product, what are the important read-throughs on DTC adoption, and how is that translating to wholesale engagement? And then secondly, on capital allocation, cash flow has always been one of the hallmarks of the model, net leverage now within your targeted range. Is there any shift in priority between reducing leverage and increasing the share buyback? Thanks.

Andrew Rees

Okay. So I'm going to hit sandal and sneakers and then Susan can hit capital allocation. So from a sandal perspective, we've been happy with our sandal performance during Q2. We saw, I think, some strengthening relative to the Q1. That's driven by some kind of a fashion-orientated samples. So we made introductions of a couple of new collections that have been performing well. The Getaway, which is a comfort fashion sandal, and the Miami, which is more of a fashion sandal, those have been performing well, and we've been kind of chasing some inventory.

We've also driven some innovation into the Brooklyn, which has been a long-standing franchise, that's a wedge or elevated fashion sandal. We've introduced a couple of new models in there that have been performing well, including a personalized sandal where the consumer can add charms to the sandal to really dress it up. So we think that's been performing well in our penetrated markets or key Tier 1 markets. And we're confident that sandals continue to drive a long-term growth trajectory for the brand.

The sneaker orientated product is really all about testing and experimentation we did introduce at Juniper with Salehe Bembury during the quarter. We highlighted that in the prepared remarks. It's small -- very, very small, but it's really the sort of pinnacle offering, and we continue to experiment and test a whole range of kind of sneaker orientated silhouettes. That's a longer-term strategy, but it's important that we continue to innovate in that arena. Let me hand it over to Susan for capital allocation.

Susan Healy

Yes. So Jim, you asked about debt pay down and share buyback. I mean, the short answer is we like both and we're planning to do both in the back half of the year. We're fortunate to have a business with very strong cash flow, and we're also within our net leverage target range of 1 to 1.5x. So that gives us the flexibility to deploy capital both ways. And in answer to your question, no change at this point to that target. We really like where we are from a cash flow and liquidity standpoint.

Operator

Our next question is a follow-up from Baird. Please go ahead.

Jonathan Komp

Hi, thank you. Just one more follow-up. I wanted to ask a bigger picture question around the philosophy for the SG&A investments. And obviously, this year is a year in which you're planning to grow revenue 3% to 5% and yet, you're spending almost 20% higher SG&A for the year. So could you just maybe remind us your overall philosophy? And as we look out, is the hope that these investments drive faster revenue growth, and any color there in terms of the overall strategy? Thanks.

Andrew Rees

Yeah, great question, Jon. So obviously, we're starting off -- I would say we're starting off from a base of extremely high profitability, right? So even this year with that distorted investment profile that you just highlighted in your question, we will achieve kind of 25.5% in terms of EBIT margin, an extraordinary level relative to our peers in the industry which we're in. And obviously, that's due to the very high gross margins we experienced on our Crocs brand and also the efficiency of our business model.

In terms of philosophy going forward, I think there will be periods of time when we choose to invest in SG&A, both variable and SG&A because most of our marketing is variable and can be turned on and off at any point in time, and where we will make investments in talent and people and infrastructure and capabilities that we think will be important for the future.

The intent of those investments is to support and -- sorry, support and guarantee -- no guarantee is not the right word, but assure a long-term growth. So we're trying to build a company and a brand that has long-term growth potential and can continue to grow for many years to come. So I would say there will be periods of time when we distort in SG&A, there were periods of time when we leverage SG&A, and that's kind of how we think about it from a long-term philosophy perspective. Okay.

CONCLUSION**Operator**

This concludes our question-and-answer session.

Andrew Rees

Look, I just want to say thanks --

Operator

-- I would like to turn the conference back over

Andrew Rees

-- Okay, sorry --

Operator

-- Please go ahead.

Andrew Rees

Jumped the gun a little bit there. Thanks, everybody, for their thoughtful questions. And thank you, everybody, for joining us today and their interest in our company. So we appreciate it.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.