S&P Global
Market Intelligence

Skechers U.S.A., Inc. NYSE:SKX

Company Conference Presentation

Monday, March 04, 2024 3:25 PM GMT

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John M. Vandemore
Chief Financial Officer

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Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

Presentation

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

All right. Good morning, everyone. Thank you for joining us for Raymond James Institutional Investors Conference. I'm Rick Patel, research analyst covering softlines, retail, global brands and e-commerce here at Raymond James. I'm thrilled to be hosting our next guest from Skechers. Skechers, as you all know, is one of the biggest footwear brands globally with wholesale and direct-to-consumer distribution and is well known for its comfort, value and very cool pop culture collaborations.

We're thrilled to be joined by Chief Financial Officer, John Vandemore. John, thank you so much for being here.

John M. Vandemore
Chief Financial Officer
Yes. Thanks for having us.

Question and Answer

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

So maybe just to kick things off, you've accomplished a lot in a relatively short period of time. Revenues hit $8 billion last year, so congratulations on that. I'd love to hear about your long-term target and the building blocks that you think will get you there.

John M. Vandemore
Chief Financial Officer

Well, boy, that's a big question. If our CEO, Robert Greenberg, were here, he would exclaim that our objective is nothing less than total footwear domination. And those aspirations, while sounding wild, were probably even more wild 5 years ago when we barely scratched the surface of $3 billion in annual sales. And as Rick mentioned, we got 8 -- almost precisely $8 billion last year. We think there's a huge opportunity for our brand across the globe in footwear as well as other categories. Our strength is that, as Rick mentioned, we focus on style, quality, comfort and innovation but all at a reasonable price.

And it's really when you kind of boil it down to brass tax, it's comfort and value, where we resonate more strongly with consumers, no matter where we're selling than every other footwear brand. And we think that gives us a license to continue to grow. Today, we're the third largest footwear-only brand. We expect to at least stay in that position, if not ultimately challenge for 2, yes, maybe 1. That growth is going to come as it has for us probably largely outside of the United States. Over 60% of our sales today come from outside of the United States. And it's going to come from a growing presence in the direct-to-consumer channel, much like other brands have chosen to imitate of late. We, for a long time, have operated dually in the wholesale, in the direct-to-consumer marketplace with the end objective, quite frankly, of simply getting our product to as many consumers as possible and making it as convenient for them as possible to engage in our brand.

More tactically, we continue to open stores. We continue to expand our presence online. We continue to expand our presence in many markets across the globe where -- while we're also dealing with local competitors, we're dealing with many other international brands. But we feel we have the right mix of product and consumer focus to really out achieve kind of the industry growth and continue to expand our brand presence.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

And can you talk to us about how investors should think about Skechers' competitive positioning? So what differentiates the brand from others? And as you think about the marketplace today, which parts do you think are underserved where Skechers can do well?

John M. Vandemore
Chief Financial Officer

Yes. I mean, the first thing I would reiterate is that most people don't realize that we are the third largest footwear brand in the world. So you might be able to name the first. My guess is you could probably hazard I guess at the second. But I doubt any of you coming into this would have understood that we're the third largest brand today. And why that matters is because in footwear in the branded space, at some point, scale matters a lot. And we have that scale. We're selling north of 250 million pairs of shoes globally every year. And that's an important relative position as you think about others downstream who aren't yet nearly at that size.

The second thing I'd point out is that I think from an investor standpoint, what distinguishes us is that we're a fast-growing business. Our compound annual top line growth rate is low double digits today, and we've sustained that for close to 10 years. That's a pretty remarkable record. And while certainly, other brands have outdistanced that in a given year, and there will be hot brands and hot fads that outdistance us in the future in that, to deliver that level of growth on a day in and day out, year in and year out basis, I think it's pretty remarkable.

I would also say one of the challenges we face when we talk about our brands is the breadth of what we offer. If I were to reference a brand up north in Oregon, you would talk about athletic. If I were to talk about a brand of extruded plastic in Denver, you'd probably talk about clogs. But when you think about Skechers, what's remarkable is the breadth of the categories in which we operate. That gives us a lot of alacrity in the marketplace other brands don't have. When a trend softens in one area, we can go to others. But more importantly, quite frankly, what we can leverage is a consumer in one category to another.

Because remember, as I said, it's style, comfort and quality, innovation at a reasonable price. Those characteristics remain true irrespective of the category. So if you're out there looking for a pair, I'll knock on the candidate before us, golf shoes. We have golf shoes. And I guarantee you, they are the most comfortable golf shoes you'll wear. But if you then need a pair of walking shoes, what you will quickly realize once you've crossed over from one category to another is that we offer the most comfortable walking shoes. So if you're traipsing around Europe, for your summer vacay with the family, we're a great solution.

And then what you begin to realize is when you need a pair of work shoes because you're going to your job in the new shiny Amazon distribution center and you need a pair of steel-toed shoes that are comfortable, Skechers is there for you. So that breadth of product also, I think, is incredibly distinguishing and isolates us from some of the vagaries that happen in fashion-driven industries like ours, but also give us extended opportunities to grow shelf space and to grow into markets where we're brand new. Because we can attack a market from many different angles, whereas many of our competitors are very focused on one category or another. Just a few examples of things that I think are unique.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

As we think about the footwear market, the premium side seems to be getting more and more crowded. So you've always had Nike, now you have On, you have Hoka. As we think about what's happening there, can you talk to us about what's happening on the value side of the equation both in terms of the market? And as companies take their price points to more elevated areas, does that leave an opportunity for pricing for Skechers?

John M. Vandemore
Chief Financial Officer

First of all, I really wish you hadn't asked that question because the last thing we want anybody focusing on is value. We'll own that one. That's fine. I do think -- look, there's a lot of great product out there. The typical path to market for many new brands is to go premium. And to be fair, that's a great path if you're focused on lower volumes, if you don't have the infrastructure to support a bigger expansion. The reality is it's a really crowded space. It's tough. And what you see in that kind of vein of the market is a lot of market share changing hands over the course of a 5-year horizon. And it's a lot of shift among the premium consumer.

And while certainly, we have versions of our product that we think can compete at that level, that's obviously not where we play most significantly. We like to play below that. And the reality is as consumers, we think there's certainly occasion to purchase premium. We don't begrudge you for doing that. But the reality is there's also a lot of instances where you don't want a premium footwear solution. My example a second ago, you're going traipsing around Europe. You probably don't want to wear your best Air Jordans to go walk through endless churches and museums, as my kids would describe a European vacation. And so there's a value solution available to you that's really comfortable, it works from a style perspective and is very reasonably priced.

And so we're not trying to command the closet but we think we play an important role for a lot of people. Now look, there are certainly consumers out there who are much more focused on value on a regular basis and we'll play an outsized role in theirs. But we think we can play across a lot of different closet spaces out there, everywhere from premium to the pure value consumer. And unfortunately, you can't do that if you're premium. If you're premium, you're going to be battling in premium. And again, no disrespect to whatsoever to a lot of those brands you mentioned. They do a great job of delivering premium shoes.

But we think there's a very important role to play in value. And again, I would distinguish between what some of you might inadvertently conclude cheap. Cheap is not what we do. We're not delivering cheap shoes. It's value. Because we do believe quality, style, those are really important elements of what we offer. So we're not looking to compete directly with private label. But it's a combination of those features matched with, I think, the purchase intent. The last example I'll give you which is probably my favorite is, if you're going to work in that Amazon DC, you don't want to spend a ton of money on the footwear that's required to work there. You need a slip-resistant steel toe black sneaker. Who wants to go [sell] out $240 for a high top on that, right? No, you want something that is comfortable, it works, it's qualified. And that's a great example of where we fit nicely into the marketplace.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

And I'd love to dig deeper into the growth opportunities by channel. So maybe starting with direct-to-consumer. You've made a ton of progress there over the last few years and the outperformance of that channel has been really impressive. As we think about what's happening now, talk to us about the levers that you have to continue to grow in that direct-to-consumer channel. And then also, as wholesale potentially recovers, should we -- what should happen to the growth rate for that channel?

John M. Vandemore
Chief Financial Officer

Yes. Well, the first thing I'll tell you is when I first got into footwear, there was this new in-vogue strategy where every brand was going straight direct to consumer. They were getting rid of wholesale partners and all that. And we felt it was an incredible complement because we have been in the direct-to-consumer business pretty significantly for a while. Now the truth is that was not a brilliant stroke of strategy. When we started as a brand, we could not secure the type of distribution we thought our brand deserved. And so we actually ventured into direct-to-consumer not out of sheer strategic brilliance, but rather complete and total desperation. But as a result, we've grown up operating with a strong wholesale and direct-to-consumer presence for quite a while, and we've done so successfully.

What we've seen overall with consumers is that it's -- at least in our view, it's most important to get them the opportunity to purchase the product that they want to purchase wherever they want, whenever they want. And so even today despite, I think, what was a strategic shift and then maybe a shift back now, we're fairly agnostic. Because what we believe is that the consumer should choose where they want to buy something. And if that's at a wholesale partner, so be it. If that's in one of our beautiful stores, that's great, too. The advantage for us of direct-to-consumer is that it allows us to bring a broader array of product to market for the consumer than they'll find typically in a wholesale partner. Not many wholesale partners carry more than 5% of our total line.

And usually, that's because they're focused on a specific segment of consumer. Whereas in our stores, what we're focused on is people with feet. And so we're offering the opportunity for the mom to come and purchase footwear for her children and herself, and let's face it, in most instances, her spouse. And so what we want to bring in the direct-to-consumer world is a broader, more fuller expression of what we offer, and we've seen tremendous success with that. Now I think it does dovetail with a broader trend, the brands being more directly involved in the purchase cycle with consumers. And certainly, we're going to advantage ourselves there.

We see a ton of run runway in the U.S. in particular in new stores and an enhanced omnichannel solution for consumers, but probably more importantly and ultimately more lucratively, outside of the United States. Because outside of the United States, there's more burden territory for us, But also, it helps us firmly establish the brand with consumers, just because having that nice street side store with all the branding that comes with it is a testimonial to the presence of the brand, the strength of the brand.

And so the direct-to-consumer business for us, we still anticipate it will be one of our fastest-growing segments. It's going to be a combination of stores.

I would tell you, I think we're still in the early stages of figuring out what the omnichannel solution for our consumer looks like. And so continuing to plow forward with digital domains is going to be clearly important. But I would stress one thing, it's not to the exclusion of wholesale partners. We want to continue to work with wholesale partners who will treat our brand properly, who then we can help meet their consumer needs if they're looking for stylish, comfortable and high-quality footwear with reasonable price because that's what we intend to give them as well.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

And I'd love to hear more about the wholesale channel. So that channel has been very difficult across the entire branded space for over a year now. So as you think about what's happening now, are you seeing green shoots for that channel? And what's the right way to think about growth over the next year?

John M. Vandemore
Chief Financial Officer

Yes, no doubt, the wholesale channel particularly in the U.S. has been challenged for, I'd say, going on a little bit more than a year now. I think the reasons for that ultimately are as varied as the number of retailers we count. And I would make it a point to say that not all retailers have been struggling. There's been some out there that have done remarkably well. I'd say where we've seen challenges, clearly they've emanated from situations in part a result of kind of post-COVID supply chain disruption. Most notably, that was evidenced with more inventories than many wanted to be carrying. But there were other issues as well.

It feels like things are getting better, but I would obviously consciously acknowledge that a feeling isn't a great data point. In terms of green shoots, at some point, they have to go past shoot stage. But in terms of what we're seeing right now, it looks like bookings for the first half of the year are favorable for the first time in a bit. And more importantly, I would say the conversations we're having with retail partners is more encouraging. I don't want to, in any way, suggest that retail is out of the woods entirely because I don't think that's fair. But things do seem to be trending better domestically.

Outside of the United States, I'd actually say the wholesale side of the business has held up pretty well, and if not, in some markets done very well. And I think that's because you didn't see as much disruption emanating from kind of post-COVID supply chain outside of the United States. Now to be fair, the disruption hit the United States harder and faster than in other markets. So even from our operational perspective, when we saw what was happening 2 years ago in the U.S. supply chain, we reacted quickly internationally so we could avoid the situation. So there was a benefit there.

But I would also just say, in general, for our brand at least the opportunity to continue to grow in spite of some of those challenges remained pretty healthy and that was a good offset. Net-net, I would tell you, our long-term expectations continue to be that the U.S. domestic wholesale marketplace, it shouldn't be a 20% per year growth market. It should be kind of a mid-single-digit growth market. It's a very mature market. It's a very competitive. But outside of the United States, wholesale stands an opportunity to grow much faster than that. And as we said just a second ago, I mean, the DTC, coupled with that international wholesale, that's really the engine of growth for Skechers.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

And you touched on this, but as we think about inventories, not just in wholesale but just more broadly across the marketplace, what are your thoughts on the status of inventories? Are things still elevated in certain pockets or have we turned the corner here?

John M. Vandemore
Chief Financial Officer

At least as it relates to our brand, I think we've turned the corner. Now that being said, that's the visibility we have into our brand either in our channel or our partner channels. What we don't have visibility into is other brands with those same retail partners, private label with those retail partners, et cetera. So we don't have 100% visibility. We've actually been pretty enthusiastic about our inventory levels in all channels for quite a while. What we haven't seen lately, and this is, I think, in contrast to pretty much the old rule of thumb in retail, is that if inventories are properly managed, sell-in and sell-through will match up.

And that hasn't been the case. So there's something else disrupting the flow, the link between those two metrics, It does again feel like it's gotten better, but we haven't seen inventory levels be the positive harbinger of future orders lately than we would have seen in the past. That all being said, as I mentioned, again we are seeing good booking trends. That's a good signal. For our brand, really throughout the last year, sell-through pricing, margins, inventory levels all looked pretty healthy. So from a consumer standpoint, I think it's probably stacked up really well. And clearly, you see that in our DTC business performance. It just feels like the wholesale -- the balance of the wholesale needs to catch up a little bit.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

And can you share your thoughts on inventories for Skechers itself? So you exited the fourth quarter with pretty lean inventories, in our view. And as you think about the future, like how do you walk that tight rope of investing to stay on the offense while being defensive and just not getting over your skis?

John M. Vandemore
Chief Financial Officer

Let me first admit, this is going to sound like I'm bragging hardcore, and I am. But very rarely in my career have I set a working capital target and like massively exceeded it. In '22, we had a spend close to -- at one point in time, close to $700 million on inventory. This was in the midst of the supply chain challenges out there. And it wasn't bad inventory. It was inventory that had orders. It was good inventory. It just came in too fast.

And so kind of like hopefully, an optimistic gambler, we continue to push the chips in. We were going to buy the inventory. We're going to bring it in. As you know, we spend a lot of money to deal with it to make sure that it stayed in the right cycle of processing. And over the course of last year, almost every dime of that unwound. And I couldn't be happier from that, mostly because it puts a big pile of cash in our bank, but it's also a really hard aspect of the business to manage. There's an old saying that if you're not watching inventory every day, you shouldn't be in retail. Wholeheartedly agree with that statement.

And I think what we did over the course of the last year to unwind that investment in inventory which, again, we had to make, while simultaneously maintaining the margins -- the gross margins that we did, it's probably, if I look back on 2023, one of the things I'm most proud of as a company because we set out a plan, we accomplished the plan. I should knock on something. And it kind of worked almost as precisely as we planned it. And so I'm thrilled with where we sit right now. We feel kind of like we've just trained for a boxing match and we're peak physical shape from an inventory perspective.

Now the reality is you get about a day to enjoy that and then you have to focus on the future. And so to your point, obviously, watching consistently where are we putting inventory. We don't, by nature, take a lot of bets on inventory. So it really is -- it's got to be driven by that commercial relationship with your partners. But continuing to monitor that on a daily basis is part of what we do.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

Well done on the management. So maybe we can shift gears and talk about margins.

John M. Vandemore
Chief Financial Officer

I really feel like I should have recorded that. I hope somebody somewhere did.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

It's being recorded.

John M. Vandemore
Chief Financial Officer

A ring tone in the future.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

I'd love to shift gears and talk about margins, if we can. Perhaps remind everyone where your margins are now and what your long-term goals are. And what are the mechanics on what it will take to get there?

John M. Vandemore
Chief Financial Officer

Gross margins or operating margins?

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

Operating margins.

John M. Vandemore
Chief Financial Officer

I would have much rather talk about gross margin.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

We'll get there.

John M. Vandemore
Chief Financial Officer

Listen, the struggle with Skechers is always, we're facing two diametrically opposed demands from you all, to be fair. One is to grow at the rate we're capable of growing, right, which is at least a high single digit, if not low double-digit opportunity. And we're -- we fully embrace that objective. But on the flip side, we also get asked incessantly about our operating margins, which today clock in just under 10%. I would step back and say, the way that challenge manifests in the P&L is every decision we make to invest in a new store is a challenge to operating margin in year 1. As much as we try, opening a fully profitable store right off the bat is difficult.

The same can be said for a distribution center. The same can be said for a category like football or basketball, which we recently entered into. And so we're constantly faced with the juggling act of do we want to grow or do we want to harvest the operating margin? And if you follow the stock for even a week, much less a year or more, you know that we're going to bias towards the growth, which I think is actually the right answer ultimately for optimal value creation. Now it's not that we ignore the operating margin. This business definitely has a low teens operating margin in it. It's not a question of whether or not, and this is a question I get often, there's anything structural impeding that. There absolutely is not.

The imposition comes from growing and investing in that growth. Now, again, we look every year. This year, we've kind of set the same objective. We don't want to deleverage in SG&A. We want to continue to grow the business. And then we'll look for opportunities to get leverage out of G&A as we go forward. But that's always going to be a secondary demand to investing further for growth. That being said, as the business matures over time, we'll have more opportunities to focus on harvesting for increased profitability. That kind of, what we say traditionally is kind of the 11% to 13% range in operating, but that's certainly achievable. But it's not going to stand in the way of growth.

And so again, that's our mantra at least between here and the next 2 to 3 years where we're looking to get past the $10 billion mark. But even beyond that, I would say, we think more value can derive from growing the business faster than the market than can be had from stopping and harvesting operating margin dollars to just artificially drive that margin. But again, I would say structurally, there's nothing that impedes kind of that low teens operating margin.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

And maybe we can unpack that now. So talking about gross margins, as we think about the next year, what's the right way to think about the puts and takes? And longer term, where do you see margins going just given the changes in the sales mix?

John M. Vandemore
Chief Financial Officer

Yes. I mean, the first thing I'd say is we're coming off a great year from a gross margin perspective. It's the result of a lot of different efforts that we're all kind of aimed at, trying to augment our gross margins equivalent to what we felt like the brand could achieve. Some of that was the pricing actions that we took in the face of COVID and afterwards. Some of that was seeing the natural evolution of kind of, in particular, the shipping market get back to normal. Today, we sit here with what we consider to be really good kind of product level merch margins. And that's great because you're seeing very little in the way of outside factors influencing from shipping to FX to raw materials. So that looks really stable to us for at least the next year or so.

What that gives us the opportunity to then do is mix the business for margin accretion. I'll say that but let me just caveat. Our #1 objective actually is not gross margin. It's actually gross profit dollars. So I'll come back to that in a second. What we want to aim for, quite frankly, is a stable to growing gross margin on the back of mix shifts that will be borne out of that faster DTC growth rate and that faster international wholesale growth rate, both of which are gross margin accretive businesses to us. The caveat, as I just mentioned, is if we see an opportunity to grow faster in a lower-margin business, we're definitely going to take it because that means the brand is growing. That means we're meeting consumer needs.

And the example we always give for that is our distributor business. There's a couple of markets out there where we don't operate directly. We utilize third-party distributors, people who have partnered with us for decades. It's a lower gross margin business, it's in the kind of mid- to high 20s, but a very good operating margin business. But that's a good example of if we have incremental opportunity there, we'll take it. But that in and of itself would be margin-dilutive. All margin kind of within the segment is equal, we do expect over time that the gross margin will continue to accrete at probably a 20, 30, 40, 50 basis points rate year-on-year as we mix in more DTC and more international wholesale. But again, I would say that has to be mix-adjusted. If you're talking about mix-independent, we're actually really happy with the merch margins as they sit today.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

It's hard to have a conversation about a big global brand without talking about China. So you have a pretty sizable presence in China. I'd love to hear how you think about the long-term opportunities there and also how investors should think about some of the near-term macro volatility that's going on?

John M. Vandemore
Chief Financial Officer

Yes. I would express nothing but optimism for China. I mean, I know it's been of late, I think, a little bit more common for people to be talking about derisking that market. But I would tell you, on the back of a really solid fourth quarter and a very impressive year, we continue to see China as a lucrative opportunity long term. We're continuing to invest in the market, both in terms of infrastructure, both stores and distribution but also people and capabilities. Clearly, China before the pandemic was a relatively unique growth story. The growth rates were fantastic in eye-popping. And the law of large number ultimately will catch up to you.

But we still think the market has tremendous long-term opportunity. For us, in particular, it's about increased penetration in the Tier 1 and 2 cities we're in as well as opportunities outside of that in the 3 through 7. One of the unknown, I think, evolutions in China lately is that there has been a tremendous amount of infrastructure improvement outside of the Tier 1 and 2 cities that is actually opening up markets that didn't exist today. Maybe just think from an infrastructure standpoint, without consistent, reliable travel corridors, supplying a Tier 5 city used to be a big challenge. Today, that's not a challenge anymore. So we think that market holds a lot of continuing opportunity. There's going to be some near-term challenges, but it still has more people transitioning into middle class consumer behavior than any other market in the world. And that includes, in contrast on India.

And ultimately, we do believe that market will reset away from kind of the real estate concentration that had been the norm for the last 10 years into more productive technology and other manufacturing bases. And we think that then will continue to advantage transition to the middle class. So again, I -- it's important to keep in mind the geopolitical context of the discussions, but I would tell you, we continue to be opportunistic about China and I somewhat view that we're in a bit of a weird stage where people are talking more about derisking the market than taking advantage of the market. And I, for one, would probably bet on the market continuing to deliver outsized growth as an opportunity than anything else.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

And last question, as you think about the year ahead, what are you most excited about in terms of the opportunities? And then also, what gives you the most caution?

John M. Vandemore
Chief Financial Officer

I'm most excited about just having a normal year, right? I was just joking in a meeting earlier. We got to talk about weather recently. It feels like it's been 3 years since we talked about weather impacts in retail, and there's something comforting to me about that. But not having supply chain disruptions, not having a challenge in the domestic wholesale marketplace, not having COVID. I mean, there's been so much over the last 3 to 5 years that we've had to deal with. I, for one, would be really excited about just a normal operating environment. Coupled with that, we've got some really exciting categories that I think we're all eager to see how they develop early stage. Any trepidation would come from the consumer, just not knowing where the consumer is going to go but that not any different than any other year.

Rakesh Babarbhai Patel
Raymond James & Associates, Inc., Research Division

That's great. Well, thank you for the insights. Appreciate your time, John, and thank you, everyone, for joining us.

John M. Vandemore
Chief Financial Officer
Thanks, Rick.