Crocs Inc. Stock Valuation

SEE READING:

CROCS, INC.

Crocs, Rockwood Capital Mgt.

Time Period:

- Nov 1, 2007 – Crocs stock price meltdown -36%
- Prior to that time, rapid rise in Revenues and value

Rockwood Capital Management's Stacy Yeung:

- Behind investment in Crocs
- Should she re-evaluate her projections and analysis?

CEO Ron Snyder:

- Expressed surprise
- *"Looks like a bit of an overreaction in the marketplace."*

Stacy Yeung, Rockwood, and Crocs

Stacy Yeung and Rockwood Capital

- Financial Analyst at Rockwood Asset Mgt.
- Crocs fan, believed it was a sustainable brand
- Since IPO, accumulated Crocs in Rockwood portfolio
- Six fold increase in stock price since IPO
- Nov 1, 2007 precipitous decline
- Still behind Crocs investment as sustainable brand
- Time for new look at Crocs stock value

Crocs: Early Success

Proprietary resin: light, comfortable, odor-free

Comfort, function, low cost

Led to many types of customers

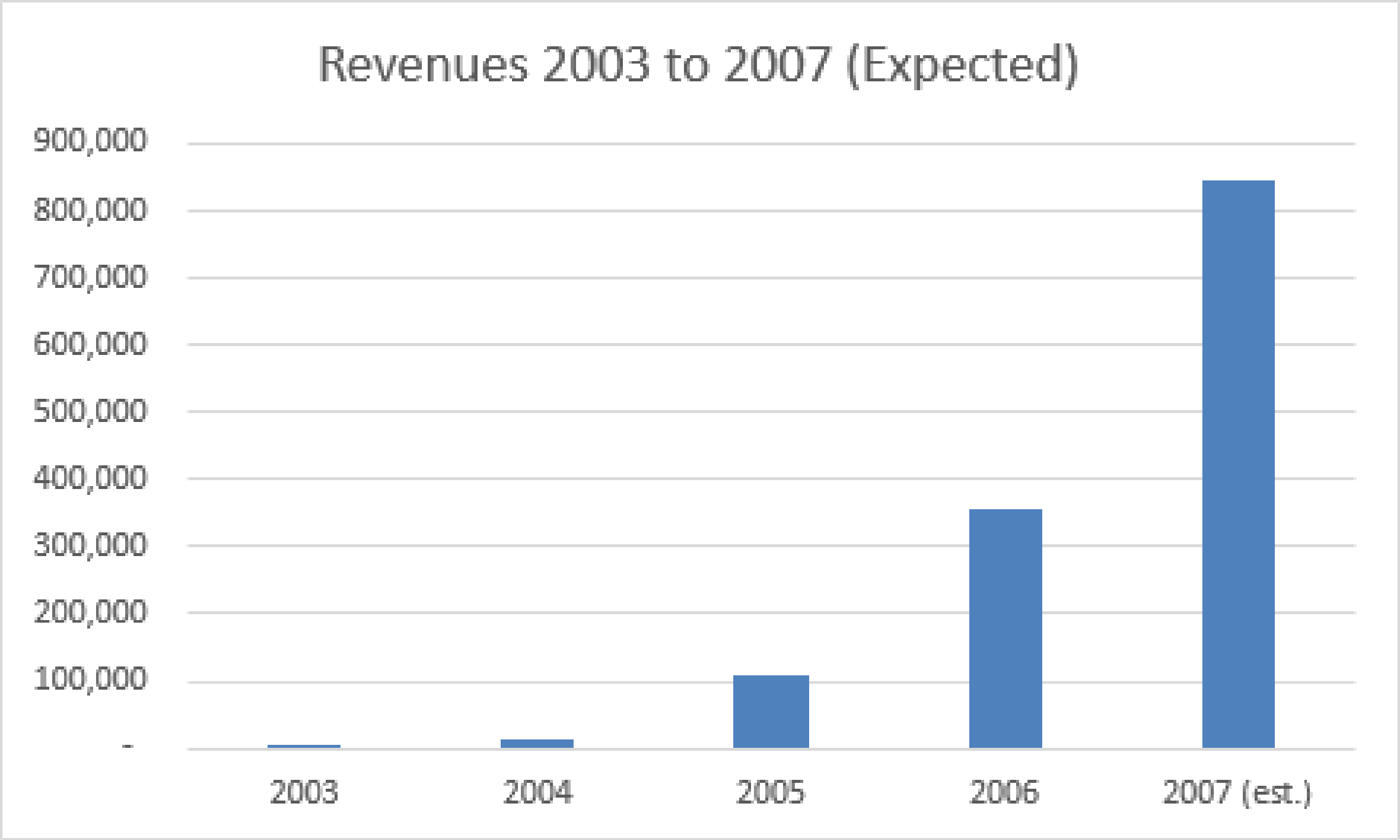
Expanded product line from 6 to 27 styles

Specialized footwear- healthcare, food industry

Distribution Channels very wide

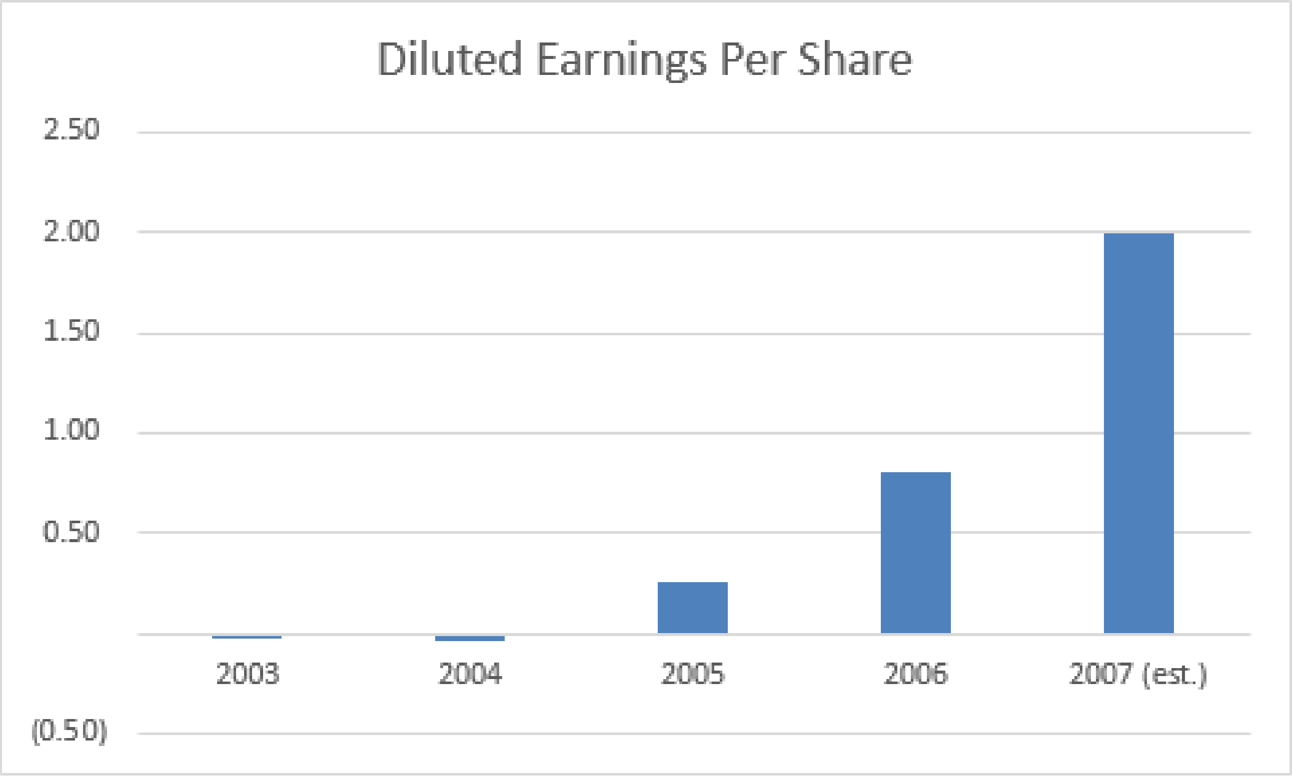
Specialty retail, sports and department stores, web, etc.

Revenues – 2003 to 2007



Earnings Per Share – 2003 to 2007

From (.03) to $2.00 over four years



Investment Thesis

Broad Appeal of Crocs footware

Sold in 90 countries worldwide

> 11,000 & > 8,000 domestic & international retail

High Revenue Growth

High operating margins, in 2006 = 27%

Economies of Scale

- 17% Crocs facilities in U.S., Italy, Brazil
- 83% of production in third party operated facilities
- Such as China, Vietnam, Bosnia, Romania

Growth – Both Organic and Aquisitions for Life Style Brand

Phenomenal Growth in Crocs Shoe

- High growth rates in U.S. and Canada
- High growth rates in Europe and Japan

Growth through Acquisition

- 2004 Foam Creations (proprietary Croslite material)
- 2006 Fury (hockey and lacrosse equipment)
- 2006 Jibbitz (charms that snap onto Crocs)
- 2007 Ocean Minded (recyclable materials)
- 2007 Bite (Golf, travel, adventure shoes)

Growth 2007 and Beyond

Natural maturation of Crocs products in U.S. and Canada

Rate of sales growth would moderate

Crocs’ targeted growth of new products

- Internally developed cool-weather models
- Continued acquisitions

Crocs’ targeted growth globally in new markets

- History shows potential for high penetration rates
- Global growth from new and fast growing markets
- Russia, Brazil, China, India

Industry Analysis: Casual Footwear and Apparel

Global, highly competitive

Low barriers to entry

- simple technology
- low capital requirements
- outsourcing

Retailers had bargaining power

- Shift inventory holding risk to manufacturers
- Favorable terms on pricing, advertising

Industry Analysis Continued

Competition Among Players

- brand awareness, distribution, marketing
- functionality, pricing, design

Demand

- State of economy and consumption
- Changes in consumer preferences

Footwear companies response

- Diversify into Apparel and build Life-Style Brand
- Customize merchandise, build brand loyalty

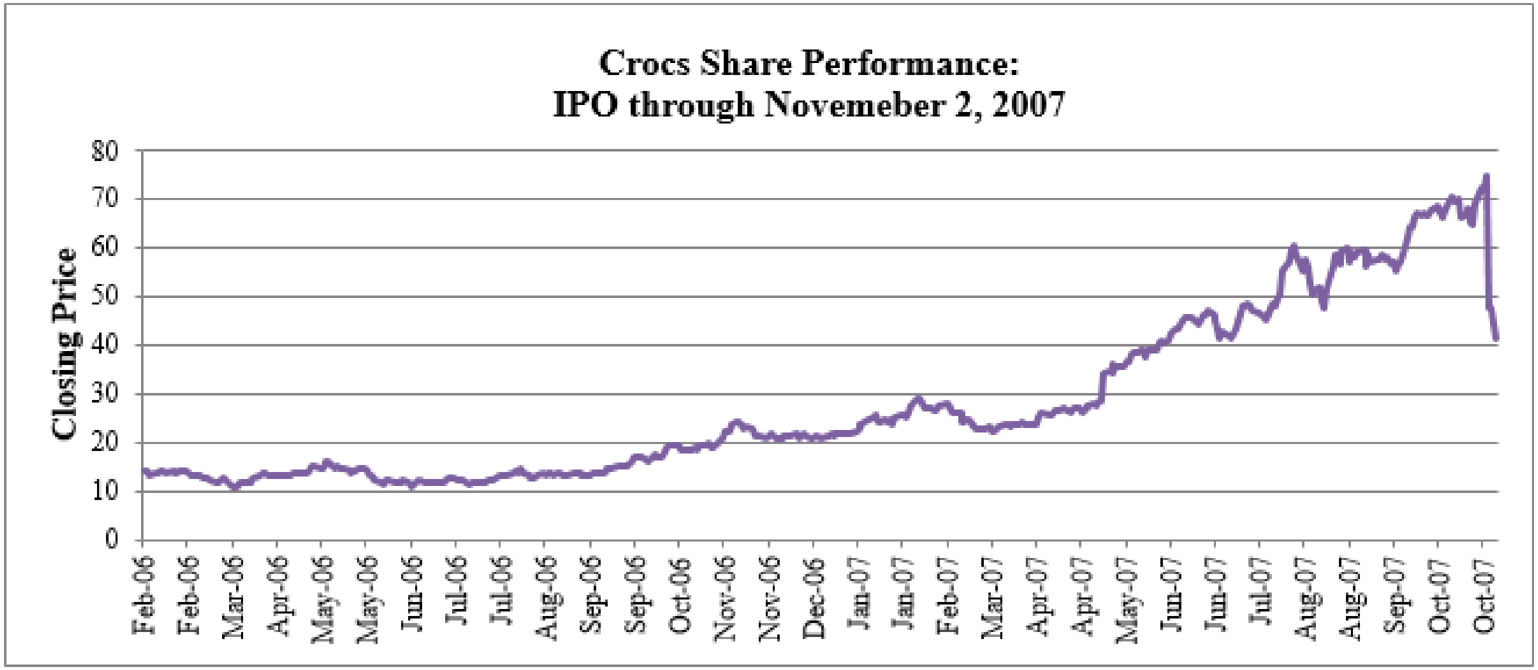
Risks of Crocs and Recent Success

From Company Financial Documents
- Limited operating history
- Management team relatively unproven
- Niche products so downside risk if popularity wanes
- Cheap imitations emerging

Since IPO Outstanding Success
- Company growth met market's very high expectations
- Top-line growth of 227% in 2006
- 130% or more expected in 2007

Crocs (CROX) Stock price October 2007 high of $74

Crocs Share Price Performance: IPO through November 2, 2007



Note: These prices are corrected for stock splits.

Crocs: Stock Price Meltdown; Decline of 36% to $47.74

Q3 2007 earnings call by Management mixed

- Q3 profits exceeded expectations
- Revenue guidance for 2007 = 130% growth
- Revenue guidance for 2008 = 55-65% growth
- *Market had expected that management would raise Q4 2007 earnings forecast but management did not*
- *Inventories Q3 increased 300% over last year*
  - Management, though, said build up intentional

Bullish Type Analyst Reaction

Yes, late 2007 economic growth in U.S. is slowing

Crocs is still a growth company, just not a hyper-growth company.

Crocs topped expectations this past quarter

Expectations were not "shattered" so the stock price fell

The velocity of the brand remains outstanding.

Crocs has outgrown the fad stage…it is here to stay

The decline from $74 to $47.74 is a temporary overreaction

Bearish Type Analyst Reaction

Late 2007 economic growth in U.S. is slowing

Management has yet to admit how quickly growth is fading and will slow

The market has yet to understand how quickly Crocs is losing traction

Customer interest is difficult to keep and grow

Crocs was all the rage and now that "fad" is over

The decline from $74 to $47.74 is just the beginning

Crocs is still overvalued

Yeung Reappraises latest DCF

Yeung reappraises her DCF and comps valuation

Latest DCF before earnings call

- 2007 Revenue Growth = 134%
- 2008 Revenue Growth = 65%
- Terminal Value Growth = 6% (high end)
- Market risk premium = 5.5% (low end)
- Original target price was $85
- Unlikely to actually get to $85 with updated news?

Should Yeung temper growth forecasts?

How would a bear or short side analyst model DCF?

Bullish Simplified DCF of Crocs- You do the Work

Bull might forecast beta risk estimate and thus discount rate as *lower*

Bull might estimate future CFs as *higher*

Discount Rate	11%			
BULL ANALYST				
Forecast Year		**1**	**2**	**3**
FCF		150	216	6360
PV of CFs (NPV)	X			
Number shares	85			
Stock Price Estimate	X			
Price Estimate / Target	X			
Current Price	X			
Upside / Downside	X			

Bearish Simplified DCF of Crocs- You do the Work

Bear might forecast beta risk estimate and thus discount rate as *higher*

Bear might estimate future CFs as *lower*

Discount Rate	13%			
BEAR ANALYST				
Forecast Year		**1**	**2**	**3**
FCF		100	144	4240
PV of CFs (NPV)	X			
Number shares	85			
Stock Price Estimate	X			

Price Estimate / Target	X
Current Price	X
Upside / Downside	X

Mean / Median Simplified DCF of Crocs- You do the Work

Market forecast of beta and discount rate is the median

Market estimate future CFs is also the median, TV year 3 included

Discount Rate	12%			
MEDIAN ANALYST				
Forecast Year		**1**	**2**	**3**
FCF		125	180	5300
PV of CFs (NPV)	X			
Number shares	85			
Stock Price Estimate	X			

Price Estimate / Target	X
Current Price	X
Upside / Downside	X

Solution Bullish Simplified DCF of Crocs

Bull might forecast beta risk estimate and thus discount rate as *lower*

Bull might estimate future CFs as *higher*

Discount Rate	11%			
BULL ANALYST				
Forecast Year		**1**	**2**	**3**
FCF		150	216	6360
PV of CFs	$4,960.82			
Number shares	85			
Stock Price Estimate	$58.36			

Price Estimate / Target	$58.36
Current Price	47.74
Upside / Downside	22.25%

Solution: Bearish Simplified DCF of Crocs

Bear might forecast beta risk estimate and thus discount rate as *higher*

Bear might estimate future CFs as *lower*

Discount Rate	13%			
BEAR ANALYST				
Forecast Year		**1**	**2**	**3**
FCF		100	144	4240
PV of CFs	$3,139.80			
Number shares	85			
Stock Price Estimate	$36.94			

Price Estimate / Target	$36.94
Current Price	47.74
Upside / Downside	-22.62%

Solution: Mean / Median Simplified DCF of Crocs

Market forecast of beta and discount rate is the median

Market estimate future CFs is also the median, TV year 3 included

Discount Rate	12%			
Median Analyst				
Forecast Year		**1**	**2**	**5**
FCF		125	180	5300
PV of CFs	$4,027.54			
Number shares	85			
Stock Price Estimate	$47.38			

Price Estimate / Target	$47.38
Current Price	47.74
Upside / Downside	-0.75%

Bull View Multiples Valuation – Five Comps from Apparel

Identifies 5 high growth companies (growth 54%)

Apparel: P/E = 43.59

Apparel: EV/EBITDA = 22.91

2007 per share data for Crocs:

- NI = 168; # shares = 84.19; EPS = 1.995
- EBITDA = 258
- Debt = .65
- Cash & Marketable Securities = 45.546

Bull View of Crocs – Do the work

Apparel: P/E = 43.59 **Example: Lululemon**

P/E Valuation = Comps' PE * company EPS

P/E Valuation = ______*1.995 = ________

Apparel: EV/EBITDA = 22.91

EV/EBITDA Valuation

= [Comps' EV/EBITDA * company EBITDA - debt + Cash] / # shares

=[(________* 258) - .65 + 45.546]/ 84.19 = ______

Average of two = _______

Bear / Hold Multiple View of Crocs

Footwear: P/E = 21.58 **Example: NIKE**

P/E Valuation = Comps' PE * company EPS

P/E Valuation = ______*1.995 = ________

Footwear: EV/EBITDA = 13.32

EV/EBITDA Valuation

= [Comps' EV/EBITDA * company EBITDA - debt + Cash] / # shares

=[(________* 258) - .65 + 45.546]/ 84.19 = ______

Average of two = _______

Solution: Bull View of Crocs – Do the work

Apparel: P/E = 43.59

P/E Valuation = Comps' PE * company EPS

P/E Valuation = **43.59** *1.995 = ***$86.96***

Apparel: EV/EBITDA = 22.91

EV/EBITDA Valuation

= [Comps' EV/EBITDA * company EBITDA - debt + Cash] / # shares

=[(22.91* 258) - .65 + 45.546]/ 84.19 = ***$70.74***

Average of two = **$78.85**

Solution: Bear / Hold View of Crocs

Footwear: P/E = 21.58 **Example: NIKE**

P/E Valuation = Comps' PE * company EPS

P/E Valuation = 21.58*1.995 = ***$43.05***

Footwear: EV/EBITDA = 13.32

EV/EBITDA Valuation

= [Comps' EV/EBITDA * company EBITDA - debt + Cash] / # shares

=[(13.32* 258) - .65 + 45.546]/ 84.19 = ***$41.35***

Average of two = **$42.20**