

Crocs, Inc (CROX)*“Initiating Coverage; International Markets Drive Revenue Growth; Attractive Valuations; BUY”***SUMMARY:**

Rating: **BUY**
 Current Price:(5/23/2008) **\$11.12**
 Intrinsic Value Est: **\$13.78**
 52 Wk Range: **\$9.53 - \$75.21**

SUMMARY:

Sector: **Consumer Goods**
 Industry: **Textile-Apparel, Footwear & Accessories**
 Asset Class: **Small Cap**

Year	2007	2008e	2009e
Sales (Net)	847	1,017	1,159
Earnings Per Share	\$2.00	\$1.67	\$1.92
Operating Profit Margin	28.1%	19.5%	19.5%
P/E Ratio	5.57	6.67	5.80
PEG Ratio	0.80	0.95	0.83
Price to Sales Ratio	1.08	0.90	0.79
Beta		1.2	
Dividend/Yield (%)	NA	NA	
LT Growth (%)		7%	
Shares Outstanding (mill)		82.49	
Market Cap (US \$ mill)		\$917.27	
FY Ends:		31-Dec	

CHART 1- STOCK PERFORMANCE HISTORY:

Company Description: Crocs, Inc. and its subsidiaries design, develop, and manufacture consumer products from specialty resins worldwide. The company primarily offers footwear for men, women, and children under the Crocs brand. It also offers apparel, gear, and accessories, including backpacks and messenger bags, kneepads, gloves, sticks, pants, shin guards, pads, spa pillows, and seats and pads for kayaks and canoes, as well as hockey and lacrosse equipment. The company sells its products through customer store locations, including company-operated kiosks and retail stores; Web stores; sporting goods and department stores; specialty retailers; and sales agents and buying groups. As of December 31, 2007, it operated 29 domestic and international retail stores, 174 domestic and international retail kiosks located in malls and other high foot traffic areas, and 6 outlet stores. The company was founded as Western Brands, LLC in 1999 and changed its name to Crocs, Inc. in 2005. Crocs, Inc. is based in Niwot, Colorado.

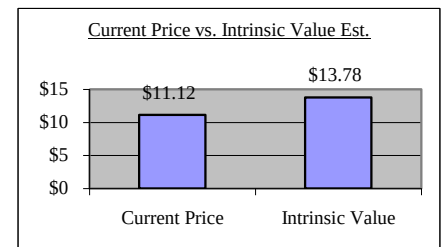
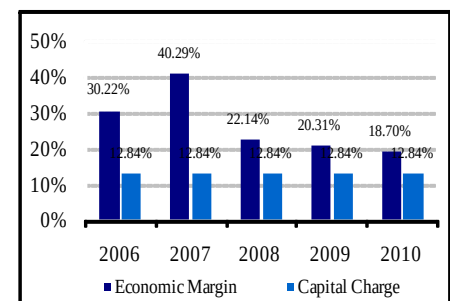
INVESTMENT RATIONALE:

5/26/2008

We initiate coverage on the shares of **Crocs, Inc (CROX)** with a **BUY** rating. Based on our *Shareholder Value Analysis*, the shares of CROX are trading at a 24% discount to our \$14/share intrinsic value estimate. The company's expected FY08 economic return of 22% is significantly above its 13% cost of capital, indicating the company's operations are creating shareholder value. Our BUY rating is based on the following factors.

Consistent Improvement in Sales: Over the past 9 quarters, CROX has reported double-digit revenue growth. Also, for its latest reported quarter (*Q1 FY08*), the company reported revenue growth of 40% y-o-y. We believe such strong revenue increase is commendable given the weak economic outlook in the U.S. Due to its diverse product-mix, the company has been able to offset the losses from one product against profits from other high-margin products. As the company is consistently reporting strong revenue growth, which has positive impact on its earnings outlook, we believe CROX is well positioned to create long-term shareholder value. Also, we believe the company's strategy of restructuring underperforming stores will improve its profitability over the medium term.

Outlook: CROX expects its FY08 revenue growth of 20% and its EPS to \$1.54-\$1.64. Strong revenue growth coupled with increase in market share and synergies from international operations should enable the company to meet its expectations. We are bullish on the company's ability to meet its guidelines. Further, given the initiatives to reduce inventory, decrease in head counts (*announced 669 job cuts recently*) and decision to close a Canadian operation should further reduce the company's operating costs and enable the company to meet its guidelines.

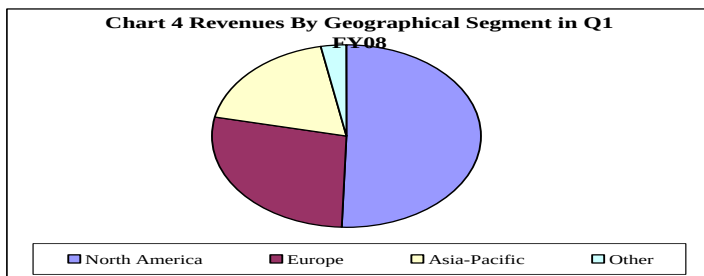
CHART 2: SHAREHOLDER VALUE ANALYSIS (EXHIBIT: V)**CHART 3: ECONOMIC RETURN ANALYSIS (EXHIBIT: VI)**

QUARTERLY SNAPSHOT:

Q1FY08 Results: CROX reported Q1 FY08 net revenues of \$198.54 million, up 40% compared to Q1FY07 (See Table 2, Page 5). The revenue was driven by higher sales of its footwear products, continued growth outside the U.S, primarily in Europe and Asia, and the favorable impact of foreign currency impact. Q1 FY08 SG&A expenses increased 63% y-o-y to \$76.98 million due to higher sales and advertising expenses. CROX had to incur \$14.60 million in impairment and restructuring charges in Q1 FY08. The company decided to close its operations in Canada and integrate it with its U.S operations. Accordingly, CROX reported operating loss of \$6.40 million in Q1 FY08 compared to operating income of \$37 million in Q1 FY07. Higher capital expenditure to open more new stores, coupled with higher term debt led to losses for CROX. Accordingly, CROX reported Q1 FY08 net loss of \$4.53 million, compared to net income of \$24.95 million in Q1 FY07.

INVESTMENT MERITS:**Global Diversification Should Reduce Concentration Risk:**

Although large chunk of revenues of CROX come from the U.S. markets (51% of total Q1FY08 revenues), the company is expanding into international markets (See Chart 4, Below). CROX's presence in fast-growing markets like China, India and Europe strengthen the company's revenue visibility. Due to its optimal mix of emerging markets in Asia-Pacific and developed nations in Europe, we believe CROX should be able to continue to earn higher profits. Strong rise in sales in Europe (109%) and Asia-Pacific (93 %,) should offset the relative weak sales growth in the U.S. (12%).



Compelling Valuation: CROX's current valuations look attractive compared to its peers (See Table; 1, Below). The company's gross margin, EBITDA margin and sales growth are way above its peers and industry average. CROX's ROA and ROE are at also higher than its peers and industry average. CROX's P/E and EV/EBITDA ratios are lower than its peers and industry average. These parameters justify our BUY rating on the stock.

TABLE:1 CROX's Comparable Valuations

	Ind Avg	CROX	DECK	NKE	TBL
Sales Growth	30.5	100	47.6	12.4	-7.3
Gross Margin%	45.8	55.1	46.5	44.5	45.9
EBIDTA Margin %	16.9	25.8	24.6	16.2	8.7
ROA	15.5	27.4	22.4	16.6	6
ROE	21.4	39.5	25.6	25.3	8.4

Retail Industry Sales Set to Improve: In January 2008, the National Retail Federation (NRF) released its 2008 economic forecast, in which it predicts retail industry sales (excluding automobiles, gas stations, and restaurants) will increase 3.5% compared to 2007. Consumer spending represents approximately 70% of the U.S. economy, and a 3.5% increase should have strong positive trickle-down impact on companies such as CROX.

INVESTMENT CONCERNS:

Inventory Pile up A Cause for Concern: CROX's was unable to meet its growing demand and hence resorted to over production in FY07. Due to lower sales in the U.S, the company is forced with out of style inventory of shoes. We expect the company to clear the excess inventory by resorting to price markdowns. Further, price markdowns could impact the company's profit margin adversely in the near term.

Weak Recent Consumer Spending Trends: As per a survey by Discover Financial Services, consumer spending was at 85.4. Consumer spending accounts for two-thirds of total economic activity in the U.S. We believe the levels signal lack of confidence among consumers, burdened with higher gasoline prices, rising household expenses and the fallout from the sub-prime mortgage crisis. We believe weak trend in consumer spending will weigh on the company's business over the medium term.

CONCLUSIONS:

We initiate coverage on the shares of **Crocs, Inc (CROX)** with a **BUY** rating. Based on our *Shareholder Value Analysis*, the shares of CROX are trading at a 24% discount to our \$14/share intrinsic value estimate. The company's expected FY08 economic return of 22% is significantly above its 13% cost of capital, indicating the company's operations are creating shareholder value.

Our **BUY** rating is based on:

- CROX has a niche market for its products and we believe the demand should increase further.
- Internet business should generate additional revenue and help the company reduce its operating costs.
- Focus on reducing the inventory should help the company drive its profitability.
- International diversification should ensure consistent revenue growth in the long term.

In addition, we also expect the company to generate investment yield of 9% (i.e. average five year free cash flow by market capitalization). Hence, based on (1) attractive valuation, (2) strong economic profit, (3) cost-savings moves and (4) international expansion initiatives, we initiate with a **BUY**.

Exhibit I: Income Statement (in millions of U.S. \$)

	2006	2007	2008e	2009e	2010e	2011e	2012e
Sales (Net)	355	847	1,017	1,159	1,298	1,389	1,459
Cost of Goods Sold	146	329	473	545	617	660	693
Gross Profit	209	519	544	614	682	729	766
SG&A	105	260	325	365	402	438	467
Earnings Before Interest, Taxes, & Depreciation	103	259	219	249	279	292	299
Depreciation & Amortization	8	21	20	23	26	28	29
Operating Profit	95	238	198	226	253	264	270
Other Revenues & Gains	1	0	0	0	0	0	0
Earnings before Interest & Taxes	97	238	198	226	253	264	270
Total Interest Income	0	3	1	3	5	9	14
Total Interest Expense	0	0	3	3	3	3	3
Earnings Before Taxes	97	240	197	226	255	270	280
Total Taxes	32	72	59	68	77	81	84
Net Income	64	168	138	158	179	189	196
Earnings Per Share	\$0.80	\$2.00	\$1.67	\$1.92	\$2.17	\$2.29	\$2.38
Shares Outstanding (Diluted)	80	84	82	82	82	82	82

Exhibit II: Balance Sheet (in millions of U.S. \$)

	2006	2007	2008e	2009e	2010e	2011e	2012e
Total Cash & Marketable Securities	68	37	76	135	218	342	489
Accounts Receivable	66	153	181	206	231	247	259
Inventory	86	248	362	418	473	506	530
Other Current Assets	18	30	31	31	32	32	33
Total Current Assets	238	468	649	791	954	1,128	1,311
Gross Fixed Assets	44	115	172	233	295	350	403
Less: Accumulated Depreciation	9	27	48	71	97	124	154
Net Fixed Assets	35	88	125	162	198	226	249
Other Assets	27	71	74	74	75	75	76
TOTAL ASSETS	299	627	848	1,027	1,227	1,429	1,637
Accounts Payable	44	83	116	134	152	163	170
Notes Payable	1	7	43	43	43	43	43
Other Current Liabilities	44	77	79	80	81	82	83
Total Current Liabilities	88	167	238	257	276	288	296
Total Long-Term Debt	0	0	0	0	0	0	0
Deferred Income Taxes	2	2	2	2	2	2	2
Other Liabilities	1	14	16	18	20	22	24
Total Liabilities	91	183	255	277	298	311	322
Total Equity	208	444	592	750	929	1,118	1,314
TOTAL LIABILITIES & EQUITY	299	627	848	1,027	1,227	1,429	1,637

Exhibit III: Ratio Analysis

	2006	2007	2008e	2009e	2010e	2011e	2012e	5 Yr Avg.
Sales Growth Rate (G) (%)	226.69	138.87	20.00	14.00	12.00	7.00	5.00	11.60
Change in Earnings Per Share (%)	298.40	148.80	(16.50)	14.92	13.05	5.51	4.04	4.20
Cost of Capital (K) (%)	12.84	12.84	12.84	12.84	12.84	13.00	13.00	12.91
Earnings Per Share	0.80	2.00	1.67	1.92	2.17	2.29	2.38	2.08
Free Cash Flow Per Share	(0.32)	(0.57)	(0.05)	0.70	0.96	1.42	1.64	0.93
Capital Expenditure Per Share	0.30	0.70	0.69	0.73	0.76	0.67	0.64	0.70
Sales Per Share	4.42	10.27	12.33	14.05	15.74	16.84	17.68	15.33
Book Value Per Share	2.60	5.38	7.18	9.10	11.27	13.55	15.93	11.41
Shares Outstanding	80.17	84.19	82.49	82.49	82.49	82.49	82.49	82.49
Gross Profit Margin (%)	58.81	61.20	53.50	53.00	52.50	52.50	52.50	52.80
Operating Profit Margin (P) (%)	26.88	28.06	19.50	19.50	19.50	19.00	18.50	19.20
Return on Assets or Investment (%)	21.51	26.88	16.59	15.69	14.82	13.41	12.18	14.54
Return on Equity (%)	30.92	37.88	23.23	21.07	19.24	16.87	14.93	19.07
Days in Receivables	67	66	65	65	65	65	65	65.00
Days in Payables	109	92	90	90	90	90	90	90.00
Days in Inventory	215	276	279	280	280	280	279	279.69
Fixed Asset Turnover	10.18	9.61	8.15	7.16	6.55	6.15	5.85	6.77
Debt/Total Capital (%)	0.31	1.58	6.74	5.39	4.40	3.69	3.15	4.67
Current Ratio	2.70	2.79	2.73	3.08	3.46	3.92	4.42	3.52
Working Capital	150	301	411	534	678	840	1,015	695.75
Price to Sales Ratio	4.28	2.07	1.55	1.22	0.99	0.82	0.70	1.06
Price to Earnings Ratio	13.85	5.57	6.67	5.80	5.13	4.86	4.67	5.43

Exhibit IV: Cash Flow Statement (in million of U.S. \$)

	2006	2007	2008e	2009e	2010e	2011e	2012e
Net Income	64	168	138	158	179	189	196
Depreciation Expense (Funds)	8	21	20	23	26	28	29
Total Interest Expense	0	0	3	3	3	3	3
Less: Non-Operating Profit	1	3	1	3	5	9	14
Less: Extraordinary Items	(0)	0	(0)	0	0	0	0
Funds from Operations After Tax	71	187	160	181	203	211	215
Less: Working Capital Consumption	(73)	(177)	(107)	(63)	(61)	(38)	(27)
Cash from Operating Cycle	(2)	10	53	118	141	173	188
Less: Fixed Capital Investment	24	57	57	60	62	56	53
Less: Additions to Goodwill & Intangibles	18	32	2	0	0	0	0
Add: Proceeds from Asset Sales & Other	(3)	(4)	2	2	2	2	2
Operating Cash Flow after Capex	(47)	(84)	(5)	60	81	119	137
Add: Non-Operating Income	(2)	(18)	1	2	5	8	13
Less: Interest Expense	0	0	3	3	3	3	3
Less: Dividends	0	0	0	0	0	0	0
Free Cash Flow	(50)	(102)	(7)	59	82	124	147
Cash Flow from Debt Financing	(11)	6	36	0	0	0	0
Cash Flow from Equity Financing	118	105	11	0	0	0	0
Net Cash Flow	57	9	39	59	82	124	147

Exhibit V: Shareholder Value Analysis

Year	Cash Flow	PV Cashflow	Cum PV Cashflow
2008e	(5)	(4)	(4)
2009e	60	47	43
2010e	81	56	99
2011e	119	74	173
2012e	137	75	248
2013e	150	72	320
2014e	167	71	391
2015e	183	69	460
2016e	188	62	523
2017e	187	55	577
2018e	193	50	627
2019e	196	44	671
PV of Residual Value			469
Cum. PV of Cash Flows and Residual Value			1,140
Total Marketable Securities			33
Long-Term Funding Asset			0
Investments in Stocks and Bonds			6
Corporate Value			1,180
Market Value of Debt			43
Underfunded Pension Liabilities			0
Market Value of Other Obligations			0
Shareholder Value			1,137
Divided by Shares o/s			82
Shareholder Value per Share (PV)			\$13.78
Current Stock Price			\$11.12
Premium/Discount to Current Price			23.9%

PV Cashflow is calculated by discounting cashflows using the company's cost of capital.

Exhibit VI: Economic Profit Analysis

	*Adjusted NOPAT	Capital - Charge	Excess = Returns	Economic Margin	Cost of - Capital	Excess = Returns
2006	63	27	36	30.2%	12.8%	17.4%
2007	182	58	124	40.3%	12.8%	27.4%
2008	141	82	59	22.1%	12.8%	9.3%
2009	161	102	59	20.3%	12.8%	7.5%
2010	182	125	57	18.7%	12.8%	5.9%

Adjusted NOPAT: Net operating profit after tax

Adj Capital Base= Debt, Equity, and Min Int

Capital Charge: Cost of capital * Adj Capital Base

Economic Margin : A djusted NOPAT / Adjusted Capital Base

RECENT FINANCIAL PERFORMANCE:

TABLE 2: (Amount in US \$ except EPS)	Q1FY08	Net Sales	Q1FY07	% of Net Sales	% Change
Net Sales	198.54		142.00		40%
COGS	113.31	57.07%	57.52	40.50%	97%
Gross Profit	85.24	42.93%	84.49	59.50%	1%
SG&A	76.98	38.77%	47.33	33.33%	63%
Restructuring Charges	3.85	3.40%	0.00	0.00%	NM
Impairment Charges	10.81	NM			
Operating Inc/Loss	(6.40)	-7.51%	37.16	43.98%	-117%
Interest Expense	0.37	0.19%	0.06	0.04%	493.65%
Other Inc/Expenses	(0.36)		(0.52)		NM
Loss/Inc before Taxes	(6.42)	-3.23%	37.61	26.49%	-117%
Income Tax	(1.89)	-0.95%	12.67	8.92%	NM
Net Income/Loss	(4.53)	-2.28%	24.95	17.57%	-118%
Diluted Loss/Share	(\$0.05)		\$0.30		-118%
Dilutes Shares O/S	82.488		82.439		0%

Exhibit VII: Peer Group Analysis

Name	Current Price	Mkt Cap (In Millions)	FY P/E	Consensus EPS Growth Rate	EPS Revision 4 wks	Intrinsic Value Est.	Economic Returns	Cost of Capital	BOE Rating
Crocs, Inc	\$11.12	\$917	6.67	7%	\$0.01	\$13.78	22.1%	12.8%	BUY
NIKE INC CL B	\$64.77	\$1,910	16.36	NC	\$0.06	\$70.66	19.20%	10.0%	HOLD
DECKERS OUTDOOR CP	\$130.94	\$1,710	16.96	NC	NC	NC	NC	NC	NC
TIMBERLAND CO A	\$17.51	\$1,040	17.17	NC	NC	NC	NC	NC	NC

NC denotes Not Covered

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