

Crocs, Inc.  
Form 10-Q  
August 14, 2007

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended **June 30, 2007**

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. **000-51754**

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## Crocs, Inc.

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**20-2164234**  
(I.R.S. Employer  
Identification No.)

**6328 Monarch Park Place, Niwot Colorado 80503**

(Address of Registrant's principal executive offices)

**(303) 848-7000**

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of July 31, 2007, Crocs, Inc. had 81,548,116 shares of its \$0.001 par value common stock outstanding.

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Crocs Inc.  
Form 10-Q  
Quarter Ended June 30, 2007  
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**PART I FINANCIAL INFORMATION****ITEM 1. Financial Statements**

**CROCS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands, except share and per share data)  
(Unaudited)

|  | Three Months Ended June 30, |            | Six Months Ended June 30, |            |
|--|-----------------------------|------------|---------------------------|------------|
|  | 2007                        | 2006       | 2007                      | 2006       |
| Revenues   | \$ 224,273                  | \$ 85,635  | \$ 366,275                | \$ 130,477 |
| Cost of sales  | 92,329                      | 38,665     | 149,845                   | 59,828     |
| Gross profit   | 131,944                     | 46,970     | 216,430                   | 70,649     |
| Selling, general and administrative expense          | 63,472                      | 23,312     | 110,799                   | 36,978     |
| Income from operations                               | 68,472                      | 23,658     | 105,631                   | 33,671     |
| Interest expense                                     | 51                          | 92         | 115                       | 391        |
| Other income net                                     | (399 )                      | (366 )     | (915 )                    | (662 )     |
| Income before income taxes                           | 68,820                      | 23,932     | 106,431                   | 33,942     |
| Income tax expense                                   | 20,369                      | 8,266      | 33,035                    | 11,835     |
| Net income   | 48,451                      | 15,666     | 73,396                    | 22,107     |
| Dividends on redeemable convertible preferred shares |                             |            |                           | 33         |
| Income attributable to common stockholders           | \$ 48,451                   | \$ 15,666  | \$ 73,396                 | \$ 22,074  |
| Income per common share: (note 4)                    |                             |            |                           |            |
| Basic  | \$ 0.60                     | \$ 0.20    | \$ 0.92                   | \$ 0.31    |
| Diluted  | \$ 0.58                     | \$ 0.19    | \$ 0.88                   | \$ 0.28    |
| Weighted average common shares:                      |                             |            |                           |            |
| Basic  | 80,253,555                  | 76,573,750 | 79,761,491                | 71,217,747 |
| Diluted  | 83,686,108                  | 80,855,402 | 83,066,178                | 78,702,492 |

See notes to condensed consolidated financial statements.

**CROCS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data)  
(Unaudited)

|   | As of<br>June 30, 2007 | December 31, 2006 |
|---|------------------------|-------------------|
| <b>ASSETS</b>   |                        |                   |
| Current assets:   |                        |                   |
| Cash and cash equivalents   | \$ 61,262              | \$ 42,656         |
| Restricted cash   | 3,726                  | 2,890             |
| Short-term investments  | 24,390                 | 22,325            |
| Accounts receivable, net  | 117,345                | 65,588            |
| Inventories   | 118,647                | 86,210            |
| Deferred tax assets   | 3,694                  | 3,690             |
| Prepaid income tax  |                        | 4,715             |
| Prepaid expenses and other current assets   | 14,581                 | 9,617             |
| Total current assets  | 343,645                | 237,691           |
| Property and equipment, net   | 55,994                 | 34,849            |
| Goodwill  | 22,931                 | 11,552            |
| Intangible assets, net  | 19,020                 | 12,210            |
| Deferred tax assets, net  | 1,591                  | 1,280             |
| Other assets  | 9,128                  | 1,875             |
| Total assets  | \$ 452,309             | \$ 299,457        |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                        |                   |
| Current liabilities:  |                        |                   |
| Accounts payable  | \$ 59,806              | \$ 43,794         |
| Accrued expenses and other current liabilities  | 54,337                 | 31,109            |
| Income taxes payable  | 6,084                  | 12,465            |
| Note payable, current portion of long-term debt and capital lease obligations   | 280                    | 541               |
| Total current liabilities   | 120,507                | 87,909            |
| Long-term debt and capital lease obligations, net of current portion  | 71                     | 116               |
| Deferred tax liabilities  | 1,844                  | 1,688             |
| Other liabilities   | 7,122                  | 1,486             |
| Total liabilities   | 129,544                | 91,199            |
| Commitments and contingencies (note 8)  |                        |                   |
| Stockholders' equity:   |                        |                   |
| Common shares, par value \$0.001 per share; 250,000,000 shares authorized, 81,019,866 and 78,681,418 shares issued and outstanding in 2007 and 2006 | 81                     | 77                |
| Preferred shares, par value \$0.001 per share; 5,000,000 shares authorized, no shares issued and outstanding in 2007 and 2006                       |                        |                   |
| Additional paid-in capital  | 169,399                | 131,796           |
| Deferred compensation   | (3,782 )               | (5,702 )          |
| Retained earnings   | 154,477                | 81,081            |
| Accumulated other comprehensive income  | 2,590                  | 1,006             |
| Total stockholders' equity  | 322,765                | 208,258           |
| Total liabilities and stockholders' equity  | \$ 452,309             | \$ 299,457        |

See notes to condensed consolidated financial statements.

**CROCS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)  
(Unaudited)

|  | <b>For the Six Months<br/>Ended June 30,</b> |             |
|--|--|-------------|
|  | <b>2007</b>                                  | <b>2006</b> |
| <b>Cash flows from operating activities:</b>   |  |             |
| Net income   | \$ 73,396                                    | \$ 22,107   |
| <b>Adjustments to reconcile net income to net cash provided by (used in) operating activities:</b> |  |             |
| Depreciation and amortization  | 7,523  | 3,218       |
| Loss on disposal of fixed assets   | 135  | 479         |
| Unrealized foreign exchange rate   | (2,048 )                                     |             |
| Deferred income taxes  | (297 )                                       | (113 )      |
| Share-based compensation   | 9,728  | 4,399       |
| Excess tax benefit on share-based compensation   | (21,245 )                                    | (1,281 )    |
| Bad debt expense   | 667  | 877         |
| <b>Changes in operating assets and liabilities:</b>  |  |             |
| Accounts receivable  | (51,586 )                                    | (30,084 )   |
| Inventories  | (29,426 )                                    | (12,118 )   |
| Prepaid expenses and other assets  | (10,036 )                                    | (1,481 )    |
| Accounts payable   | 13,426                                       | (5,225 )    |
| Accrued expenses and other liabilities   | 32,707                                       | 4,543       |
| Cash provided by (used in) operating activities  | 22,944                                       | (14,679 )   |
| <b>Cash flows from investing activities:</b>   |  |             |
| Purchases of short-term investments  | (29,100 )                                    |             |
| Sales of short-term investments  | 27,035                                       |             |
| Cash paid for purchases of property and equipment  | (24,693 )                                    | (6,892 )    |
| Cash paid for intangible assets  | (4,217 )                                     | (1,421 )    |
| Acquisition of businesses, net of cash acquired  | (2,665 )                                     |             |
| Restricted cash  | (773 )                                       |             |
| Cash used in investing activities  | (34,413 )                                    | (8,313 )    |
| <b>Cash flows from financing activities:</b>   |  |             |
| Proceeds from note payable, net  |  | 1,801       |
| Repayment of long-term debt and capital lease obligations  | (205 )                                       | (11,957 )   |
| Proceeds from initial public offering, net of offering costs                                       |  | 94,454      |
| Excess tax benefit on share-based compensation   | 21,245                                       | 1,281       |
| Exercise of stock options  | 8,554  | 11          |
| Payment of preferred dividends   |  | (171 )      |
| Cash provided by financing activities  | 29,594                                       | 85,419      |
| Effect of exchange rate changes on cash  | 481  | (197 )      |
| Net increase in cash and cash equivalents  | 18,606                                       | 62,230      |
| Cash and cash equivalents beginning of period  | 42,656                                       | 4,787       |
| Cash and cash equivalents end of period  | \$ 61,262                                    | \$ 67,017   |
| <b>Supplemental disclosure of cash flow information cash paid during the period for:</b>           |  |             |
| Interest   | \$ 147                                       | \$ 219      |
| Income taxes   | \$ 10,216                                    | \$ 14,206   |
| <b>Supplemental disclosure of non-cash, investing, and financing activities:</b>                   |  |             |
| In conjunction with the acquisitions made liabilities were assumed as follows:                     |  |             |
| Fair value of assets acquired  | \$ 3,827                                     |             |
| Cash paid for capital stock  | 2,233  |             |
| Liabilities assumed  | \$ 1,594                                     |             |
| Assets acquired under capitalized leases   | \$   | \$ 563      |
| Accrued purchases of property and equipment  | \$ 1,456                                     |             |
| Accrued Jibbitz purchase price   | \$ 3,500                                     |             |

See notes to condensed consolidated financial statements.

**CROCS, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The accompanying condensed consolidated financial statements of Crocs, Inc. and subsidiaries (collectively, "Crocs" or the "Company") have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the rules and regulations for reporting on Form 10-Q. Accordingly, they do not include certain information and disclosures required for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature. Operating results for the three and six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2007.

These statements should be read in conjunction with the consolidated financial statements and footnotes included in the Company's Form 10-K for the year ended December 31, 2006. Except for derivatives and hedging activities, which are described below, the accounting policies used in preparing these condensed consolidated financial statements are the same as those described in Note 2 to the consolidated financial statements in the Company's Form 10-K.

*Accounting for Derivatives and Hedging Activities*

The Company uses derivative financial instruments to limit exposure to changes in foreign currency exchange rates. The Company accounts for derivatives pursuant to the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"), as amended and interpreted. FAS 133 establishes accounting and reporting standards for derivative instruments and requires that all derivatives be recorded at fair value on the balance sheet. Changes in the fair value of derivative financial instruments are either recognized in other comprehensive income (a component of stockholders' equity) or net income depending on whether the derivative is being used to hedge changes in cash flows or fair value.

**Stock Split**

On May 2, 2007, the Board of Directors declared a two-for-one stock split of the Company's common shares, which was effected in the form of a 100% common stock dividend distributed on June 14, 2007. All references to share and per share amounts in the consolidated financial statements and accompanying notes to the consolidated financial statements have been retroactively restated to reflect the two-for-one stock split.

**Income Taxes**

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 requires the use of a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in a tax return and disclosures regarding uncertainties in income tax positions. The Interpretation is effective for fiscal years beginning after December 15, 2006. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized on adoption of FIN 48. The adoption of FIN No. 48 did not have a material impact on the Company's condensed consolidated balance sheet, statement of operations or cash flows. The Company had a liability for unrecognized tax benefits of \$614,000 at January 1, 2007 and \$2.0 million as of June 30, 2007. The

Company expects that the requirements of FIN 48 may add volatility to its effective tax rate and therefore the expected income tax expense in future periods.

Interest and penalties related to income tax liabilities are included in income tax expense. The balance of accrued interest and penalties recorded in the consolidated statement of operations at January 1, 2007 was \$128,000 related to the adoption of FIN 48 and additional \$226,000 and \$289,000 accrued during the three and six months ended June 30, 2007 for a total of \$417,000.

The Company is potentially subject to U.S. federal, state and local or non-U.S. income tax audits by taxing authorities for years 2005 and 2006. In addition, the Company's Canadian subsidiary, Foam Creations, is potentially subject to Federal and Provincial income tax audits for years 2002 through 2006.

## 2. RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurement* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The Statement is effective for financial statements issued for the first annual or interim reporting period beginning after November 15, 2007. The Company will adopt SFAS 157 effective January 1, 2008. The Company is currently evaluating the impact this new standard will have on its future results of operations and financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 will be effective at the beginning of fiscal 2008. The Company is currently evaluating the impact this new standard will have on its future results of operations and financial position.

## 3. STOCK-BASED COMPENSATION

During the three months ended June 30, 2007, the Company issued 392,200 options to purchase shares of its common stock to eligible employees with a weighted average grant date fair value of \$18.93 and a weighted average exercise price of \$38.36. In the three months ended March 31, 2007, the Company issued 1,050,000 options to purchase shares of its common stock to executive officers for the 2007 annual grant, with grant date fair values of \$11.22 and \$11.90 per share and exercise prices of \$22.92 and \$24.36 per share. The Company also granted in the three months ended March 31, 2007, to eligible employees 807,100 options to purchase shares of its common stock with grant date fair values of \$11.78 and \$11.90 and exercise prices of \$23.93 and \$24.36 per share, respectively. All options granted will vest ratably over four-years with the first year a cliff basis and monthly vesting for the remaining three years. Compensation expense is recognized equally over the four year vesting period.

Stock-based compensation, including options and non-vested shares, was \$5.2 million and \$9.7 million in the three and six months ended June 30, 2007, respectively, and \$2.5 million and \$4.4 million in the three and six months ended June 30, 2006. For the three and six months ended June 30, 2007, \$1.1 million and \$1.8 million, respectively, of the stock-based compensation was capitalized in inventory as part of the overhead allocation and intangible assets in the condensed consolidated balance sheet. During the three and six months ended June 30, 2007, 926,448 and 2,046,424 options to purchase common shares were exercised, 222,763 and 366,379 options to purchase common stock were forfeited, and 253,092 and 282,300 shares of restricted stock vested, respectively.

## 4. EARNINGS PER SHARE

Basic income per common share ( EPS ) is computed by dividing the net income available to common stockholders by the weighted average number of common shares outstanding for the period.



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Diluted EPS reflects the potential dilution from securities that could share in the earnings of the Company. Antidilutive securities are excluded from diluted EPS (in thousands except share and per share data).

|   | Three Months Ended June 30, |            | Six Months Ended June 30, |            |
|---|-----------------------------|------------|---------------------------|------------|
|   | 2007                        | 2006       | 2007                      | 2006       |
| <b>Reconciliation of net income for dilutive computation:</b> |                             |            |                           |            |
| Income attributable to common stockholders                    | \$ 48,451                   | \$ 15,666  | \$ 73,396                 | \$ 22,107  |
| Preferred dividend  |                             |            |                           | 33         |
| Net income for dilutive computation                           | \$ 48,451                   | \$ 15,666  | \$ 73,396                 | \$ 22,074  |
| <b>Basic income per common share:</b>                         |                             |            |                           |            |
| Weighted average common shares outstanding                    | 80,253,555                  | 76,573,750 | 79,761,491                | 71,217,747 |
| Basic income per common share                                 | \$ 0.60                     | \$ 0.20    | \$ 0.92                   | \$ 0.31    |
| <b>Diluted income per common share:</b>                       |                             |            |                           |            |
| Weighted average common shares outstanding                    |                             |            |                           |            |
| Dilutive effect of preferred stock                            |                             |            |                           | 3,211,700  |
| Dilutive effect of stock options                              | 3,068,111                   | 3,050,885  | 2,865,739                 | 3,048,306  |
| Dilutive effect of unvested stock                             | 364,442                     | 1,230,767  | 438,948                   | 1,224,739  |
| Weighted average diluted common shares outstanding            | 83,686,108                  | 80,855,402 | 83,066,178                | 78,702,492 |
| Diluted income per common share                               | \$ 0.58                     | \$ 0.19    | \$ 0.88                   | \$ 0.28    |

For both the three and six months ended June 30, 2007 and 2006 there were options outstanding to purchase 263,000 and 3.2 million shares of the Company's common stock with a weighted-average exercise price per share of \$42.61 and \$11.27, respectively, which could potentially dilute basic earnings per share in the future, but which were not included in diluted earnings per share as their effect was antidilutive.

### 5. SHORT-TERM INVESTMENTS

At June 30, 2007, the Company's short-term investments consisted exclusively of auction rate securities. Auction rate securities are variable rate bonds of states and joint municipal agencies tied to short-term interest rates with maturities on the face of the underlying securities in excess of 90 days. These securities have interest rate resets through a modified Dutch auction, at pre-determined short-term intervals, usually every 7, 28 or 35 days. They trade at par and are callable at par on any interest payment date at the option of the issuer. Interest paid during a given period is based on the interest rate determined during the prior auction. The Company recorded such securities as short-term investments based on the short-term nature and structure, the frequency with which the interest rate resets and the ability to sell auction rate securities at par and at the Company's discretion with the intent of meeting the Company's short-term working capital requirements.

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Investments in auction rate securities are classified as available-for-sale and are reported at fair value in the Company's consolidated balance sheets. There were no unrealized gains or losses as of June 30, 2007. The following table summarizes the contractual maturities of available-for-sale securities at June 30, 2007 and December 31, 2006. (in thousands).

|                                    | June 30,<br>2007 | December 31,<br>2006 |
|------------------------------------|------------------|----------------------|
| Within one year                    | \$               | \$                   |
| After one year through five years  |                  |                      |
| After five years through ten years | 2,000            |                      |
| After ten years                    | 22,390           | 22,325               |
|                                    | \$ 24,390        | \$ 22,325            |

Proceeds from sales of short-term investments totaled \$13.1 million and \$27.0 million in the three and six months ended June 30, 2007, respectively. Purchases of short-term investments totaled \$28.1 million and \$29.1 million in the three and six months ended June 30, 2007, respectively. There were no realized gains or losses related to the sales of short-term investments in the three and six months ended June 30, 2007.

### 6. INVENTORIES

Inventories by major classification are as follows (in thousands):

|                  | June 30,<br>2007 | December 31,<br>2006 |
|------------------|------------------|----------------------|
| Finished goods   | \$ 104,564       | \$ 78,938            |
| Work-in-progress | 1,172            | 445                  |
| Raw materials    | 12,911           | 6,827                |
|                  | \$ 118,647       | \$ 86,210            |

### 7. GOODWILL AND INTANGIBLE ASSETS

The following table summarizes the Company's identifiable intangible assets as of June 30, 2007 and December 31, 2006 (in thousands):

|                                      | June 30, 2007               |                             |                           | December 31, 2006           |                             |                           |
|--------------------------------------|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
|                                      | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
| Finite lived intangible assets:      |                             |                             |                           |                             |                             |                           |
| Patents, copyrights, and trademarks  | \$ 2,182                    | \$ 51                       | \$ 2,131                  | \$ 1,441                    | \$ 12                       | \$ 1,429                  |
| Customer relationships               | 4,717                       | 1,498                       | 3,219                     | 3,547                       | 657                         | 2,890                     |
| Core technology                      | 4,541                       | 2,729                       | 1,812                     | 4,154                       | 2,082                       | 2,072                     |
| Non-competition agreement            | 636                         | 276                         | 360                       | 636                         | 212                         | 424                       |
| Capitalized software                 | 12,086                      | 741                         | 11,345                    | 5,516                       | 274                         | 5,242                     |
| Total finite lived intangible assets | \$ 24,162                   | \$ 5,295                    | \$ 18,867                 | \$ 15,294                   | \$ 3,237                    | \$ 12,057                 |
| Indefinite lived intangible assets:  |                             |                             |                           |                             |                             |                           |
| Jibbitz trade name                   | \$ 153                      | \$                          | \$ 153                    | \$ 153                      | \$                          | \$ 153                    |
| Total intangible assets              | \$ 24,315                   | \$ 5,295                    | \$ 19,020                 | \$ 15,447                   | \$ 3,237                    | \$ 12,210                 |

On January 31, 2007, the Company acquired substantially all of the assets of Ocean Minded, LLC ( Ocean Minded ) for \$1.75 million in cash, plus a potential earn-out of up to \$3.75 million based on Ocean Minded hitting certain earnings targets over a three year period. Ocean Minded is a designer and manufacturer of high quality leather and EVA (Ethylene Vinyl Acetate) based sandals primarily for the beach, adventure and action sports markets. The Company recorded \$600,000 in customer relationships and \$953,000 in goodwill on the date of acquisition for Ocean Minded.

The Company's goodwill balance of \$22.9 million and \$11.6 million as of June 30, 2007 and December 31, 2006, respectively, relates predominately to the acquisitions of Ocean Minded in 2007, Jibbitz, Fury and EXO in 2006 as well as the acquisition of Foam Creations in 2004.

On June 26, 2007 the Company amended the membership interest purchase agreement with Jibbitz, LLC ( Jibbitz ) (Purchase Agreement) to amend the terms of the potential earn-out consideration included in the Purchase Agreement. The amendment removed the earnings targets for payment of the earn-out with \$3.5 million payable on the effective date of the amended Purchase Agreement and the remaining \$6.5 million payable on the first business day for the following thirteen months the Company will pay \$500,000 to the earn-out recipients, for a total payment of \$10.0 million. The Company recorded the additional \$10.0 million purchase price in the three months ended June 30, 2007.

## 8. COMMITMENTS AND CONTINGENCIES

On September 17, 2004, the Company entered into a Manufacturing Supply Agreement with MDI Products, LLC ( MDI ), a Florida limited liability company whereby the Company agreed to purchase 15,000 pairs of shoes per month for 36 months to maintain exclusivity. The pricing is to be agreed on every twelve months. Termination fees apply for losses incurred by MDI due to premature termination by the Company.

On July 26, 2005, the Company entered into an amended and restated four year Supply Agreement with Finproject S.P.A., the former majority owner of Foam Creations, where the Company has the exclusive right to purchase the material for the manufacture of finished shoe products, except for certain current customer dealings (including boot manufacturers). Based on the supply agreement, the Company has contractual purchase requirements to maintain exclusivity throughout the agreement. The pricing is to be agreed on each quarter and fluctuates based on order volume, currency fluctuations and raw material prices.

The Company indemnifies certain of its vendors and its directors and executive officers for specified claims. To date, the Company has not paid or been required to defend any indemnification claims, and accordingly, has not accrued any amounts for its indemnification obligations.

## 9. MATERIAL CONTRACTS

### *Deferred Compensation Plan*

On May 2, 2007, the Board of Directors approved the 2007 Executive Deferred Compensation Plan ( the Plan ) for certain highly compensated employees. The Plan, which is unfunded, allows for the Company or the employee to defer all or a portion of his or her compensation and requires any performance bonus under the 2007 Bonus Plan in excess of two times the minimum performance bonus percentage amount to be automatically deferred under the Plan terms, with a maximum deferral amount of \$6.0 million. Under the terms of the Plan, all required deferrals will vest ratably on a quarterly basis from March 31, 2008 through December 31, 2010.

*Hedging Transactions and Derivative Financial Instruments*

The Company is exposed to global market risks, including the effect of changes in foreign currency exchange rates. The Company uses derivatives to manage financial exposures that occur in the normal course of business. The Company does not hold or issue derivatives for trading purposes.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking hedge transactions. This process includes linking all derivatives to either specific assets and liabilities on the balance sheet or specific firm commitments or forecasted transactions. The Company enters into forward exchange contracts to hedge certain portions of future cash flows denominated in foreign currencies. All derivatives outstanding as of June 30, 2007 are designated as a cash flow hedge and there was no mark-to-market impact for the three and six months ended June 30, 2007.

**10. OPERATING SEGMENTS AND RELATED INFORMATION**

The Company operates in the consumer products industry in which the Company designs, manufactures, markets and distributes footwear, apparel and accessories. Operating results are assessed on an aggregate basis to make decisions about necessary resources and in assessing performance. Consequently, under the provisions of SFAS No. 131, Disclosure About Segments of an Enterprise and Related Information ( SFAS 131 ), and based on the nature of the financial information that is received by the chief executive officer as chief operating decision maker, the Company has one reportable segment for financial statement purposes.

The Company's sales by product line are as follows (in thousands):

|       | Three Months<br>Ended June 30, |           | Six Months<br>Ended June 30, |            |
|-------|--------------------------------|-----------|------------------------------|------------|
|       | 2007                           | 2006      | 2007                         | 2006       |
| Shoes | \$ 198,134                     | \$ 83,416 | \$ 327,748                   | \$ 126,209 |
| Other | 26,139                         | 2,219     | 38,527                       | 4,268      |
|       | \$ 224,273                     | \$ 85,635 | \$ 366,275                   | \$ 130,477 |

Geographic information about the United States and international territories is presented below, the Company has allocated revenues to the geographical locations based on the location of the customer (in thousands):

|   | Three Months<br>Ended June 30, |           | Six Months<br>Ended June 30, |            |
|---|--------------------------------|-----------|------------------------------|------------|
|   | 2007                           | 2006      | 2007                         | 2006       |
| <b>Revenue</b>                                |                                |           |                              |            |
| United States                                 | \$ 115,374                     | \$ 58,000 | \$ 198,365                   | \$ 92,918  |
| Canada  | 17,484                         | 9,571     | 26,177                       | 12,565     |
| Mexico  | 2,703                          | 220       | 4,290                        | 329        |
| North America Total                           | 135,561                        | 67,791    | 228,832                      | 105,812    |
| Asia  | 37,206                         | 11,955    | 56,453                       | 16,568     |
| Europe  | 49,932                         | 4,897     | 76,353                       | 6,837      |
| Other   | 1,574                          | 992       | 4,637                        | 1,260      |
|   | \$ 224,273                     | \$ 85,635 | \$ 366,275                   | \$ 130,477 |
| Total for countries outside the United States | \$ 108,899                     | \$ 27,635 | \$ 167,910                   | \$ 37,559  |

|   | June 30, 2007 | December 31, 2006 |
|---|---------------|-------------------|
| <b>Long-lived assets</b>                      |               |                   |
| United States                                 | \$ 29,773     | \$ 19,482         |
| Canada  | 13,034        | 9,161             |
| Mexico  | 1,588         | 1,204             |
| North America Total                           | 44,395        | 29,847            |
| Asia  | 4,096         | 2,821             |
| Europe  | 5,482         | 2,181             |
| Other   | 2,021         |                   |
|   | \$ 55,994     | \$ 34,849         |
| Total for countries outside the United States | \$ 26,221     | \$ 15,367         |

There were no customers that comprised greater than 10% of the consolidated revenues of the Company for the three and six months ended June 30, 2007 and 2006.

## 11. COMPREHENSIVE INCOME

Comprehensive income for the three and six months ended June 30, 2007 and 2006 was as follows (in thousands):

|                              | Three Months Ended |           | Six Months Ended |           |
|------------------------------|--------------------|-----------|------------------|-----------|
|                              | June 30,<br>2007   | 2006      | June 30,<br>2007 | 2006      |
| Net income                   | \$ 48,451          | \$ 15,666 | \$ 73,396        | \$ 22,107 |
| Foreign currency translation | 1,123              | 201       | 1,584            | 226       |
| Comprehensive income         | \$ 49,574          | \$ 15,867 | \$ 74,980        | \$ 22,333 |

## 12. LEGAL PROCEEDINGS

In January 2005, Crocs' direct subsidiary Foam Creations filed a lawsuit against Holey Soles Holdings Ltd. ( "Holey Soles" ) in the Federal Court of Canada, Trial Division (at Toronto, Ontario). The complaint alleges trademark and copyright infringement relating to the design of some of Crocs' shoe models. Crocs is seeking a permanent injunction with respect to any further acts of infringement on its intellectual property, as well as damages and attorneys' fees. This action is still pending.

In August 2005, Holey Soles filed a lawsuit against Crocs in the United States District Court for the Southern District of New York. Holey Soles seeks a declaratory judgment that Crocs does not have any valid copyright or trade dress rights with respect to the design of its footwear. In addition, Holey Soles seeks a declaratory judgment that the manufacture, sale and distribution of its footwear products does not constitute unfair competition and does not infringe on Crocs' copyrights or trade dress rights. On Crocs' motion, the action has been transferred to the United States District of Colorado where it has been stayed pending the outcome of the International Trade Commission ( "ITC" ) Investigation No. 337-TA-567 discussed below. The Company does not expect the ultimate resolution of this matter will have a material adverse impact on its business.

On March 31, 2006, Crocs filed a complaint with the ITC against Acme Ex-Im, Inc., Australia Unlimited, Inc., Cheng's Enterprises, Inc., Collective Licensing International, LLC, D. Myers & Sons, Inc., Double Diamond Distribution, Ltd., Effervescent, Inc., Gen-X Sports, Inc., Holey Soles Holdings, Ltd., Inter-Pacific Trading Corporation, and Shaka Holdings, Inc., alleging patent and trade dress infringement and seeking an exclusion order banning the importation and sale of infringing products. The utility and design patents asserted in the complaint were issued to Crocs, Inc. on February 7, 2006 and March 28, 2006 respectively, by the United States Patent and Trademark Office. The ITC has issued final determinations terminating Shaka Holdings, Inc., Inter-Pacific Trading Corporation, Acme Ex-Im, Inc., D. Myers & Sons,

and Australia Unlimited, Inc. from the ITC investigation No. 337-TA-567 on the basis of settlement and Cheng's Enterprises, Inc. on the suspension of accused activities. The ITC Administrative Law Judge ( ALJ ) issued an Initial Determination of non-infringement related to one of the patents at issue. Crocs filed a petition with the Commission to review this determination. The Commission granted Crocs's petition and on February 15, 2007, after briefing by the parties, the Commission vacated the ALJ's determination of non-infringement with respect to the remaining respondents and remanded it to the ALJ for further proceedings consistent with the Commission's order. In light of the Commission's Order, the procedural schedule and hearing date were reset pursuant to Order No. 38. The schedule has subsequently been revised pursuant to Order Nos. 40 and 42, with the hearing currently set from September 7 through September 14, 2007.

On April 3, 2006, Crocs filed a complaint in the U.S. District Court for the District of Colorado alleging patent and trade dress infringement and seeking injunctive relief against Acme EX-IM, Inc., Australia Unlimited, Inc., Cheng's Enterprises, Inc., Collective Licensing International, LLC, D. Myers & Sons, Inc., Double Diamond Distribution, Ltd., Effervescent, Inc., Gen-X Sports, Inc., Holey Soles Holdings, Ltd., Inter-Pacific Trading Corporation, Shaka Holdings, Inc., and Does 1-10 the utility and design patents asserted in the complaint were issued to Crocs, Inc. on February 7, 2006 and March 28, 2006 respectively, by the United States Patent and Trademark Office. Consent judgments have been entered against Shaka Holdings, Inc., Interpacific Trading Corporation and Acme Ex-Im, Inc. Crocs has entered into settlement agreements with Australia Unlimited, Inc., and on January 25, 2007 filed a stipulation for dismissal of all claims and counterclaims. Crocs has entered into a settlement agreement with D. Myers & Sons, Inc. and on May 23, 2007 filed a consent judgment with the court related to D. Myers & Sons, Inc. The Company does not expect the ultimate resolution of this matter will have a material adverse impact on its business.

On January 29, 2007, Crocs filed an action in Colorado District Court, Boulder County, alleging breach of contract by Australia Unlimited. Crocs alleges Australia Unlimited breached the settlement agreement from the prior litigation by introducing a new shoe design not approved by Crocs. Crocs obtained a temporary restraining order enjoining Australia Unlimited sale of the new shoe; however, Crocs's motion for preliminary injunction was denied. Australia Unlimited removed the case to federal court, Case No. 07CV00221, and alleged a counterclaim for breach of contract and that it is entitled to recover damages for the time that the temporary restraining order was in effect. The Company does not expect the ultimate resolution of this matter will have a material adverse impact on its business.

Although the Company is subject to other litigation from time to time in the ordinary course of its business, the Company is not party to any other pending legal proceedings that the Company believes will have a material adverse impact on its business.

### 13. SUBSEQUENT EVENTS

On July 27, 2007, the Company acquired 100% of the membership interests of Bite, LLC, ( Bite ) a Washington limited liability company, for \$1.75 million in cash and assumed debt of \$1.3 million, plus potential earn-out consideration of up to \$1.75 million based on Bite's revenues over the three years following the date of acquisition. Bite markets and sells supportive performance shoes and sports sandals worldwide in five categories including, golf, adventure, healthy lifestyle, travel and watersports.

On July 9, 2007, at the annual stockholders' meeting, the Company's stockholders approved the 2008 Cash Incentive Plan (the 2008 Plan ), which previously had been approved by the Company's Board of Directors. The 2008 Plan will be effective as of January 1, 2008. The payout of awards under the 2008 Plan will be contingent upon the degree of attainment of specified performance measures over the applicable performance period. All awards under the 2008 Plan for a performance period will be paid in cash following the end of such performance period and the Compensation Committee's certification of the

degree to which applicable performance measures were attained. The maximum individual award payment that can be made under the 2008 Plan may not exceed \$2 million for a quarterly performance period or the corresponding multiple of that amount for any performance period that is more than one quarter in duration.

Also on July 9, 2007, at the annual stockholders meeting, the Company's stockholders approved the 2007 Incentive Plan (the 2007 Plan), which previously had been approved by the Company's Board of Directors. The 2007 Plan is effective as of March 30, 2007. The bonus levels under the 2007 Plan expressed as a percentage of 2007 base salary range from 25% to 800% based on achieving earnings per share growth of 10% to 175% in the year ending December 31, 2007 over the earnings per share for the year ended December 31, 2006.

Also on July 9, 2007, at the annual stockholders meeting, the Company's stockholders approved the 2007 Equity Incentive Plan (the 2007 Plan), which previously had been approved by the Company's Board of Directors. The 2007 Plan will be effective as of July 9, 2007. After giving effect to the Company's two-for-one stock split of its common stock distributed on June 14, 2007, the total number of shares of the Company's common stock available for distribution under the 2007 Plan is 9,000,000, subject to adjustment for future stock splits, stock dividends and similar changes in the Company's capitalization.

Also on July 9, 2007, at the annual stockholders meeting, the Company's stockholders approved a Certificate of Amendment to the Restated Certificate of Incorporation of the Company. The Certificate of Amendment amends the Restated Certificate of Incorporation of the Company to increase the Company's authorized capital stock from 130,000,000 shares, of which 125,000,000 are common stock and 5,000,000 are preferred stock, to 255,000,000 shares, of which 250,000,000 are common stock and 5,000,000 are preferred stock.

**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Forward-Looking Statements**

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In addition, the Company may make other written and oral communications from time to time that contain such statements. Forward-looking statements include statements as to industry trends and future expectations of the Company and other matters that do not relate strictly to historical facts and are based on certain assumptions by management. These statements are often identified by the use of words such as may, will, expect, believe, anticipate, intend, could, estimate, or continue, and similar expressions or variations. These statements are based on the beliefs and assumptions of the management of the Company based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from future results expressed or implied by such forward looking statements. These forward-looking statements include statements in this Item 2, Management Discussion and Analysis of Financial Condition and Results of Operations. Important factors that could cause actual results to differ materially from the forward-looking statements include, among others, the risks described in the section entitled Risk Factors under Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2006. We caution the reader to carefully consider such factors. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

**Overview**

We are a rapidly growing designer, manufacturer, and marketer of footwear for men, women, and children. All of our crocs-branded footwear products incorporate croslite, which enables us to produce a soft and lightweight, non-marking, slip- and odor-resistant shoe that retails at attractive price points ranging from \$19.99 to \$59.99. In addition to our footwear products, we acquired Jibbitz, a unique accessory brand with colorful snap-on products specifically suited for Crocs shoes, and introduced a line of Crocs-branded apparel and accessory items. We also acquired Fury, which produces and distributes hockey and lacrosse equipment for adults and children, and EXO, a Italian designer and producer of EVA (Ethylene Vinyl Acetate) based finished products, primarily for the footwear industry. In January 2007, we acquired substantially all of the assets of Ocean Minded, a design and manufacturer of high quality leather and EVA based sandals primarily for the beach, adventure and action sports market. In July 2007, we acquired Bite, a design and manufacturer of comfortable and supportive performance shoes and sports sandals sold worldwide in five categories including, golf, adventure, healthy lifestyle, travel and watersports. We also use croslite to manufacture non-branded products that we sell to original equipment manufacturers.

We currently sell our Crocs-branded products throughout the U.S. and in over 90 countries worldwide. We sell our products directly to retailers or through distributors where we believe they offer a preferable alternative to direct sales. We also sell directly to consumers through our website and our company-operated kiosks and retail stores. The broad appeal of our footwear has allowed us to market our products to a wide range of distribution channels in the U.S., including traditional footwear retailers as well as a variety of specialty channels. As of June 30, 2007, our retail customer base in the U.S. included over 12,000 sales locations selling our products.

We have achieved significant growth since our inception, driven largely by the popularity of our footwear products and our ability to significantly expand the breadth and depth of our distribution network and manufacturing capacities. For the quarter ended June 30, 2007, we recorded revenues of \$224.3 million and net income of \$48.5 million, compared to \$85.6 million of revenues and net income of



\$15.7 million for the quarter ended June 30, 2006. We have also achieved strong gross profit margins on sales of our Crocs footwear. For the quarter ended June 30, 2007, our gross profit was \$131.9 million, or 58.8% of revenues, compared to \$47.0 million, or 54.9% of revenues, for the quarter ended June 30, 2006. We believe a number of factors have contributed to our ability to achieve gross profit margins at these levels including our use of third party manufacturers. Our company-operated manufacturing facilities have allowed us to maintain a relatively low cost structure while enabling us to achieve significant production flexibility.

## General

Revenues are recorded when products are shipped and the customer takes title and assumes risk of loss, collection of related receivables are probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable. Title passes on shipment or on receipt by the customer depending on the country of the sale and the agreement with the customer. Allowances for estimated returns and discounts are recognized when related revenue is recorded. Because we use internal manufacturing and also contract with third parties to manufacture our products, our cost of sales represents our costs to manufacture products in our own facilities, including raw materials costs and all overhead expenses related to production, as well as the cost to purchase finished products from our third party manufacturers. Cost of sales also includes the cost to transport these products to our facilities and all warehouse and outbound freight expenses. Our selling, general and administrative expense consists primarily of selling, marketing, wages and related payroll and employee benefit costs, travel and insurance expenses, research and development costs, depreciation, amortization, professional fees, facility expenses, bank charges and non-cash charges for stock based compensation, net of those allocated to cost of sales.

## Results of Operations

### Three Months Ended June 30, 2007 Compared to Three Months Ended June 30, 2006

*Revenues.* Revenues increased 161.9% or \$138.6 million, to \$224.3 million, in the three months ended June 30, 2007, from \$85.6 million in the three months ended June 30, 2006. In addition, our revenues from sales outside of the United States were \$108.9 million in the three months ended June 30, 2007 compared to \$27.6 million in the three months ended June 30, 2006. This increase was primarily a result of significantly higher unit sales of our footwear products. The higher unit sales resulted from an increase in the number of retail stores selling our products, additional sales resulting from new product offerings, stronger sales to our existing wholesale customers and increased sales at retail locations owned by us and through our webstore.

*Gross profit.* Gross profit increased 180.9% or \$85.0 million, to \$131.9 million, in the three months ended June 30, 2007, from \$47.0 million in the three months ended June 30, 2006. Our gross profit margin improved by 400 basis points to 58.8% in the three months ended June 30, 2007, compared to 54.8% in the three months ended June 30, 2006. This increase in margin was primarily attributable to better freight management and a decrease in the average order fulfillment costs due to reducing our reliance on third party distribution facilities. We have also improved efficiencies in managing inventory requirements and improved leverage of fixed operating costs due to higher volume. In addition, the increase in international sales and the addition of Jibbitz improved the margin as we recognize higher margins on these sales.

*Selling, general and administrative expenses.* Selling, general and administrative expense increased 172.3% or \$40.2 million, to \$63.5 million in the three months ended June 30, 2007, from \$23.3 million in the three months ended June 30, 2006. As a percentage of net revenues, selling, general and administrative expenses increased 110 basis points to 28.3% for the three months ended June 30, 2007 from 27.2% for the three months ended June 30, 2006. This increase was primarily a result of higher costs associated with increased sales volumes, including an increase in selling and marketing expenses of \$10.1 million related to our increase in corporate sponsorships such as the AVP Crocs Tour and college

sponsorships, and increases in personnel expenses of \$22.4 million due to our growth and expanding operations. In addition, professional and consulting fees increased approximately \$6.1 million, primarily as a result of increased accounting fees related to our efforts to comply with the Sarbanes-Oxley Act of 2002, contract labor and general consultants.

*Interest expense.* Interest expense was \$51,000 in the three months ended June 30, 2007, compared to \$92,000 in the three months ended June 30, 2006. The Company does not consider this to be a material change.

*Other income, net.* Other income was \$399,000 in the three months ended June 30, 2007, compared to \$366,000 in the three months ended June 30, 2006 which resulted primarily from an increase in interest income related to an increase in cash and cash equivalents.

*Income tax expense.* During the three months ended June 30, 2007, income tax expense was \$20.4 million, representing an effective income tax rate of 29.6%, compared to income tax expense of \$8.3 million, representing an effective income tax rate of 34.5% in the three months ended June 30, 2006. The decrease of 490 basis points relates primarily to an increase in the pre-tax earnings in jurisdictions with lower relative income tax rates as a percentage of total pre-tax earnings.

#### **Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006**

*Revenues.* Revenues increased 180.7% or \$235.8 million, to \$366.3 million, in the six months ended June 30, 2007, from \$130.5 million in the six months ended June 30, 2006. In addition, our revenues from sales outside of the United States were \$167.9 million in the six months ended June 30, 2007 compared to \$37.6 million in the six months ended June 30, 2006. This increase was primarily a result of significantly higher unit sales of our footwear products. The higher unit sales resulted from an increase in the number of retail stores selling our products, additional sales resulting from new product offerings, stronger sales to our existing wholesale customers and increased sales at retail locations owned by us and through our webstore.

*Gross profit.* Gross profit increased 206.3% or \$145.8 million, to \$216.4 million, in the six months ended June 30, 2007, from \$70.6 million in the six months ended June 30, 2006. Our gross profit margin was 59.1% in the six months ended June 30, 2007, compared to 54.1% in the six months ended June 30, 2006. This increase in margin was primarily attributable to better freight management and a decrease in the average order fulfillment costs due to reducing our reliance on third party distribution facilities. We have also improved efficiencies in managing inventory requirements and improved leverage of fixed operating costs due to higher volume. In addition, the increase in international sales and the addition of Jibbitz improved the margin as we recognize higher margins on these sales.

*Selling, general and administrative expense.* Selling, general and administrative expense increased 199.6% or \$73.8 million, to \$110.8 million in the six months ended June 30, 2007, from \$37.0 million in the six months ended June 30, 2006. This increase was primarily a result of higher costs required to support increased sales volumes, including increases in personnel expenses of \$43.3 million (including share-based compensation), increases in selling and marketing expenses of \$15.8 million, and increases in professional fees of \$10.7 million, primarily as a result of increased accounting fees related to our efforts to comply with the Sarbanes-Oxley Act of 2002, and general consulting. In addition, depreciation and amortization expense increased \$2.9 million, due to the increase in capital expenditures and intangible assets associated with the acquisitions of Jibbitz, Fury, EXO and Ocean Minded. As a percentage of revenues, selling, general and administrative expense increased to 30.3% in the six months ended June 30, 2007, from 28.3% in the six months ended June 30, 2006, as we hired additional personnel and incurred increased costs related to our growth.

*Interest expense.* Interest expense was \$115,000 in the six months ended June 30, 2007, compared to \$391,000 in the six months ended June 30, 2006. Interest expense decreased due to our use of a portion of



the proceeds from our initial public offering to retire bank loans. This debt retirement led to a decrease in average borrowings outstanding on our line of credit and long term debt during the six months ended June 30, 2007 compared to average borrowings outstanding under those arrangements during the six months ended June 30, 2006.

*Other income, net.* Other income was \$915,000 in the six months ended June 30, 2007, compared to income of \$662,000 in the six months ended June 30, 2006, which resulted from an increase in interest income related to an increase in cash and cash equivalents and short-term investments held in interest bearing accounts, resulting from our initial public offering.

*Income tax expense.* During the six months ended June 30, 2007, income tax expense was \$33.0 million, representing an effective income tax rate of 31.0%, compared to income tax expense of \$11.8 million, representing an effective income tax rate of 34.9% in the six months ended June 30, 2006. The decrease relates primarily to an increase in the pre-tax earnings in jurisdictions with lower income tax rates as a percentage of total pre-tax earnings.

### **Liquidity and Capital Resources**

As of June 30, 2007, we had \$89.4 million in cash and cash equivalents and short-term investments compared to \$67.9 million as of December 31, 2006. The increase in cash and cash equivalents reflects the proceeds of cash from operations. In the six months ended June 30, 2007, we used, \$24.7 million for capital expenditures related to increasing our manufacturing capacity and improving our infrastructure, \$4.2 million to expand and upgrade our existing information technology systems, and \$2.7 million for acquisitions, net of cash received.

The significant components of our working capital are cash, accounts receivable, inventory, accounts payable and accrued expenses. Capital requirements related to manufacturing include compounding and injection molding equipment for facilities we operate, as well as footwear molds used in our company-operated facilities or purchased for use by our third party manufacturers.

Cash used in operating activities consists primarily of net income adjusted for certain non-cash items including depreciation, amortization, deferred income taxes, provision for bad debts, stock-based compensation and changes in working capital and other activities. Cash provided by operating activities in the six month period ended June 30, 2007 was \$22.9 million and was primarily related to net income of \$73.4 million plus non-cash items of depreciation and amortization of \$7.5 million, unrealized foreign exchange gain of \$2.0 million and share-based compensation of \$9.7 million, partially offset by increases in working capital resulting from increases in inventory of \$29.4 million and accounts receivable of \$51.6 million. Cash used in operating activities in the six month period ended June 30, 2006 was \$14.7 million and was primarily related to net income of \$22.1 million plus non-cash items of depreciation and amortization of \$3.2 million and share-based compensation expense of \$4.4 million, increases in accrued liabilities and other liabilities of \$4.5 million, partially offset by increases in working capital resulting from significant increases in inventory of \$12.1 million, and accounts receivable of \$30.1 million, and decrease in accounts payable of \$5.2 million.

Cash used in investing activities for the six months ended June 30, 2007 was \$34.4 million, which resulted from net purchases of investments of \$2.1 million, capital expenditures for molds, machinery and equipment of \$24.7 million, \$4.2 million related to the upgrade and expansion of our information technology systems and \$2.7 million for acquisitions, net of cash received. Cash used in investing activities in the six months ended June 30, 2006 was \$8.3, which resulted from to capital expenditures of \$6.9 million and \$1.4 million related to the upgrade and expansion of our information technology systems.

Cash provided by financing activities was \$29.6 million for the six months ended June 30, 2007, which resulted from exercises of stock options of \$8.6 million and excess tax benefit on share-based compensation

of \$21.2 million. Cash provided by financing activities was \$85.4 million for the six months ended June 30, 2006, which resulted from the completion of the initial public offering of our common stock whereby we received net proceeds of \$94.5 million, after deducting underwriting discounts and commissions and related offering costs, offset by payments on long-term debt and capital lease obligations of \$12.0 million.

In connection with the Jibbitz amended purchase agreement, the Company has accrued the remaining \$3.5 million additional purchase price at June 30, 2007, which is to be paid out over thirteen months beginning in July 2007.

### **Seasonality**

Due to our significant sales growth since our inception, we cannot assess with certainty the degree to which sales of our footwear products will be subject to seasonality. However, we expect that our business, similar to other vendors of footwear and related merchandise, will be subject to seasonal variation. We believe many vendors that market footwear products suited for warm weather normally experience their highest sales activity during the second and third quarters of the calendar year. While we have introduced footwear models that are more suitable for cold weather uses, such as the Endeavor, Georgie, All Terrain, Highland, Snowmini, and YOU by Crocstm, we expect demand for our products, and therefore our sales, may be subject to seasonal variations and significantly impacted by weather conditions, as over 67% of our revenues during the three months ended June 30, 2007 were attributable to our Beach and Cayman (classic) models and our flip-flops and other open-toed models, which are more suitable for warm weather. In addition, our quarterly results of operations may fluctuate significantly as a result of a variety of other factors, including the timing of new model introductions or general economic or consumer conditions. Accordingly, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year, and revenues for any particular period may decrease.

### **Critical Accounting Policies and Estimates**

Our accounting policies and accounting estimates critical to our financial condition and results of operations are set forth in our Annual Report on Form 10-K for the year ended December 31, 2006. We have not modified the policies and estimates set forth in our Annual Report on Form 10-K for the year ended December 31, 2006, except for the accounting for the adoption of FIN 48.

#### *Income Taxes*

In July 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( Interpretation No. 48 ). Interpretation No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. Interpretation No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Interpretation No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition and was effective beginning January 1, 2007. There was no cumulative effect of the adoption of Interpretation No. 48.

Our annual tax rate is based on our income, statutory tax rates and tax planning opportunities available to us in the various jurisdictions in which we operate. Significant judgment is required in determining our annual tax expense and in evaluating our tax positions. We establish reserves at the time we determine it is probable we will be liable to pay additional taxes related to certain matters. We adjust these reserves, including any impact on the related interest and penalties, in light of changing facts and circumstances, such as the progress of a tax audit.

Tax law requires items to be included in the tax return at different times than when these items are reflected in the consolidated financial statements. As a result, the annual tax rate reflected in our consolidated financial statements is different than that reported in our tax return (our cash tax rate). Some of these differences are permanent, such as expenses that are not deductible in our tax return, and some differences reverse over time, such as depreciation expense. These timing differences create deferred tax assets and liabilities. Deferred tax assets and liabilities are determined based on temporary differences between the financial reporting and tax bases of assets and liabilities. The tax rates used to determine deferred tax assets or liabilities are the enacted tax rates in effect for the year in which the differences are expected to reverse. Based on the evaluation of all available information, we recognize future tax benefits, such as net operating loss carryforwards, to the extent that realizing these benefits is considered more likely than not.

We evaluate our ability to realize the tax benefits associated with deferred tax assets by analyzing our forecasted taxable income using both historical and projected future operating results, the reversal of existing temporary differences, taxable income in prior carryback years (if permitted) and the availability of tax planning strategies. A valuation allowance is required to be established unless management determines that it is more likely than not that we will ultimately realize the tax benefit associated with a deferred tax asset.

Additionally, undistributed earnings of a subsidiary are accounted for as a temporary difference, except that deferred tax liabilities are not recorded for undistributed earnings of a foreign subsidiary that are deemed to be indefinitely reinvested in the foreign jurisdiction. We have formulated a specific plan for reinvestment of undistributed earnings of its foreign subsidiaries which demonstrates that such earnings will be indefinitely reinvested in the applicable tax jurisdictions. Should we change our plans, we would be required to record a significant amount of deferred tax liabilities.

### **ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

#### *Interest Rate Risk*

We earn interest income on both our cash and cash equivalents and our investment portfolio. Our investment portfolio generally consists of readily marketable investment-grade debt securities of various issuers and maturities. All investments are denominated in U.S. dollars and are classified as available for sale. These instruments are not leveraged, and are not held for trading purposes. We have performed a sensitivity analysis to estimate our exposure to market risk of interest rates and if the weighted average rate of return on cash and cash equivalents, restricted cash, and marketable securities were to increase or decrease by 1%, the impact on interest income would be \$168,000, net of tax during the three months ended June 30, 2007.

#### *Credit Risk*

We do not have any variable rate debt instruments and we are not exposed to market risk due to changes in interest rates such as the prime rate and LIBOR.

#### *Foreign Currency Exchange Risk*

We pay the majority of our overseas third party manufacturers in U.S. dollars and have had significant revenues from foreign sales in recent periods. Our ability to sell our products in foreign markets and the U.S. dollar value of the sales made in foreign currencies can be significantly influenced by foreign currency fluctuations. A decrease in the value of foreign currencies relative to the U.S. dollar could result in downward price pressure for our products or losses from currency exchange rates. We have performed a sensitivity analysis to estimate our exposure to market risk of foreign exchange rates. If the U.S. dollar were to increase or decrease in value by 1%, the impact on international sales of \$108.9 million during the

three months ended June 30, 2007 would have been an increase or decrease in consolidated revenues by \$184,000, net of tax. The volatility of the applicable rates and prices are dependent on many factors that cannot be forecast with reliable accuracy. In the event our foreign sales and purchases increase and are denominated in currencies other than the U.S. dollar, our operating results may be affected by fluctuations in the exchange rate of currencies we receive for such sales. We may engage in forward foreign exchange contracts to reduce our economic exposure to changes in exchange rates. Forward contracts are entered into to hedge specific commitments and anticipated transactions but not for speculative or trading purposes.

**ITEM 4. Controls and Procedures**

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of June 30, 2007, our disclosure controls and procedures are effective in ensuring that information required to be disclosed in our Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

We are currently undergoing a comprehensive effort in preparation for compliance with Section 404 of the Sarbanes-Oxley Act of 2002. This effort includes the documentation, testing and review of our internal controls under the direction of senior management. During the course of these activities, we have identified certain opportunities to improve our internal controls over financial reporting. As a result, we are evaluating and implementing improvements to our internal controls over financial reporting and will continue to do so. These improvements include further formalization of accounting standards and guidelines, improved segregation of duties, hiring additional competent accounting managers and staff, and improving information technology system controls. Any further opportunities to improve our internal controls identified by our continued compliance efforts will be addressed accordingly.

During the three months ended June 30, 2007, we made changes to our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. On June 1, 2007 we implemented a new accounting and operational software package for our Jibbitz operations. Certain processes and controls were changed to accommodate the needs and requirements of our growth and the new financial reporting system.

**PART II.**  
**OTHER INFORMATION**

**ITEM 1.** Legal Proceedings

On April 3, 2006, we filed a complaint in the U.S. District Court for the District of Colorado alleging patent and trade dress infringement and seeking injunctive relief against Acme EX-IM, Inc., Australia Unlimited, Inc., Cheng s Enterprises, Inc., Collective Licensing International, LLC, D. Myers & Sons, Inc., Double Diamond Distribution, Ltd., Effervescent, Inc., Gen-X Sports, Inc., Holey Soles Holdings, Ltd., Inter-Pacific Trading Corporation, Shaka Holdings, Inc., and Does 1-10. The utility and design patents asserted in the complaint were issued to us on February 7, 2006 and March 28, 2006 respectively, by the United States Patent and Trademark Office. Consent judgments have been entered against Shaka Holdings, Inc., Interpacific Trading Corporation and Acme Ex-Im, Inc. We have entered into settlement agreement with Australia Unlimited, Inc., and on January 25, 2007 filed a stipulation for dismissal of all claims and counterclaims. We have entered into a settlement agreement with D. Myers & Sons, Inc. and, on May 23, 2007, filed a consent judgment with the court related to D. Myers & Sons, Inc. We do not expect the ultimate resolution of this matter will have a material adverse impact on our business.

Although we are subject to litigation from time to time in the ordinary course of our business, we are not party to any pending legal proceedings that we believe would have a material adverse impact on our business.

**ITEM 1A.** Risk Factors

We had no material changes to the risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2006. In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**ITEM 6.** Exhibits

**Exhibit List**

| <b>Exhibit Number</b> | <b>Description</b>   |
|-----------------------|--|
| 3.1**                 | Restated Certificate of Incorporation of Crocs, Inc.   |
| 3.2@                  | Certificate of Amendment to the Restated Certificate of Incorporation of Crocs, Inc.   |
| 3.3**                 | Amended and Restated Bylaws of Crocs, Inc.   |
| 4.1*                  | Specimen common stock certificate.   |
| 31.1                  | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act. |
| 31.2                  | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act. |
| 32                    | Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 USC. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act.                        |



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\* Incorporated herein by reference to Crocs, Inc.'s Registration Statement on Form S-1 (File No. 333-127526).

\*\* Incorporated by reference to Crocs, Inc.'s Registration Statement on Form S-8, filed on March 9, 2006 (File No. 333-132312).

@ Incorporated by reference to Crocs, Inc.'s Current Report on Form 8-K, filed on July 12, 2007 (File No. 000-51754).

Filed herewith.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: August 14, 2007

CROCS, INC.

By:

/s/ PETER S. CASE

Name:

Peter S. Case

Title:

*Chief Financial Officer, Senior Vice  
President Finance and Treasurer*