JIM SUVA, SVP FINANCE

Thank you, operator, and good afternoon, everyone. Thank you for joining us on Cricut's first quarter 2023 earnings call. Please note that today's call is being webcast and recorded on the Investor Relations section of the company's website. A replay of the webcast will also be available following today's call. For your reference, accompanying slides used on today's call, along with a supplemental data sheet, have been posted to the investor relations section of the company's website, investor.cricut.com.

Joining me on the call today are Ashish Arora, Chief Executive Officer, and Kimball Shill, Chief Financial Officer. Today's prepared remarks have been recorded after which Ashish and Kimball will host live Q&A.

Before we begin, we would like to remind everyone that our prepared remarks contain forward-looking statements and management may make additional forward-looking statements, including statements regarding our strategies, business, expenses, and results of operations, in response to your questions. These statements do not guarantee future performance, and therefore, undue reliance should not be placed upon them. These statements are based on current expectations of the company's management and involve inherent risks and uncertainties, including those identified in the Risk Factors section of Cricut's most-recently filed Form 10-K. Actual events or results could differ materially. This call also contains time-sensitive information that is accurate only as of the date of this broadcast, May 9, 2023. Cricut assumes no obligation to update any forward-looking projection that may be made in today's release or call.

I will now turn the call over to Ashish.

ASHISH ARORA, CHIEF EXECUTIVE OFFICER

As we mentioned last quarter, we expected Q1 revenue to be materially below prior year. Even with that, revenue in the first quarter was softer than we expected for Connected Machines (down 45% year-over-year) and Accessories and Materials (down 39% year-over-year) as retailers continue to take a conservative approach to inventory commitments and softer consumer spend. These trends continue quarter-to-date. Subscriptions revenue, on the other hand, grew 16% year-over-year and 6% sequentially. Despite these mixed results, the strength of our financial profile allows us to deliver positive profits and strong cash flow. We will continue to operate in a fiscally disciplined way, making focused investments that will deliver increased user engagement and growth over the medium term.

The Cricut platform now has over 8.2 million total users, up 19% over Q1 last year. 3.7 million users – or 45% of total users – have cut a project at least once within the first quarter. This creates a tremendous opportunity for us to build deeper user engagement on our platform. Our goal is to bring a majority of our users into Design Space monthly to be inspired. We believe increasing visits to Design Space and improving our ability to serve relevant, makeable content that matches the interests of each user will lead to higher engagement and an increase in paid subscribers. We also want to broaden user engagement activities such as liking, bookmarking and sharing projects. As users increasingly drive growth in shared community projects, and our platform more effectively matches content tailored to each user, these mutually reinforcing effects will create value in our platform for all users.

2023 Priorities

As we outlined last quarter, we have intensified our focus around new user acquisition and platform expansion in order to drive engagement, subscriptions and increased monetization. We also laid out a two-year path to re-accelerate growth in Accessories and Materials. These investments are also leveraged across international markets where the opportunity for growth has never been stronger. In fact, as of the end of Q1, we have crossed a milestone with over 1.1 million international users outside of North America.

New User Acquisition

We continue to simplify and streamline the consumer purchase journey. Last quarter we rolled out several new creative assets and tools that bring relevant information to consumers more quickly across all channels. We'll continue to iterate on these experiences and add to the growing content on our website and social media channels. We previously launched a new homepage along with comparison tables to help users compare various machines. By way of example, we have since seen an increase of time on page for our machine comparison tool of over 50%. Last month we also added a new, simple machine quiz to help consumers decide which machine is right for them. Given the success and positive feedback from these assets, we plan to leverage them broadly across all consumer touchpoints, including several retail and ecommerce destinations. We have already begun to roll out improved in-store retail merchandising to enhance the consumer shopping experience. For example, we worked with Target on a redesigned planogram that has been deployed across 80% of store locations. This new redesign will improve in-store branding and better communicate the value of the Cricut ecosystem.

We're also better optimizing our marketing efforts and audience targeting. As part of this, we are rebalancing some of our investments over the year from bottom-of-the-funnel to top-of-the-funnel activities such as digital and influencer marketing across proven channels, as well as increased PR coverage. For example, we are very excited about the PR coverage we are receiving going into Mother's Day as Cricut being the perfect gift for moms in our lives. We believe this strategy will bear more long-term fruit and have greater lasting branding effects than one-off promotional plans during the course of the year.

We are also focused on creating greater upfront value for consumers. One way to do this is through more machine bundles, which can include digital content, materials and accessories. These bundles enhance the out-of-box experience and ensure users have all the things they need to make initial projects and get them quickly on the path toward user engagement.

Engagement

As I mentioned last quarter, we are putting a great deal of focus on user engagement, which starts the moment we acquire a user. Our data shows that the first few weeks of a new user's experience are often indicative of their engagement over time. Our current focus includes improving our onboarding process and driving users to Design Space early in their user journey. We are seeing early signs of success and are expanding our onboarding initiatives, like expanding lesson plans over the coming quarters to cover a broader set of machines.

Content drives inspiration, which drives engagement. We think of content both in terms of images and makeable projects, which include images plus design/layout work, photos of the finished project and can include instructions and lists of materials. We are creating more effective ways for users to find relevant content, while further reducing friction between designing and cutting projects. For example, we recently introduced visual-based search which lets users find similar images.

We are constantly increasing our image library. Our Contributing Artists Program, also known as CAP, launched just one year ago. The CAP program represents an increasingly significant portion of new images on Design Space. Sourced from diverse artists around the world, CAP also helps meet the need for localized content in many markets around the world.

Community projects will increasingly be a fresh source of inspiration and makeable content for our subscribers. These projects are created and designed by our community of users, and in addition to the design layouts and photos of the finished project, may also include instructions and a list of materials to use, making it easier for others to create. These projects can be shared inside the platform and on other social media using links, thus inspiring other users to make and creating network effects. This user generated content drives incremental value to Design Space and is becoming an increasingly important way to add content to the platform.

As we grow our library of makeable content on our platform, we are also improving the ways we deliver personalized and curated experiences to our members to find the most inspiring and relevant content to them. We are beginning a number of projects across our marketing technology, commerce and design platforms to significantly improve this experience. We see this as an important pillar in our journey to drive greater engagement.

Subscriptions

We ended the quarter with 2.7 million Paid Subscribers, a 17% increase year-over-year. We benefit from strong attach rates and are increasingly leveraging Design Space touchpoints to better communicate the benefits of our subscription services.

We continue to execute against our roadmap of Cricut Access exclusive software features. Warp is our latest addition. Warp enables creative effects on any text object. This is an impactful tool given that over 50% of projects made on our platform contain text. In many cases, new features we launch coincide with increased subscriber growth, highlighting our ability to develop valuable, highly sought-after features. Our priority is to ensure subscribers continuously discover and use the content, features and functionality available to them. We have an opportunity to increase user awareness of our many features through touch points and advertising on and off our platform, which will help us attract and retain subscribers. We are still in the very early days of our roadmap.

Subscribers are our most valuable customers. The primary reason subscribers stop subscribing is that they don't use Design Space often enough to justify the cost. So, one of our highest engagement priorities is to drive subscribers to engage more frequently. Closely related is gaining more subscribers. We capture most subscribers early in their Cricut journey, making our onboarding improvements another key source of future value.

Accessories and Materials

Turning to Accessories and Materials. As I mentioned, we are in the early days of re-building this business. We continue to hold market share when we compete on price, but overall, users are cutting fewer projects and therefore needing less material, which we believe is influenced at least in part by softer consumer discretionary spend. Longer term, we believe that Accessories and Materials will re-accelerate as we focus on cost reductions over time, sound promotional strategies for increased market share, more machine and materials bundles across more diverse channels, and increased user engagement.

Closing Remarks

We acknowledge the pressure that muted discretionary consumer spend continues to put on Connected Machines and Accessories and Materials. Subscriptions continues to be resilient, and we are excited about our international opportunities. We are more focused than we have ever been and are taking the right steps to grow our business for the long term. Our focus on new user acquisition, which starts with the purchase of a connected machine, and platform expansion to drive engagement, subscriptions, and increased monetization will help us navigate the current uncertainty and position us well for when consumer spend returns.

I'll now turn the call over to Kimball for the financials.

KIMBALL SHILL, CHIEF FINANCIAL OFFICER

Thank you Ashish, and welcome everyone.

In the first quarter, we delivered revenue of $181.2 million, a 26% decline compared to prior year. We generated $9.1 million in net income as we continued to invest in our key priorities.

Revenue

Breaking revenue down further, revenue from Connected Machines was $34.1 million, down 45% over Q1 2022. As we said on our last call, we ended 2022 with healthier channel inventory levels and anticipated that retailers would replenish inventory within the quarter. Retailers, however, continued to be cautious in rebuilding inventory due to softer consumer discretionary spend. They continue to purchase, but below our expectations.

Revenue from Accessories and Materials for the quarter was $72.0 million, down 39% over Q1 2022 and was impacted by retailers' conservative stance on rebuilding inventory levels. Also impacting revenue in this segment is lower engagement discussed above.

Subscriptions revenue for the quarter was $75.1 million, a 16% increase over Q1 2022, reflecting targeted investments in Cricut Access and the expansive improvements made over the last several quarters, as well as an uplift from Q4 seasonal strength in machine sales.

In terms of geographic breakdown, international revenue was $33.5 million, compared to $36.5 million in Q1 2022. As a percentage of total revenue, international was 18%, compared to 15% of total revenue in Q1 2022.

Users and Engagement

Turning to users and engagement.

I'm pleased to share we ended the quarter with over 8.2 million total users, or 19% growth over Q1 2022. As we increase engagement through the initiatives Ashish outlined, we have a significant opportunity to bring new users through the Cricut experience. This includes onboarding them more effectively and getting them to engage more quickly on Design Space.

We ended the quarter with over 3.7 million engaged users. This was flat over Q1 last year.

We ended the quarter with over 2.7 million paid subscribers, up 17% from Q1 2022. Our subscription attach rate matched Q1 2022 at 33%.

Gross Margin

Moving to gross margin. Total gross margin in the first quarter was 42.3%, an improvement compared to 40.5% in Q1 2022. Breaking gross margin down further:

Gross margin from Connected Machines was 3.1%. This compares to 2.7% in Q1 of last year. Looking at 2023, amortizing fixed costs on warehousing and capitalized operations expense across lower volumes will continue to put pressure on margins. Offsetting this partially, end-of-life machines, which carry lower gross margins, are becoming a smaller part of our machine mix as expected, which is helping machine margins.

Subscriptions gross margin for the quarter was 89.8%, down slightly compared to 2022 of 90.3%.

Gross margin from Accessories and Materials was impacted by an excess inventory write-down, fixed operating costs amortized over lower volumes for the quarter, and a consistent cadence in promotions. First Quarter gross margin for Accessories and Materials was 11.3% and included a write-down of $8.6 million of excess inventory primarily related to bulk configurations of Smart iron on and vinyl materials. Excluding this write-down, A&M margin would have been 23.2% in the quarter. This compares to 33.0% in Q1 2022.

Operating Expenses

Turning to operating expenses. We continue to operate the business with discipline and flexibility to navigate current trends. Given the pressure we saw coming into Q1, we implemented cost reductions including an 8% reduction in force, resulting in a $1.2 million charge in Q1. As a result, we expect to produce gross savings of $6.7 million for the full year. Total operating expenses for the quarter were $66.1 million and included $9.8 million in stock-based compensation expense. This was down 2% from $67.6 million in Q1 2022.

Operating Margin & Net Income

Operating income for the quarter was $10.5 million, or 5.8% of revenue, compared to $31.4 million, or 12.8% of revenue in Q1 last year. The decrease is related to lower revenue and an $8.6 million inventory write-down. Excluding the inventory write-down, operating margin would have been 10.5%.

We delivered our 17th consecutive quarter of positive net income. Net income was $9.1 million, or $0.04 cents per diluted share (and $0.07 cents per diluted share excluding the inventory write-down and related tax effect), compared to $23.5 million, or $0.11 cents per diluted share in Q1 2022.

Balance Sheet & Cash Flow

Turning now to the balance sheet and cash flow.

We continue to generate healthy cash flow on an annual basis, which funds inventory needs and investments for long-term growth. For the quarter, we generated $95.2 million in cash from operations, ending with a balance of $307.3 million and we remain debt free.

During the quarter, we used $3.2 million of cash to repurchase 347 thousand shares of our stock. We have $28.3 million remaining in the repurchase program. In addition, in Q1 we used $75.5 million to pay a special shareholder dividend.

Outlook

Consistent with our commentary last quarter, we continue to see softer consumer spend and retailers taking a conservative approach to inventory commitments and are thus taking a prudent and prioritized approach in our planning as we look ahead to 2023. We expect operating margins to be slightly down for the full year given Q1 performance.

From a revenue standpoint, we entered 2023 with healthier channel inventory levels and revenue should be more directly linked to consumer demand, but as already noted, retailers continue to be conservative on inventory commitments in the current environment. However, we expect typical second half seasonality, and year-over-year comps should improve in the second half.

In terms of new user growth, we still expect to add fewer new users in 2023 than we did last year, and we started 2023 with softer-than-expected Connected Machine sales in Q1, which puts further pressure on new user growth. While we have a positive outlook on Subscriptions, lower new users will put pressure on our subscriber growth rate and attach rate throughout the year and Paid Subscribers may be flat for the year, or even down, if current trends worsen.

Gross margins will continue to be pressured. On physical products, higher fixed costs as a percentage of revenue in warehousing and operations expense will continue to be a factor throughout 2023. Accessories and Materials will also continue at a similar promotional cadence to remain price competitive. As a result, we expect full-year Accessories and Materials margins will be similar to Q4 ‘22’s gross margin of 15.9%, inclusive of the write-down this quarter.

We remain focused on managing our profitability, while investing in areas with the highest impact. Should macro conditions worsen, we will continue to make adjustments as needed, just as we demonstrated in 2022. We expect to continue generating healthy cash flow from operations and remain committed to our long-term operating margin targets of 15-19%. Our proven model has demonstrated that when we operate at scale and drive topline growth, these margins are achievable.

With that, I’ll turn the call over to the operator for questions.