

Jim Suva - Cricut, Inc. - SVP Finance, Treasurer, and Investor Relations

Thank you, operator, and good afternoon, everyone. Thank you for joining us on Cricut's first quarter 2024 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 or Form 10-Q that we have filed with the Securities and Exchange Commission ("SEC"). 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 7, 2024. 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 - Cricut, Inc. - CEO

Thank you, Jim, and welcome, everyone.

Q1 played out largely as expected. Operating margin dollars grew significantly by 139% or \$15 million, driven by lower inventory write-offs, more paid subscribers and higher sales of connected machines despite an 8% YoY drop in overall sales. Given the confidence in the sustainability of our profitable operations, the board of directors approved three capital allocation items: a special dividend of \$0.40 per share, a recurring semi-annual dividend of \$0.10 per share, and another \$50 million stock repurchase program. Kimball will go over these three capital allocation items in detail in a few minutes.

In Q1, Platform revenues increased 3% on paid subscriber growth. Products revenues declined 15% as the positive growth in connected machines from higher units was more than offset by a decline in accessories and materials.

The areas where we could do better are straight forward. We need to attract more new users to buy our connected machines. We need to reverse weakening engagement trends and re-inject enthusiasm among our users. We need to be more effective competitors in accessories and materials. Remember we have four priorities: New user acquisition, User engagement, Subscriptions, and Accessories & Materials. I will briefly review these items and provide some detailed commentary on our new platform innovations.

New User Acquisition

As mentioned in our press release, going forward we will talk about active users who have used their connected machine in the past year and Kimball will go into more detail on metrics and KPIs.

We ended the quarter with over 5.95 million Active Users who cut in the past year, slightly up from 5.94 million a year ago and in line with our expectations. We continue to focus on new user acquisition and engagement growth on our platform, which ultimately drive our monetization flywheel.

During Q1, we accelerated our investment in marketing spend and doubled down on our PR via live broadcast, gift guides, product reviews and lifestyle coverage.

As we move people down the funnel, our research shows consumers consider the cost of the machine plus the ongoing cost of using it and how much they will use it. To address these concerns, we wanted to show them that they could save money, while experiencing the joy of creating and personalizing things. Recognizing this appeal, we recently launched a campaign called Make vs. Buy, which highlights specific examples of savings of making projects vs. buying similar finished products. For example, personalized door mats cost only \$10 to make, compared to up to \$150 to buy. Another example is fashionable personalized tote bags, which cost only \$3.08 to make compared to \$30 to buy. You can see these and many more examples on our website.

During Q1, we leaned into programs that show our target consumers different making occasions. We executed integrated programs for key seasonal moments including Valentine's Day, National Craft Month, Women's History Month, and Easter. We saw a trend towards personalizing apparel and party décor for the NFL playoffs, including a broadcast hit on Fox News' talk show, Fox and Friends. Each of these programs was supported by an integrated marketing plan, leveraging vehicles including digital marketing, influencer posts, organic social, social brand partnerships, and live broadcast.

We were highlighted recently in USA Today, which stated and I quote, "Cricut's newest cutting machine is the perfect size for casual crafters. The Cricut Joy Xtra is an ideal choice for hobby crafters who want all the cutting power of a full-size Cricut without having to store a bulky machine."

As a follow up to the Cricut Make Their Day Valentines event, we launched our Make Mom's Day sales event on April 28. This two-week sales event is supported by retailer programs and content marketing strategies, incorporating influencers, social, editorial, and deals coverage.

User Engagement

We ended the quarter with over 5.95 million Active Users who cut in the past year, and we had 3.5 million 90-Day Engaged Users who cut during the quarter, down from 3.7 million in Q1 2023. We continue to experience engagement erosion from our large user cohorts from 2020 and 2021, and from prior years, who age on their engagement curve and are not offset with as many new users in recent quarters. Our focus remains to maximize engagement of our most impactful cohorts, which are new users onboarding onto the platform (or Onboarders) and Paid Subscribers.

Recently, we developed more data instrumentation that increased our understanding of the challenges Onboarders can run into during their initial journey within our Platform. This has helped us focus our efforts to improve this experience. In Q1, we saw an improvement in the percentage of new users who successfully start and complete their out-of-box experience. Our efforts will continue across the journey for new users, from test

cut and first project, through first week and first month on our platform. In the first quarter, we adjusted how we present our educational video content, which we now show directly in Design Space.

In addition to a larger content library, we have also made improvements to our search and personalization algorithm. We now provide personalized recommendations for images and projects on the Inspire page in Design Space mobile apps. We will continue to make progress on search personalization over time.

We have also enhanced our machine learning personalization model to consider additional inputs from user behavior on our platform. We are also prioritizing projects and images that have a higher chance of make success.

In Q1, our team improved the projects recommendation system and created an in-house system that is more flexible, adaptable and designed to capture different aspects of user preferences. For example, we use AI deep learning to suggest projects that users might like based on user behavior to recommend similar projects and help find popular projects that are time sensitive. We tested this new system, and it did better than our old models and increased the number of customized projects made on our platform.

We also applied AI to examine and label images, to suggest suitable tags for images uploaded to our database and help produce better search results for our users. We also intend to use this algorithm to refine existing tags in our database, which should improve search retrieval. We have several more improvements planned for search enhancements in future quarters.

Subscriptions

Paid subscribers were in-line with our expectations and increased 82 thousand YoY and increased 27 thousand sequentially in Q1, ending with just under 2.8 million Paid Subscribers. Our subscriptions efforts continue to bear fruit in terms of converting purchasers of new machines into subscribers. At the other end, our subscription attrition curves have remained steady despite declines in engagement. Lower new user adds compared to prior years puts pressure on our subscriber growth rates and created some quarterly fluctuations in 2023 that will likely repeat in 2024.

We have a rich roadmap to continually increase the value proposition for subscribers, including an ever-growing suite of premium design tools, along with the content strategies described above. In January, we launched Create Sticker, which dramatically simplifies the process of turning a raw image into a finished sticker in a few easy steps. We also made significant improvements to the background removal tool, which is one of the most used subscription features by our members, by leveraging and testing multiple variants of machine learning and AI based models to increase the accuracy of removing backgrounds from images uploaded by our users.

Our goal is to make it incredibly compelling to sign up as a subscriber to leverage our software and services. As our engagement efforts bear fruit, we expect to see a boost to subscriptions.

Accessories and Materials

Accessories and Materials sales declined 26% YoY in Q1. Clearly, we still have a long way to go to establish our expected competitive position here. We recognize the role affordability plays in our materials business and are working on several solutions. The aim is to stimulate purchasing activity and boost engagement. In addition, we

face the stiffest competition in this part of our business, with lower barriers to entry than cutting machines and our digital platform.

I am excited to give you a tangible update on some positive progress in this area. Towards the end of Q1, we launched the Cricut Value Materials online. Designed to deliver maximum performance at a great price, this new offering was aimed to compete effectively with online marketplaces, which are more price competitive and require hitting the right price points with shipping economics to compete more effectively. This is accomplished through re-engineered product, re-engineered packaging and improving supply chain efficiencies. It will take us some time to work through current inventory as we roll new products in, but we expect to achieve margin improvements in this business over time, while still creating a differentiated offering that works seamlessly with our machines and platform. Feedback thus far has been encouraging and I look forward to sharing more with you in the quarters ahead.

Growth in this segment should emerge as we are successful in driving new customer acquisition at a higher rate and our engagement efforts begin to bear fruit. Consistent with prior comments, we will continue our promotional cadence in this category to remain price competitive for consumers with a focus on winning share. We see that when we are in the price range of our competitors, we get our fair share.

We are intensely focused on the overall customer experience, and we are motivated to work with those retailers that help us create a great experience both on shelf and for actual use of our ecosystem. It's our fundamental belief that when we give people more reasons and inspiration to make things that are appealing to them and we make it easier to make things affordably, we will see a lift to materials consumption. We are driven to continue to innovate while exhibiting both long-term focus and current discipline.

I will now turn the call over to Kimball.

Kimball Shill - Cricut, Inc. - CFO

Thank you, Ashish

I would like to provide more details on the capital allocation items. The board of directors approved a special, one-time dividend of \$0.40 per share and a recurring semi-annual dividend of \$0.10 per share. Both dividends are payable on July 19, for shareholders of record on July 2. The recurring semi-annual dividend of \$0.10 is anticipated again in about six months, which would be the January timeframe but is subject to board approval. The board of directors also approved a new \$50 million stock repurchase program. As mentioned in our last earnings call, we effectively completed our previously authorized stock repurchase program announced in August 2022. The board of directors views this level of capital allocation, both stock repurchases and dividends, as appropriate given the company's operating and financial plans and will continue to evaluate capital allocation on a regular basis.

These capital allocation decisions are possible due to past profitability and our confidence in the sustainability of our profitable operations. We want Cricut to always have ample liquidity to sustain and grow our business, but not to hold excess cash for no reason. We do not anticipate the need for any debt or utilization of our credit line in the near term. Now on to the financials of Q1 and our outlook.

Last quarter, I mentioned that we would adjust our reporting segments and KPIs. Recall, Cricut has been a public company for approximately three years. During 2020, in preparing to go public, we developed a package of quarterly information to provide meaningful transparency for investors, including our reporting segments and KPIs. After three years of business evolution, we have redesigned some aspects of our quarterly information package. We increasingly view Cricut as a platform business with physical products.

My commentary will be consistent with our new segments of Platform and Products. We also updated our public KPIs to focus on the most meaningful indicators for our current and future operations. You will notice we now provide active users rather than total users, which more accurately reflects our business. For definitional purposes, an Active User is a unique user who has used their connected machine to make a project in the last 12 months. We will also continue to share our shorter-term engagement metric of 90-day Engaged Users, which represent a unique user who has used their connected machine to make a project in the last 90 days. On our investor relations website, we have provided historical information on our new segments and KPIs.

In the first quarter, we delivered revenue of \$167.4 million, an 8% decline compared to the prior year and in line with our expectations. We generated \$19.6 million in net income, a 116% YoY increase and our 21st consecutive quarter of positive net income, as we continued to invest in our key priorities.

Breaking revenue down further, Q1 2024 revenue from Platform was \$78 million, up 3% year over year. Revenue from Products was \$89 million, down 15% over Q1 2023. Connected machines increased 8%, driven by higher units sold, while accessories and materials decreased 26%. Some retailers started to restock inventory levels partially in Q1, unlike in 2023 when they were destocking. However, during key sales events, we found retailers' shelves light on inventory to fully capture the opportunity.

In terms of geographic breakdown, international revenue was \$32.6 million or down -3%, compared to \$33.5 million in Q1 2023. The year-over-year decline in Q1 was primarily driven by UK and EU Central regions. As a percentage of total revenue, international was 19% in Q1 2024, compared with 18% of total revenue in Q1 2023.

Turning to Active Users and engagement. We ended the quarter with over 5.95 million Active Users, a slight increase from 5.94 million a year ago. We ended the quarter with over 3.5 million 90-Day Engaged Users, which was a 5% decline from Q1 last year. As Ashish mentioned we have more work to do to improve engagement.

We ended the quarter with nearly 2.8 million paid subscribers, up 3% from Q1 2023, and up 27 thousand sequentially. As discussed in earlier calls, there is some natural subscriber attrition; so, subscriber growth will be muted until we increase the pace of machine sales and new user acquisition.

Moving to gross margin. Total gross margin in the first quarter was 54.7%, an improvement compared to the 42.3% in Q1 2023. The improvement reflects a higher amount of Platform revenue as a percentage of total revenue and less impairments than last year.

Breaking gross margin down further, gross margins from Platform were 88.8% compared to 89.8% a year ago. The slight decline in Platform gross margins was primarily related to higher amortization of capitalized software costs, which we expect to continue.

Gross margin from Products was 24.8%, compared to 7.8% in Q1 a year ago. The increase in gross margins was primarily due to less impairments in materials than a year ago.

Total operating expenses for the quarter were \$66.4 million and included \$10.3 million in stock-based compensation. Total operating expenses were up less than 1% from the \$66.1 million in Q1 2023. As we mentioned last quarter, we increased our 2024 plans for increased marketing, which drove the sales and marketing costs up \$3.4m or up 12%, but this was largely offset by a \$2.9m decrease in R&D.

Operating income for the quarter was \$25.2 million, or 15.1% of revenue, compared to \$10.5 million, or 5.8% of revenue in Q1 last year. This was a 139% increase in operating income, which we are encouraged with, despite the decline in sales. The increase in operating income is primarily due to higher paid subscriptions, coupled with less impairments in our materials business.

Our tax rate of 30.6% increased from 29.2% a year ago, primarily due to the tax impact of stock vesting at a lower price.

We delivered our 21st consecutive quarter of positive net income. Net income was \$19.6 million, or \$0.09 per diluted share, compared to \$9.1 million, or \$0.04 per diluted share in Q1 2023.

Turning now to 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. In Q1, we generated \$57 million in cash from operations, compared to \$95 million a year ago. We ended Q1 with a cash and cash equivalents balance of \$282 million. We remain debt free. Inventory decreased by \$68 million from a year ago to \$225 million at the end of Q1 2024.

During Q1, we used \$10.8 million of cash to repurchase 1.7 million shares of our stock, which effectively completed our \$50 million stock repurchase program that was authorized in August 2022. As discussed previously, the board of directors authorized a new \$50 million stock buyback program, which will commence in Q2.

Outlook

Recall we do not give detailed quarterly or annual guidance but we do want to offer some color on our outlook for 2024.

We are focused on bringing excitement to our category. We are doing this through an increased focus on marketing and continuing our strategy of deeper promotions on cutting machines and a continued cadence on accessories and materials to drive affordability.

We expect continued sales pressure on our Products segment, especially in accessories and materials and accordingly, we do not expect positive Q2 revenue growth year over year.

We will continue to accelerate marketing to generate consumer excitement. But given ongoing retailer conservatism and only two major sales events under our belt, it is too soon to call an inflection point; hence, we may even see a decline for the full year.

We expect paid subscriber count and subscriptions revenues to grow slightly and become a larger portion of total company sales and profits for the full year. Lower new user growth rates will put pressure on our subscriber growth, following a similar pattern to 2023, and could result in a seasonal pattern of paid subscriber growth in Q1 and Q4 but flat to declining in Q2 and Q3.

Typical revenue seasonality is 40% in the first half and 60% in the second half of the year. However, we anticipate 2024 seasonality will look a lot like 2023, where revenues were distributed 47% in the first half and 53% in the second half.

In 2024, our operating expenses will increase modestly as we increase our marketing spend to reinvigorate excitement in the category. We expect total year operating margins to be about flat year-over-year.

We expect to be profitable each quarter and generate significant positive cash flow during 2024.

Our long-term financial model remains unchanged with operating margin targets of 15% to 19%. Our proven model has demonstrated that when we operate at scale, which we define as revenue above \$1 billion, and drive top line growth, these margins are achievable.

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