

**JIM SUVA, SVP FINANCE**

Thank you, operator, and good afternoon, everyone. Thank you for joining us on Cricut's second 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](http://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-Q. 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, August 8, 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**

Thank you, Jim.

We finished the quarter in line with our expectations. We continue to manage the business with an eye toward profitability even as we navigate softer consumer spend. I am proud of the accomplishments the team has made and we launched some important innovations that I will discuss in detail.

Looking at Q2 highlights, on a year-over-year basis, Q2 Total Revenues were down 3%, machine sales were up 5%, and Operating Income was down 4%. We are striving to return to growth but remain disciplined with how we spend. We are also very focused on innovation and strengthening our platform.

**Cricut Venture**

I am also excited to share that on July 18, we launched Cricut Venture, the largest and fastest connected cutting machine on the Cricut Platform. Cricut Venture represents the fourth, all-new architecture of connected machines in our history and demonstrates our commitment to innovation.

Cricut Venture cuts a wide variety of materials with precision at commercial speeds, as well as writes, scores, and foils. With Cricut Venture, makers can create for occasions that require larger sizes and quantities, from bigger custom wall decals to large batches of custom t-shirts or tote bags. Cricut Venture is able to cut up to 75 feet of repeated images. It works seamlessly with Design Space and is compatible with all of our existing 13" Smart Materials, as well as our newly introduced 25" width.

Powered by Cricut Design Space, our platform helps millions of users discover, make and share their projects and Cricut Venture expands the ability for users to make, thanks to enhanced software features that support this new machine. We focus on makeable content, featuring projects and art that lend themselves to large projects including education, parties, weddings, sports events and apparel, large batch quantities and much more. We are excited to see how makers will use Cricut Venture to create projects and share them with other community members.

We launched Cricut Venture on July 18 with our first in-person consumer event since 2020. We love the energy these events generate within our community and are planning to do more in-person customer events around new products and our Cricut platform. We are pleased with early sales performance.

### **2023 Priorities**

Recall that we have 4 priorities which are 1) New user acquisition, 2) User engagement, 3) Subscriptions, and 4) Accessories and materials. I will briefly review these items and also provide some detailed commentary on our new platform innovations.

#### **New User Acquisition**

We added over 200 thousand new users in the quarter, approximately in line with our expectations. We continue our focus on new user acquisition and platform expansion to ultimately drive engagement, subscriptions and increased monetization.

We have shared previously that our funnel is healthy and we see an opportunity in holiday to pull consumers through the funnel who have been pausing in their purchase decisions. A recent survey among consumers in the Cricut cutting machine funnel confirms that current financial situations are a key barrier to purchase. About a third of consumers in the Cricut funnel stated that they are struggling to make ends meet on a personal level. Consumers at the top of the funnel are most interested in understanding the capabilities of the Cricut machine and how it fits into their lives. As consumers get closer to purchasing a Cricut, affordability becomes a constraint. Among these consumers at the bottom of the funnel, affordability is the #1 barrier to purchase. About half of those consumers say that they are saving money to purchase a Cricut while about a third are waiting for a sale or special deal. We are using these insights to inform our strategy heading into the holiday season. We plan to be more promotional in the 4th quarter with deeper promotions for shorter periods of time, combined with a 360-degree marketing plan, including adding over 200 paid influencers, to pull more consumers through the funnel.

#### **Engagement**

We ended Q2 with nearly 3.7m engaged users, which was roughly flat year over year. We are pursuing efforts to drive engagement along our members' journey from on-boarding to stimulating discovery and inspiration, to assisting making and encouraging sharing. As we have highlighted before, mobile plays an important role in driving more interactions. We launched an enhanced home page inside Design Space on mobile platforms in July 2022 and continue to make improvements on an ongoing basis. For the first half of 2023, over half the interactions on design space home page came from mobile devices.

We have also greatly simplified navigation on the platform for desktop users. This new navigation also makes learning plans, heat guide, Cricut Learn and Shop easily accessible from inside the platform. Increasingly, we will integrate more and more video content, learning aids, and instructions inside the platform itself, where users spend the majority of their time.

We are always listening to our customers and prioritizing enhancements that alleviate pain points and friction and increase the value of our Cricut Access subscriptions. In Q2, we launched enhancements for Print Then Cut. Print Then Cut functionality gives users the ability to print an image on their color printer and then cut the outline of their printed design. This gives them colored designs without having to use layers of different materials in different colors.

Last quarter, we shared the introduction of Warp, which enables creative effects on text. In the coming months, we will be releasing version 2 of that feature where users can warp their images, giving them greater creative possibilities.

In our last call, we mentioned how community projects shared on our platform can help inspire and match content to other users. These mutually reinforcing effects will create value in our platform for all users. At the end of Q2, we improved the way members can search within the library of community projects and saw a notable increase in members' engagement with those projects.

### **Subscriptions**

We ended the quarter with over 2.7 million paid subscribers, which was essentially flat quarter over quarter and up 15% year over year and was in line with our expectations.

AI, machine learning, and, especially, generative AI models are much in the news. I would like to point out some examples of how we are using AI and machine learning to add more valuable benefits to Cricut subscribers.

### **AI & Machine Learning**

AI is an area of exciting potential for the Cricut platform and is complementary to our strategy. We see opportunities for AI to impact the experience throughout the user journey, around both search & discovery and design & make within Design Space. We have been working on machine learning and AI for a long time, and we've recently delivered several AI-powered capabilities and are in active development on others. I want to give you some insights into these AI and machine-learning capabilities.

On the design & make side, Automatic Background Remover uses a custom machine-learning model and is one of our most popular Cricut Access features across our desktop and mobile apps. On the search & discovery side, our Similar Images functionality is powered by a machine-learning model that is trained on, and tuned for, vector images. Building on the Similar Images foundation, we are also developing Semantic Search, a richer search capability that leverages modern machine learning techniques. We are currently testing Semantic Search with both internal and external users. We expect to see richer search capabilities powered by semantic search in the future.

AI techniques will also be used to drive the display of personalized content on the Design Space home page and in our engagement marketing, and we continue to actively refine our personalization algorithms.

Generative AI is an area of great interest and excitement in design software, and it holds great promise to augment the already rich Cricut Access content offering. We are actively experimenting with generative AI capabilities that allow users to create unique images based on detailed natural-language prompts, such as “a sailboat with dolphins jumping in the waves nearby.” A unique challenge and area of differentiation for Cricut in building generative art functionality is that we will ensure that generated images are optimized for cutting machines.

Our teams are investigating other ways in which AI will add meaningful value to our platform, with a focus on facilitating the journey for our members between inspiration and making.

We see Generative AI as being complementary and will enhance our content strategy in a meaningful and positive way. At the same time, we believe that it does not replace human creativity but enhances it. We are focused on doing this responsibly while ensuring we protect copyrights and our artists.

### **Accessories & Materials**

We are excited about the new ecosystem of materials we launched alongside Cricut Venture, including 25” width materials and all-new markers developed to support the scale and speeds that Cricut Venture enables.

As we’ve highlighted before, we are on a 2-year journey to transform this business. Consistent with prior comments, we will continue our promotional cadence in this category to remain price competitive for consumers. We see that when we are in the price range of our competitors, we get our fair share.

We have a strong focus on optimizing our products for lower costs so we can compete better in the market with improved margins, while still creating a differentiated offering that works seamlessly with our machines and platform. 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 the shelf and for actual usage of our ecosystem.

### **Closing Remarks**

I have never felt so encouraged and excited about the Cricut platform. We are in the early days of this transformation, while still remaining profitable. We are driven to continue to innovate while exhibiting both long-term focus and current discipline.

With that I will transition the call over to Kimball to go into the financial details.

### **KIMBALL SHILL, CHIEF FINANCIAL OFFICER**

Thank you Ashish, and welcome everyone.

In the second quarter, we delivered revenue of \$177.8 million, a 3% decline compared to prior year. We generated \$16.0 million in net income – our 18th consecutive quarter of positive net income – as we continued to invest in our key priorities.

### **Revenue**

Breaking revenue down further, revenue from connected machines was \$37.3 million, up 5% over Q2 2022. As Ashish mentioned, new user acquisition was in line with our expectations in Q2, as we continued to experience

the effects of softness in consumer discretionary spending. While we are encouraged to see YOY machine revenues turn back to positive growth, we are still far from where we aspire to be.

Revenue from Accessories and Materials for the quarter was \$64.4 million, down 20% over Q2 2022. Note that in Q2 2022, we benefitted from channel fill for the launch of Autopress and Hat Press. Excluding this, revenue from Accessories and Materials would have been down approximately 4% compared to Q2 last year. As Ashish referenced, we have more work to do here. Subscriptions revenue for the quarter was \$76.1 million, a 13% increase over Q2 2022, reflecting targeted investments in Cricut Access and the expansive improvements made over the last several quarters.

In terms of geographic breakdown, international revenue was \$32.6 million up 34%, compared to \$24.3 million in Q2 2022. As a percentage of total revenue, international was 18%, compared to 13% of total revenue in Q2 2022.

### **Users & Engagement**

Turning to users and engagement.

I'm pleased to share we ended the quarter with over 8.4 million total users, or 17% growth over Q2 2022.

We ended the quarter with nearly 3.7 million engaged users, essentially flat with Q2 last year.

We ended the quarter with over 2.7 million paid subscribers, up 15% from Q2 2022, and flat sequentially. Our subscription attach rate declined to 32% in Q2 2023 from 33% last year. 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.

### **Gross Margin**

Moving to gross margin. Total gross margin in the second quarter was 49.3%, an improvement compared to the 46.5% in Q2 2022, and reflects a higher amount of subscription revenue as a percentage of total revenue.

Breaking gross margin down further:

Gross margin from connected machines was 9.4%. This compares to 1.6% in Q2 of last year. The increase in margin was primarily due to less promotional activity as a percentage of revenue and a favorable product mix compared to Q2 2022, when our end-of-life Maker machine was a greater percentage of machine sales.

Subscriptions gross margin for the quarter was 89.6%, compared to Q2 2022 of 90.9%.

Second Quarter gross margin for Accessories and Materials was 24.7%. This compares to 29.1% in Q2 2022. The decline in margin was driven by increased promotional activity and warehouse and operations costs as a percentage of revenue, along with an impairment of unused equipment and components associated with the wind down of manufacturing of certain products.

Looking into the second half for both Connected Machines and Accessories and Materials, margin pressures from amortizing fixed costs on warehousing and capitalized operations expenses will accelerate through the 2H, especially in Q4, as we reduce inventory levels. Also, Q4 is typically our lowest gross margin quarter. Machine

sales are seasonally higher with the holidays, which will naturally pressure margins, since machines carry lower gross margins than other products and will represent a higher percentage of revenue in that quarter.

### **Operating Expenses**

Total operating expenses for the quarter were \$68.4 million and included \$11.2 million in stock-based compensation expense. Total operating expense was up nearly 5% from \$65.4 million in Q2 2022. While Research and Development and Sales and Marketing declined year-over-year, General and Administrative expense increased, primarily due to an increase for bad debt allowance, increased personnel-related expenses, and an increase in professional services.

### **Operating Margin & Net Income**

Operating income for the quarter was \$19.3 million, or 10.8% of revenue, compared to \$20.0 million, or 10.9% of revenue in Q2 last year.

We delivered our 18th consecutive quarter of positive net income. Net income was \$16.0 million, or \$0.07 cents per diluted share, compared to \$13.8 million, or \$0.06 cents per diluted share in Q2 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. Year to date, we have generated \$159.6 million in cash from operations compared to \$13.0 million a year ago, ending with a cash and cash equivalents balance of \$361.5 million (before paying the dividend in July) and we remain debt free.

As you recall, as part of our COVID risk mitigation strategies, we intentionally built up our on-hand inventory to ensure we could supply our customers during the pandemic. Starting late last year and continuing for the next few quarters, we began to focus on bringing inventory levels in line with historical norms. As part of the Company's ongoing evaluation of capital allocation, we seek to balance multiple considerations, including ensuring that the Company has more than adequate liquidity and financial flexibility, evaluating opportunities to invest in our business to drive long-term shareholder returns, whether organically or through potential acquisitions, and returning capital to our shareholders. Given this, in Q2 we announced an additional \$234.6 million special shareholder dividend, of which \$232.2 million was distributed in July, with the remainder to be paid upon vesting of restricted shares. This dividend comes as a result of right-sizing our balance sheet post-COVID and converting inventory into cash.

During the quarter, we used \$1.0 million of cash to repurchase 104K shares of our stock. We were constrained on stock repurchases as we were considering the special dividend, as well as a higher stock price. We have \$27.3 million remaining in the repurchase program.

### **Outlook**

Much of our outlook is consistent with what I communicated in our prior earnings call but I do want to highlight a few additional items.

During Q3 and specifically in July, we paid the special dividend, which will result in a lower cash balance and lower interest income in the second half of the year.

We expect to continue generating healthy cash flow from operations and to end the year with substantial cash and no debt.

Consistent with our commentary last quarter, we continue to see soft 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 the second half of 2023. We expect operating margins to be slightly down for the full year relative to our original expectations, given first half of the year performance.

Typical revenue seasonality is 60% in the second half. Given the current macro environment, we expect second half revenue to be slightly softer as a percentage of full year revenues.

In terms of new user growth, we still expect to add fewer new users in 2023 than we did last year. 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.

Leveraging our consumer analytics, we plan to execute deeper Q4 promotions for machines, combined with comprehensive marketing plans, to address consumer concerns about affordability and consumer reluctance to spend.

Gross margins will continue to be pressured. On physical products, higher fixed costs as a percentage of revenue in warehousing and capitalized operations expense will continue to be a factor throughout 2023 and more pronounced in Q4 as inventory levels decrease. Accessories and Materials will also have a promotional cadence to remain price competitive. As a result, we expect full-year Accessories and Materials margins will be similar to Q4 2022's gross margin.

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.