

STACIE CLEMENTS, INVESTOR RELATIONS, THE BLUESHIRT GROUP

Thank you, operator, and good afternoon, everyone. Thank you for joining us on Cricut's third quarter 2022 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-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, November 8, 2022. 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, Stacie, and welcome everyone.

As expected, we ended the third quarter with healthier channel inventory. Revenue in the third quarter was \$177.0 million, slightly down from last quarter, as retailers continued to work through their inventory.

Underpinning our resilience in this more challenging macro environment is our durable business model and focused investments on high impact initiatives.

We generated net income for the 15th consecutive quarter, once again demonstrating our proven track record of sustainable profitability.

I am confident in the fundamentals of the business and encouraged by the positive momentum in some areas while navigating challenges in others.

Business momentum

First, we strongly believe that we have millions of new users to acquire domestically and internationally. Our user communities have never been stronger. Our top three Cricut-related hash tags have garnered over 6 billion views on TikTok. Brand familiarity continues to expand with strong Search interest on "What is Cricut." And the

success we saw with Amazon Prime Days in July and October indicates that our sales funnel is healthy. These trends give us confidence in our overall market opportunity and point to expanded interest in the category. We will continue to run the business for the long term, ensuring category and brand health.

Our funnel is healthy, and we have a large market opportunity ahead of us. Our qualitative research tells us that interest continues to be strong but customers are taking longer to convert and have a higher threshold before they make a purchase decision, as they prioritize their needs over wants given the current economic environment. Net new users added in the quarter were down 26% compared to last year, while connected machine revenue was down 49%, indicating that inventory moved through the channel. So, consumers continue to purchase our products at a healthier pace than our revenue suggests.

Highlighting this point is the 30% year-over-year growth in our user base to nearly 7.5 million, up from 5.7 million the same quarter last year.

I'm particularly pleased with the growth we're seeing in our subscription services, as we continue to create a richer, more valuable experience for our Cricut Access subscribers. New subscriber growth has outpaced user growth on a percentage basis for 11 consecutive quarters. We continue to drive high margin revenue and leverage the strength of our platform with attach rates now consistently around 33%, compared to mid-20's pre-pandemic.

Differentiated platform approach

Our platform provides an integrated experience that inspires new design ideas, fosters community, and supports both designing and making. Design Space is our software platform through which users create a profile, follow other users and connect with a broader Cricut community. Once users discover something they want to create, they can easily create a design or modify an existing one, using our suite of tools. They can also easily bookmark projects, images, and fonts for later use, providing us with valuable insight into their personal preferences.

Because we're a connected platform, all of these interactions, including designs and projects, are stored in Design Space and cannot be transferred to an outside ecosystem, making our platform extremely sticky.

Our connected platform creates a competitive moat. All users must use Design Space to cut with our machines. This gives us valuable touch points with our entire user base each time they create, as well as giving us insights into their behavior and preferences.

Our goal is to create a habit-forming experience, where users come back often. Most recently, we launched a set of robust image manipulation tools, typically only available in high-end software. These tools give users greater flexibility to easily create designs, reducing hours of design time in the process. The more users interact in Design Space, the more value they create and derive from our platform. For example, shared projects can be leveraged within the Cricut community, saving users valuable design and editing time.

Subscriptions

Cricut Access, our subscription service, fuels our efforts in these areas, and offers more tools and content to help users achieve their creative potential. We have talked before about our Contributing Artist Program that provides a marketplace for artists to publish images and share in revenue streams as subscribers use their images. While the program is still young, subscriber reaction has been very enthusiastic. Contributing Artists are an important source of localized content in many international markets. Also, we recently launched a beta version of Editable Images, a key benefit for Cricut Access subscribers that we highlighted in our last call. This represents one of the most significant advancements in our image architecture and offers our Cricut Access members a tremendous amount of creative flexibility with Editable Images. We continue to invest in the platform to improve discoverability and provide more inspiration, community features, diverse content, and design tools, some of which will be available only to Cricut Access subscribers.

We are creating more advertising touchpoints in Design Space to drive increased monetization and subscribers. For example, we have multiple touchpoints related to user onboarding, content searches, and design tools that deliver context sensitive ads depending on what the user is doing. Early success in these initiatives is driving an increase in trials and subscribers. The chart shows our top 10 touchpoints, but there are many others and we continue to optimize and learn. Aside from general advertising at key touchpoints in the user's journey, significant upsell touchpoints to Cricut Access include content and subscriber-only, premium design tools.

As a result of these efforts, we added approximately 89,000 net new subscribers in Q3, which was better than expected in the face of slower machine demand and user growth. We have a solid roadmap of features and data-driven marketing capabilities to further enrich the platform.

Onboarding

Just as importantly, we continue to invest in our onboarding initiatives. We know that the faster a user gets up and running, the more they create, engage, and share over their entire lifecycle. Last year, we rolled out an online Learning Center, which was primarily focused around "how to" guides for specific projects. Most recently, we integrated a virtual Learning Plan into Design Space that walks users step-by-step through a series of simple and fun lessons. These lessons teach users the basics of Design Space, and how to use their connected machine, Cricut materials, and more. In addition, users can take advantage of our Learning Kits on Cricut.com, which provide materials and tools to complete specific projects that enable our users to build their confidence in their designs and crafting efforts.

Engagement

We have almost half of our total user base cutting on our platform in the past 90 days, with nearly 3.6M engaged users, up 11% year over year. Keep in mind that these engaged users are defined by how many users have actually cut a project.

Our current definition of engaged user doesn't take into account the hundreds of thousands of daily users coming into design space that aren't cutting but are taking a variety of actions. For example, users have bookmarked over 120 million images and projects, and we see this accelerating with nearly 2 million bookmarks being added each week since the middle of Q3. The majority of these users who come in on any given day end up cutting over the next week. When we ask users who have not cut with their machines in over 90 days, 80% of them are motivated to use their Cricut machines more often and express a strong desire and interest in doing so. We believe that if we can give them compelling reasons to come into Design Space more often to browse and be inspired, and make it easier and faster to find the right idea and make projects, we can get these users to engage.

Our mobile apps play a key role in making it easier for users to take some action on our platform and have a frictionless experience for even the briefest moments of engagement – whether it's a spare 5 minutes for project discovery, checking community notifications or creative design work. Our data shows that users who use Design Space on more than one device are significantly more likely to cut and are much more likely to subscribe to Cricut Access than those using only one device. The more time users spend in Design Space and use the platform, the more opportunities we have to monetize and ultimately cut.

Accessories & materials

Additional monetization opportunities exist within our Accessories and Materials business where we continue to innovate in ways that uniquely leverage our platform.

Last quarter we noted that we are seeing competition, especially online, as well as more placement of competitive materials in our retail channels. While our members realize that Cricut materials work seamlessly with our machines and our software, users are more price sensitive than they have ever been. During Q3 we began running additional promotions to help improve affordability and help right size channel inventory. We plan to continue to focus on making our products more affordable through cost reductions and promotions.

We will also continue to expand into new use cases. In Q3, we launched a wide range of items for card making, labeling and personalization. These included Watercolor cards, Markers & Brush sets, Smart Labels, Glow in the dark vinyl and Iron On, and several other consumables. The early results show that these items are driving additional sales of accessories and materials and helping people do projects quicker and easier. Finally, we will lean into those retailers that help tell the entire Cricut ecosystem story, showcasing compatibility between machines and Cricut materials.

International

International remains an important priority. The trends that have driven our business since 2014 also hold true internationally and our research shows an almost universal propensity for crafting.

In Q3, we executed a new go-to-market model in Australia, deploying a local warehouse facility, which will allow us to improve customer experience. We continue to make strides in continental Europe, especially France and Germany with expanded distribution and awareness.

Our platform investments, such as the Contributing Artists Program and Editable images, will play a key role in our international expansion in existing and new markets.

We recently launched into South Korea, Japan and Saudi Arabia, with imminent launches in India and Taiwan. Additionally, we localized versions of Design Space in nine new languages – Swedish, Polish, Danish, Hungarian, Czech, Norwegian, Romanian, Finnish and Thai.

Summary

In summary, operating in this macro environment has been challenging, but I believe we are stronger for it – with greater focus and discipline than ever before. As we enter 2023, we believe channel inventory imbalance will be mostly behind us, and we anticipate sell in and sell out to be more closely aligned.

We have a large serviceable addressable market, with less than 10% penetration and we will continue to drive new machines sales and user growth over the long term. We benefit from our Design Space platform, giving us significant opportunity to drive user engagement and monetization. Some of our investments are already showing signs of success, building confidence that what we're doing today will have lasting impacts for long-term growth.

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

KIMBALL SHILL, CHIEF FINANCIAL OFFICER

Thank you, Ashish and good afternoon, everyone.

We continue to see the effects on consumer demand of a softer macro environment. Retailers' orders in September were a little softer than historical trends would have indicated as retailers worked through channel inventory positions. In October, we started to see orders for holiday season, although at lower levels than previous years, as retailers are taking a cautious approach to inventory levels. Given this dynamic, we continue tightly managing what is within our control.

Revenue

In the third quarter, we generated revenue of \$177.0 million, a 32% decline compared to prior year Q3, and we generated \$12.4 million in net income.

Breaking revenue down further, revenue from connected machines was \$52.4 million, down 49% year over year, against difficult comps for Q3 2021, related to sell-in of next generation cutting machines and continued replenishment orders. New user adds (as a proxy for machine sell out to end consumers) were down only 26% for the same period, indicating that consumers continue spending – albeit at a lower level – as retailers work through inventory.

As you'll recall, we entered Q3 with some retailers holding higher-than-normal channel inventory positions, while at the same time, managing to lower inventory targets. Exiting the third quarter, we believe retailer inventory positions are much healthier, with most retailers needing to place new orders to fully capture expected holiday demand. We believe holiday demand remains seasonally strong. We are working closely with our retail partners, as well as leveraging our more flexible direct to consumer sales channels, to place inventory where needed to meet demand.

We are proud of our subscription performance. Revenue from subscriptions was \$68.9 million, up 29% over last year and 2% sequentially. Our continued success highlights the durability of our business model and validates the focus we've placed on Cricut Access and the expansive improvements we've made over the last several quarters as Ashish mentioned.

Revenue from Accessories and Materials was \$55.7 million, down 47% over last year when we benefited from channel fill of Smart Materials related to the launch of next generation cutting machines, continued replenishment orders, and higher engagement trends.

Let me provide some context around Accessories and materials. Our revenue mostly derives from selling into retailers and is influenced by multiple factors including consumer buying behavior such as pantry loading, promotional activity, competition and currency.

Further, we have been more promotional in this segment and see favorable share gains when our products are closer to price parity with the competition. Accessories and Materials continues to be the segment with the most competition.

In terms of geographic breakdown, international revenue was \$27.6 million, down 11.5% from prior year Q3, and up 13.8% sequentially. International again grew as a percentage of the total business, representing 15.6% of total revenue, compared to 12.0% in Q3 of the prior year.

Users and engagement

Turning to users and engagement.

We ended the quarter with nearly 7.5 million total users, up 1.7 million users over last year.

The number of users engaged on our platform, meaning those who cut at least once for the 90-day period ending September 30, was nearly 3.6 million, up 11% year over year.

Engagement as a percent of total users dropped from 51% last quarter to 48% this quarter. Keep in mind that summer is historically the lowest period for engagement and the scale of this seasonal drop is similar to what we saw from Q2 to Q3 last year. As expected, we are seeing engagement pick up as we head into the holidays.

As Ashish talked about, we are increasingly looking at engagement on a more holistic level, starting with the number of users that are interacting in Design Space on a daily and weekly basis. We will continue to invest in content, community and software features with a specific focus on mobile to move users through their journey from inspiration to cutting over time.

Paid Subscribers grew by more than 600 thousand on a year-over-year basis and approximately 89K sequentially, ending the quarter with nearly 2.5 million. Attach rate remained high at 33%.

ARPU

We measure user monetization through Average Revenue Per User in both Subscriptions and Accessories and Materials by dividing revenue for the period in those segments by our entire user base.

ARPU for Subscriptions in the third quarter was \$9.40, down slightly from \$9.60 in Q3 2021. For context, three factors generally explain variability in subscription ARPU from one quarter to the next, when subscribers are growing and attach rates remain high: 1. Timing of signups during the quarter, 2. Mix of new vs renewals subscriptions, and 3. The increasing mix of international subscriptions.

Accessories and Materials ARPU was \$7.61, compared to Q3 2021 ARPU of \$18.79, due to lower sell-in revenue in the quarter.

Gross margin

Moving to gross margin. Total gross margin in the third quarter was 46.2%, an improvement of nearly 7% compared to Q3 2021 and effectively flat on a sequential basis, which highlights the benefit of our diverse revenue streams.

Breaking gross margin down further:

Gross margin from connected machines was 6.1%, up 450 basis points sequentially from Q2, reflecting a benefit in product mix. This compares to 14.5% in Q3 of last year. The year-over-year decline in margin was primarily attributable to an increase in promotions as a percentage of revenue, particularly on older machines moving to end of life.

Subscriptions was effectively flat with last year at 90.6%.

Gross margin from Accessories and Materials was 29.2%, down from 38.2% in the prior year, reflecting increased promotions, as well as fixed operating costs over lower volumes. Going forward, you will see us offer more promotions in our materials business, with a focus on remaining competitive on price and on market share.

Operating expense

Total operating expenses were \$64.4 million and included \$11.1 million in stock-based compensation. This was essentially flat compared to \$64.3 million in Q3 2021, as we continue investing for the long term.

Operating margin & net income

Operating income for the third quarter was \$17.4 million, or 9.8% of revenue, compared to \$37.7 million, or 14.5% of revenue in Q3 2021. Operating income was impacted by lower revenues in the quarter while maintaining targeted investments for long-term growth.

We delivered our 15th consecutive quarter of positive net income. Net income in the third quarter was \$12.4 million, down from \$30.0 million in Q3 of the prior year. Diluted earnings per share was \$0.06 compared to \$0.06 sequentially and \$0.13 in Q3 2021.

We continue to manage the business for the long term, while navigating short-term headwinds. Our profitable business model gives us the flexibility to continue to invest and deliver healthy operating margins as we work toward our long-term target range of 15%-19%.

Balance sheet

Turning now to the balance sheet and cash flow.

We benefit from a strong balance sheet. We ended the quarter with \$198.0 million in cash, cash equivalents, and marketable securities and our \$300 million credit line remains untapped. During the quarter, we repurchased 1.38 million shares of our stock at a cost of \$10 million.

As a reminder, we generate cash on an annual basis. Cash generated is the primary source of funding toward our annual inventory needs and additional investments for long-term growth. This fosters a balanced and disciplined approach to capital allocation. It is common for us to be cash flow negative in Q2 and Q3 as we build inventories and generate cash in Q4 with the higher seasonal sales. We were cash flow positive from operations YTD in Q3.

Outlook

As we look to the fourth quarter, we expect to see sequential growth as demand picks up.

We have seen some retailers ordering appropriately to meet holiday demand, while others have taken a conservative inventory approach. Our goal is to have product on shelves throughout holiday and enter 2023 with healthy channel inventory levels. Downside risks include 1) the timing of the remaining retail orders, and 2) possible retailer reluctance to spend dollars on new inventory of any type.

We anticipate operating margins in Q4 to be lower versus Q3, as revenue mix is more weighted to physical products, along with the impact of higher inventory procurement costs flowing through the P&L, and some inventory reserves, tied primarily to Accessories and Materials.

As we look ahead to 2023, we are taking a conservative approach in our planning. We anticipate entering 2023 with healthy channel inventory levels and plan to maintain a more linear relationship between sell in and sell out going forward.

Given the success of our most recent investments in subscriptions and our profitable business model, we are able to invest at consistent levels to drive long-term growth. While we remain committed to our annual operating margin targets of 15-19% over the long term, we expect small incremental improvements toward that goal toward the end of next year.

Looking at the long term, we believe the trends that have driven our business over the last eight years remain intact. We are confident in the unique value proposition that Cricut brings to millions of users and to the millions more around the world that we have an opportunity to bring to the Cricut platform. The significant growth in our user base over the last two years also provides opportunity to further drive engagement and monetization. We are focused on managing our profitability, while investing in areas with the highest impact, including improving onboarding, fostering higher levels of engagement, and innovating on our platform to drive growth in Cricut Access and our accessories and materials business.

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