STACIE CLEMENTS, INVESTOR RELATIONS, THE BLUESHIRT GROUP

Thank you, operator, and good afternoon, everyone. Thank you for joining us on Cricut's first quarter 2022 earnings call. Please note that today's call is being webcast 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 and. Jason Dea, VP of Finance.

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 10th 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.

Revenue in the first quarter was $244.8 million, a significant year-over-year decline reflecting a tough comp from an exceptionally strong Q1 last year, which benefited from the pandemic.

As anticipated, January and February followed a reversion to more typical, pre-pandemic seasonal trends. Starting in March, we began to see additional impacts of slowing consumer demand. Our sound business model and our ability to execute operationally continued, delivering our 13th consecutive quarter of profitability.

As we enter Q2 and look ahead to the remainder of the year, we anticipate these pressures persisting in the near term and are highly focused on executing with a balanced and disciplined approach.

We continue to view our business through a long-term lens, optimizing the many levers within our control. We are focused on the business fundamentals that position us well for medium to long-term growth and profitability.

- We added more than 495 thousand new users to the platform in the first quarter.

- Our subscriptions business was strong, with over 33% of our total users being paid subscribers at the end of Q1.
- We improved gross margins on a sequential basis, reflecting our diverse revenue streams and the work we have done to stabilize our pricing and promotions
- Our balance sheet and inventory levels remain healthy, and
- We continue to operate with agility and discipline – all while delivering attractive profitability.

Coming off a two-year hyper growth period, the Cricut brand is more mainstream and retailers have given significantly more shelf space to our growing ecosystem of connected products and materials. We have a strong and passionate user base, which will fuel our flywheel of engagement and increase user monetization for many years to come. We've invested in driving significant customer acquisition – adding more retail partners and influencers across the globe.

At the end of Q1 2022, we had nearly 7 million users on our platform, a growth of more than 4 million users from two years ago, with 54% of total users engaged over the last 90 days. We continue to focus on building a robust engagement engine, which ultimately leads to greater monetization. This engine also fuels our flywheel, creating low-cost customer acquisition through strong word-of-mouth influence. I am personally energized and focused on everything we need to do to operate in the short term, optimizing the tradeoff between current profitability and investments in our long-term growth opportunities. We'll continue to invest in international markets against a proven playbook of seeding the market long before revenue contribution. Looking at our user base as a whole, we have a significant opportunity to drive growth in our subscriptions and accessories and materials businesses as we further strengthen user engagement and the onboarding experience.

Our product roadmap is robust. We are focused on enhancing the value proposition of our subscriber product. We are excited by the new things we are launching over the next 3 to 6 months that will enable more content and functionality for our Cricut Access subscribers. We're also making significant investments in our accessories and materials products, where we have opportunity to expand the Cricut ecosystem. Ultimately, these are the drivers that will result in robust growth in the long term as we continue to grow our user base. For consumers looking for a seamless, connected ecosystem for their projects – there is no alternative. It's never been a better time to be a Cricut user.

Underscoring our confidence are four key trends that demonstrate resilience in the market, and have driven our business forward since 2014:

- First, the desire for personalization.
- Second, the digitization of tools that makes personalization easy and seamless.
- Third, technology has opened the door to a new generation of entrepreneurs.
- And fourth, the proliferation of social media drives community – a significant barrier to entry for others looking to enter the market.

These key trends also hold true internationally where we have significant growth opportunity across new and existing markets. Similar environmental challenges exist in our more mature international markets, like the UK and Australia. Our newer markets, like Germany and France, continue to expand and thrive as we add new stores at a high rate with existing retailers and add new retail and ecommerce partnerships. We look at things like user engagement levels, Google search terms, and brand familiarity, all of which have contributed to our success in these markets. As we enter new markets, we utilize the same Cricut playbook, with a focus on the same strong fundamental drivers of the business. We have just recently launched in Turkey, and I am very excited about our upcoming launches in Japan and South Korea over the next few months.

At the local market level, we drive continued growth by identifying influential voices, fostering community, and partnering with key retailers.

We're also investing heavily in user engagement, starting with how we onboard first-time users. We believe that a great onboarding process plays a strong role in driving long-term engagement and monetization. When a user first receives their machine, it is our goal to delight them at every turn - the set up and registration process should be seamless. We're also developing product bundles and learning experiences, which we believe will help smooth the path for users who are just starting out. In addition to our focus on onboarding, we are investing significantly in our platform to help drive user engagement. This starts with Design Space, where we have a unique opportunity to foster more user engagement. This year, we're focused on bringing more versatile and editable content along with expanding the amount of diverse content.

We recently launched our new home page for Cricut Design Space, creating a more dynamic experience and improving content discovery both within our app and across our users' social media feeds. We're also focused on delivering greater parity between the desktop and mobile experiences so users can have a consistent experience across all of our apps. We recently launched our Design Space app for Android in April, following our new and improved iOS launch at the end of last year. Our mobile apps are key to our overall engagement strategy and a critical pillar of our community efforts. All of these efforts around onboarding and engagement ultimately create more monetization opportunities on our platform.

We had over 2.3 million paid Cricut Access subscribers at the end of Q1, nearly 700 thousand more paid subscribers compared to prior year Q1.

Our strategy with Cricut Access is to further expand our offering beyond simply adding more content to include enhanced software and services to further delight our user base and bring additional value to them. Investments in software and subscriptions are resulting in an expansive roadmap of new functionality for our Cricut Access subscribers. One example is our Monogram Maker tool that we will be releasing soon, and exclusively for subscribers. This addresses a popular use case. The tool now allows users to quickly create beautiful, personalized monograms from a wide library of template designs and fonts.

Additionally, our Contributing Artist Program, which I mentioned in our last earnings call, has received great feedback from our beta users. We are making significant steps to extend the program to a broader audience over the next month, bringing more artists to the platform and a wide range of diverse content to our users.

We have been increasingly advertising Cricut Access inside Design Space and now have the capabilities to feature different messaging and upsell offers for Cricut Access and to measure the effectiveness of each of these placements inside Cricut Design Space.

Another opportunity for monetization is through accessories and materials, with engagement as a key driver. The more users make, the more materials they need. Our competitive advantage in accessories and materials is that we design materials to be seamlessly compatible within the Cricut ecosystem. This means that the materials are specifically designed with our software and connected machines in mind. This is an area of significant opportunity for us – one where we can differentiate from competitors. We will continue to work and partner with those retailers who will help bring these seamless experiences to the end consumer.

We'll continue to innovate and leverage our compatibility story to differentiate and drive demand for Cricut materials.

Although there is a lot of uncertainty in the current macro-environment, we are as confident as ever about our medium- and long-term opportunity for growth. We continue to see a large opportunity to expand our nearly 7 million users over time as we grow into new markets and retailers. Our focus is on driving deeper engagement, including improving the onboarding process and making it easier for our new users beginning their journey. Driving more engagement in turn leads to more opportunities to monetize the user base through subscriptions and accessories and materials. We continue to invest in our future growth through continued innovation that will extend and expand our connected platform. In turn, this will enable us to continue to deliver profits and delight users around the world. Notwithstanding the currently bumpy road, our foot is still squarely on the accelerator pedal of 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. For those of you who haven't met me yet, I've led Cricut's operations and supply chain for the past 3 years. Our purpose-driven mission – to help people lead creative lives – is what inspires me, and our teams, every day. Our products foster mental health and wellbeing, entrepreneurship, and community to millions of consumers around the globe. The diversity of our revenue streams, and our proven track record of profitability, allow us to operate Cricut through a long-term lens. I'm excited to be here today and look forward to meeting you all in person over the coming quarters.

In the first quarter, we delivered revenue of $244.8 million, a 24% decline compared to prior year Q1, which benefited from a strong, pandemic-related, year-over-year growth rate of 125%. Looking at growth momentum over the longer term, Q1 revenue was up 70% over the pre-pandemic comparative quarter Q1 2020.

In our last call, we talked about our expectations for a reversion to historical seasonality as we emerge from the pandemic. In March, we also started to see softening in consumer demand, which we believe relates to current macro-economic factors. That softness continues quarter to date.

First quarter revenue was also impacted by higher channel inventory. As discussed on our last call, some retailers took a more proactive approach in managing their inventory, and we entered Q1 with approximately $35 million of higher-than-normal channel inventory. During the quarter, some retailers worked down these inventory levels, while others continued to build their stocks. On a net basis, we estimate the higher-than-normal channel inventory levels decreased by approximately 20%, but given current market conditions, this process may continue into Q3. We have no plans for additional promotional activity to move this inventory and believe higher channel fill is primarily a result of retailers' own proactive approaches to managing inventory.

We view these factors – tough year over year comps, softer consumer demand due to macro uncertainties, and higher inventory levels at retailers – as short term in nature. We continue to believe in our strong business fundamentals and our long-term growth trajectory.

Operating margins were up 70 basis points from Q1 2020, despite a nearly 250% increase in operating expenses over the same two-year period. We delivered $23.5 million of net income in the first quarter, demonstrating a durable business model and our continued focus on profitability.

Breaking revenue down further: Connected machines revenue was impacted by reduced consumer demand trends that began in March, as well as the higher-than-normal channel inventory positions that some of our retailers held entering the quarter.

Revenue from Connected Machines was $62.4 million, down 56% year over year. Compared to pre-pandemic Q1 2020, connected machine revenues grew nearly 10% on a two-year basis.

Revenue from subscriptions was $64.8 million, up 40% over last year, and nearly 238% on a two-year basis, driven by seasonally high machine sales in Q4 and prior investments made to increase the value in Cricut Access.

Revenue from Accessories and Materials was $117.6 million, down 14% over last year. Compared to the pre-pandemic Q1 2020, accessories and materials revenues grew 74% on a two-year basis, reflecting growth in our engaged user base.

In terms of geographic breakdown, international markets grew as a percentage of total business, representing 15% of total revenues, compared to 10% in Q1 of the prior year. Revenues from international on a year-over-year basis increased by about 9%, with softness in our most mature markets like the UK, offset by growth in newer geographies. On a two-year basis, international revenues have grown 285% compared to Q1 2020.

We continued to fuel our monetization flywheel for long-term growth. In the first quarter, we added over 495 thousand new users and ended the quarter with more than 6.9 million total users.

The number of users engaged on our platform for the 90-day period ending March was up 21% year over year, climbing to 3.7 million engaged users.

As a percentage of total users, user engagement was 54% in the first quarter, down from 62% in the prior year, when we benefited from stay-at-home pandemic conditions. This was down on a sequential basis from 60%. Typically, Q4 is our seasonal high. Keep in mind, this calculation will fluctuate over time with seasonality, and as we broaden our user base, and expand into new verticals and use cases.

We are increasingly attracting Gen Zs and beginner crafters, creating a great opportunity for us in the medium to long term as we broaden the appeal of our products and our platform. Typically, beginner crafters will be less engaged at the start of their crafting journey, with significant opportunity for us to drive higher engagement over time. As Ashish pointed out, onboarding and driving engagement is one of the top priorities for the company and we continue to invest in this area.

We also saw strong momentum with Cricut Access. The number of paid subscribers grew by 696 thousand on a year-over-year basis, ending the quarter with just over 2.3 million paid subscribers. Attach rates in the quarter rose to over 33%, up significantly from pre-pandemic periods, when our attach rates were in the mid-20s.

Subscriber growth is fueled by connected machine sales and new user adds in the prior quarter, offset by a historically consistent level of churn against our now much larger base. Paid subscriber growth typically lags new user additions by about a quarter, as free trials end and users choose to transition to paid subscription plans. As we look to the rest of the year, we expect pressure on subscriber growth, particularly in Q2 and Q3 as we navigate through the short-term environment of slower consumer demand and new user adds.

We measure user monetization through Average Revenue Per User in both Subscriptions and Accessories and Materials by dividing revenue in those segments by our entire user base within that period. ARPU for Subscriptions in the first quarter was $9.73, down slightly from $9.96 in Q1 2021.

Accessories and Materials ARPU closely relates to user engagement and channel inventory. ARPU from Accessories and Materials in the first quarter was $17.67. This compares to Q1 2021 APRU of $29.45, which was higher due to unusually high engagement trends during COVID and also reflects heavier buying from our retailers as they restocked depleted inventory levels at the beginning of last year.

We have a strong focus on monetizing our growing user base through subscriptions and accessories and materials. Keep in mind, we grew our user base by 4.1 million since Q1 2020.

Moving to gross margin. Total gross margin in the first quarter was 40.5%, an improvement of over 13 points compared to Q4 2021, and up from 37% in Q1 last year. This represents the leverage in the business model associated with our diverse revenue streams, as a greater percentage of revenue in the quarter derives from subscriptions and with new promotional strategies.

You will recall comments during our last call regarding our efforts to improve our overall promotions policies, including new strategies to give us greater flexibility on a go-forward basis, enabling us to better manage the business and support retail partnerships.

Breaking gross margin down further:

Gross margin from connected machines in the quarter was 2.7%. On a year-over-year basis, connected machine margin is down compared to 15.3% in Q1 2021, when we were at the height of the pandemic and saw elevated machine sales. The lower connected machine margin was the result of pricing on end-of-life machines and the impact of fixed costs with significantly lower unit volumes. In addition, on a year-over-year basis, Q1 2022 saw impact of elevated freight, warehousing, and handling costs. As we move through 2022, we also anticipate the impact of increases to commodities and labor costs.

On a sequential basis, connected machine margins improved from prior quarter of negative 1.5%, as we took corrective actions to the promotional challenges during Q4.

Gross margin from Subscriptions in the quarter was 90.3%, which is essentially flat year over year.

Gross margin from Accessories and Materials in the first quarter was 33.0%, down from 41.7% in the prior year primarily driven by higher costs, including higher freight and handling, as well as lower average selling prices.

Starting in Q2, we began to implement price increases. We are in the process of rolling these out with our retail and distribution partners across connected machines, accessories, and materials to help mitigate the impact of the recent cost escalations. We expect these actions to begin benefitting margins later in Q2, with a material impact in the second half of the year.

Moving on to operating expenses. We continued to significantly invest in the business with a disciplined focus, while making long-term improvements in operating margin. On a two-year compare, we improved operating margin by 70 basis points while more than doubling operating expenses.

Total operating expenses in the first quarter were $67.6 million and included $8.9 million in stock-based compensation. This was an increase over the $55.6 million in Q1 2021, primarily reflecting continued investments that Ashish outlined.

Total operating expense as a percentage of revenue was 28% in Q1, an increase over 17% from a year ago, primarily due to lower revenues in the quarter.

Operating income for the first quarter was $31.4 million, or 12.8% of revenue, compared to $64.7 million, or 20% of revenue in Q1 2021, driven by lower revenues for the quarter and increased investments.

As we navigate headwinds in the short term, we remain focused on managing our resources and continuing to deliver healthy operating margins, even though in the short term, they will likely be below the long-term target range of 15%-19%.

Our business remains durable, with a healthy profitability profile. We delivered our 13th consecutive quarter of positive net income. Net income in the first quarter was $23.5 million, down from $49.4 million in Q1 of the prior year. Diluted earnings per share was $0.11 compared to $0.24 in Q1 2021.

Turning now to the balance sheet and cash flow.

Our balance sheet is strong and enables us to navigate through periods of market volatility. We ended the quarter with $245.7 million in cash and cash equivalents and healthy inventory levels. Our credit line of $150 million remains untapped. Cash generated from operations for the quarter was positive $15.6 million. We plan to carry higher inventory levels to mitigate supply chain risks, as we continue to see long lead times for components and materials. We are carefully monitoring known risks and plan to manage down inventory levels to match as risks unwind.

Let me spend a few minutes talking about what we see as we look ahead to the rest of the year. As a reminder, Q2 is typically a softer quarter for us. Also, as we mentioned, we saw significant consumer softness starting in March and that continues so far in Q2. Based on this, our target of reaching 8 million total users this year will likely prove to be more challenging than we previously thought, which will likely impact subscriber growth.

As I mentioned earlier, new subscriber growth typically lags user growth. Therefore, we expect the number of paid subscribers in Q2 and Q3 to be flat or possibly decline, primarily related to fewer new users added to the platform. We continue to see churn rates that are consistent with historical trends. We view this flat-to-decline in subscribers as short term in nature. We remain focused on the user's journey, which we believe will increase the value proposition and maximize user monetization.

Looking at the long-term, we believe the trends that have driven our business over the last eight years remain intact. We are strongly 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 over a larger base of users. 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.

We remain focused on driving profitable growth and are committed to our annual operating margin targets of 15-19% over the long term. In the short term, as we continue to invest, we will likely be below this range by a few percentage points for the remainder of this year.

We have a strong balance sheet, solid cash position, and unique business model that enables us to navigate these uncertain times and remain focused on our long-term opportunities. We have a consistent track record of driving profitability, while managing our financial resources. Our disciplined approach has been cultivated since 2014 and is ingrained in how we manage and operate our business model. The tremendous growth we've achieved lays the foundation for us to scale and grow even further, and we are as focused as ever on optimizing the things that will truly drive our business forward.

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