Jim Suva, SVP Finance, Treasurer, and Investor Relations

Thank you, operator, and good afternoon, everyone. Thank you for joining us on Cricut's second 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, August 6, 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, Chief Executive Officer

Thank you, Jim, and welcome everyone.

We are pleased with strong Q2 profitability and early signs that our acquisition and marketing strategies with retailers and consumers are starting to bear fruit. Connected machines revenue grew for the second consecutive quarter from increased sell-in to retailers while sell-out to consumers was about flat in the quarter compared to a decline in Q1. Remember, our flywheel begins with the purchase of a connected machine, which then presents the opportunity to monetize our customers through subscriptions and accessories and materials. Operating margin dollars grew significantly, up 37% or $7 million, driven by higher Platform revenue as a percentage of total revenue and benefits from inventory impairment related items, despite a 6% YoY drop in overall sales. International sales grew 3% YoY.

In Q2, Platform revenues increased slightly on paid subscriber growth. Products revenues declined 10% as connected machines units and revenue growth were more than offset by a decline in accessories and materials.

Paid subscribers grew 3% to over 2.8 million. We ended the quarter with over 5.9 million Active Users who cut in the past year, slightly up from a year ago. Our 90-Day engaged users declined -3% YoY, and I would like to give you some examples of our effort to improve this important KPI. Engagement is a key focus for our company both in terms of onboarding as well as stimulating on-going engagement for all users. Onboarders are a particular focus because the more they interact with our platform early the more likely they are to interact with our platform over time. We made progress in delivering a simpler, more delightful experience to our Onboarders.

We introduced several improvements during the quarter. Starting with the out-of-box experience, we made it simpler to connect to your machine and work through guided steps to connect with the platform. Along with other improvements, this led to a YoY increase in the share of members who complete a project during their first day and who complete several projects in their first week. These are leading indicators for longer-term engagement. In Q2, we further expanded our content library, which has now surpassed 1 million high-quality makable images within Cricut Access.

We continued with our increased investment in marketing. Some highlights include: a partnership with The Jennifer Hudson show to support Teacher Appreciation week, a featured story on the evening edition of CBS News on Mother's Day, additional broadcast segments focused on seasonal themes throughout the quarter, an expansion of our digital marketing campaigns to reach consumers on streaming television, and a continued focus on the expansion of influencer marketing partnerships. Initial results are promising, measured by driving traffic to Cricut.com, which plays a central role in pulling consumers through the funnel regardless of where they purchase their machine.

Our deeper promotional strategy that we started in late 2023 is working. In Q2, we saw growth in connected machines sell-in to retailers, as well as improving trends in sell-out to end consumers. This is a healthy, positive indicator, and this is despite retailers holding below optimal inventory levels, which resulted in missed sales opportunities. Our discussions with retailers regarding our planned deeper promotions and their on-hand inventory levels are constructive, with the goal of returning to total sales growth.

Accessories and materials declined 27% YoY. Our materials are engineered to work seamlessly with our machines to create the best user experience. We launched the Cricut Value line of materials in late Q1, which we designed to compete in online marketplaces, and we are optimistic about this product, but it's still early and a small portion of our portfolio. We have additional innovation, products and cost reductions coming in the quarters ahead.

The areas where we could do better are straightforward. 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.

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 is 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 longer-term focus and current discipline.

I will now turn the call over to Kimball.

Kimball Shill, Chief Financial Officer

Thank you, Ashish

In the second quarter, we delivered revenue of $167.9 million, a 6% decline compared to the prior year and in line with our expectations. We generated $19.8 million in net income, a 23% YoY increase and our 22nd consecutive quarter of positive net income, as we continued to invest in our key priorities.

Breaking revenue down further, Q2 2024 revenue from Platform was $77.6 million, slightly up year over year. While paid subscribers increased 3%, Platform revenue was up less, as the mix shifted more to annual vs monthly subscriptions and the geographic mix shifted more international compared to a year ago. Both shifts are targeted efforts. Platform ARPU increased 5% to $52.61.

Revenue from Products was $90.3 million, down 10% over Q2 2023. Connected machines increased 18%, driven by higher units sold and positive mix shift, while accessories and materials decreased 27%. Some retailers started to restock inventory levels on connected machines partially in Q2, unlike in 2023 when they were destocking more broadly. However, during key sales events, we found retailers' shelves light on inventory to capture the opportunity fully.

In terms of geographic breakdown, international revenue was $33.5 million or up 3%, compared to $32.6 million in Q2 2023. As a percentage of total revenue, international was 20% in Q2 2024, compared with 18% of total revenue in Q2 2023.

Turning to Active Users and engagement. We ended the quarter with over 5.9 million Active Users, a slight increase from a year ago. We ended the quarter with over 3.5 million 90-Day Engaged Users, which was a 3% decline from Q2 last year. As Ashish mentioned, we are encouraged by improvement in leading indicator metrics for Onboarders but have more work to do to improve engagement.

We ended the quarter with over 2.8 million paid subscribers, up 3% from Q2 2023, and up marginally 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 second quarter was 53.5%, an improvement compared to the 49.3% in Q2 2023. The improvement reflects higher Platform revenue as a percentage of total revenue and benefits from excess and obsolete and other inventory impairment related items compared to prior year.

Breaking gross margin down further, gross margins from Platform were 88.6% compared to 89.7% 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 23.3%, compared to 18.2% in Q2 a year ago. The increase in gross margins was primarily due to positive impacts from excess and obsolete and other inventory impairment related items compared to prior year.

Total operating expenses for the quarter were $63.4 million and included $10.2 million in stock-based compensation. Total operating expenses decreased 7% from $68.4 million in Q2 2023, driven primarily by less reserves this year versus last year, the timing of some expenses that will be larger in Q3, and the unwinding of some prior reserves, which will not recur next quarter. As we mentioned last quarter, we increased our marketing plans for 2024 and you will see this in our higher sales and marketing spend.

Operating income for the quarter was $26.4 million, or 15.7% of revenue, compared to $19.3 million, or 10.8% of revenue in Q2 last year. This was a 37% increase in operating income, despite the decline in sales, for the reasons discussed previously.

Our tax rate of 33.6% increased from 30.2% a year ago, primarily due to the tax impact of stock vesting at a lower price.

Net income was $19.8 million, or $0.09 per diluted share, compared to $16.0 million, or $0.07 per diluted share in Q2 2023.

Turning now to balance sheet and cash flow. We continued to generate healthy cash flow on an annual basis, which funds inventory needs and investments for long-term growth. In Q2, we generated $35 million in cash from operations, compared to $64 million a year ago. We ended Q2 with a cash and cash equivalents balance of $299 million. We remain debt free. Inventory decreased by $102 million from a year ago to $192 million at the end of Q2 2024.

During Q2, we used $9.3 million of cash to repurchase 1.5 million shares of our stock, resulting in $41.2 million remaining on our $50 million authorized stock repurchase program. In July, we paid approximately $108 million in dividends for the special one-time dividend of $0.40 per share, plus our first recurring semi-annual dividend of $0.10 per share.

These capital allocations are possible due to past profitability and our confidence in the sustainability of our future profitable operations. We want Cricut to always have ample liquidity to sustain and grow our business, but not to hold excess cash. We do not anticipate the need for any debt or utilization of our credit line in the near term. Now on to our outlook.

Outlook

Recall, we do not give detailed quarterly or annual guidance, but we do want to offer some updated color on our outlook for 2024. Given our first half performance, you can expect some incremental improvement in operating margins, while the remaining outlook remains generally unchanged.

We expect continued sales pressure on our Products segment, especially in accessories and materials, and accordingly, total company revenue may be down Q3 YoY.

We will continue to accelerate marketing to generate consumer excitement. But given ongoing retailer conservatism and pressure in our accessories and materials segment, as well as year-to-date performance, it is too soon to call an inflection point; hence, we may even see a decline for full-year company revenue.

We expect paid subscriber count and subscriptions revenues to grow slightly and may 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. While Q2 paid subscribers grew, it was modest compared to Q1. Like last year, Q3 may see negative growth in paid subscribers in the quarter but not enough to change our full-year view. We continue to expect growth in Platform revenue and paid subscriber count for the full year.

In 2024, our operating expenses will increase modestly as we increase our marketing spend to reinvigorate excitement in the category.

Given first half performance, we expect some incremental improvement in operating margins in 2024 compared to 2023. Remember, we typically sell more machines in the second half of the year and especially in Q4, and this increase in machine sales naturally pressures margins. We also benefited in the first half from the unwinding of some reserves, which will not continue in the second half of the year. Hence, the operating profits in the first half of the year will not fully carry to the second half of the year.

We expect to be profitable each quarter and generate significant cash flow during 2024. We paid approximately $108 million in cash in July for the dividends after Q2 closed, so we remind you that our cash balance and associated interest income should be adjusted accordingly.

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.