Jim Suva - Cricut, Inc. - SVP Finance

Thank you, operator, and good afternoon, everyone. Thank you for joining us on Cricut's fourth 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.

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, March 5, 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.

We moved through 2023 focused on profitability even as we navigated a dynamic consumer discretionary environment. 2023 was our seventh consecutive year of positive net income. We generated $53.6 million of net income even with the $45.9 million of excess and obsolete inventory reserves and fixed asset impairment charges. We are encouraged by our 49% operating income increase in Q4 year over year and the positive uplift from our promotions in Q4. However, we were disappointed that sales fell in the quarter and full year by 18% and 14%, respectively. Our promotions uplift was smaller than we expected and is attributable in part to lower retailer inventory, but in hindsight, we could have conducted more aggressive marketing and promotions. We intend to boost our marketing efforts and spending in 2024 to generate more interest and demand throughout the funnel. We will continue our deeper promotional strategy while focusing on maintaining great pricing discipline. We will keep concentrating on acquiring new users and enhancing their engagement and revenue generation.

I would like to look back on 2023 on what went well and what we could do better.

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. Much of our discussion today will focus on these priorities.

In 2023, our total user base increased 13% to over 8.9 million users, paid subscribers increased 6% to 2.77 million, and engaged users in the last 90 days decreased 3% to 3.9 million.

Now looking at Q4. We saw a positive uplift from our deeper promotions in Q4, although it was smaller than expected. In hindsight, we could have given more discounts and advertised more aggressively to address consumer affordability concerns. These weaknesses were worsened by lower retailer inventory. We saw several retailers miss out on significant Q4 sales due to insufficient channel inventory of our machines. While we are working with those retailers to restock to more adequate inventory levels and we are seeing some improvements thus far in Q1, we expect some retailers to continue being conversative on inventory commitments. In addition, addressing consumer affordability and making the overall making experience more accessible are significant opportunities for us.

As the category leader, we are significantly increasing our marketing spend both in media coverage and expanding the size of our marketing talent and team. Our goal is to reaccelerate consumer excitement for the brand and category.

Now on to an update on our priorities. Recall that 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

We ended the quarter with over 8.9 million total users, up 13% YoY and approximately 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. We have previously shared that our funnel is healthy, and more recent data supports that conclusion. While our platform and products have universal appeal to creators of all ages and demographics, we are particularly focused on women 25-44 years old.

After several years of reductions in marketing spend, we accelerated our investment as we prepared for the holiday season. Our plan is to further increase marketing efforts and investment in 2024 to drive full-funnel excitement.

Influencer marketing plays an important role in our strategy. We accelerated the onboarding of new influencers in the back half of the year and increased the number of influencers by more than 4-fold — from adding 57 new influencers in the front half 2023 to adding 247 in back half. We also expanded our reach through increased work on organic and paid social content on Pinterest, TikTok, Meta, and YouTube. Finally, our investment in media relations paid off with a total potential reach of 555 million through broadcast segments and 651 million through gift guides and product reviews. During the holidays, our partnership with The Kelly Clarkson Show holiday giveaway segment also drove excitement and interest in our brand and category.

As planned, we were more promotional in Q4 compared to the rest of the year. The promotions were supported by integrated marketing plans including retailer programs and content marketing strategies incorporating influencers, social, editorial, and deals coverage. While we did see an uplift, it did not meet our expectations.

As we enter 2024, we continue to focus on driving brand awareness and pulling people through the funnel. Our plans include accelerated investment in digital marketing, influencer marketing, and focus on lifestyle and product coverage. In addition, we are expanding our messaging through marketing campaigns that focus on the role Cricut machines can play in different life stages. One example is our partnership with Pinterest around this year's wedding trend, which will be supported by content on and off the Pinterest platform. Our marketing programs also include integrated plans for key moments throughout the year where there is higher motivation to personalize or make things.

We introduced the Cricut Make Their Day Valentines event, which was held February 4-10 in North America, and serves as an example of how we plan to leverage promotions throughout 2024. We saw a meaningful uplift in sales and excitement compared to prior weeks from consumers and retailers. As we move through the year, we expect to instill confidence in our retailers to better partner with us and carry more inventory to leverage these integrated marketing and promotional opportunities.

User Engagement

We ended 2023 with 5.93 million users who made a project using their cutting machine in the past 365 days, up 2% from the end of 2022. Engaged Users at the end of 2023, defined as users who made at least one project in the past 90 days, declined YoY to 3.93 million, 3% below a year ago. Our focus remains to maximize engagement of our most impactful cohorts, which are new users onboarding onto the platform (or on-boarders) and Access Subscribers.

As we look to our Engagement priority for 2024, our focus remains on enabling our Users to Discover, Make and Share projects easily, as well as expanding our marketing capabilities to reach members when outside Design Space to stimulate them to return to our platform.

We want to increase our breadth and depth of content. Make it easier to find that content and inspire action through great visualization.

Let me first talk about how we increase depth and breadth. We think of content as both projects and images. You can think of them as recipes and ingredients. Over the holidays, we showcased holiday projects that had better photos of the finished project, how to instructions and a design layout. When a user initiated a new project based on one of those holiday projects, we saw a higher likelihood to cut relative to a project that did not have good instructions, photos and layout help. In addition, continuing to grow our library of images remains a priority. A wide choice of images is one of the main benefits our subscribers seek. In Q4, we surpassed 750 thousand images in our Cricut Access library, with the majority of these now coming from our Contributing Artists Program.

As we've mentioned before, search personalization is important to us. As our library grows, so has our search and image navigation capabilities. For example, we are testing personalized search ribbons that show images and projects based on user history. We see a higher click rate when showing personalized results. We also measure success in the quality of our library by tracking the share of projects made with images from our library versus uploaded images, and this ratio is increasing favorably YoY.

Now let me briefly comment on visualization. We also launched a redesigned visualization experience that allows members to mockup any image on a series of blanks such as a t-shirt, cap, or a tote bag to inspire action.

Subscriptions

Paid subscribers were in-line with our expectations and increased 161 thousand YoY and increased 71 thousand sequentially in Q4, ending with 2.77 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. Alas, lower new user adds compared to prior years puts pressure on our subscriber growth and attach 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. 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 & Materials

Accessories and Materials sales declined 28% YoY in Q4. Affordability plays a key role in materials, and given current consumer sentiment, consumers are buying less materials overall and engaging less as a result. 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. This puts continued pressure on our business. Even so, we feel our share of the materials market has not changed significantly over the past year.

We are relentlessly focused on driving costs out of this business so Cricut materials are the obvious choice when users want to make. We will ultimately accomplish this through re-engineered product, re-engineered packaging and improving supply chain efficiencies.

We have been incrementally capturing cost reductions in our materials with more to come over the coming quarters. It will take us some time to work through current inventory as we roll new products in but expect to achieve margin improvements in this business over time, while still creating a differentiated offering that works seamlessly with our machines and platform. We expect to provide more details on progress in this area as we move through 2024.

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 the 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 transition the call to Kimball.

Kimball Shill - Cricut, Inc. - CFO

Thank you, Ashish, and welcome everyone. In the fourth quarter, we delivered revenue of $231.2 million, an 18% decline compared to the prior year and below our expectations for the fourth quarter. We generated $11.3 million in net income, a 4% YoY increase and our 20th consecutive quarter of positive net income, as we continued to invest in our key priorities.

Full year 2023 revenue was $765.1 million, a 14% decline over 2022, as retailers took an even more measured approach to inventory commitments and higher average selling prices for machines dampened consumer sales. We experienced higher average selling prices as our newer, more expensive machines became a larger part of the mix. Also, retailers were unable to fully leverage promotions we offered because of lighter inventory positions, so we spent fewer promotional dollars driving sales than we had planned.

Breaking revenue down further, Q4 2023 revenue from connected machines was $77.4 million, down 24% over Q4 2022 and full year revenue decreased 21% YoY. Retailer commitments were below demand, causing stock outs at some retailers, which negatively impacted our sales. Remember, when retailers miss out selling machines to consumers, they also miss out on selling the initial basket of accessories and materials that go along with the machine sale. We are working with retailers to restock to more adequate inventory levels as we continue our strategy of deeper promotions in 2024 and our expanded marketing efforts to generate excitement.

Revenue from Accessories & Materials for the quarter was $77.3 million, down 28% over Q4 2022. For the full year, accessories & materials revenues decreased 27%.

Subscriptions revenue for the quarter was $76.5 million, an 8% increase over Q4 2022, reflecting targeted investments in Cricut Access and the expansive improvements made over the last several quarters. For the full year, subscription revenues increased 12% in 2023 compared to 2022.

In terms of geographic breakdown, international revenue was $51.5 million or down 5%, compared to $53.9 million in Q4 2022. The year over year decline in Q4 was due to a slowdown in the UK, Australia and META, which we define as Middle East, Turkey, and Africa. As a percentage of total revenue, international was 22% in Q4 2023, compared to 19% of total revenue in Q4 2022. For the full year 2023, international revenue increased 9% and represented 20% of total company revenues.

Turning to users and engagement. We ended the quarter with over 8.9 million total users, or 13% growth compared to Q4 2022. We ended the quarter with over 3.9 million engaged users, which was a 3% decline from Q4 last year. On a full-year basis, we had 66% total users engaged during 2023 compared to 74% in 2022. To some extent, this reflects the limitations of our total user metric: it is a count of users acquired since the launch of Explore in 2014, some of whom have not cut in years.

We ended the quarter with 2.77 million paid subscribers, up 6% from Q4 2022, and up 71,000 sequentially. Our subscription attach rate declined to 31% in Q4 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.

Moving to gross margin. Total gross margin in the fourth quarter was 42.0%, an improvement compared to the 29.8% in Q4 2022. The improvement reflects a higher amount of subscription revenue as a percentage of total revenue and higher machine margins.

Breaking gross margin down further, gross margin from connected machines was 17.2%, compared to 2.8% in Q4 a year ago. On a full-year basis, connected machine gross margins increased to 13.0% from 3.3%. The increase in gross margins was primarily due to a favorable product mix compared to Q4 2022, as legacy machines continue to represent a smaller percentage of machine sales, coupled with higher average selling prices compared to a year ago. Also, selling fewer than expected units on promotion in Q4 benefitted margins as retailers did not fully utilize the promotional spending we had planned.

Subscriptions gross margin for the quarter was 88.7%, compared to Q4 2022 of 89.5%. On a full year basis, subscriptions gross margins decreased 90bps. The decline in subscriptions gross margins both for Q4 and 2023 was primarily related to higher amortization of capitalized software costs, which we expect to continue.

Fourth quarter gross margins for Accessories & Materials was 20.6%, which compares to 15.9% in Q4 2022. The Q4 increase in margins was driven primarily by improved costs per unit and lower freight costs. These more than offset some impairments. Recall we had some larger impairments in this segment throughout the year, which pressured margins, resulting in the full year 2023 gross margins for accessories and materials to decrease to 17.5%, compared to 26.5% in 2022. Full year accessories and materials margins were in line with expectations.

Total operating expenses for the quarter were $80.5 million and included $12.1 million in stock-based compensation. Total operating expenses increased 11% from $72.5 million in Q4 2022. The $8 million increase in total operating expenses was largely due to higher stock-based compensation expense and an impairment of unused equipment and capitalized costs as we further focus our development efforts on connected machines. A careful assessment of our future product roadmap resulted in a decision to terminate certain new machine projects to focus our efforts on more impactful opportunities. In Q4, we wrote off $12.6M of capitalized development from the discontinued projects. Full year 2023 operating expenses increased 1% compared to 2022.

Operating income for the quarter was $16.5 million, or 7.1% of revenue, compared to $11.1 million, or 4.0% of revenue in Q4 last year. This was a 49% increase in operating income, which we are encouraged with despite the decline in sales and the reserves and impairments that Ashish referenced. For the full year 2023, operating income as a percent of sales was 9.1% compared to 9.0% in 2022. Excluding the impairments of unused equipment, operating income would have been $29.1 million for the quarter.

Our tax rate of 38.9% was higher than normal, compared to 13.6% in Q4 last year. In 2023, the full year tax rate was 32.8% compared to 26.0% in 2022. The higher tax rate was due mainly to lower R&D credits in Q4 2023 and an increase in uncertain tax positions.

We delivered our 20th consecutive quarter of positive net income. Net income was $11.3 million, or $0.05 per diluted share, compared to $10.9 million, or $0.05 per diluted share in Q4 2022. For the full year, we generated $53.6 million of net income and diluted EPS of $0.24, down from $60.7 million in net income and $0.28 diluted EPS in 2022.

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 2023, we generated $288 million in cash from operations, compared to $118 million in 2022. We ended 2023 with a cash and cash equivalents balance of $245 million. We remain debt free. Recall, we are generating higher levels of cash as we work to bring inventory more in line with pre-pandemic norms. Accordingly, inventory decreased by $107 million from a year ago to $244 million at the end of the year.

During Q4, we used $15.7 million of cash to repurchase 2.1 million shares of our stock. After the end of the quarter and through March 1, we used $10.8 million of cash to repurchase 1.7 million additional shares of our stock, which effectively completes our $50 million approved stock repurchase program that was authorized in August 2022.

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.

During the first few weeks of the quarter, we saw sales below expectations. In our first deeper promotion combined with integrated marketing, we saw a positive uplift in consumer demand, even comping YoY machine sales for the promo week. Unfortunately, we saw several retailers with inadequate on-hand inventory that missed out on significant Q1 demand. Accordingly, we do not expect positive Q1 revenue growth year over year.

We will continue to accelerate marketing to generate consumer excitement. But given ongoing retailer conservatism and only one major sales event 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. Lower new user growth rates will put pressure on our subscriber growth and attach rates, 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. Our connected machine revenues will see pressure as we are more promotional with lower average selling prices in 2024 compared to 2023 to address consumer affordability concerns. Our accessories and materials sales will see pressure in 2024 due to lower engagement and machine sales following a weaker-than-expected 2023 and Q1 2024. We expect to see incremental improvement in accessories and materials margins for 2024.

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 terms of new user growth, we expect to add fewer new users in 2024 than we did last year, given 2023 holiday performance and a slower than expected start to Q1 2024.

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

Cricut has been a public company for almost 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 are planning to redesign aspects of our quarterly information package for 2024. We increasingly view Cricut as a platform business with physical products. Going forward, we are changing the way we report our segments to be Platform and Products. We will also update our public KPIs to focus on the most meaningful indicators for our current and future operations.

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