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Earnings Call

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Thomas A Singlehurst
Citigroup Inc., Research Division

Presentation

Operator

Good day, everyone, and welcome to the Stride, Inc. Q1 FY '25 Conference Call. At this time, I would like to hand the call over to Mr. Tim Casey. Please go ahead, sir.

Timothy Casey
Vice President of Investor Relations

Thank you, and good afternoon. Welcome to Stride's First Quarter Earnings Call for Fiscal Year 2025. With me on today's call are James Rhyu, Chief Executive Officer; and Donna Blackman, Chief Financial Officer. As a reminder, today's conference call and webcast are accompanied by a presentation that can be found on the Stride Investor Relations website.

Please be advised that today's discussion of our financial results may include certain non-GAAP financial measures. A reconciliation of these measures is provided in the earnings release issued this afternoon and can also be found on our Investor Relations website. In addition to historical information, this call may also involve forward-looking statements. The company's actual results could differ materially from any forward-looking statements due to several important factors as described in the company's latest SEC filings.

These statements are made on the basis of our views and assumptions regarding future events and business performance at the time we make them. And the company assumes no obligation to update any forward-looking statements made during this call. Following our prepared remarks, we'll answer any questions you may have. Now I'll turn the call over to James. James?

James J. Rhyu
CEO & Director

Thanks, Tim. This year marks the 25th anniversary for K-12, Stride's preeminent brand. In those 25 years, we have served over 3 million families and students. It took us over 15 years to reach the first million and it has taken us just over 3 years to reach the third. In that time, technologies have advanced, our footprint has grown and the country has evolved, but one constant has remained, our focus on providing customers choice in education. Just as we have choice in most facets of our lives from shopping to entertainment to health care and financial services, so too should customers have choice in education.

And all the surveys and research I have seen, irrespective of political leaning, supports the customer preference for choice. Education should not be a political issue. It should be a customer-focused one. As we prepare for our next 25 years, we are positioning K-12 to continue to lead by delivering tomorrow's education today. And that vision extends beyond the hundreds of thousands of students we currently serve each year. We believe we can deliver meaningful products and services to millions of students and customers each year with the range of initiatives that we are currently in development.

A key element of our evolution is to ensure we stay focused on our customers. And we see the families that have embraced our programs come from a broad range of backgrounds. Why? Well, because what we offer caters to the needs of families instead of forcing them to cater to the rigidity of the program. That's choice. Our programs are affordable and accessible. We embrace being career-forward and we are leaning into new technologies and investing in innovation like never before.

Now in our core business, which, as you can see, remains robust and more demand as indicated by our application volumes is accelerating. The issues that we can address for families span a wide range from safety to academics, to mental health, to mobility, to flexibility and on and on and everything in between. It is that range of promise that we offer families that will be a cornerstone for our next 25 years.

Now as you saw in our press release, we announced record enrollments for our first quarter, an 18.5% year-over-year growth and an acceleration in demand from this time last year. Apart from the pandemic year, this is the highest recorded year of gross enrollment growth this company has seen since it became

publicly traded over 15 years ago. We have seen continual and rising demand for the services we provide and the support for students this enables.

In our 25th year, I feel confident saying that we continue to raise the bar for families looking for educational opportunities. We remain as committed as ever to offering tomorrow's education today. Our results for the first quarter demonstrate that more and more families are embracing what we have to offer, and our guidance suggests we are on pace for another record year.

I'll now turn the call over to Donna. Donna?

Donna M. Blackman
Executive VP & CFO

Thanks, James, and good evening, everyone. As James mentioned, the demand we saw this quarter has set us up for another strong year. As with every year, I'm incredibly grateful to all the Stride employees who support the thousands of families who come to our programs. It's an incredible opportunity for us to impact the lives of so many students.

The strength of our enrollments this year gives me confidence that we remain on track to achieve our fiscal 2028 targets. I think our compelling fiscal year '25 guidance further demonstrates that we are well on pace and confirms the continued underlying demand for our offerings.

Turning to our quarterly results. Revenue for the quarter was $551.1 million, up 15% from first quarter of fiscal year '24. Adjusted operating income was $58.4 million, an increase of $43.6 million or 295% from last year. Diluted earnings per share were $0.94, up $0.83 from last year. Capital expenditures in the quarter were $14.8 million, down $1.3 million from last year. As we discussed last quarter, these results reflect the continued demand for our core offerings. Our total enrollments for the quarter exceeded 222,000, almost 100,000 more than we had prior to the pandemic in FY '20.

Families continue to seek out educational opportunities and Stride is filling a need in the market for virtual options. Our execution around marketing, enrollment, and school operations demonstrates our ability to grow enrollments sustainably for the long term. Career Learning middle and high school revenue for the quarter was $198.9 million, up more than 30% from last year. Career Learning enrollments grew 30.4% to 91,700.

General Education revenue grew 10% to $329.4 million on enrollment growth of 11.3% to 130,900 students. Total revenue for enrollment across both lines of revenue was $2,303, up slightly from last year. As we mentioned in the fourth quarter, the loss of ESSER funding is a headwind to our revenue per enrollment this year. However, this is being offset by a positive funding environment. While we were up this quarter, we expect to see some impacts from the state mix and timing and therefore, believe we will finish the year flattish to down slightly in revenue per enrollment.

Adult Learning revenue continues to be impacted by the slowdown in our software development products, which we've outlined previously. Revenue for the quarter at $22.8 million was down from last year. Looking at the full year, we think this quarter's Adult Learning revenue is a good proxy for what we expect for revenue in the upcoming quarters. Gross margin for the quarter was 39.2%, up 320 basis points from last year. We continue to see improvements in gross margins as our business scales, and like last year, we managed our teacher hiring well. Both of these contributed to our strong gross margins in the quarter. For the full year, we expect gross margins to improve by 100 to 200 basis points compared to FY '24.

Selling, general and administrative expenses totaled $168.5 million, in line with last year. As I've mentioned before, I think we've done a good job of holding down our administrative costs even as we continue to grow. While we've managed these costs well, we do expect to see some SG&A increase for the full year. Even with this slight increase, we will still generate significant operating leverage out of the business.

Stock-based compensation for the quarter was $8.4 million, in line with last year. We expect to see a modest increase in stock-based compensation due to the impact of some long-term performance grants and therefore, full year stock-based compensation will likely be in the range of $34 million to $39 million.

Adjusted operating income for the quarter was $58.4 million, up almost 300% compared to FY '24. Adjusted EBITDA was $83.9 million, up 111%. Diluted earnings per share were $0.94, up $0.83 from last year. Our profitability strength was driven by growth and operating margin improvements as we continue to see benefits of scale as we grow. For the full year, we expect depreciation and amortization to increase marginally from last year.

Capital expenditures in the quarter were $14.8 million, down $1.3 million from last year. Free cash flow, defined as cash from operations less CapEx, was negative $156.8 million compared to negative $151.5 million in the prior year period. Cash flow in the first quarter followed our typical seasonality related to school launch and the onboarding of students. As with last year, we expect to see positive cash flow for the next 3 quarters. We finished the quarter with cash, cash equivalents, and marketable securities of $539.4 million.

Turning to our guidance. For the second quarter of fiscal year 2025, we are forecasting revenue in the range of $560 million to $580 million, adjusted operating income between $115 million and $125 million, and capital expenditures between $13 million and $15 million. For the full year, we expect revenue in the range of $2.225 billion to $2.3 billion, adjusted operating income between $395 million and $425 million, capital expenditures between $60 million and $65 million, and an effective tax rate between 24% and 26%.
Thank you for your time today and for your continued support. Now I'll pass the call back to the operator for your questions. Operator?

Question and Answer

Operator

[Operator Instructions] We'll take the first question today from Jason Tilchen, Canaccord Genuity.

Jason Ross Tilchen
Canaccord Genuity Corp., Research Division

I'm curious in terms of the really strong demand that drove the record enrollment in the quarter. If you could maybe shed a little more light on some of the drivers of this momentum. Were there certain use cases or certain states that you saw really strong growth? Was some of this driven by some of the more effective marketing spend? Any color you could share would be greatly appreciated.

James J. Rhyu
CEO & Director

Yes, I think it's pretty broad-based. We actually -- I think as Donna mentioned in her remarks, our SG&A was pretty flat year-over-year, and so the increased demand sort of would imply, all things being equal, a lower cost of acquisition profile, which I think from everything we can see at least points to a lot of sort of growth in organic demand. I think word-of-mouth organic demand, the sort of the general word-of-mouth type of virality that we're seeing for our programs has been pretty strong. And so just over the past couple of years, we keep seeing that growing. And it's -- I think it's sort of a good indicator that the customer voice for our product is strong and continues to grow.

Jason Ross Tilchen
Canaccord Genuity Corp., Research Division

Great. That's really helpful. And then just one follow-up. I'm curious, in terms of the -- you talked a little bit in the prepared remarks around how school choice is becoming a more bipartisan issue over recent years. I'm curious, as we look at the election coming up in a few weeks, are there any states or, even from a national perspective, anything we should be focusing on in terms of any potential benefits or risks to the company either from a school choice perspective or from a funding perspective?

James J. Rhyu
CEO & Director

Listen, I certainly don't want to project what's going to happen in a couple of weeks here with the election. I think that's probably a dangerous thing to do. What I would say is double down on my comment that
I don't think education should be a political issue. I think that the customers have spoken that this is a pretty bipartisan type of product.

We see a lot of demand from people with all different kinds of backgrounds. And I just think that our politicians should govern the country and focus on educating everybody, and providing this kind of choice for people who really need it is an important part of the educational system. So hopefully, we can get all of our politicians, irrespective of party, to focus on those things.

Operator

The next question is from Jeff Silber, BMO Capital Markets.

Jeffrey Marc Silber
BMO Capital Markets Equity Research

I wanted to focus on the comments about revenue per student. I know there's been some questioning in terms of the impact of the roll-off of ESSER funding. Can you talk about what the impact of ESSER funding was on your company last year from a revenue perspective and, if possible, from a profit perspective? And

how that's impacting your guidance this year?

James J. Rhyu
CEO & Director

So I think we've previously discussed that last year, the revenue impact was less than 3%. I don't believe we've previously disclosed the exact profit impact of that, although I think it's not -- even if it's in the range of our normal profitability, it's completely immaterial. If it was anything significantly more than that, I think you would have seen a different profile this year than we're giving.

So clearly, it's not out of the range of sort of profit margin that we saw for the overall company last year. And so I'd rather we get everybody looking forward for this company. We've got a tremendous demand profile, customers are really gravitating to our products and services. And I think we've set ourselves up for a really strong year.

Jeffrey Marc Silber
BMO Capital Markets Equity Research

Okay. And as long as we're looking forward, can we talk about the impact in the current fiscal year in terms of [nuked] schools or schools that were lost? And going forward, are there any major schools at risk that we should be aware of?

James J. Rhyu
CEO & Director

Yes. I mean, I think we've talked before that generally speaking, we see long term, there's going to be an opportunity to add a school or 2 here or there. We have not lost any significant programs for this year. We're currently unaware of any significant programs that we would use for next year or future years. So I think we would consider continuing to add programs.

Not all of those programs that we would add would be in new states necessarily. We like the diversity sometimes of having multiple programs serving different customer constituents in the same state gives us greater flexibility and helps us meet customer demand in those states. So we think we're set up pretty well for future -- for meeting future customer demand.

Operator

Gregory Parrish from Morgan Stanley has the next question.

Gregory Scott Parrish
Morgan Stanley, Research Division

Yes, congrats on the pretty incredible result here. Maybe talk about enrollment a little bit differently than maybe the drivers this year. If you think about kind of retention, what you're doing there, maybe reaching new students, the messaging that you're going to market with, the conversion rates that you have, what really -- what were the biggest drivers this year? I imagine it's a combination, but maybe kind of flesh out really where you're finding success and what's improved versus last year.

James J. Rhyu
CEO & Director

Yes. I mean, I think -- well, to sort of reiterate, I think that the biggest piece of this equation that is helping drive our business is the demand side. Customer demand has been strong, and everything else, all things you mentioned, retention, conversion, all the other stuff, sure, we're always looking to make those things better. I don't think that they were -- in any one of those things, by the way, were the single driver of our performance this year.

I think it was clearly customers have said that they want this product, and the demand side of this equation has been very strong. It continues to look very strong. We continue to obviously drive as good conversion as we can, retention, all those metrics. But this year wasn't driven by those things. This year was driven by the demand side of the equation.

Gregory Scott Parrish
Morgan Stanley, Research Division

Okay. That's helpful. And on the margin, I don't think guidance here is up nearly 400 basis points at the midpoint. You're guiding to 11% revenue growth. So I think a lot of this is operating leverage. But Donna, I guess, maybe if you could help sort of flesh out how much is operating leverage, how much is from efficiencies, if you could kind of contrast the 2, if you could?

Donna M. Blackman
Executive VP & CFO

Yes. So on the gross margins, we are expecting 100 to 200 basis point increase in margins. And that's certainly driven by the strong demand that we saw and the leverage that we have in the business. And we expect to continue to see that. And you've heard me talk over the past couple of years about making sure that we continue to see that strong -- to maintain that strong leverage.

And then on the SG&A side, look, we've talked about being disciplined, right? We talked about how we're able to grow the business this year without adding more marketing spend, without adding more enrollment spend, showing discipline around that without adding some additional headcount. So it's a combination of the flow-through that we see on the top end from a gross margin perspective but also on the SG&A, which is driving the AOI that we're seeing.

Gregory Scott Parrish
Morgan Stanley, Research Division

Okay, that's great. And then a follow-up, my last one, I think this could be helpful for a lot of investors. Maybe talk about why the public financials of some of the nonprofit schools that you manage, why those don't necessarily line up with what flows to you, why there can be differences? And then maybe more specifically, why some of those nonprofits could take ESSER funding and why that wouldn't necessarily go to you and what those could be used for, I think that could be helpful here.

James J. Rhyu
CEO & Director

Yes. I'm not going to speak on behalf of all of our clients. I think that's a very irresponsible thing for us to be doing. I'll speak for what we do and how we do it. And I have great respect for how our clients manage what they do and I'd let them speak for themselves. But I think that whatever our clients do, we want to be supportive of their mission and their goals, and indirectly, that means that we're supporting the students that want to be participating in these programs.

And so the rest of that stuff, like what our clients are doing, I mean, first of all, we have no providence over that. And so it's not like we have an ability to even always have insight into how they make all those decisions. Those are proprietary to them and I'd rather leave it to them to describe.

Operator

And next up is Alex Paris, Barrington Research.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

Congratulations on the super strong quarter. I'm wondering, in terms of your guidance, Donna, for fiscal 2025, have you embedded in that any expectations for new states or states in which you have caps that may be or will be lifted or raised?

Donna M. Blackman
Executive VP & CFO

We have not factored in any new states. We have some increases in some caps that's already factored in, into the results that we have in Q1 as well as for the full year. But the overriding factor that is driving our revenue is, as James said, the demand that we're seeing. And so we are able to meet the demand with

our ability to execute via our marketing, via our enrollment, but it really is us being able to capture the demand that's in the marketplace.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

Great. And then looking at the 2 programs, General Education and Career Learning, I think last fall, you had 91 GE and 56 Career Learning. Do you anticipate opening up additional Career Learning programs in existing states in fiscal '25?

Donna M. Blackman
Executive VP & CFO

We have the same number of programs this year that we did last year in terms of our Career Learning programs in total.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

Okay. The idea and do you envision opening up additional Career Learning programs this year or next year?

James J. Rhyu
CEO & Director

Not for this fiscal year. I do think that there is a chance we might open a couple next year.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

Got you. And then last question and that's a follow-up on some of the other questions regarding ESSER. How do the ESSER funds come to Stride? It's my understanding that they've largely been used by school districts within your Learning Solutions business. Is that accurate?

James J. Rhyu
CEO & Director

Like I said, really it's tough for us to be able to answer how ESSER funds go to all of our partner clients because that's something that they manage, that they're responsible for. What we know is that during the time that ESSER was in place, certainly, there are some of our clients who made the decision to support programs that we provided that were eligible for those funds.

But it's sort of -- I don't know, I would say it's sort of beside the point at this time because for this fiscal year, ESSER is in the rearview mirror and we've got tremendous demand for the business that we're running, and that's with ESSER in the rearview mirror. So I think we've set ourselves up well from here to grow. And that's with all of that in the rearview mirror. So I think I want this company to stay focused on this year, which doesn't really have the ESSER benefit in it and moving forward from there.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

Got you. Not only does it not have the ESSER benefit, it has a little bit of a headwind on a year-over-year basis. You had previously said less than 1.5% of revenue would be the impact in fiscal '25. Is that still a good thought?

James J. Rhyu
CEO & Director

Yes. And so yes, year-over-year, it would be, as you're defining it, a headwind, correct.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

Got you. But that will be largely offset by state funding increases in mix, so we're expecting flat to slightly down revenue per enrollment for full year, just to clarify?

James J. Rhyu
CEO & Director

That is correct.

Alexander Peter Paris
Barrington Research Associates, Inc., Research Division

Great. Congratulations again.

Operator

Next, you'll hear from Tom Singlehurst, Citi.

Thomas A Singlehurst
Citigroup Inc., Research Division

Congrats on the results. Apologies to ask about ESSER as well, but I'm interested in any second order impact from reduced ESSER funding. Actually, I'm thinking about this on the positive side. I mean is there -- are there other programs that would have been handled by school districts or schools internally that now might be outsourced? Any views on that would be very much appreciated. That's my first question.

James J. Rhyu
CEO & Director

Yes. I don't know that I see any second order impact of that nature having any material or significant impact on our business for this year. And again, I just -- I don't want to guess how district clients out there either have or are using or intend to use any remaining ESSER funds as it pertains to us. So I don't really have a lot comment there.

Thomas A Singlehurst
Citigroup Inc., Research Division

Perfect. And second question if it's okay is on whether you've seen continued -- or expect to continue to see sort of intra-year enrollment growth? I mean in the last couple of years, we've had a sort of new normal where the 1Q enrollment number's, not the high watermark, it happens later in the year. I'm interested in whether you think that might happen again in 2025.

James J. Rhyu
CEO & Director

Yes, it's a great question. As I said, we continue to see strong demand. I don't know if it's a new normal yet but it has been 2 years running, as you said. I can tell you that as of yesterday, I haven't looked
yet today, but as of yesterday, we continue to see that strong demand come through. So we are, as of yesterday, higher than we were as of September 30. And if the trend continues, yes, I think we would expect that.

But I don't think we're guiding to that and we're not indicating that right just yet. We want some more of this in-year period to mature for us to feel comfortable. We're only 3 weeks into this in-year period. So I don't know that it's a complete set of information for us to be making those statements yet. But like I said, 21 days in, demand remains strong.

Thomas A Singlehurst
Citigroup Inc., Research Division

Perfect. But the guidance is not based on that [indiscernible].

Donna M. Blackman
Executive VP & CFO

The guidance reflects certainly taking into account what's happened in the past 2 years but also taking into account that we only have 2 years behind us, right? So with the balance of what's happened over the past 2 years but not ignoring what's happened over the past 23 years, right? And so it's a balance of it.

But to James' point, what we've seen today, there's more upside. And so the full benefit of it may not be taken into account. But again, we're only -- we're still in the month of October, and that number could change. And so there could be some more upside. But again, we don't know what that trend will look like for the rest of the year. So with 3 years in, it's not quite yet a trend.

Thomas A Singlehurst
Citigroup Inc., Research Division

Perfect. And one very final one, I promise. Any change to the 2028 outlook and guidance on the back of today?

James J. Rhyu
CEO & Director

We're not providing any update to the 2028 today.

Donna M. Blackman
Executive VP & CFO

Other than say that we feel confident in our 2028 numbers, as I said in my prepared remarks, and we are reiterating our confidence in our 2028 guidance.

Operator

[Operator Instructions] We'll go next to Stephen Sheldon, William Blair.

Patrick James McIlwee
William Blair & Company L.L.C., Research Division

You've got Pat McIlwee on for Sheldon's team today. Just a couple of quick ones here. So you talked about the demand side a few times now, but can you just talk us through what supported the outsized growth in Career Learning this quarter and if you've made any progress in building out that kind of separate marketing funnel you've talked about in the past there?

James J. Rhyu
CEO & Director

Yes, really good question. So I think the -- I'll take that second part first and then circle back on the first part. Unfortunately, I don't think we've made a lot of progress in building out a separate funnel. So it's something we continue to work on. I think for all the great work that the marketing team has done over the past year or so, that's one area where I think we still haven't cracked the nut and we continue to look at ways to do that.

But the first part of your question, you have to remember that pretty much now at this point, most of our high school is basically a career program. And so the growth in Career Learning is, in some respects, a proxy for the growth in certain grade levels. And so we're seeing a lot of strong demand in those grade levels that support Career Learning. And I think that, that's been a trend that we've seen for some period of time. And so we're going to continue to support all the grades, but we are seeing a little bit stronger demand in certain grade levels that really cater to the Career Learning programs that we have.

Patrick James McIlwee
William Blair & Company L.L.C., Research Division

Okay, makes sense. And then in tandem to the questions on the elections and Career Learning program expansion as well, you've previously talked about opening schools and hopefully a handful of new states in '25, '26. Can you just provide any updated thoughts on state expansion targets at this point in time?

James J. Rhyu

CEO & Director

Yes, listen, it's -- any state expansion is a multiyear effort that has a lot of uncertainty to it. We, of course, want to plant flags in every state that we're not currently in as long as it makes sense for the business, right? And there are probably a couple of cases where it actually just doesn't make sense because of whatever the regulatory environment, demand characteristics, whatever.

But by and large, for most of at least the states that we're not in, we have efforts underway that look to expand into those states. I think as we diversify some of our portfolio, whether it's things like tutoring or other things, we see that there's opportunities to potentially plant flags in those states that may not include just the pure core managed program. And so we're looking to do things in a lot of states that may not just be around the core managed program but may include some other types of products and services that we can provide.

Of course, to the extent that we can break down and get into these states that don't have the sort of the full-time online programs, we're trying to do that as well. But like I said, no new news to report for this fiscal year. We are cautiously optimistic that over the next couple of few years, we will be able to make some progress on some new states.

Operator

And at this time, there are no further questions. That does conclude our conference for today. Thank you all for your participation. You may now disconnect.

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