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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the K12 First Quarter Fiscal 2021 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions) I would now like to hand the conference over to your speaker today, Mike Lawson, VP, Investor Relations. Thank you. Please go ahead.

Mike Lawson - *K12 Inc. - VP of IR*

Thank you, Chantel, and good afternoon. Welcome to K12's first quarter earnings call for fiscal year 2021.

Before we begin, I would like to remind you that in addition to historical information, certain comments made during this conference call may be considered forward-looking statements. These statements are made pursuant to safe harbor provisions of the Private Securities Litigation Reform Act of 1995. They should be considered in conjunction with cautionary statements contained in our earnings release and the company's periodic filings with the SEC. Forward-looking statements involve risks and uncertainties that may cause actual performance or results to differ materially from those expressed or implied by such statements. In addition, this conference call contains time-sensitive information that reflects management's best analysis only as of the day of this live call. K-12 does not undertake any obligation to publicly update or revise any forward-looking statements. Further information concerning risks and uncertainties that could materially affect financial and operational performance and results, please refer to our reports filed with the SEC. These reports include, without limitation, cautionary statements made in K12's 2020 annual report on Form 10-K. These filings can be found on the Investor Relations section of our website at www.k12.com.

In addition to disclosing financial results in accordance with generally accepted accounting principles in the U.S. or GAAP, we will discuss certain information that is considered non-GAAP financial information. A reconciliation of this non-GAAP financial information to the most closely comparable GAAP information was included in our earnings release and is also posted on our website.

This call is open to the public and is being webcast. The call will be available for replay for 30 days.

With me on today's call is Nate Davis, Chief Executive Officer and Chairman of the Board; and Tim Medina, Chief Financial Officer. Also on the call today is Mike Kraft, our former Head of Investor Relations, who remains with the company as Senior Vice President of Corporate Communications. Following our prepared remarks, we will answer any questions you may have.

I'd now like to turn the call over to Nate.

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

Thank you, Mike, and good day, everyone. First time, huh? Good afternoon, everyone. Thanks for joining us on the call today. With so much uncertainty in our lives right now, I feel fortunate. Our business is stable. It's growing, is well positioned for the future. As you know, the pandemic is helping to drive a shift to more online learning, but our great results are not just because of the COVID-19 crisis, independent of the pandemic. As we've said in the past, there is an evolving view of online learning as a quality option for many families. This trend started before the pandemic and will continue after the pandemic.

A new study commissioned in partnership with a third-party researcher called Qualtrics, shows that more than 60% of parents believe that quality of education students receive from an online school is equal to what they receive in a traditional brick-and-mortar school. In fact, independent research recently published by Dr. Ian Kingsbury corroborate these findings. Dr. Kingsbury's studies concluded that the virtual schools often outperform brick-and-mortar schools when it comes to key learning experiences, which includes promoting active learning, communicating effectively, managing classroom and providing high-quality instruction.

Key takeaway is this. While the pandemic may have accelerated this trend, the awareness and the acceptance of online and blended learning has been increasing every year. Again, we believe this shift has been a key contributor to our growth this year.

So how does this growth impact our financial results? Specifically, first quarter fiscal year 2021 revenues were $371 million up 44.3% from revenues of the same period in FY '20. Adjusted operating income was $39.2 million (sic) [$23 million], up 275% from the loss in the same period of fiscal '20. And similarly, adjusted EBITDA was up even more on a percentage basis as was cash on the balance sheet. By all measures, we're stronger, we're growing faster than any time in our recent history. I won't steal all Tim's thunder because I'm going to let him address the full set of financials.

Our financial results reflect the multiyear strategy I communicated to investors several years ago and since then have implemented. As some of you may remember, we had 2 goals: first, to support the growth of our core General Education business; and second, to more efficiently use our strong balance sheet to expand into this career learning industry. As you can see in the results we announced today, both segments are growing. Gross and operating income margins are starting to improve, which leads to improved return on invested capital. And we believe these improvements are just the beginning of the benefits from the strategy I first described in mid-2018.

To align with this strategy and to help investors better understand our progress and our performance, we're providing new disclosures in our reporting starting this quarter. Student enrollment and revenue data will now be reported separately for our General Education and our Career Learning lines of revenue. This will allow investors to more easily see our progress in building Career Learning while maintaining focus on the core General Education market. Additionally, we'll be providing detail on adult learning so that investors can track our expansion into that market for consumers, enterprises and military.

Lastly, for your reference, we've provided historical results in the new reporting format. Tim will provide additional details on the definition of each line of revenue in his remarks.

With that as the backdrop, I want to turn to the general education market. For the first quarter, we posted enrollment of nearly 165,000 enrollments or a 49% increase year-over-year. This is the largest enrollment increase we've delivered in over a decade. We saw enrollments rise in the vast majority of states and schools where we support full-time public programs as well as in all of our private schools. I'd like to also point out that enrollments rose the most in Grades K to 5. The skew to younger grades makes sense in our COVID environment era because students at that age aren't able to adhere to social distancing guidelines as effectively as older students. Therefore, many parents of younger students are choosing an online option.

Importantly, even with the huge surge in enrollment, and the logistics associated with onboarding tens of thousands of students, our outreach data indicates that over 75% of parents were satisfied with the enrollment process. In fact, parent satisfaction actually rose year-to-year, even though we onboarded more than twice as many new students. They handled the volume. We honed and automated our document submission process, improved communications and engagement learnings as -- in parents. We increased the functionality of the K-12 app and made a host of other improvements. That's not to say the enrollment process went without challenge. For example, the availability of computers and materials during this shortage was amazing. If you tried to buy a medium to low-priced computer during this period, you know it wasn't easy.

Another example, the availability of document the parents needed to enroll in our schools when schools and doctors' offices were often closed. Difficult for them to get those documents. Another example, some boards raised their cap. So what we -- put limit on enrollment, but we did so at the last minute or late in the enrollment season. But through it all, we persevered, and we now support nearly 80 full-time general education programs, which include our private schools that are up, running and providing an engaging learning environment. These results are a testament to the depth of experience in our organization. The strong relationships we have with our schools and school district customers and also strong relationships with our supply chain partners. This demonstrates our ability to quickly scale our business. Rolling out online learning isn't easy when we do it at scale. And I can't say enough about how the K-12 team rose to meet these unprecedented challenges.

I'm often asked about our operational competency. Our ability to enroll this many students and turn up this many new programs and higher teachers demonstrate our operational excellence. Our core competency and operational excellence comes from the ability to take this complicated process of enrolling students and operating a school and transform it into a well-run, legally compliant, solid educational program. So the behind-the-scenes work is where we excel.

In addition to our school solutions, we also saw growth in revenues by selling a la carte products and services to school districts and schools across the country. Our learning solution team, which you may have heard us say is the institutional business, added over 150 new schools and district partners this year, bringing our total to over 1,000 school districts nationwide. These programs will support over 25,000 learners, including students from David Douglas College in Oregon, the Tumwater School District in Washington, the Rescue Union School District in California, and State College Area School District in Pennsylvania. I just wanted to name a few to show you the geographic diversity of our district customers.

We're also in the early phase of implementing a new program in partnership with the Rhode Island Department of Education. This program will support medically vulnerable students, those with English language learning requirements and other families seeking alternatives to in-person instruction during the pandemic.

Importantly, we didn't just win new customers. We retained the vast majority of the existing base. On a year-over-year basis, over 85% of our largest learning solutions customers renewed their services for this school year. This is a result of strengthening and reimagining our institutional business in the past few years, while it was shrinking rather than abandoning that line of revenue.

However, I want to be clear with something. Even these great results, unfortunately, not all of the new implementations went as smoothly as we like. A few custom implementations that we look to launch on very short time frames did not go as planned. One such feasibility, high visible implementation was the Miami data implementation, where we faced a very large custom implementation with numerous systems interfaces and evolving requirements. Because we believe in the vision of Superintendent Carvalho, we committed to delivering that solution in 6 weeks, something that should have taken us 6 months to implement in regular circumstances. Unfortunately, this just wasn't enough time to iron out all the kinks in the interfaces and systems in a short time frame. To this day, we still maintain great respect for Superintendent Carvalho and his staff and their vision.

Now I'd like to turn to Career Learning, for which we posted another year of very strong growth. Enrollments were near 31,000, an increase of 127% year-over-year. We saw growth in 90% of the programs we administer while adding 4 new programs this school year. The ongoing interest in career learning program is clearly in line with what many families are looking for in their students' education.

In the same Qualtrics survey I mentioned previously, more than 83% of the parent surveyed believe that career programs are a good way to prepare their students for in-demand jobs and for attending trade schools and certification programs without needing to take on college debt or go to college. Most of these parents say that they would rather prefer their students take career-oriented courses as opposed to general electives in school. Remember, many students taking career learning programs will still attend college but with a better knowledge of their interest and skills. These results underscore how K12's career learning programs are in place with the right direction at the right time.

During fiscal '21, we will continue to invest in building out our career rep programs for middle and high school students. We plan on adding between 2 and 5 new programs or schools this year. And as we noted in previous calls and communications, over the next 2 to 3 years, we plan on expanding our career learning programs across all 31 states in which we operate full-time programs. In fact, we'll also look to add a second or third program in several states due to the high demand for these programs.

So this year, we're also planning on adding new industry pathways in digital media and legal and law enforcement. The California Virtual Academy will be leveraging a new relationship with the California Broadcasters Association, nickname CBA, to expose more California high school students to digital journalism and media sales pathways. This collaboration will give K12-powered students access to CBA's network of industry experts.

The program also includes an industry-endorsed curriculum that integrates project-based learning with technical and production experience, hands on experience. To complement our career learning offerings, we established a student participation agreement with 2 important organizations, the Business Professionals of America and the Family, Career and Community Leaders of America. Through these arrangements, students will have an opportunity to represent their schools at virtual and in-person events, competitions at the local, state, regional and national levels. The lot will be able to gain access to each organization's programming, resources and national networks of career-focused peers and industry professionals, which is what motivates a young student to stay and focus in their career pathway.

These partnerships are just a few examples of how K12 powered learning programs is much more than just a cricket. It's a comprehensive interactive experiential learning environment. Look for more partnerships in the near future.

Our Career Connection partner, Tallo, has also experienced an incredible growth. This quarter, their community of users grew to over 1.1 million, an increase of 10% since just last quarter and nearly doubling from a year ago. Tallo also added new industry partners like Abbott Labs, CVS, Exelon and Publix for leveraging the platform to fill current job offerings and to connect to future workforce. And through the end of the summer, Tallo made more than 15,000 direct engagement matches between Tallo users and a college of community -- I'm sorry, a college or company or other organization partners.

As important as making these career connections are, Tallo also finds the right fit for the users even more importantly. That's why Tallo has also forged strategic partnerships with jobZology, which houses an award-winning career assessment algorithm; and Yello, who you may have heard of, the nation's leader in management recruiting software.

Last year this past quarter, Tallo successfully launched Ping, the new web-based app that offers an innovative solution to in-person college fairs. This launch included 3 successful virtual fairs that connected students with colleges and companies across the country. Future events will build on this success and will also provide connections for a diverse community of students and job seekers, including the Historically Black Colleges & Universities virtual college fair. Proud of it.

Now I'd like to turn to the adult market. The adult market for Career Learning and our Galvanize business is very strong, starting to accelerate after months of pandemic-related impacts. In fact, this month's consumer education class is the largest that we've ever had. The enrollment has grown more than 30% quarter-over-quarter and 45% year-over-year. In-person classes have been minimal, due to the pandemic, as we monitor safety precaution. However, we've seen remote learning not only become a short-term substitute or in-person classes but actually expand the student population.

In addition, we're seeing increased interest from our nation's veterans. I'll talk more about that in a minute. This quarter, we also launched software engineering classes in San Jose to capture Bay Area interest. As the pandemic increases, we're considering adding 1 to 3 additional markets to support continued growth in Galvanize's consumer business.

On the enterprise side of Galvanize's business, the effects of COVID continued to slow decision-making by corporations who are strapped for cash. However, this quarter, we did secure new business with IDT, a communications company; and Citadel, an investment firm, to provide data science training.

We also saw further expansion in our military business, as I mentioned a minute ago. This quarter, we became a subcontractor on a military training program for which we are onboarding software engineers to the Air Force Platform One. We do this through weekly workshops. In addition, we launched one of the very first 12-week software engineering immersive classes for selective active duty members. Due to this success, we received requests to deliver 3 more immersive classes in the coming quarter. While still in the early stages of development, the military segment of Galvanize's business has grown more than fourfold in the past year.

As I mentioned last quarter, the community business segment for Galvanize continued to be slowed by COVID-19. However, we delivered -- we believe that a combination of Galvanize's immersive bootcamp business, what we call the consumer business, and the enterprise business will deliver revenue growth in fiscal '21. As expected, Galvanize posted a $7.6 million loss in EBITDA for the recent quarter, first quarter. But we continue to believe this organization will contribute a positive EBITDA by the fourth quarter of this year. This assumes the economy and our community business rebound a bit in the second half of the year. If that rebound is delayed, then we could see breakeven get delayed into FY '22.

Taking all of this into account, our revenue guidance for the year is $1.445 billion to $1.470 billion. This is an increase of up to 41% year-over-year.

Guidance for operating income. We expect adjusted operating income in the range of $120 million to $130 million. That's an increase of up to 110% year-over-year. This income improvement comes from both revenue growth, the inherent leverage in our business and proactive management of our cost structure. This year, we'll continue to reallocate funds to fuel our career learning activities while also investing in programs that enhance the customer experience, increase the teacher efficiency, improve student outcomes and improve student retention.

Regarding capital expenditures, we are increasing our investment in the range of $50 million to $60 million. This reflects one of our stated use of funds from a recent financing, reinvesting in the core business and core business opportunities. As a part of this, we're stepping up our spending specifically to grow our Career Learning business and strengthen our systems and infrastructure. We're continuing to modernize our curriculum and increase the use of gamification, video and artificial intelligence to improve student engagement; and in building enhancing tools that support teachers and introducing new products and services for school districts that want to expand their capabilities especially in career learning. Additionally, our investment in Career Learning will include expanding a number of project-based learning courses, deepening the content of existing pathways and expanding into new career pathways.

In summary, we posted an extraordinary strong quarter, provided guidance for a record year. Total full-time program enrollments exceeding 195,000, up 57%; revenues approaching $1.5 billion profitability to more than double on a year-over-year basis. It's important to note that current trends and public opinion support our enthusiasm and our investment in our Career Learning business. This includes improving trends at Galvanize, which we continue to believe will be accretive to EBITDA as we exit the year.

Let me close on the 5 key focus areas for the year. These are the things we'll focus on. First, we remain committed to constantly reimagining the online and blended learning experience, investing in teachers and school leaders. Second, through our customer experience organization I initiated nearly 2 years ago, we will work to retain as many students as possible, showing them the K12-powered program standing head and shoulders above the rest. Internally, we say we've got to delight the customer. Our improvement in retention over the last few years demonstrates the effectiveness of our focus on the customer experience. Third, we'll continue to invest in and grow our General Education business. This includes ensuring that we have products, quality and infrastructure to scale the business. We're targeting consistent single-digit revenue growth in this business for the next couple of years.

Now we all know nobody knows what's going to go on with the pandemic, so the impact of that is still unknown. If there's an effective vaccine, there's treatment, if it's rolled out fast, we could see more than we thought. Students go back to brick and mortar, and we might see flat to declining enrollment. But right now, our belief is we can see single-digit revenue growth in this business for the next couple of years.

Fourth, we continue to expand our Career Learning business. That includes expanding our footprint, programs, partners and capabilities. We're targeting high double-digit revenue growth over the next couple of years, and we might -- just might see another year of triple-digit percentage growth next year.

And fifth, we will work with school districts to grow our sales of a la carte products through the learning solutions business. We believe that our continued focus on these 5 areas; our unwavering dedication to academic, service and innovation; an increase of awareness and acceptance in the marketplace for online and blended learning will enable us to produce consistent revenue growth for our shareholders over the long term.

Thank you very much for your time today. I'll turn the call over to Tim Medina. Tim?

Timothy J. Medina - *K12 Inc. - CFO*

Thank you, Nate, and good afternoon, everyone. We are pleased with our very strong first quarter results. The tremendous growth we are experiencing demonstrates the strength of our business model and innovative approach to education. We are proud to serve more students, parents and school districts than ever before with our industry-leading online and blended learning programs and solutions. In the next few minutes, I will review the results of the first quarter, our Q2 and full year guidance and some of the key initiatives we are executing on to sustain revenue growth, margin expansion and strong cash flow into the future.

First, though, I want to draw your attention to the changes in how we report revenue. The successes we are enjoying in Career Learning results from the execution of a strategic vision over the past several years. Our operating structure is designed to support high sustainable growth in the Career Learning business while continuing to grow and reinvest cash flow from the core General Education business. Given the long runway we see with this growth strategy, we decided now is the time to adapt how we report our revenue.

Specifically, our reporting has shifted from a product-based focus, such as managed schools and institutional sales, to a market-based focus on the revenues we earn from the 2 markets we are addressing, general education and career learning. This line of revenue change fits better with how we run our business. It also will provide investors with greater insight into the business and more clarity around the key drivers of growth.

To help investors understand the transition from our old to new lines of revenue reporting, we have provided a short presentation that accompanies our earnings release. Slides 3 and 4 provide reconciliations from our old to new reporting for revenue and enrollments. I encourage investors to review our SEC filing on Form 10-Q for additional details on our new lines of revenue.

Now please turn to Slide 5 for a financial overview starting with the income statement. Revenue for the quarter was $371 million, an increase of 44.3% from the prior year. Revenue in the quarter for our General Education business totaled $313.8 million, a 34.4% improvement over the same period last year. This increase was driven by a 48.6% increase in student enrollment, partially offset by a 7.6% reduction in revenue per enrollment.

Revenue for our Career Learning business more than doubled compared with the prior year to $57.1 million. This increase was driven by 126.5% increase in enrollments in the acquisition of Galvanize. As you know, we acquired Galvanize in January of this year, so we are seeing a full year impact of Galvanize in fiscal '21. This is the fifth consecutive year that we grew enrollments, reflecting the long-term ongoing trend of greater acceptance of online education and at K12, improving student retention rates each year.

Certainly, COVID-19 has been a strong tailwind for top line growth in enrollments in fiscal 2021, as Nate mentioned. However, without the effects of the pandemic, overall enrollments would have grown in a range consistent with the historical prepandemic levels of growth we've seen over the past few years.

On the topic of revenue per enrollment, the current results are due to state budgetary pressures in the wake of COVID-19, particularly in California. In addition, the impact of school mix was a significant factor as a substantial portion of our growth is occurring in lower-funded states. For the rest of this fiscal year, we expect to see continued pressure on state budgets from the pandemic and the risk of some recessionary pressures on the overall economy.

Over the longer term, we believe revenue per enrollment will rise in line with historical trends. Over the past 20 years, per student education funding for grades K through 12 has risen between 1% to 2% on average across the United States. While the impact to our company may vary due to school and state mix, the overall trend is upwards.

Gross margins for the quarter were 35%, over 90 basis points higher than the prior year. Margin improvement was driven by higher enrollments in both General Education and Career Learning, partially offset by the lower revenue per enrollment. We believe that gross margins for the full year will improve on a year-over-year basis, largely due to the scale of our business. Over the long term, we see opportunity for further margin expansion from continuing to grow our top line, including in higher gross margin adult learning revenue as well as from efficiencies we're driving into our operations.

Similar to my comments on gross margin, over the longer term, as we scale the business, we expect to realize increased operating leverage and cost efficiencies in our SG&A cost structure. This operating leverage was demonstrated this quarter as our SG&A as a percent of revenue for the first quarter was 31.8% compared to 41.7% for the same period last year.

SG&A expenses for the quarter were $117.8 million, an increase on a nominal basis of $10.6 million or 10% compared with the same period a year ago. This nominal $10.6 million increase in SG&A is directly related to the rise in enrollments and the scaling of our onboarding, sales and technology costs to support that growth, partially offset by a lower media spend.

In addition to ongoing efficiencies that we're driving into our acquisition efforts, we also saw reduced media costs as a result of the pandemic. Not only were other companies lowering advertising expenditure this summer, but when the Olympics were canceled, media costs fell. It's also worth noting that first quarter expenses include expenses for Galvanize acquired at the end of January 2020.

As I previewed in my comments last quarter, we have updated our definition of adjusted operating income, which presently excludes stock-based compensation to also exclude amortization of intangible assets. With the acquisition of Galvanize and potential acquisitions we may make, we believe this offers investors a better way to understand our operating and financial performance. It also aligns us more closely with how other companies are reporting their adjusted operating results.

Now for the quarter, adjusted operating income was $23 million compared with a loss of $13.1 million in the first quarter of fiscal 2020. The improvements in profitability are largely due to higher enrollments and lower seasonal marketing expense. Stock-based compensation expense for the quarter totaled $8.9 million compared with $5.5 million for the same period last year. The increase in stock-based compensation is due largely to the timing of certain stock-based grants tied to our Career Learning business. We currently estimate stock-based compensation of between $35 million and $38 million for the year.

Adjusted EBITDA for the quarter was $39.2 million compared with $3.3 million for the prior year, driven by the higher gross profit. Our effective tax rate in the quarter was a negative 23%. The rate was negative due to a tax benefit from stock-based compensation reflected each year in our fiscal Q1 despite positive operating income in this year's first quarter. Free cash flow in the first quarter was negative $127.3 million as compared to negative $103.8 million in the prior year. This was mainly due to the normal seasonality of higher cash outflows in the first quarter for school launch activities with timing of cash receipts later in the year. We expect to generate substantial free cash flow in the remaining quarters of the year with free cash flow in line with our full year AOI guidance.

Learning -- turning to the balance sheet. Cash and cash equivalents on September 30, 2020, totaled $308.8 million, an increase of $96.5 million compared with June 30, 2020. During the quarter, we successfully completed a $420 million 7-year convertible senior notes offering with net proceeds of $348.2 million received by the company. The notes bear an interest rate of 1.125% per annum and, again, mature in 2027.

In connection with the notes, the company entered into Capped Call Transactions that are expected to reduce potential dilution to the company's stock upon any conversion of the notes. The upper strike price of the Capped Call Transactions is $86.17 per share. The cost of the capital -- of the Capped Call Transactions was $60.4 million and was recorded within additional paid in capital.

We used $100 million during the quarter to pay down our revolving credit facility and intend to use the balance of the proceeds for general corporate purposes. Our increased CapEx guidance this year is one example of that. We'll also use the proceeds for any organic investments, especially in support of our fast growing Career Learning business.

CapEx in the first quarter was $12.8 million. And as Nate pointed out, we are increasing our full year guidance for CapEx to a range of $50 million to $60 million to drive improvements in academic performance, student and family experience, customer service, retention and innovation. Accelerating the benefits of these road map investments to sustain our growth beyond the current year and to enhance our competitive position in the marketplace is prudent given the current strength of the business, the opportunities and our balance sheet. Our capital priorities for fiscal year 2021 are our free cash flow generation, balance sheet strength and flexibility, investing to sustain organic growth and strategic acquisitions.

Finally, turning to Slide 6 and our guidance. For the second quarter of fiscal 2021, the company is forecasting revenue in the range of $358 million to $366 million, capital expenditures between $12 million and $15 million, and adjusted operating income between $42 million and $45 million. For the full year, the company is forecasting revenue in the range of $1.445 billion to $1.470 billion. Adjusted operating income is anticipated to range between $120 million and $130 million. Capital expenditures are expected to range between $50 million and $60 million. And the effective tax rate for the full year is expected to range between 26% and 29%.

And with that, I will turn it back over to Nate.

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

Thanks, Jim. We obviously are covering a lot today with the change in reporting, the guidance, the new numbers, so I hope it's all being absorbed well. We're here to answer questions. So let's open the floor up to questions, operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Henry Chien with BMO.

Sou Chien - *BMO Capital Markets Equity Research - Senior Associate*

Sorry, I'm on mute. Can you hear me?

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

Yes, now we can hear you, Henry.

Sou Chien - *BMO Capital Markets Equity Research - Senior Associate*

All right. Great. Yes. No, thanks for the update, and it's very helpful to hear or to refer to the new segmentation. Wondering if you could talk a little bit about -- I guess 2 things, is 1 in terms of the enrollment. I guess what's sort of your -- I mean just trying to disaggregate a little bit how much of it is related to pandemic versus how much of you're expanding services or you're expanding TAM, if you can provide any insight to that. And if you could also speak as well now, now that with this -- the new segmentation, how leverage in the model would work. Understanding it's -- probably has a decent amount of leverage as a tech and software model, but I was wondering if you could speak a little bit to that as well.

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

Okay. Well let's try to tackle those in the enrollment -- disaggregating the enrollment growth. We talked about the fact that the career readiness growth, and I don't think that has much to do with the pandemic, there may be some people out there who said, "I'm going to dive into career learning because my normal high school is closed." But for the most part, we think that's growth due solely to the new programs we put in place.

Certainly, the Galvanize growth was not associated with the pandemic. Although you do see it sometimes in the people who when they're not working and they've lost their jobs, they go spend a little more time getting educated. So we may have a little bit of that bleeding in there. But we think the vast majority of the enrollment growth in Career Learning and the revenue growth in Career Learning is really associated with the program itself.

It's hard to tell on the General Education side to be honest with you. I hesitate to give you any number or try to split that out because I just don't think we know it. I don't think we know how many people made which kind of decision. I would say this though. Here's one way to think about it. When we looked at the kind of growth, the nominal growth we were getting in the last couple of years, we were getting well into the 14,000, 15,000 student growth, and it was growing. So you can assume that, of our growth this year, it would have been somewhere north of 15,000, south of 90,000. I can't tell you what number it would be though. It's just the best way I could disaggregate it. It's just -- it's hard to tell because parents make the decisions on the basis of many things. And some of it was safety for sure, but some of it was also what we've just seen as an exposure in the marketplace.

Sou Chien - *BMO Capital Markets Equity Research - Senior Associate*

Got it.

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

I don't know how we're getting -- the leverage, Tim, you want to answer the leverage?

Timothy J. Medina - *K12 Inc. - CFO*

Yes. Henry, for the last several years, we've been focused on improving profitability and free cash flow. And this year, we did see some benefit from scale and really on both lines of revenue, Career Learning and General Education, of course. And so I'm not sure exactly where you wanted to go with that question. You may want to clarify it.

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

Before, you clarify, I'll give you a couple of points to understand. When we saw more people interested in online learning, we didn't have to spend as much money in media and advertising, right? So the marketing spend went down. The spend for enrollment center, however, has to keep pace. But the marketing spend, promotional loan could go down. We didn't have to increase most of the corporate department. Our accounting department didn't increase. Our finance -- reporting department didn't have to increase. Our logistics department didn't have to increase. Now all of those departments are sized -- whether we double the enrollments or triple the enrollments, doesn't increase the number of -- the amount of support there.

Yes, we have to buy more computers. Yes, we have to buy more materials, but those things are the variable costs. The fixed costs associated with the size of the departments was already there. And in fact, we have started in FY '19 -- I'm sorry, FY '20, we started in FY '20 with a cost reduction program that we've put in place. It saved us some money in FY '20, and it kicked in on a run rate basis going into '21. So those are the reasons why I think you're seeing margins get better and leverage is there because most of the growth that we're getting doesn't require additional expenses at our corporate department. It really requires extra teachers, extra computers and extra material. Beyond that, for the most part, we don't really have to increase expense to take on more loan.

Sou Chien - *BMO Capital Markets Equity Research - Senior Associate*

Yes. Got it. Okay. Yes, yes, I was also thinking the growth in career, the career side of things and then whether that's a different leverage profile versus General Education.

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

I think it's a different leverage profile in the early years because in General Education, we've pretty much built all the content that we need to build. We're going to try to upgrade it with some artificial intelligence and newer technologies like that. But we're still building project-based learning courses, which is the interactive course that allows a student to learn their career ready -- career courses. So we're building more content there. So I think there's a little less leverage in the Career Learning business because it hasn't reached its scale curve yet. So I think there's less leverage there than there is in General Education.

Sou Chien - *BMO Capital Markets Equity Research - Senior Associate*

Got it. Okay. Yes, makes sense. Congrats on the stellar results.

Operator

Our next question comes from Greg Pendy with Sidoti.

Gregory R. Pendy - *Sidoti & Company, LLC - Consumer Analyst*

So I mean if I'm not mistaken, then essentially, not to harp on the prior question, but the SG&A only going up, say, $10 million, it's your student acquisition costs, I assume, is really what's driving -- are coming down. And if that is the case, can you just give us a little bit more color on sort of what a normalized rate would be, you think, maybe going forward, assuming maybe the media one-offs and everything kind of came in?

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

Well first of all, I'm going to let Tim talk about what the run rate kind of cost might be. But I would draw your attention to the fact that I don't think it was just acquisition cost per student. I think it was also our corporate costs were not going up. And we've kept SG&A at the corporate level flat for a number of years. We had a little bit of an increase this year but not nearly the kind of increase compared to what enrollments were. So I don't think it was just acquisition costs. I think it's also overall corporate costs.

We have produced a pretty efficient finance department, logistics department, legal department, and all of those departments did not really see any increase. The little bit of increase that we did see came primarily from the area focusing on retention. We put a customer experience department in place, small increase there, but we did add some hits there. Just about all the other departments remained flat. So I don't think it was just acquisition costs. Tim?

Timothy J. Medina - *K12 Inc. - CFO*

And Greg, we don't disclose that metric. However, it is accurate that our overall media spending, like many other companies, was down this quarter, and we had so much enrollment driven by -- more generally into our company. So our acquisition costs, especially on the media side, were much lower than in prior year, but we don't disclose that metric.

Gregory R. Pendy - *Sidoti & Company, LLC - Consumer Analyst*

Okay. That's helpful. And then just one more, I guess. The world has changed a lot since the Galvanize acquisition. Can you just kind of give us, I guess, big picture maybe some of the areas maybe exceeded and maybe some of the areas where it's been a little bit behind just in your opinion since you did the deal?

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

Yes. And let's start with the areas that are behind. Most clearly and most visibly, there are 3 parts of this business. One is the community business. It's not the reason we purchased it, but it came along with it. It looks like a little like the WeWork business. You have physical facilities where people are leasing space, especially entrepreneurs, young entrepreneurs, and they're leasing a wide open kind of friendly space. Obviously, with COVID, people are not coming into that space, and so that community business not only was not growing but also shrank during the COVID period. So that business is not performing as we thought it would when we did the acquisition.

The enterprise business is growing but is not growing at the pace we thought it would. And that's primarily because, as you know, many companies, whether you're an airline or you're a hotel company or you're retail companies, they're a little cash strapped right now to say the least. They're not getting the kind of revenue that they thought they were going to get, so they're not spending money on the things such as training employees and building more IT systems. So we're seeing a slowdown in the spend there. Other companies who are in a place like telecom companies are still growing. So we mentioned the T-Mobile deal last time. So that business is sort of slightly growing, not nearly growing as fast as we thought.

The upside business has been the -- first one is the community business. The upside business is the consumer business. And that's where the individual decides that they want to get an immersive training in software engineering or in data science. That business is growing much faster than we actually thought it was or thought it would at the time we did the acquisition. And even though we're not in the physical classrooms, we're still getting more on what we call remote, more online learning going on. So as I mentioned in my script, there are more students enrolled in that program than ever before by a factor -- by a factor of 2. So it is actually performing much better than we thought it would. And we think if we were back into a brick-and-mortar environment between the remote and the brick-and-mortar environment together, it'll grow even faster.

The final piece of the puzzle that is growing faster than we thought is the military business. It was a nascent little opportunity, and now we're finding that the federal government and the military also wants to train its personnel as they lead the military service to help make sure they get jobs. And obviously, IT jobs are very well-paying job, so they want to make sure they're getting the training. So that's another one that's performing better. So summary, military, consumer performing better. Enterprise is performing less fast than we thought -- growing less fast than we thought, and community business is declining. Is that helpful?

Gregory R. Pendy - *Sidoti & Company, LLC - Consumer Analyst*

Yes, that's very good.

Operator

(Operator Instructions) Our next question comes from Stephen Sheldon with William Blair.

Stephen Hardy Sheldon - *William Blair & Company L.L.C., Research Division - Analyst*

Wanted to ask first what you've roughly assumed in the full year guide for starting to ending enrollments in both General Education and Career Learning. It looks like it's been down, I think, mid-single digits in aggregate the past 3 years start to end. Would that be a fair assumption for this year, for the end year-to-end year decline?

Timothy J. Medina - *K12 Inc. - CFO*

Yes. So I'm also not -- I don't think we actually give a point-to-point number there. But what I will say is that we saw much higher reregistration in the spring semester students coming into this year, and so we -- at the same time, on the other side of the pandemic, we're modeling higher withdrawals. And so we don't give a pinpoint number. As you mentioned, it usually does slightly decline, and we would expect this year would have a similar -- a slight decline as the year progresses. The -- we'll have to see as time goes by. Have to see some of the factors Nate mentioned about the virus, the vaccine. Those are all uncertainties that make that prediction difficult.

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

If we just looked at the first 2 months of the year already from September until the end -- we're almost at the end of October, so the end of October. Our internal reports tell us that we're not declining as fast as we did last year, but we don't think that will hold. We think that, over time, we'll start to see some more deterioration. But right now, retention is better than it was last year. It actually improved last year. And you can imagine some of that's COVID.

As people start to hear that this year the COVID rates are already going up in colder states and the expectations that we're going to see it go up through the winter, we may, in fact, see better retention than we thought we would. Normally, we see some deterioration during the year. We may not see that this year. But as Tim said, he said it appropriately, we just don't know. At this point in time, I'll challenge anybody to predict what's going to happen with COVID, how it's going to impact.

Stephen Hardy Sheldon - *William Blair & Company L.L.C., Research Division - Analyst*

Got it. Yes, that makes sense. And as more of your revenue comes from middle school and high school career learning, how could that impact overall retention rates and marketing efficiency over the next few years? So yes, looking at Career Learning enrollments versus General Education.

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

Well in Career Learning, I think the best way to look at it is we will likely see some -- the cost of teachers is a little higher. The retention is a little bit better. So there's sort of an offsetting there. But we expect to see retention better because that's what our -- so all the early data from the first couple of years of the program has told us that retention is better in those programs. Therefore, the cost of acquisition, we don't have to acquire as many because we're not replacing as many.

Now it's not like an order of magnitude. It's not 2 to 1. But we're seeing percentage point improvement for Career Learning over what General Education has done. So I expect to see over the next couple of years that the cost of acquisition for Career Learning will probably go up a little bit and then stabilize, up a little bit only because we're going to spend some time exposing the market to it.

The second big factor is scale. We have 31 states in which we operate for our General Education programs, but we're only at 20 states or so for our Career Learning. When that gets to 30, I think we're going to be able to leverage national advertising programs, both digital and on air, and we'll start to see more efficiency in that program.

Now the General Education sort of has a different mix. General Education, we already are at scale on the customer acquisition side. And I think that you'll see it -- it probably won't change much. We did have a dip, as Tim talked about this year, but I don't think it's going to go back to where it was because the visibility of online education is still greater than it was before COVID. So that's sort of my -- I didn't give you any numbers there because I can't give you numbers, but I can tell you, directionally, that's how I see it shaking out.

Stephen Hardy Sheldon - *William Blair & Company L.L.C., Research Division - Analyst*

No, that's really helpful. Makes a lot of sense. And just last one for me. If you think about kind of the opportunity for hybrid career learning options, I know you have some small hybrid offerings out there right now and basically, Wisconsin is one. But how are you thinking about potentially to more broadly roll out hybrid offerings over the next few years? And what would be the challenges, I guess, to do that?

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

Everybody on the management team that's sitting in the room or anybody that's on the call is probably laughing right now because they know this is a hot button for me. I so strongly believe that face-to-face needs to be a component of everything we do. I don't know that we will go to

full-blended schools where a student goes to a classroom 5 days a week and takes just the online digital content. But I do think that students who go to an online school need to go to some place periodically where they're facing the rest of their peers and facing their teachers. And so I believe that it's a big part of what we're going to do, especially in Career Learning because there's going to need to be more hands-on experience.

We accomplished some of that through a lot of virtual tools today. We've talked before about Nepris, which allows a student to communicate with a mentor and have their projects evaluated, understand what the industry is all about through a virtual learning experience. But I think there has to be more physical learning expenses there as well. So I expect to see more blended programs, more face-to-face opportunities become a part of this.

How do we fund that? And why doesn't that change our model's funding? It doesn't because we've been working with a lot of national organizations. So national churches, the YMCA, Washington Boys & Girls clubs, theme parks, libraries, all of those are opportunities for us to spend just a little bit of money using some of their facilities, especially the facilities that sit idle during the day. You go to Boys & Girls clubs, the kids are generally there in the clubs in the evenings, on a weekend, right? But what's happening during the day when we've got kids in classes? It's empty. So for them, it's incremental revenue. For us, it's a low-cost way of having these blended operations occur.

So I think that you're going to see more and more of that in our programs, which is going to give our teachers more of a chance to interact with their students face to face. Again, I want to be 100% clear. That's not going to be 5 days a week, 7 hours a day. But it might be 1 day a week. It might be 2 days a week. It might be just mornings on Thursdays, where the teacher or the counselor gets a chance to interact with the student and students interact with their peers and students interact with corporations or partners.

So I think it's a highly important part of where we're going as an organization. It improves retention. It improves student engagement. And I'll stop there because everybody's laughing at me because they know I can wax on for this for hours. I believe in it.

Stephen Hardy Sheldon - *William Blair & Company L.L.C., Research Division - Analyst*

Well I appreciate the color and congrats on the results.

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

Thank you.

Operator

Our next question comes from Alex Paris with Barrington Research.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst*

I just have a quick question. I got on the call late, so if you addressed this, pardon me. But revenue per student was down 7.6% in General Education. I'm sure you commented on it and down a little bit more than that in Career Learning. I think that's down a little bit more than I had expected, although not entirely surprising given what's going on with tax revenue at the state level and that sort of thing. Can you just give a little additional color on that and where you maybe see it for the full year?

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

Do you want to get that?

Timothy J. Medina - *K12 Inc. - CFO*

Sure. So Alex, the current results are due to state budgetary pressures related to COVID-19, particularly in California. Also, the impact of school mix was a significant factor given all of the growth that we've had occurring in lower funded states. I commented, Alex, that we do expect to see continued pressure on state budgets from the pandemic and the risk of some recessionary pressures in the overall economy. But over the longer term, consistent with the long-term history in the U.S. of increasing funding for K through 12 grade levels increasing typically 1% to 2% the past 20 years, that's still what we expect over the longer term. Looking forward, we expect the overall trend to be upward.

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

And Alex, I don't know if you understand what happened in California. We're so proud of this enrollment growth, but it could have been much better had we not had a ruling in California where they were not funding growth enrollment. So whatever your enrollments were as of a certain date, if you grew past those enrollments, the state wasn't going to fund that enrollment. We did it a little growth anyway because we had so much demand, but we shut down a lot of the growth we could have had in California.

That meant that the revenue per student in California went down. And then the mix changes because California is a decently funded state, not overly funded but certainly decently funded. And when we couldn't grow there, but we were growing in states with lower revenue per student, that means lower revenue per student states have grown faster than California, and that affected the rate as well the overall revenue per student. So those 2 things combined, the ruling in California and the fact that we couldn't grow in California, I think, drove this number down further than it should have been, and further than we expected, quite honestly. So we're just like you.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst*

Good. Well that's helpful. I appreciate the color there. Any different explanation for Career Learning? Is that because some of the things that are in Career Learning like Galvanize and things like that? Or is it a similar set of reasons?

Timothy J. Medina - *K12 Inc. - CFO*

No. Yes, not Galvanize. We are not including any of the adult learning in our enrollment figures, and it's really the same drivers as General Ed.

Operator

Mr. Davis, there are no further questions at this time.

Nathaniel Alonzo Davis - *K12 Inc. - CEO & Executive Chairman*

All right. Well once again, I want to thank everybody who had a chance to sit in. This is -- it's a great time for us in terms of the results. It's a tough time for the country, but we're doing our best to make sure we're good citizens in the process of delivering shareholders a good business. Thanks, everybody, for attending and look forward to chatting with you further. Buh-bye.

Operator

This concludes today's conference call. You may now disconnect.
