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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Stride, Inc. Fourth Quarter Fiscal 2021 Earnings 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, Mr. Timothy Casey. Please go ahead.

Timothy Casey

Thank you, and good afternoon. Welcome to Stride's Fourth Quarter Earnings Call for Fiscal Year 2021. With me on today's call are James Rhyu, Chief Executive Officer; and Tim Medina, Chief Financial Officer.

As a reminder, today's conference call and webcast are accompanied by a slide presentation that can be found on the Investor Relations website. Please be advised that this call may include certain non-GAAP financial measures during the discussion of our financial results. A reconciliation of these measures is provided in the earnings release issued this afternoon, which is also posted in the Investors section of our website.

In addition to historical information, today's 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 described in the company's latest SEC filings. 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.

I will now turn the call over to James. James?

James J. Rhyu - *Stride, Inc. - CEO & Director*

Thank you, and good afternoon. We all appreciate what a difficult year this has been. Even in the face of this incredible adversity, Stride has been able to thrive. And we've only been able to do so because of the commitment of our thousands of team members. These folks have been dedicated to our customers and the families that need an alternative approach to education, now more than ever before. So I want to start by saying thank you to all of our dedicated staff. This was also a year in which the country and the world have noticed online and distance learning in a mainstream way. But the experience was not always positive. Across the country, many schools struggled with uncertainty and inconsistency for students and families as they vacillated between online and in-person instruction.

Thankfully, our 20 years of experience was able to deliver a seamless experience for our customers. Our teachers, platforms, content and curriculum were all developed to meet this need. Everybody now knows what online learning is. Many have not embraced. Others realized its potential if done the right way. We stand-alone having certain millions of students in our online bond. And while many schools struggled with learning loss and deteriorating test scores, our results outpaced them in the face of onboarding a record number of families for our programs. I'll get to how we are trending for this fall in a minute.

First, I want to review some of our fiscal 2021 accomplishments. By almost any measure, we had a record year by a long shot. We helped over 0.25 million full-time learners and millions of other users became interested in our programs. Learning loss became the norm, except in the schools we matched. No wonder when national data showed an overall enrollment decline of 1.5 million students. We published our first ever ESG report backed by a number of key initiatives. A new partnership with National Association of Black Male Educators designed to increase the diversity of teachers across the country, a program with Teacher for America to share practical online experience of student teachers. We stand together college scholarship, a $10 million multiyear commitment to support underrepresented students.

But we are not relying on the tailwinds of the pandemic to set our long-term path forward. We rebranded our company from K-12 to Stride to ensure that our name better reflects the commitment proving education opportunities for learners of all levels. We acquired 2 high growth, higher market companies to expand our adult career learning offers. We're having an Investor Day to outline our strategy and growth trajectory through fiscal year 2025, a trajectory that I believe we are well on track to hit. And we raised almost $350 million of convertible note offering to facilitate further investment in both organic and inorganic growth. In our general education business, we saw student enrollment increase by almost 50%.

With all the uncertainty this past year, we saw dramatic improvements in retention, in both our general education as well as our career education business. And we did not see the mass withdrawal students in the second half of the school year, as many states began to reopen their brick-and-mortar schools. This is a testament to the stickiness and value propositions of our programs. As we've mentioned previously, students enrolled in our career learning programs tend to retain at a higher level than our general education systems, and we believe this trend will continue.

We also had a record number of reregistration families indicating that they will be returning for the fall. Our Career Learning business finished the year with over $250 million in revenue. This is an increase from less than $10 million just 4 years ago, a 150% compounded annual growth. This year, we saw growth of over 125% to almost 30,000 students. These programs offer a career path without the need for an expensive college degree. And we are increasing the programs for our MedCerts acquisition that we will offer to high school students for certificates in the health care industry. Both our MedCerts and Tech Elevator acquisitions continue to grow and contribute to the bottom line and are exceeding our expectations from when we purchased. They are high growth, high-margin market opportunity platforms for us that we will continue to leverage into other areas of our business particularly our high school programs.

We will continue our focus on IT and health care training because these industries are projected to add more than 2.5 million new positions in the U.S. by 2029. On the other hand, our Galvanize acquisition has not performed according to our plan. We've restructured this business and believe we now have a glide path to both renewed growth and profitability heading into next year. We will also look for ways to invest behind and expand our adult learning offerings with the lens to make [crew learning] a $1 billion-plus business.

In June, we released our inaugural ESG initiatives report. As an education and career learning company, we have a significant opportunity to help achieve global education, workforce and diversity and inclusion goals. All of our ESG initiatives are based on the 4 cornerstones: Expanding lifelong learning for today's competitive workforce, supporting racial and socioeconomic equity and inclusion, fostering transparent leadership, governance and professional development and contributing to a more sustainable world. For me, our focus on learning outcomes is the most important aspect of all our ESG efforts. Stride is in a unique position to influence the lives of millions of students, all ages. Not many other companies have that kind of impact or carry that responsibility. We don't take that responsibility lightly.

By now, everyone is aware of the significant shortages impacting the workforce. Stride is well-positioned to help alleviate that shortage. To that end, we have set 10-year goals that are driven by learner outcomes. So by 2030, our goals are to graduate over 100,000 students from our Stride Career high school program, to graduate hundreds of thousands of students from our Adult programs and to achieve leading graduation of learning growth rates for over 1 million students. Our report contains a lot more specific information on our ESG efforts. I encourage everyone to read it. It can be found on our Investor Relations website and there is a direct link in today's earnings presentation.

Now I want to turn to fiscal year '22. The long-term trends, prospects for our general education and career learning business, both remain tremendous. The COVID-19 pandemic has raised consumer awareness around the need for and the benefits of online education in grades K-12 and in adult learning. While it doesn't work for everyone, many students and families have realized that online learning and the flexibility it provides is a preferred alternative, increased awareness and openness to different options to meet educational needs fundamentally provides for a long-term tailwind for all aspects of our business. As we do every year, we will provide formal fiscal '22 guidance during our first quarter earnings call in October.

So while we're not providing guidance right now, I do want to provide some insight into how the current enrollment season is trending. Even now in August, we're still less than halfway through the volume of our typical enrollment season. And this means that these trends could shift in the coming weeks. Additionally, the pandemic has increased uncertainty around all these metrics, so please do not extrapolate what I've said. We have not seen the mass return to look for a school putting out predictive preferences. We're currently exceeding the number of reregistrations that we saw during fiscal '21 and in previous years.

Right now, we are well ahead where we would be normally in enrollments versus pre-pandemic levels. Awareness for our offerings is at an all-time high. The pandemic helped to drive awareness, and we no longer need to explain what this sequential learning is about, they get it. And now they just need to choose. Conversion rates from our new leads are at an all-time high. So when families seek us out, they are more likely to enroll. We believe that health and safety continue to be top priorities for families, and we're seeing that. And we're seeing even stronger demand in states where the Delta variant has surged. Our goal is clear. It's to grow every year. Importantly, we remain on track to achieving the long-term revenue and profitability targets that we outlined during the Investor Day last fall. We still anticipate and keep achieving revenue of $1.90 billion to $2.2 billion, adjusted operating income of $250 million to $350 million by the year 2025.

Thank you for your time today. Now I'll hand the call over to Tim to discuss our full year 2021 results. Tim?

Timothy J. Medina - *Stride, Inc. - CFO*

Thank you, James, and good afternoon, everyone. First, let me recap our reported results. Revenue for the full fiscal year 2021 was $1.54 billion, an increase of 48% over the prior fiscal year. Adjusted operating income was $161.4 million up 160% compared to the prior year. Capital expenditures were $52.3 million, an increase of $7.3 million over last year. In each case, these results met or beat the expectations we provided in our guidance last quarter. The outperformance was primarily driven by favorable revenue per enrollment and retention.

Looking ahead to fiscal 2022, it is still too early to confidently forecast our current date enrollments for the reasons James just outlined. Given where we are in the process, there remains variability around 2 key factors: firstly, ongoing reregistration and new enrollments; and secondly, the retention of these enrollments, once school starts and through the month of September. Now here's what I can say today about fiscal year 2022. We expect to grow adjusted operating income and adjusted EBITDA year-over-year compared to our strong fiscal year 2021 results. And that is thanks to an expectation of continued strong revenue growth in career learning, margin improvements and higher operating leverage.

Furthermore, we believe that the increased awareness and acceptance of online and hybrid education, accelerated by the COVID-19 pandemic, has sustainably reset the baseline for the general education business. Therefore, we are confident that general education revenue in fiscal year 2022 will be significantly larger than it was in fiscal year 2020. As we have done in the past, we will refrain from providing guidance until we report our first quarter fiscal 2022 results in October. By that time, we will have much greater visibility into enrollments for the new school year.

Returning to our results for fiscal year 2021, revenue from our general education business increased $346 million or 37% to $1.28 billion. This was due primarily to higher enrollments, partially offset by lower revenue per enrollment. General ED enrollments rose 45% year-over-year to more than $156,000, while revenue per enrollment declined 5%. The decline in revenue per enrollment was due primarily to state budgetary pressures, resulting from COVID-19 and a higher mix of lower funded states. As we stated last quarter, we expect revenue per enrollment to improve next year, given what we know today about state budgets and policy.

Career Learning revenue rose to $256.6 million in FY '21, an increase of 140%. This growth was driven by significantly higher volumes in our Stride Career Prep programs as well as organic growth and new acquisitions in our Adult Learning businesses. We expect to continue growing our Stride Career Prep programs in FY '22, with plans to open 4 new programs and expand 8 existing programs in FY '22. Gross margins were 34.8%, up 140 basis points compared to fiscal 2020, driven by an increased contribution from the higher-margin adult learning businesses, and lower costs from efficiencies and automation initiatives. We expect margin improvement to continue into fiscal 2022. We are confident that we will achieve our 36% to 39% gross margin targets much sooner than fiscal 2025, which was our original target communicated during our November 2020 Investor Day.

Selling, general and administrative expenses were $424.4 million, up 35% from fiscal 2020. The increase in SG&A was driven primarily by higher costs associated with our enrollment growth, an increase in stock-based compensation expense and the annualization of expenses for our Adult Learning businesses. Adjusted EBITDA of $239.9 million reflects an increase of 87% over FY '20. Adjusted EBITDA margin improved 400 basis points from 12% of revenue in fiscal year '20 to 16% in FY '21. The margin improvement and growth in adjusted EBITDA are driven by higher revenue and improved operating leverage. Stock-based compensation expense came in at $39.3 million, up 67% year-over-year, driven by the timing of certain stock-based grants tied to our Career Learning business. We currently expect stock-based compensation expense to decline to a range of $30 million to $34 million in FY '22.

Interest expense totaled $18 million for fiscal 2021 in line with the expectations we provided last quarter. This consisted of approximately $5 million in cash interest and $13 million in noncash amortization of the discount and fees on our convertible senior notes. In the first quarter of fiscal 2022, we early adopted new accounting guidance related to our convertible notes. This will result in the elimination of the noncash debt discount expense, among other impacts. As such, we expect our interest expense in FY '22 to be materially lower and more in line with the cash interest we recognized in FY '21.

Our full year tax rate for FY '21 was 26%, below the guidance range we provided last quarter. We had some positive tax benefits related to stock-based compensation that had the effect of lowering our tax rate for the year. In FY '22, we anticipate an increase in nondeductible compensation that will cause our tax rate to be closer to the 28% to 30% range. Capital expenditures for the year totaled $52.3 million, up 16% from the prior year, due mainly to higher capitalized software development costs associated with adult learning, automation and improvements to our platforms. CapEx as a percent of revenue was 3.4% and that is lower than our historical average of approximately 4% to 5% over the past few years. Free cash flow, defined as cash from operations less CapEx, totaled $81.9 million for FY 2021. This was approximately $45 million below the expectations provided at Investor Day last November, due entirely to the timing of receipts, which drove lower-than-expected cash from operations.

Some of the timing issues were associated with our growth in States that regularly pay in the following year, and some were related to delayed payments due to COVID. In fiscal 2022, we expect to have significantly higher free cash flow, reflecting these timing issues from fiscal 2021. Finally, we ended the year with cash and cash equivalents of $386.1 million, an increase of $173.8 million compared to the same period a year ago. We believe that our strong free cash flow generation and liquidity will continue to provide the financial flexibility to fund our existing operations and pursue strategic acquisitions.

To summarize, fiscal 2021 was a landmark year for Stride. We saw record enrollments in both our General Ed and Career Learning businesses, which drove double-digit growth in revenue, adjusted operating income and adjusted EBITDA. Our Career Learning assets, which accounted for less than $7 million of revenue 4 years ago, generated over $250 million in revenue during the year, a sign of the tremendous demand for career education offerings and Stride's innovation and leading position within this market. In addition, we continue to improve our margin profile and bolstered our cash and liquidity position, while maintaining a low level of indebtedness. As James mentioned, we could not be more excited about the prospects for our business, and we'll continue to execute on our high-growth career learning strategy and margin expansion initiatives.

And with that, I'll turn it over to the operator for Q&A. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

First question comes from the line of Jeff Goldstein of Morgan Stanley.

Jeffrey Daniel Goldstein - *Morgan Stanley, Research Division - Equity Analyst*

So I know in your prepared remarks, you mentioned reregistrations are performing very well. So I have to ask, are you able to put some numbers either around that or other figures that could help us better understand the trajectory of enrollments to this point? Or if not, I guess, broadly speaking, are enrollments coming in above your expectations at this point? And then when you mentioned enrollments are doing well, where Delta has surged, would you characterize that as making up a majority of your enrollment base? Just trying to think overall like additional color that you have around either enrollment trends and how Delta is affecting that really?

James J. Rhyu - *Stride, Inc. - CEO & Director*

It's James. As we said, we're not providing any guidance right now. So I really can't give you a lot more color than what we've given you. The enrollment trends, reregistration trends are very strong. We're seeing more than we've ever seen. We're not disclosing sort of new percentages. The Delta variant, you can see a lot of the States that have spikes in the Delta variant places like Texas, we just see sort of unprecedented demand, very similar to what we actually saw last year. So we see that spike happening now. We think that a lot of people are going to have ongoing concerns with their safety, and we think it bodes well for the long-term prospects for our business, but we're not going to provide more color right now.

Jeffrey Daniel Goldstein - *Morgan Stanley, Research Division - Equity Analyst*

Okay. No problem. I thought I would ask. And then I know a bigger focus for you recently is trying to sell more digital services on an ad hoc basis for districts that may not need a fully managed program. So I'm just curious for any update on progress there and what type of demand you're hearing from districts for those services as we enter another year that likely has some virtual options?

James J. Rhyu - *Stride, Inc. - CEO & Director*

Yes. It was really good last year. That sort of distance business, if you will, almost doubled, and so we saw a lot of good business there. We continue to see a lot of interest in our pipelines. I think at this stage in the year, our pipeline for that business is actually stronger than it's ever been. We also have states like California that are sort of mandating districts sort of get ready to some legislation there that sort of helps us and help providers like us.

So -- and frankly, I think that, that trend means that the sort of district demand trend that's one irrespective of the pandemic, it's just unlikely to go away. Because who knows what the future holds and I think districts can't be caught flatfooted going forward and most districts just don't have the resources or skill to stand up and down programs like ours easily. And frankly, I think that they need to concentrate on the programs that they've got going. So I think, in many cases, it just makes more sense to the outsource of somebody like us.

Operator

Next question comes from the line of Jeff Silber of BMO Capital Markets.

Jeffrey Marc Silber - *BMO Capital Markets Equity Research - MD & Senior Equity Analyst*

Again, I appreciate that you're not providing guidance for the current year, but you did give us some indication in terms of where you expect both adjusted operating income and adjusted EBITDA to go. Can we get a little bit more color what's driving that in our specific segments, specific leverage? Anything you can help us out would be great.

James J. Rhyu - *Stride, Inc. - CEO & Director*

I think the biggest thing is what we sort of laid out in our Investor Day presentation, which is we think gross margins are going to improve. We think that drives great leverage in our business. And obviously, we'll keep a line on the SG&A expenses. We're pretty confident that we can continue to grow our bottom line, irrespective of what happens here for the rest of the season.

Jeffrey Marc Silber - *BMO Capital Markets Equity Research - MD & Senior Equity Analyst*

Okay. Fair enough. You had also talked about expectations for revenue per student in your General Education business to grow in the current fiscal year based on I think you said budgets that you've been tracking so far. I know a lot of the federal stimulus money is not directly allocated to you, but are you seeing benefits? Or do you expect benefits from that? And if so, will that continue beyond fiscal 2022?

James J. Rhyu - *Stride, Inc. - CEO & Director*

Yes. The good news and the bad news is that we really -- we're not seeing much of a benefit for us. I think those dollars are, as you said, they're not really directed towards us, either directly or indirectly. We could provide some limited services, I think, in some instances, where districts may choose to allocate some of those dollars for something that we can help them with. But we're not really seeing a big bump in that. We don't expect to see it. But the other side of that is that it's also nothing that's going to go away in future years. So having that one kind of one-time bump for us, I don't think it would have been that meaningful anyway. And we're really just focused on helping the districts that we can in any way we can, and we're not as focused on those dollars.

Operator

Next question comes from Alex Paris of Barrington Research.

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

I won't ask you anymore regarding the fall, but I'm glad to see that early leading indicators are positive. I wanted to dive a little deeper into per pupil funding. It was down this year. I noticed, though, at least from the press release, it looked like it was down more on the Career Learning side than the General Education side. What's going on there?

James J. Rhyu - *Stride, Inc. - CEO & Director*

Jim, I can probably expand a little bit more. I think it's predominantly a function of mix. A lot of our Career Learning programs where we have a lot of larger programs. They just happened to be in place and have slightly below average of funding level. I wouldn't read too much into it, frankly. And I think over the next several years, it will normalize back probably more in line with the overall average. I wouldn't underestimate that change.

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

Okay. Fair enough. And then specifically, during fiscal '21, California's approach to funding impacted revenue per enrollment for the full year. For example, as I recall, they did not fund incremental students, yet you served them anyway. Has California finished their budget and what are their plans for the coming year? And how do you expect your California schools to be funded?

James J. Rhyu - *Stride, Inc. - CEO & Director*

Yes, we do expect our enrollments to be fully funded from California in fiscal 2020 till, Alex.

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

Okay. Great. And then -- and that will contribute to an increase in revenue per enrollment in '22 versus '21?

James J. Rhyu - *Stride, Inc. - CEO & Director*

That's correct.

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

Just a follow-up on a prior question and comments, federal stimulus. It's not aimed at you, but the school districts benefit. So would you expect a benefit to LRN in your Learning Solutions business as a result?

James J. Rhyu - *Stride, Inc. - CEO & Director*

Yes. I don't think we're seeing a material benefit. Of course, there could be some. And -- but just in the overall context of our business. They're not dollars that we'll specifically chase, if you will. What we're doing is we're trying to provide a virtual learning program for as many districts, need to stood up either for the fall or even in an emergency situation. And we sort of leave it to the district to decide how they fund it, whether it's from state dollars, federal dollars or any other pools of money that they have, that's really up to them, and we really lead up to them, so we sort of don't want to get too much into the -- how they allocate their dollars. That's the job of the districts.

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

Okay. Fair enough. And I guess the last one I'll ask you is, and I think I know the answer to this. I don't think you have any new states planned for the coming year. I appreciate the fact that you're going to open up for new Stride preps and you're willing to expand 8. But what about new states in general?

James J. Rhyu - *Stride, Inc. - CEO & Director*

No new states anticipated for fiscal year 2022 at this point.

Operator

(Operator Instructions) Next question comes from the line of Stephen Sheldon of William Blair.

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

Thanks for the question. So it seems like the gross margin improvement is trending a bit ahead of schedule here. I just wanted to ask if you have any update on the efficiency, some of the efficiency improvements that you were -- that you had in progress, such as the automation of the enrollment process that we -- that you all have spoken about previously?

James J. Rhyu - *Stride, Inc. - CEO & Director*

Sure. Well, this is the first enrollment season where a parent can, in a fully automated manner without interaction with a human on our side, enroll their student. So that's a big plus for us from an efficiency standpoint. It's also an outstanding customer satisfaction. Now many -- most parents still want some interaction. They have some questions, et cetera, but that capability has been turned out entirely, Stephen, as a big example.

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

Okay. And then another quick one. So it seems like, for the most part, trends were positive and in Career Learning with the obvious exception of Galvanize, just curious if you could expand a little bit on what's going on there? What kind of headwinds you're seeing?

James J. Rhyu - *Stride, Inc. - CEO & Director*

Yes. I mean, you may remember, the Galvanize business is really sort of three pieces. There was a direct-to-consumer piece, there's an enterprise piece, and there was a non-workforce piece around what they call the community business like a WeWork type of real estate business. And I think, obviously, in the past year since the pandemic hit, that third leg of the stool just crumbled underneath this. And so we closed the acquisition early in the first calendar quarter of last year and then the pandemic hit sort of late in that calendar quarter. And so virtually this entire year, we were hit fiscal '21. We had a very weak community business. In addition, the pipeline and the enterprise business did not materialize in the way that we thought it would.

And so the enterprise business also underperformed. The consumer -- they have a great consumer product. And I think that consumer product is going to continue to thrive. They place their students in a lot of the preeminent technology companies across the country. And so I think that trend is going to continue, and we're going to double down on the consumer business and put out the cost from those other businesses and turn this thing around this year. And so while it may be smaller overall than what we had originally expected, I still think we can put it on to a path to create a lot of value for us.

Operator

There are no further questions at this time. Presenters, you may continue.

James J. Rhyu - *Stride, Inc. - CEO & Director*

Great. Thanks for the call today, everybody, and we'll see you in October with guidance.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.
