PARTICIPANTS

Corporate Participants

Tim Casey – Vice President-Investor Relations, Stride, Inc.
James Jeaho Rhyu – Chief Executive Officer & Director, Stride, Inc.
Timothy J. Medina – Chief Financial Officer, Stride, Inc.

Other Participants

Jeffrey M. Silber – Analyst, BMO Capital Markets Corp.
Alexander Paris – Analyst, Barrington Research Associates, Inc.
Thomas A. Singlehurst – Analyst, Citigroup Global Markets Ltd.
Patrick Mcilwee – Analyst, William Blair & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Stride, Inc. Third Quarter Fiscal 2022 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Tim Casey, Head of Investor Relations, you may begin your conference.

Tim Casey, Vice President-Investor Relations, Stride, Inc.

Thank you and good afternoon. Welcome to Stride's third quarter earnings call for fiscal year 2022. 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 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 the Investors section of our 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. I will now turn the call over to James. James?

James Jeaho Rhyu, Chief Executive Officer & Director, Stride, Inc.

Thanks, Tim, and good afternoon. As you can see from our results, our business remained strong and continues to grow. Now, more than two years into the pandemic and with multiple closings and reopenings and mandates to return to normal only to find that there is a new normal, I think the world of education is not going to return to its pre-pandemic ways along multiple fronts. Demand for

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alternative learning remains strong. We see this in our core business as applications for this in year period which just ended were over 30% higher than the previous year. And even past that, we see acceptance for online learning growing.

Just this past year, some of the largest school districts in the country, notably Los Angeles and New York have announced initiatives to offer more online programs. Home schooling has increased over 50% since the start of the pandemic to around 4 million students. And increasingly, those families need online resources.

The Associated Press recently published an article indicating that the vast majority of families that began home schooling during the pandemic have not returned to their brick-and-mortar schools. Career Learning opportunities continue to expand for us. More importantly, the focus on career skills as opposed to career college degrees is gaining mainstream appeal.

Just the other week, the Wall Street Journal published an article: Blue-Collar Workers Make the Leap to Tech Jobs, No College Degree Necessary. So the macro environment, I believe, has reached a tipping point where skills training, like the kind we offer, is becoming a more valuable asset for an increasingly large segment of the workforce. And we hold multiple competitive advantages. Our focus on the high school and middle school markets, our ability to provide a holistic solution and the approach we will be taking to ensure we make our offerings financially viable for the customers we serve.

The vast majority of our programs are free to the families we serve. This summer, we will be launching a pilot of a program where we will take high school students in partnership with a school district and offer them a single platform to engage in career discovery and exploration, to take career-related courses, to earn career certificates, and to get placed in well-paying jobs. We will focus at first on the healthcare and technology industries and expand from there. And all of this will be offered to school districts for free, again at no charge to school districts or their families. Additionally, when students and families come to us, they are more likely to stay.

The result of our General Education Parent Satisfaction survey demonstrates a success. Our schools have a Net Promoter Score of 63, which is dramatically higher than most school districts and ranks favorably with other consumer products you may use every day.

Our customer satisfaction survey suggests satisfaction ratings in excess of 80%. This year, parents feel more supported by school staff and students are more motivated to learn and work independently than in prior years. This has led to more parent satisfaction and more loyalty. And we see our investments paying off. We invested this year in a new K-5 curriculum, and as a result, satisfaction with curriculum in our K-5 programs has improved by 400 basis points. That curriculum took pressure off the parents and learning coaches who supervise their students.

A new grade, [ph] K-2 and 3-5 (05:42) parent satisfaction with their experience increased 700 basis points over last year. Our focus on improving our customer experience and delivering value for our customers will drive greater lifetime value for them and for us.

Yeah. I realize most of you are focused on the fall enrollment numbers. And as you know, with our season just under way, it's still too early to gauge where we are. But as I said last year at this time, our plan is to grow next year and we see the demand characteristics to achieve that growth.

I also want to provide a quick update on some of the new programs I mentioned last quarter. We continue to see more states interested in offering full time online options for their students. And we've now officially opened our new programs in both West Virginia and Georgia. Both of these programs are now accepting enrollments for the fall school year.

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We're also looking to expand our footprint by leveraging our core assets to offer more products and services to a broader range of customers. In the past, we have focused our innovation on our full time programs and we've built some of the best digital learning products and services around. However, these are only used by a small percentage of the students, teachers and families in the United States.

We are now in the process of adapting and improving those innovative products to make them more mainstream. And in some cases this means making them more easily accessible to consumers, sometimes it's rethinking the go to market approach to an existing offering. What is most compelling about this to me is that we're able to make this investment in organic growth without increasing our capital expenditures as a percentage of revenue.

As Tim will outline, our guidance for CapEx this year is $65 million to $70 million or just over 4% of revenue. And this is in-line with our typical CapEx spend. And this investment allows us to launch our products into much larger markets.

Just this morning we announced a partnership with the UN endorsed Global Ecosystem for Ocean Solutions to introduce a fun and educational angle for students to get involved in their environment while applying the gaming skills they learned in the popular Minecraft game.

We also offer an e-sports summer camp open to all students. Students participate in coding classes taught by industry professionals and have the opportunity to play some of those popular e-sports games. However, this is just the beginning of our e-sports ambitions. Over the last few years, we've seen many of our full time programs launch e-sports teams and we are now looking to formalize these teams into a league.

This represents a unique opportunity for us. e-sports is one of the world's fastest-growing sports, and our position as a leading online education provider means there's opportunity for us to bring together learning and gaming to better prepare students for the jobs of tomorrow. By making these and other investments, Stride will now offer more flexibility and options to students, families, teachers, and schools than ever before. And in an effort to build large communities around these products, we anticipate making many of these products available at little or no cost. We believe these communities will help all students achieve their goals and we want them to be broadly available. We'll start rolling some of these products out in the next few months, so stay tuned for more information.

With that, I want to pass the call over to Tim Medina to discuss our financial results for the quarter. Tim?

Timothy J. Medina, Chief Financial Officer, Stride, Inc.

Thank you, James, and good afternoon. First, let me quickly recap our reported results. Revenue was $421.7 million, an increase of 7.5% from the same period last year. Adjusted operating income was $69.4 million, up 26%. And capital expenditures were $18.4 million, an increase of $7.1 million. We had another strong quarter of enrollment and operating performance and as a result we're able to once again exceed the revenue and profitability guidance we provided last quarter.

Our third quarter enrollment actually exceeded last year's third quarter enrollment, driven by strong in-year enrollment and retention. As a result, we are increasing our revenue guidance and the bottom end of our profitability guidance range, which I'll provide more specifics on later.

Returning to our quarterly results in more detail. Revenue from our General Education business was down slightly to $315.9 million. As we've mentioned, this is due to the expected decline in

enrollments after last year's large COVID-driven surge, somewhat offset by an increase in revenue per enrollment.

Gen Ed enrollments in the third quarter were more than 143,000, down 8%. We started the year down over 10% in enrollment, but we've been able to close the gap somewhat due to strong in-year demand. We believe this shows the strength of the sustainable demand in the business. Revenue per enrollment in Gen Ed increased 7%. We now expect to see revenue per enrollment for the full fiscal year that exceeds last year by about 10%.

Career Learning revenue came in at 105.9 million, up 52%. In fiscal year 2020, just two years ago, this business did $100 million in revenue for the full year. Now we are achieving $100 million in the quarter.

Revenue for Middle and High School Career Learning was $83.2 million, up almost 60% from last year. This was driven by a 42% increase in enrollments and a 13% increase in revenue for a moment. As with our General Education business, revenue per enrollment growth in our Middle and High School Career programs has been solid. We expect it could end up just over 10% higher than last year. Adult Learning revenue was $22.6 million, up 30% from last year's third quarter. Since we acquired MedCerts and Tech Elevator in the second quarter last year, this quarter is the first full quarter comparison to show the organic growth we are achieving in this business.

Gross margins for the quarter were 36.7%, up 120 basis points from last year. We continue to see improvement in gross margins from our Adult Learning businesses and manage school operations. It is worth noting that inflationary pressures including teacher and staff costs have put a little pressure on our gross margins. Regardless of the inflationary environment, we still believe we are on track to achieve our long-term gross margin targets.

Third quarter selling, general, and administrative expenses were $94.2 million, down 6% from the prior-year period. We still expect that SG&A expense for the full year will be in line with last year. Our fourth quarter is when we begin to roll out marketing for next school year so seasonally the third quarter is a low point in our SG&A spend. Stock-based compensation was $5.6 million. We expect we will finish the year with stock-based compensation in the range of $19 million to $21 million. Adjusted operating income was $69.4 million, exceeding the guidance we've issued last quarter.

Adjusted EBITDA was $90.3 million. Our profitability has been driven by continued strength in retention, enrollments, revenue per enrollment, a return to our more normal seasonality of expenses as we've outlined during previous earnings calls, as well as the continued growth in Adult Learning. Diluted earnings per share totaled $1.02, up from $0.57 a year ago. Our effective tax rate was 28%. And capital expenditures were $18.4 million, up $7.1 million from the third quarter last year. And as James outlined, we are investing behind organic growth as we position ourselves for incremental long-term growth in mainstream markets. Free cash flow was $74.6 million and we finished the quarter with cash and cash equivalents of $308.6 million.

As we typically do, we expect to see strong cash flow in the fourth quarter. We also updated and raised our full year guidance and we are now forecasting revenue in the range of $1.645 billion to $1.660 billion, up from $1.62 billion to $1.64 billion previously. We're now forecasting adjusted operating income between $180 million and $185 million, up from $175 million to $185 million previously. And we're forecasting capital expenditures between $65 million and $70 million. And lastly, an effective tax rate between 27% and 29%. Thank you for your time today.

I'll turn the call back to the operator for the question and answer session. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Jeff Silber with BMO Capital Markets. Your line is open.

<Q – Jeff Silber – BMO Capital Markets Corp.>: Thanks so much and congratulations on the strong results. James, I just wanted to clarify one of the things you said in your opening remarks. You talked about applications for in-year being over 30% higher year-over-year. Is that applications for the current school year or for the upcoming fall?

<A – James Rhyu – Stride, Inc.>: Sorry. Yeah, good question, Jeff. That's applications for the current in year period. As you know, we enrolled – we're not really enrolling much now, but we enroll all through the year and that was for the in-year period. Applications for next fall have really just begun. There's not really enough volume to give an indication.

<Q – Jeff Silber – BMO Capital Markets Corp.>: Okay, good. I just wanted to clarify that. I know – again the applications have just started. Any leading indicators you can give us in terms of interest meetings, et cetera? Any guidance would be great for next fall.

<A – James Rhyu – Stride, Inc.>: I think the in-year, this in-year period is actually a good indicator because that shows that there's continued interest in our programs through this in-year period which we think will translate into the fall. But again, not enough numbers for the fall, but if there is an indicator, I think that would be it.

<Q – Jeff Silber – BMO Capital Markets Corp.>: Okay, that's really helpful. And how about what you're expecting for the funding environment next year?

<A – James Rhyu – Stride, Inc.>: So far what we see across the landscape of where we manage programs, the political landscape, the policy landscape, the funding environment continues to be neutral to strong. Across our heat map there's no red, maybe just a yellow or two and largely green.

<Q – Jeff Silber – BMO Capital Markets Corp.>: Okay. That's great to hear. I'll just sneak in one more. You mentioned the new schools in West Virginia and Georgia. Are there any limitations, any caps, anything else that we need to be aware of?

<A – James Rhyu – Stride, Inc.>: There is. Georgia has a cap. It's actually a fairly small cap year one. It's at 500 students. West Virginia, it's a small state so I don't think it's going to be a meaningful number regardless but it's just good to, I think, expand our programs, but it won't be a meaningful number.

<Q – Jeff Silber – BMO Capital Markets Corp.>: Okay. And the Georgia cap, is that lifted after the first year or are there ongoing caps after that?

<A – James Rhyu – Stride, Inc.>: It does. It's an ongoing cap. It rises a couple hundred each year.

<Q – Jeff Silber – BMO Capital Markets Corp.>: Okay. All right. Fantastic. All right. I'll jump back in the queue. Thanks so much.

<A – James Rhyu – Stride, Inc.>: Thank you.

Operator: Your next question comes from the line of Alex Paris with Barrington Research. Your line is open. Alex Paris with Barrington Research, your line is open.

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<Q – Alex Paris – Barrington Research Associates, Inc.>: Hi. I'm sorry, I had it on mute. My congratulations as well. Thanks for taking my questions. I have a follow-up question or two to Jeff's questions as well as some of your overview comments. I know it's way too early to tell about next fall, but taking into account the comments that you just made, how about – I was just going to – I'd like to ask if you could give us any model logic, so to speak. General Education enrollment down a little bit, I mean just stands to reason given schools going back. Revenues for student positive, Career Learning strong, continued strong. Similar thought with regard to revenue per student in the adult businesses growing. Is that the way to think of it?

<A – James Rhyu – Stride, Inc.>: Yeah. I'm not going to comment specifically. I don't think you have poor logic generically, but certainly not going to comment on any of the specifics. I think, as I mentioned, we intend to grow next year. I think there's number of variables that will come into play to do that. I think we've got momentum around certainly our career business, I think our adult businesses are performing well. I think the overall environment for online learning continues to improve. So I think that generally speaking, the environment for the businesses and customers that we serve remains strong, and I think that sets us up for long-term growth and I think that we continue to be on pace for our long-term projections that we put out -- or long-term guidance that we put out a year ago.

<Q – Alex Paris – Barrington Research Associates, Inc.>: And then a follow-up or two, obviously big year in revenue per enrollment, sort of a recovery from the prior year. How should we think about, given your comments with regard to the heat map, how should we think about revenue per enrollment next year, back to sort of the normal range of 0 to 2%?

<A – James Rhyu – Stride, Inc.>: I think you should assume back to the normal range. Mix plays a big part, I think, as you know, in this. So depending on the mix, obviously, it could it could average into something different. But we see generically speaking on average back to sort of a normal range, not an elevated range like we saw this year.

<Q – Alex Paris – Barrington Research Associates, Inc.>: Got you. Thank you. And then new states Georgia and West Virginia, are up and accepting applications. I think you had mentioned that New Hampshire, I know it'll be a small state as well, should be a new state for the coming year. Any update there?

<A – James Rhyu – Stride, Inc.>: Yeah, I think we still feel good about one or two potential additional clients, potentially our partners, but nothing to announce at this time. But I think we do feel pretty good that we might have one or two more hit before the summer.

<Q – Alex Paris – Barrington Research Associates, Inc.>: And then I guess my last question for you are just an update on teacher hiring, teacher shortages that we experienced early in the fiscal year. I think you got a good handle on those now. How do you feel about your positioning with regard to teachers for the coming fall?

<A – James Rhyu – Stride, Inc.>: Yeah, I mean, I think the overall macro environment remains the same, meaning that teachers – there continues to be teacher shortage. I think teachers continue to be leaving brick-and-mortar school districts in record numbers. I think that we do offer for those teachers that want to continue teaching a compelling proposition for them. Obviously, being online, no commute, no mask mandate, no vaccine mandate, those kinds of things I think will still continue to influence decisions that people make. And I think we just offer a compelling alternative.

I think operationally, in addition to that, we are trying to get ahead this year, anticipating the enrollments for the fall a little earlier, making offers for teachers a little bit earlier. So hopefully we are operationally also getting ahead of it.

<Q – Alex Paris – Barrington Research Associates, Inc.>: Great. Well, thank you so much. I'll get back in the queue.

<A – James Rhyu – Stride, Inc.>: Thanks.

Operator: Your next question comes from the line of Tom Singlehurst with Citi. Your line is open.

<Q – Tom Singlehurst – Citigroup Global Markets Ltd.>: Yeah. Thanks. Tom here from Citi. Thanks for taking the question. You talked a little bit about sort of potential gross margin pressures from rising inflation. I know you weren't really sort of raising too much alarm on that. But I'm just interested in whether there's any potential inflationary benefit on revenue per enrollment. Can you just maybe sort of talk about how inflation pressures feed through to the funding environment and then on to revenue per enrollment? That was the first question and I've got a follow-up if that's okay.

<A – James Rhyu – Stride, Inc.>: Yeah. I think it's a great question. So, yeah, I think on the university revenue side of the equation, I don't think for this fall there will be a significant impact of an inflationary pressure. I think there's a delay, meaning it's often driven by tax-based revenue. There's a delay in that. And so therefore, what I do think, though, is that over a longer period of time, those inflationary pressures will impact both sides of the equation. They have to because the biggest part of the funding mechanisms, they go towards teacher salaries. Teacher salaries are part of the inflationary equation, as we all know. And so in order just to keep up and we we've got to make sure that we're enticing, incenting teachers to stay in our systems. So I think we sort of have to do that. But I do think that there's going to be a lag.

<Q – Tom Singlehurst – Citigroup Global Markets Ltd.>: Perfect. The second question is on the pure Adult Learning businesses. I mean, 30% top line is one hell of a sort of organic run rate. I'm just interested in what the pipeline for M&A looks like whether you guys are in a hurry to try and sort of further build scale in that area, or given that organic run rate, do you just leave it deep for the short-term?

<A – James Rhyu – Stride, Inc.>: So, I think I'd look at it this way. We have to be fair. We don't have a stellar long-term track record in M&A. We've done a couple of recent deals, I think, that have really panned out well. I think that part of the reason they panned out well is that we had good planning going in, we had a good strategic logic and we didn't overpay. We weren't too anxious to get a deal done. And I think that discipline will pay off for us in the long-term and future deals as well. So, we have a lot of capital that we can deploy. We've got a lot of dry powder in our back pocket. Our board, I think, is supportive to deploy for the right assets at that capital and we are actively looking to deploy that capital. But I think it also is important that we stay disciplined. And I think if we continue to do that, we'll earn a good return for our shareholders. But, so I think we do want to stay active. We've got a pipeline of deals that we are always looking at, but I don't think that we're going to jump the gun anytime soon irresponsibly.

<Q – Tom Singlehurst – Citigroup Global Markets Ltd.>: Understood. And then maybe one very final follow-up in there. I mean, I know in particular the Tech Elevator [indiscernible] (27:00) I mean, there's an online element to it. But, physically speaking, you don't necessarily have sort of national coverage. I mean, is there any way that you can sort of step on the accelerator there by building out the sort of physical footprint?

<A – James Rhyu – Stride, Inc.>: Yeah. I think the short answer is that we want to balance our growth in all of our growth businesses, ensuring that we do it responsibly. Tech Elevator is a really special asset because it has the best outcomes in the entire industry. Not only does it have the best outcomes in the entire industry, it has been profitable virtually since day one. And you find me and it's a pretty small scale operator. And we see in the marketplace a $100 million-plus operators who still can't make money. So not only are we getting great outcomes, we're getting good returns. And

what we don't want to do is upset that balance. And so we're deploying capital for the assets like Tech Elevator that we think can return, but we don't want to do it too aggressively where we upset that balance. We want to make sure that our customers get served well. We want to make sure that our outcomes remain strong. And we want to make sure that we retain the financial profile that we think is responsible for our shareholders.

So I don't think that that means that we're going to step on the accelerator for Tech Elevator too much more, but I do think it means we will continue to deploy capital behind Tech Elevator, that we've got a great leader there. I think you know him. He's done a wonderful job and I think we're going to continue to bet behind him.

<Q – Tom Singlehurst – Citigroup Global Markets Ltd.>: That's magic. Thanks very much.

Operator: Your next question comes from the line of Stephen Sheldon with William Blair. Your line is open.

<Q – Pat Mcilwee – William Blair & Co. LLC>: Hi. This is actually Pat Mcilwee on for Stephen. Just a couple of quick ones here. So on the General Education side, we touched on this a bit already, but can you just talk a little bit about how much of an impact the teacher shortage has had on enrollments there versus retention and then just the general demand from new students and families.

<A – James Rhyu – Stride, Inc.>: Yeah. So this past fall, the teacher shortage, I think I've indicated before that we definitely could have surpassed last year's number, probably hit a number like 200. If it weren't for the teacher shortage, it was particularly at two states, California and Texas, those two states over the past couple of years have been states that have had tremendous pent-up demand. So we see a lot of demand in those states that we have not been able to fulfill. We've had to turn off our enrollments early in those states because of the teacher shortage last year.

So I think just in those two states, obviously large states in terms of gross population, they have increasing acceptance towards alternative education particularly. And for different dynamics, California, the dynamics in that state really, I think, prompt a lot of families to consider alternative forms of education.

And so I think that they're both just tremendous states with great populations for the types of products that we serve. The in-year dynamic of the teacher shortage really was getting teachers. We were hiring throughout the first semester and trying to sort of either backfill or ramp up to an appropriate level and to ensure that we can service our students as appropriately as possible. And so that's as much of an art as it is a science sometimes because you've got different grade levels coming in, you've got retention, attrition issues that you're always dealing with. And so we're always in this balancing act.

I guess I feel pretty optimistic that the worst is behind us. We've gone through a pretty, I think, turbulent year from a teacher hiring perspective this past year. I think the worst is behind us. I think we've learned from this past year. I think from a retention standpoint, we did not see any meaningful degradation in retention this year that we could tie to the teacher shortage. In fact, generally speaking, retention has stayed pretty consistent with the elevated levels that we saw last year.

<Q – Pat Mcilwee – William Blair & Co. LLC>: Understood. That's really helpful. Thanks for the color there. And then my next one. So, just one launching programs in new states, in general, can you just talk a little bit about the cadence of that launch and generally some of the investments required behind it?

<A – James Rhyu – Stride, Inc.>: Yeah. I mean, I think sort of somewhat logical as you might actually expect it, right? Like the administration infrastructure has to get up -- set up first, right. So, we're hiring administrative staff. We're hiring staff to do the registration and the registrar type of office. We're setting up the systems for that geographic location. We are doing student acquisition type of activities, marketing, PR, things like that. And in states like we have Georgia, where there is a cap and then, we also start hiring teachers as well concurrent with that.

So, a lot of the work that precedes actually the start of school is really a set up work and as students start coming into the program predominantly over the summer, they behave exactly like other schools would behave in the sense that they get allocated to teachers and courses and things like that.

And so, the real, the heavy upfront lift tends to be now actually in the spring through to the early summer just making sure we have that infrastructure in place largely that administrative infrastructure in place. And then beyond that we're leveraging you know whether it's curriculum or the enrollment center other things we're leveraging the broader stride infrastructure for a lot of these other things.

<Q – Pat Mcilwee – William Blair & Co. LLC>: Got it. That's helpful. Thank you. Congrats on another good quarter.

Operator: [Operator Instructions] There are no further questions. This does conclude today's conference call. Thank you for joining and you may now disconnect.

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