

Stride, Inc. NYSE:LRN

FQ2 2024 Earnings Call Transcripts

Tuesday, January 23, 2024 10:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2024-			-FQ3 2024-	-FY 2024-	-FY 2025-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.35	1.54	▲14.07	1.42	4.11	NA
Revenue (mm)	498.05	504.87	▲1.37	499.88	1998.70	NA

Currency: USD
Consensus as of Jan-18-2024 2:13 PM GMT

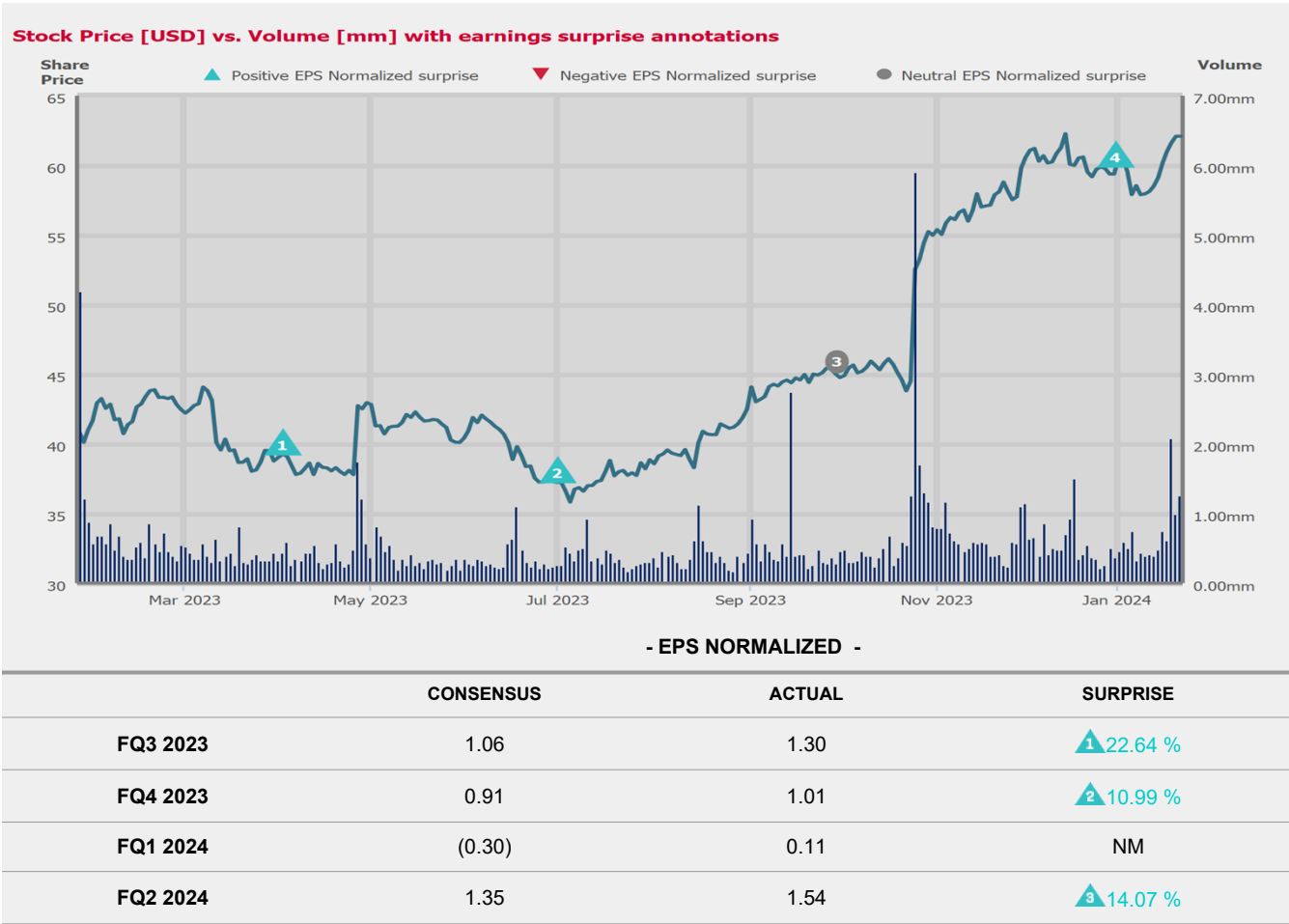


Table of Contents

Call Participants		3
Presentation		4
Question and Answer		6

Call Participants

EXECUTIVES

Donna M. Blackman

Executive VP & CFO

James J. Rhyu

CEO & Director

Timothy Casey

Vice President of Investor Relations

ANALYSTS

Alexander Peter Paris

*Barrington Research Associates, Inc.,
Research Division*

Gregory Scott Parrish

Morgan Stanley, Research Division

Jeffrey Marc Silber

BMO Capital Markets Equity Research

Stephen Hardy Sheldon

*William Blair & Company L.L.C.,
Research Division*

Presentation

Operator

Ladies and gentlemen, thank you for standing by. I would like to welcome everyone to the Stride, Inc. conference call. [Operator Instructions] Thank you.

I will now hand the call over to Mr. Tim Casey, Vice President of Corporate Development and Investor Relations. You may begin your conference.

Timothy Casey

Vice President of Investor Relations

Thank you, and good afternoon. Welcome to Stride's Second Quarter Earnings Call for Fiscal Year 2024. With me on today's call are James Rhyu, Chief Executive Officer; and Donna Blackman, Chief Financial Officer. As a reminder, today's conference call and webcast are accompanied by a presentation that can be found on the Stride Investor Relations website.

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

These statements are made on the basis of our views and assumptions regarding future events and business performance at the time we make that 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'll now turn the call over to James. James?

James J. Rhyu

CEO & Director

Thanks, Tim. Good afternoon. In November, during our Investor Day, we discussed the opportunities for our business and laid our strategy to deliver what we believe will be market-leading returns. I discuss increasing uncertainty, volatility in chaos in our country has and will continue to increase demand for our offerings. Our second quarter results speak for themselves and demonstrate the macro trends are behind us. Our strategy is beginning to play out, and we are executing better.

The year began with some uncertainty regarding the trends we might see in the year given the volatility over the past few years. We have been convinced that the market has moved in our direction, and then we were not going to fall back to pre-pandemic levels, but they still remain a question of whether we could surpass those pandemic highs.

While we ended the second quarter with 196,500 enrollments were an all-time record, surpassing our pandemic level highs. We saw enrollment growth in both our career learning and general education programs and strength in both new enrollment and retention. We have the largest cohort of new enrollments that we've ever seen. And Americans continue to believe that school choice is good for the education system.

Our recent poll by YUGO release this fall showed 84% support, giving every child in the U.S. the ability to attend the public school in their state that best meets their needs regardless of where they live. The results are clear and it's what we've been hearing for years. Parents want choice. They want to be able to choose a school that will meet the unique needs of their child. They want to be able to change their child feature.

I also continue to see reports that support our move into the career learning space. This fall, fresh enrollment in 4-year institutions for 18 to 20 year olds declined by 5.2%. And the reason for this decline was that this age group is increasingly choosing to enroll in community college or certificate programs. Students are explicitly looking for short-term programs that have a direct connection to the workforce. While we're still working on driving incremental demand to our core programs, Data like this supports our decision to focus on certificates and career pathways in fast-growing in-demand careers. Duties and our programs congratulate high school knowing they've got the skills to go directly to the workforce or to choose to attend a post-secondary institution.

There's also continuing support for our new products. In November, I outlined our K-12 tutoring product along with some of the demand drivers that support our entrance into the market. A study out of Texas showed that K-2 students who received individual

virtual tutoring during last school year, demonstrated higher reading test scores by year-end. And Virginia launched a statewide high-dosage tutoring efforts, part of a \$400 million investment in education to recover from academic declines. We know that our Trudon offering, using state-certified teachers can be part of the solution to the nation's learning loss and help drive student success.

Taken together, I remain as excited about Stride's ability to change the future for students as I ever have been. The market conditions are right for an innovator like Stride to continue to drive student success across multiple markets.

This call marks the end of my third year as CEO. And as we continue to achieve new enrollment and financial records, I still see a long runway in front of us. A couple of highlights I'd like to point out since I was appointed CEO. Gross margins are on pace to expand 300 basis points, plus or minus. Trailing 12-month reported EPS and reported operating income are both up 3x the levels prior to my appointment as CEO. We've got the right team in place and are executing against the strategy that we previously outlined.

Thank you. And I will now turn the call over to Donna. Donna?

Donna M. Blackman
Executive VP & CFO

Thanks, James, and good evening. I know James already discussed our enrollment numbers, but I think it's important to put it into perspective. It was just 2 quarters ago that we were fielding questions about whether it's a return to year-over-year enrollment growth follow independent. And now we're talking about exceeding tendinitis. This speaks to the resiliency of our offerings and the sustained demand for alternative educational options. We are proud to be able to give families a choice, and we believe that the trends point to a long-term growth in our business. All of that have resulted in the first quarter in our history that we achieved over \$0.5 billion in revenue. As we've updated our revenue guidance for the full year such that now it exceeds \$2 billion at the midpoint.

Turning to our quarterly results. We reported revenue of \$504.9 million, an increase of 10% from the second quarter of fiscal year '23. Adjusted operating income of \$94.9 million, up from \$76.3 million or 24% from the same period last year. Earnings per share of \$1.54, up \$0.35 from last year and capital expenditures of \$12.7 million, down slightly year-over-year.

Career Learning, middle and high school revenue grew 7% to \$165.1 million. This performance was driven by enrollment growth of 9% year-over-year, somewhat offset by a slight decline in revenue per enrollment. During the quarter, enrollments grew over 3,000, continuing the in-year enrollment growth trends we saw last year. In our general education program, revenue was \$313.9 million, up 14% from last year. This strength was also driven by continued enrollment growth in the quarter with enrollments finishing the quarter up \$5,400 from the end of September and average enrollment growth of 9% from last year.

Revenue per enrollment for Gen Ed increased 8%. We continue to see strength in funding for education. And while we saw some timing impact at our Career Learning revenue per enrollment, we still expect to finish the year with revenue per enrollment growth of between 4% and 6% for both lines of business.

Our adult learning business revenue declined \$4 million to \$25.9 million. On the weakness in our tech business we discussed previously. MedSurg continued to perform well. So growth in that business did not only set the declines in our

Gross margin for the quarter was 39.8%, up 270 basis points from last year. We're still seeing the effects of the efficiency efforts we put into place last year and continue to implement. Given the timing of the impact last year, we don't expect gross margin increases to be a strong year-over-year in the second half. We still expect to see gross margins improve by 200 to 250 basis points for the full year.

Selling, general and administrative expenses increased 15% to \$116.9 million. Stock-based compensation for the quarter was \$7.6 million. We now expect to finish the year with stock-based compensation in the range of \$29 million to \$33 million. Adjusted operating income for the quarter was \$94.9 million, up 24% from last year. Adjusted EBITDA was \$118.3 million.

Interest expense for the quarter was \$2 million. Our effective tax rate for the quarter was 24.9% and diluted earnings per share for the quarter was \$1.54.

Turning to our balance sheet and cash flow. Capital expenditures for the quarter were \$12.7 million, down slightly from last year. Free cash flow, defined as cash from operations less CapEx, was \$160.6 million, up \$13.2 million from the prior year period. We finished the quarter with cash and cash equivalents of \$364.4 million. Based on the strength of our enrollment, we are raising our full year revenue and profit guidance, and we now expect revenue in the range of \$1.99 billion to \$2.04 billion, adjusted operating income between \$265 million and \$285 million, capital expenditures between \$60 million and \$65 million and an effective tax rate between 25% and 27%. For the third quarter, we are forecasting revenue in the range of \$500 million to \$520 million, adjusted operating income between \$85 million and \$95 million; and capital expenditures between \$14 million and \$17 million.

Thank you for your time. Now I'll turn it over to the operator for Q&A. Operator?

Question and Answer

Operator

[Operator Instructions] Our first question for today comes from the line of Greg Parrish from Morgan Stanley.

Gregory Scott Parrish

Morgan Stanley, Research Division

Congrats on the strong quarter. I guess, start with margin, really good expense management, again. Impact the margin to be, is there anything to call out on the expense management side where you able to outperform your expectations going into the quarter? And then related, if you continue on the trajectory, there's upside to the full year, at least the way I look at it. So -- is there anything timing related or any reason why the back half margin won't be quite as strong second?

Donna M. Blackman

Executive VP & CFO

So on the gross margin, some of the things that we talked about last year, we are continuing to do this year. One of the things you heard me talk about last quarter, the timing of when we do teach your hiring had an impact on our margins, but they are a much better job with that hiring process. The material that we send out, using more digital, using innovation and technology, using our size and scale, all the things that we talked about, we continue to do that. And as you might recall, I spent a lot of time talking about gross margins last year. And I said the changes we were making were structural changes, and that still holds true.

In terms of the rest of the year, the year-over-year comparison won't be as favorable, one, because some of those efforts we put into place and put into place later in the year. So from a comparison perspective, you won't see that. And then also in Q4, we typically have more sort of school level costs like state testing and some restrictive funding that we had to spend in Q4. And so that's where you might see Q4 gross margin is typically not as high as you might see in Q2 and Q3.

Gregory Scott Parrish

Morgan Stanley, Research Division

Okay. Great. That's helpful. I guess, it sounds like you ended at [196]. So everything was trending positive throughout the quarter. So I think I know the answer. But I think we're asking this quarterly now, but so far, 23 days in January, we're seeing similar trends. So it sounds like -- and I think third quarter, it's harder to add students than in the second quarter, but this thing is still trending upwards, it seems through January here so far?

James J. Rhyu

CEO & Director

Yes. I think we're not going to talk about the specifics of January today, but yes, January so looks pretty good. I think what you said is right, meaning it's harder -- there's just less spots even open -- in Q3, a lot of the enrollment window has actually shut down in the quarter. So the ability to even add [kids] sort of closes during the quarter. But I think just from a funnel perspective, we continue to like what we see.

Gregory Scott Parrish

Morgan Stanley, Research Division

Okay. Fair enough. And then I get asked about adult learning. I know it's small, it's 5%, 6% of revenue. Last quarter, I talked a little bit about macro headwinds. But it seems like, I don't know, did something shift in the quarter? Or is there sort of a big client loss or anything to call out there? And then I guess how long does this kind of last for maybe just macro dependence, but when do you expect this to get back to how it's growing in the past?

James J. Rhyu

CEO & Director

Yes. I mean I think -- the macro headwinds continue. I think you'll see that across the industry. So I don't think we're viewing to what's happening across the industry and from an adult line perspective. I think that certainly through the rest of the year, I would expect the headwinds to continue. Next year, I think we have to see -- we're excited -- I think the difference with our business, don't learning in the industry or sort of the broader industry, if you will, is our -- we're a little bit of a Tele2 cities.

We have the technology-based stuff, the boot camp stuff, which, again, macro headwinds, I think everybody is going to see that, everybody is seeing that. But we have our health care side, which continues to perform well. And as that continues to grow and we think performed well, at some point, it will offset, I think, any declines in the other side. So whether that's next year or not remains to be seen. But I don't think either way, it won't be a material impact, up or down for next year.

Operator

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

Jeffrey Marc Silber

BMO Capital Markets Equity Research

I wanted to focus on the different segments. I'm going to start with general education. I know you have not broken out this as a separate segment for too many years. But kind of looking back historically, I think this is the first year we've seen sequential enrollment growth in Gen Ed between the first quarter and the second quarter. I know you cited some improvements in retention. But if we can get a little bit more color, it was actually a nice surprise there.

James J. Rhyu

CEO & Director

Yes. I think, generally speaking, we did find a sequential improvement. That is -- I think you're right, generally speaking, Q1 to Q2 every year, we'll see a decline. A lot of that happens just because the September period, the end of Q1, we get a little bit of actually a push of enrollment because a lot of families sort of adjust, if you will, what they're trying to do in September and many of those adjustments sort of come to us. And then you sort of have this tail off in October and November and then into December. Obviously, we were able to reverse that for this year sequentially. And I think part of it is we had strong execution. I think it remains to be seen whether there's a macro trend here for future years or not. We definitely see improved execution. So I think that helped contribute to a stronger second quarter. We see funnel metrics like conversion and things like that continuing to improve. So -- and I think that's really our execution, which is improving. I think we still have a ways to go to continue improving it. But I just there's not enough data that we can see, I think, that would suggest that the sequential trend is a macro sort of ongoing tailwind Q1 to Q2.

Jeffrey Marc Silber

BMO Capital Markets Equity Research

Okay. That's helpful. I appreciate it. If I can move on to Career Learning and let me focus on middle high school. Although we did see growth on a year-over-year basis, the growth did slow. Again, we don't have a lot of historical data, but I think it's the first time that we've seen single-digit year-over-year growth in that segment. So it looks like it did slow. Can we talk about what was going on there?

James J. Rhyu

CEO & Director

Yes. I mean I think -- single digit, we're in the 9-plus percent range. So like, yes, I mean, single-digit -- we've got, I think, a business that's starting to scale. We have a business that now in some respects, it's a same-store comp because we're not adding a lot of new programs. And I think for the year, we'll probably still be -- will still probably average out into a double-digit growth. And so I think that's -- for us, I think that's if we continue at that sort of low double-digit career growth, we're going to be pretty happy. But there's a little bit of mix a little bit. We're talking on the margin here, and the difference between 9-plus percent and 10% is a few hundred kids several hundred kids. So we're talking on the margins here, I think, a little bit.

Jeffrey Marc Silber

BMO Capital Markets Equity Research

Yes. I was actually referring to revenue. So I know you have revenue per student, there was a little pressure there. So that's okay, no worries. But -- your answer to that is valid as well.

Operator

[Operator Instructions] Our next question comes from the line of Stephen Sheldon from William Blair.

Stephen Hardy Sheldon

William Blair & Company L.L.C., Research Division

And really nice results here once again. I wanted to start with something that I've been getting asked about a lot more from investors. I'm sure you guys have too. But what does the opportunity look like to take your career learning solution into local school districts.

Copyright © 2024 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

I think you've highlighted some programs like that before where students take their core classes in person locally and then take their Electus online and your career learning programs. Do you think this is a larger opportunity to pursue in the next few years? And what could that mean to your team?

James J. Rhyu
CEO & Director

Yes. So I think the short answer is the larger opportunity, yes. I think part of the issue is going to be just with the way that districts across the country will embrace change. Our strategy, I think, does present an opportunity to get into those districts with our Career Learning program. We will do it in a multipronged way, meaning one is we will offer them literally the same program that we give our virtual students, which I think can be compelling for some districts. We'll also take a little bit of a platform strategy and offer sort of -- a little bit of a light solution, if you will, through our Tala platform that will allow for districts to do a little bit more self-serve. It will be a little bit more teacher light. It will be less sort of instructor land, et cetera. But it will still offer them what we think will be a best-in-class platform solution for career learning at the high school level. So that is -- I mean, we're probably in a beta phase of that upgrade to our platform. I don't think, just given the selling cycle, you'll see much traction for this coming fall just because the selling season for district is sort of going to get behind us pretty quickly. But I would expect us to be able to offer it a little bit more robustly in the following fall from a platform perspective. But I think the short answer to your original question, yes. It does offer us a good longer-term opportunity. I just don't think we're going to see it in the next 12 months.

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

Got it. Makes a lot of sense. Then just quickly on the Career Learning, the revenue per enrollment, and apologies if I missed this, but was that mainly lower due to the mix of students by state? Anything else to call out there in terms of that contracting a bit year-over-year? I know that the comp there was also pretty difficult. And then, Donna, I think you reaffirmed expectations for revenue per student or enrollment to be 4% to 6% system you talked about last quarter. Are trends there kind of coming in as you would have expected so far this year?

Donna M. Blackman
Executive VP & CFO

And so I'll answer the part on the second one first. Yes, we expect our revenue for enrollment for Gen Ed and career to be up 4% to 6%. We see a decline in the career for this quarter, yes, partly due to the mix, as you know, overall, our revenue per enrollment Gen Ed and Korea combined was up over 5%. You may recall that last year, in this quarter, we talked about the upside that we saw in the revenue per enrollment for Korea was student time. So this is just the offset of that, that makes for a tougher comparison.

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

Got it. Yes, makes sense. And then just last one. Maybe just when do you think you'd start building a separate marketing funnel for the Career Learning programs. I know this isn't something you've done historically, but you've talked about it more as an opportunity. Has that started yet? And if not, when could that become a bigger initiative?

James J. Rhyu
CEO & Director

Yes. I'll say, in some respects, we've had fits and starts with it already. I think that this is an area where, unfortunately, we have not executed well, I'd actually say we've executed poorly. I do think it's an opportunity. And I think we will make some investments for this coming fall season in incremental enrollments around career remains to be seen if we can be successful. But it's -- we definitely think it's a very significant opportunity. We definitely believe that part of our issue has been around execution, and we will definitely make some investments in that direction for this fall.

Operator

[Operator Instructions] Our next question comes from the line of Alex Paris from Barrington Research.

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

Also add my congratulations on the beat and raise for the quarter. I just had a couple of questions. First of all, I wanted to ask about the press release that you put out last week regarding MedCerts. It looked like you did a big new contract with Virginia State

University. Can you expand on that a little bit? And then just talk about the MedCerts business. overall, what sort of growth rates are we experiencing without -- I know you don't give granular detail on it, but orders of magnitude perhaps.

James J. Rhyu
CEO & Director

Yes. I mean I think -- okay. So when we bought the MedCerts asset whatever years ago, it was a predominantly B2C business. And it still is, by the way, today, predominantly a B2C business. I think what we see is that, that B2C part of the business is it continues to be very attractive, continues, I think, to have a lot of opportunity to grow. But I think the B2B side of it is, is in some ways, it's just going to have more legs to it. It's, I think, a bigger market opportunity. Actually, I think they're better, easier clients in respect to manage on a B2B basis. And so -- we think that the B2B side is going to be long term larger than the B2C side of the business.

So I think that means I think we could double the business over the next several years just by growing the B2B side of the business, I think that would imply some double-digit growth rate, long-term growth rate on that business. Even at that rate, it's not going to be a major contributor to the overall company anytime soon, but we are very bullish about our opportunities in that space.

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

And is the Virginia State contract, the biggest or the first in this B2B effort?

James J. Rhyu
CEO & Director

Not the biggest or the first. I think it's a university -- I think it was the University of New England or some of the university, but not the biggest nor the first. I think we don't have dozens yet, but I think we're making a lot of good progress with a lot of the conversations. So I think a lot of good traction, a lot of good early tractions.

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

Great. That's good to hear. And then the other and related question is about tutoring. You talked about it in your prepared comments a little bit, James. You've said in the past, among your new products, these are -- this is one of the ones that you're most excited about. It addresses learning losses. It has AI components as well. Anything to report there in terms of wins and go to market?

James J. Rhyu
CEO & Director

Yes. I mean I think one is we've had a couple of nice wins. You can go -- there's a public sort of announcement or press release, there's a district called Pulaski, I think District in Virginia. And we didn't -- I don't even know that -- I didn't know that they were going to do this. Maybe somebody my organization did, but -- they really -- there's like a YouTube video or something out there on it. There's a press release. They made a big deal about how our platform helped with their learning loss. And you can't -- those kind of testimonials particularly when we didn't even know we're completely on unprompted by us, I think bodes well for the long-term prospects for that business.

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

Got you. And so just to be clear, you're in the market with this product right now?

James J. Rhyu
CEO & Director

Yes, we are in the market with this product. We're also -- we think for next year, we're going to have a pretty good update to the product, which is going to embed more AI elements into it. But yes, we're in market today.

Operator

Thank you, ladies and gentlemen. As we have no further questions at this time, we will conclude today's conference call. We thank you for participating, and you may now disconnect.

Copyright © 2024 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

These materials have been prepared solely for information purposes based upon information generally available to the public and from sources believed to be reliable. No content (including index data, ratings, credit-related analyses and data, research, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON "AS IS" BASIS. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages. S&P Global Market Intelligence's opinions, quotes and credit-related and other analyses are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P Global Market Intelligence may provide index data. Direct investment in an index is not possible. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Global Market Intelligence assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P Global Market Intelligence does not act as a fiduciary or an investment advisor except where registered as such. S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

© 2024 S&P Global Market Intelligence.