

S&P Global

Market Intelligence

Stride, Inc. NYSE:LRN

Earnings Call

Tuesday, August 6, 2024 10:00 PM GMT

CALL PARTICIPANTS 2

PRESENTATION 3

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

Gregory Scott Parrish

Morgan Stanley, Research Division

Jeffrey Marc Silber

*BMO Capital Markets Equity
Research*

Patrick James McIlwee

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

Presentation

Operator

Good afternoon, and welcome to the Stride Fourth Quarter Fiscal 2024 Earnings Call. Please note that this call is being recorded. [Operator Instructions]

I will now turn the call over to Timothy Casey, Vice President of Investor Relations. You may begin your conference.

Timothy Casey

Vice President of Investor Relations

Thank you, and good afternoon. Welcome to Stride's Fourth Quarter and Year-end Earnings Call for Fiscal 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 them, and the company assumes no obligation to update any forward-looking statements made during this call.

Following our prepared remarks, we will answer any questions you may have. I will now turn this call over to James. James?

James J. Rhyu

CEO & Director

Thanks, Tim, and good afternoon, everyone. I started this year by talking about my belief that Stride can change the future of education. I outlined some of the macro trends in our country precipitating the need for change. Throughout the year, we've continued to see these trends play out. High parent dissatisfaction and surveys showing over 70% of families considering changing schools over the past 12 months, and we continue to see students reconsidering the traditional college pathway in favor of a more skills-based education.

I think that the results we posted for this year demonstrate and validate the longevity of our model. We are delivering tomorrow's education today. Students and families are looking for something different and finding it at Stride. We're providing real choice for families, choice that is affordable and accessible to anyone, anywhere, and at any time. Our offerings are personalized, career-forward and tech-driven. And that translated into another record year.

We crossed \$2 billion in revenue for the first time. We had record profitability and free cash flow. Earnings per share increased 58% year-over-year and has now grown almost 700% since 2020. We achieved our highest gross margin in over 5 years. We had our highest in-year enrollment ever, pushing us to the highest enrollment level in the company's history, even larger than during the pandemic highs. And we finished the year with more enrollments than we started for the second straight year.

As I mentioned last year, even with our strong results, including multiple years of near or above double-digit revenue growth, continued margin expansion and an attractive future growth profile, our valuation multiples still lag the market. In addition, the market continues to recognize our superior product and service offerings.

Stride was named the EdTech Breakthrough Remote Learning Solution Provider of the Year. Our MedCerts programs won a bronze medal for Best Use of AI in HealthTech from the Merit Awards. Our game-based learning offerings won almost too many awards to list, including the prestigious Royal Society of Chemistry Horizon Prize for our Periodic Rescue game in Minecraft, a gold Stevie for our Minecraft Education Worlds game; two bronze Stevies, 1 each for our MathBee and ELL/World Language games; and our professional development offerings won 2 gold Stevies.

We also continue to see early traction with our other new product offerings, including our tutoring solution, which gained formal acceptance across a number of states.

Now I understand everybody wants some color on our fall enrollment season. Please remember that it is still early and we have a long way to go to close out the season strong. Having said that, early indicators look positive. Demand, as I have said before we define as application volumes, continue to be strong and are pacing ahead of last year, consistent with the pacing we have seen for much of the prior year.

So I feel confident that we will grow our enrollments for this fall, and we remain on track for our long-term goals. All of this demonstrates what I started my comments with, that Stride is offering tomorrow's education today.

Now I'll pass the call to Donna. Donna?

Donna M. Blackman

Executive VP & CFO

Thanks, James, and good evening, everyone.

We finished fiscal year 2024 with revenue of \$2.04 billion, an increase of 11% over the prior fiscal year. Adjusted operating income for the year was \$293.9 million, up 46% from last year, and adjusted operating income margin improved 350 basis points.

Our results for the year further demonstrate the sustained demand for full-time online options in the U.S. K-12 market. Throughout the year, we saw continued strength in in-year enrollment coupled with strong retention. This led to us once again exceeding our revenue and AOI guidance, and it also means we remain firmly on track for achieving our fiscal year 2028 targets.

Returning to our full year results in more detail. Career Learning middle and high school revenues totaled \$651.2 million, up 11%, with full-year enrollments of 72,700, up more than 10% from last year. General Education revenue came in at \$1.289 billion, up 14%. Enrollments in Gen Ed for the year totaled 121,600, up more than 8%. Total revenue per enrollment for both lines of business was \$9,623, up 5.4% from last year.

Throughout the year, we saw a divergence in Career Learning and General Education revenue per enrollment. General Education finished up 8% while Career Learning was up just 1%. As we've said all year, Career Learning was up against a hard comp from last year when we finished the year up 16.3% overall funding environment for both Career and General Education throughout the year. But as with any year, revenue per enrollment was impacted by a number of things, including enrollment mix, yields, and timing impacts from prior year catch-ups.

For next year, we still see a largely positive environment from a funding perspective at the state level, though not as strong as we've seen in the past couple of years. States also are grappling with the loss of federal ESSER funding in the coming school year, which will create a headwind in revenue per enrollment growth. Given these competing dynamics, as of right now and it's still early in the year, we expect full year FY 2025 revenue per enrollment growth to be flattish to FY 2024.

Adult Learning revenue declined 16% for the year to \$99.7 million on continued softness in our IT offerings. The upside is that our Allied Health business continues to see strong growth, finishing the year with revenues up more than 20%. Going forward, this means that the struggling IT side of Adult Learning will continue to be a smaller part of the overall business.

Gross margin for the year was 37.4%, up 220 basis points from FY '23. As the business has continued to grow, we've seen benefits from our scale and the payoff from the efficiency efforts we've rolled out over the past couple of years. The teams have done an incredible job improving the leverage we get out of the business, and I will continue to challenge us to improve this going forward.

Selling, general and administrative expenses were \$514 million, up 7% from last year, driven by investments in our technology and higher stock-based compensation. As I mentioned during our Investor Day in November, we will continue to keep our SG&A spending in check, and we expect to see strong leverage out of the business going forward. SG&A as a percent of revenue has declined 500 basis points since FY '20. And we believe we can continue to improve this metric as the company grows.

Stock-based compensation for the year was \$31.5 million, up \$11.2 million from last year due to the timing of some stock grants.

Adjusted operating income came in at \$293.9 million, up \$92.9 million or 46% from last year.

Adjusted EBITDA was \$390.7 million, up \$94.6 million or 32% from the prior year.

Diluted earnings per share totaled \$4.69, up 58% from last year. Improvements in our profitability metrics were driven by our top line growth, coupled with our continued efficiency efforts and operating leverage.

Our effective tax rate for the year was 24%.

Capital expenditures were \$61.6 million for the year. Free cash flow, which we define as cash from operations less CapEx, was \$217.2 million, up \$80.6 million from last year. We finished the year with cash, cash equivalents, and marketable securities of \$714.2 million. Our cash position gives us flexibility to continue to invest in our business, be opportunistic when the right M&A deal presents itself at the right price, and consider returning capital to shareholders at the right time.

Fiscal 2024 was another record year for Stride with continued strong revenue and profitability growth. We saw enrollments exceed our pandemic high from FY '21 and, once again, finished the year with more enrollments than we started. This puts us in a strong position to see further growth in enrollments, revenue, and profitability in FY '25.

However, as James said, it's still early in our enrollment season. Historically, August and September are our busiest months so we've got a lot of work ahead of us. Because of this, as we do every year, we'll wait until our Q1 earnings report in October to provide formal guidance.

A couple of quick notes. Seasonality for next year should be in line with FY '24. Though we're still unsure if the in-year enrollment trends we've seen in FY '23 and '24 will continue, we expect to see continued gross margin improvement at a slightly lower rate of improvement than we've seen this year.

We expect to see continued gross margin improvement at a slightly lower rate of improvement than we saw this year. SG&A expense as a percent of revenue should decrease marginally. CapEx as a percent of revenue will be flattish. Interest expense, tax rate, and stock-based compensation should be in line with FY '24.

With our FY '24 results and current trends we are seeing for FY '25, we remain on track to achieving the FY '28 targets we outlined last November of total revenue CAGR of 10% and AOI CAGR of 20%, both at the midpoint.

Thanks so much for your time today, and I'll pass the call back to the operator for your questions.
Operator?

Question and Answer

Operator

[Operator Instructions] Our first question comes from Gregory Parrish with Morgan Stanley.

Gregory Scott Parrish

Morgan Stanley, Research Division

Congrats on the quarter and strong year, and thank you for the color you guys are giving here in the summer. So I want to ask, any incremental color on what you're seeing in the enrollment trends, of course. It sounds like the commentary is the same as last quarter, right? You're trending up year-over-year. You're in a strong position to grow enrollments. But I mean, has anything changed over the last 3 months, anything incremental that you're seeing maybe here in August so far?

James J. Rhyu

CEO & Director

Yes, I guess what I would say is that in the intervening 3 months since the last quarter, I think as Donna mentioned, we still have a long way to go. We've got, I think by our estimate, more than 50% of the season to go in terms of enrollment volumes, so still a lot can happen. But I would say I'm more confident today about our ability to grow into the fall than I was 3 months ago.

Gregory Scott Parrish

Morgan Stanley, Research Division

Okay. That's helpful. And then on funding, also I appreciate the color, Donna, you gave on expectation for flat, or maybe that was revenue per enrollment for flat. So do you see a scenario where funding could go backwards next year and perhaps the ESSER headwinds are a little bit greater than you think? Is that a possibility?

Donna M. Blackman

Executive VP & CFO

From what we're seeing, from looking at just the normal state funding, that funding trend looks favorable from the early funding trends that we're seeing. And from an ESSER standpoint, just given the amount of ESSER funding that we have seen, we'll see some offset to that. And so we think that will sort of offset each other. Now where we could see the variability, that we can't quite quantify yet, will be the mix, right? If we happen to grow in states that pay a lower PPR, then the PPR could be lower. If we grow at a state that pays a higher PPR, the PPR would be higher, which is why we are projecting that our PPR will be relatively flat next year, year-over-year.

Gregory Scott Parrish

Morgan Stanley, Research Division

Okay. Maybe I'll ask one more odd one and pass it. But the SG&A, historically, fourth quarter has been a little bit higher seasonally. I think you ramped up your marketing. I guess walk us through the SG&A line. It's down sequentially, down year-over-year. Maybe that's just all the efficiencies that you're getting. On the marketing side, I assume that's not down year-over-year, but I just wanted to confirm that point.

Donna M. Blackman

Executive VP & CFO

Yes. We have been more efficient. So the marketing spend actually is down. We've been doing some automation in our enrollment center, and so that is down. We've also reduced some cost in our coding business to be in line with the decrease in the revenue for that business, and we had slightly lower claims in our medical expenses. But yes, we have been more efficient in our spending for marketing as well, as I said, the automation associated with our enrollment trends.

Operator

Our next question comes from Jeff Silber with BMO Capital Markets.

Jeffrey Marc Silber

BMO Capital Markets Equity Research

Wanted to go back to the funding environment not necessarily from your perspective but from a competitive perspective. We've been reading about some states cutting back on their own virtual schools as funding has kind of slowed. Are you seeing any of that in the states that you compete or potential new states? And do you think that might give you an advantage from a competitive perspective?

James J. Rhyu

CEO & Director

Yes. I mean I think what we see in the states where we're operating is, and I think by and large, absent something very unusual, I think the fall sort of school season is upon us and therefore, for states to make a change at this point going forward, it would be very unusual, so we don't really see a lot of risk for this fall. I do think that there are a couple of states out there where there's some political pressure to either cut funding, but we just haven't seen that for this fall. And we feel pretty good about where we are heading into the season.

I think that the state political landscape for us, as you know, which is very important, I think since the pandemic has become just a little bit more bipartisan. The need to have educational choices for consumers is real. And just like in any other sector of the economy, I don't think that's exactly a partisan issue. Just customer choice is not really a partisan thing, so we're hopeful that education continues to migrate in that direction. But just the way the politics unfortunately play in the education landscape, there is a little bit, probably a couple of states, that did worry us earlier in the season, and I think sort of we've settled into a nice place for the fall.

Jeffrey Marc Silber

BMO Capital Markets Equity Research

All right. That's good to hear. I'm apologizing in advance for this next question, but you talked about being comfortable with your longer-term goals of 10% top line compounded growth in revenues and 20% compounded growth in adjusted operating income. I think that's off your base from fiscal 2023. You did better than that in 2024. Does that imply growth slows from current levels even though you still would be on track to hit those targets?

James J. Rhyu

CEO & Director

That does not imply that we think growth will slow. We think we have a good trajectory to continue momentum for the foreseeable future.

Jeffrey Marc Silber

BMO Capital Markets Equity Research

Okay. I appreciate that. I know you're not providing any forward-looking guidance beyond, I guess, what you gave us so far. And just I wanted to clarify one thing. You talked about revenue per enrollment, expecting that to be flat in fiscal 2025. Are we talking just for the General Education segment or for the total company?

Donna M. Blackman

Executive VP & CFO

For the total company.

Operator

[Operator Instructions] Our next question comes from Stephen Sheldon with William Blair.

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

You have Pat McIlwee on today. So my first question, it sounds like early indications of application volumes and conversion are looking strong. So I just wanted to ask, how much of those enrollment trends would you attribute to the kind of refreshed marketing strategy versus better retention or anything else we should be thinking about?

James J. Rhyu*CEO & Director*

Yes. I don't think -- or actually, I wouldn't exactly say our marketing strategy has changed dramatically over the past year, from last year to this year. I think our execution has improved. And I think I mentioned we brought in a new person last spring. She was able to implement a number of things during the course of last season, but we didn't really have a full season of it. We now are seeing the full season effect of some of the things that she's implemented, and I think they're paying dividends. So I think right now, we're in, I'd say, sort of a pure execution game, and I think we're putting points on the board.

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

Okay. Understood. And then my second question is on the tutoring front. It sounds like there's been some solid early acceptance with that offering. And you have more than enough teachers that are looking for supplemental income. So I just wanted to ask if you could provide an update on the monetization potential you see there and what the timing of that could potentially look like.

James J. Rhyu*CEO & Director*

Yes, it's still early. I think that there's a lot of opportunity out there. There's a lot of opportunity both with district contracts as well as with direct-to-consumer offerings. I think we're in a unique position in that market where we actually can offer a very competitive platform, I think, and you'll see this year with increasing functionality, that is going to start separating us from the marketplace.

And it's a real convenience to be able to do it online. I think there's greater acceptance to doing it online. I don't think we would expect this year for it to materially impact our financials, just sort of given such a low starting base and the fact that we're over \$2 billion of revenue now. But yes, I could see us being a serious player in the next couple of years in the tutoring marketplace. And I think that can add a couple of points of growth over the next few years.

Operator

There are no further questions at this time. With that, we will conclude today's conference call. Thank you all for your participation. 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.