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Earnings Call

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Call Participants

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Presentation

Operator

Good day, everyone, and welcome to the Stride, Inc. Q2 FY '25 Conference Call. Just a reminder, today's call is being recorded.

I would now like to hand things over to Mr. Tim Casey. Please go ahead, sir.

Timothy Casey
Vice President of Investor Relations

Thank you, and good afternoon. Welcome to Stride's Second Quarter Earnings Call for Fiscal Year 2025. 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.

Now I'll turn the call over to James. James?

James J. Rhyu
Chair of the Board & CEO

Thanks, Tim. We have once again posted record enrollments, topping 230,000 students. We continue to execute against the backdrop of ongoing strong demand.

Coming out of the pandemic, we were all uncertain if the increase in demand for our programs was structural or temporary. And for 3 consecutive years now, we have seen increasing growth in our business. And also for 3 consecutive years, we see continued in-year strength in demand. The macro environment for our business is as strong as ever. And as long as we can continue to execute effectively, I believe we can benefit from these conditions.

While every business has challenges, I believe most of ours are currently within our control. Many of our most significant challenges are to just continue improving and executing well, not just in how we have traditionally run our core business, but across all of our initiatives. That includes initiatives that I believe can take our core business to a new level while also providing us with new market opportunities. We see some early signs that our investments will pay off, but we need to remain vigilant to ensure we are setting ourselves up for success over the long run.

I remain very bullish on our prospects for future growth. We're seeing continued demand for our core offerings, growing support for school choice options and a student base seeking real career training. As a company, we're in a strong financial position and have an incredible team committed to delivering for our customers.

Thank you, and I will now turn the call over to Donna.

Donna M. Blackman

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Executive VP & CFO

Thanks, James, and good evening. This quarter confirms we're now in our third year of in-year enrollment growth in our full-time programs.

We've talked a lot about market conditions that are pushing families to seek education alternatives, and our results demonstrate that our programs can be an effective solution for many of these students. In light of this continued strength, we're raising both our revenue and profitability guidance for the full year, which I'll cover in more detail later.

Turning to our quarterly results. We reported revenue of $587.2 million, an increase of 16% from the second quarter of fiscal year '24; total average enrollments of 230,600, up 19.4%; adjusted operating income of $135.6 million, up 43% from last year; earnings per share of $2.03, up 32% from last year; and capital expenditures of $14.8 million, up from $12.7 million last year.

Revenue in our Career Learning middle and high school programs grew 29% to $213.1 million. This strength was driven by enrollment growth of 30.9% year-over-year. General Education revenue was $354.3 million, up 13% from last year, also driven by continued enrollment growth in the quarter. Average enrollments were up 12.5% from last year to $135,800. During the quarter, we saw accelerating enrollment growth in both of these lines of revenue.

As I mentioned earlier, this is now the third year in a row that we've seen strength in in-year enrollments. Total revenue per enrollment across both lines of revenue was $2,395, essentially flat to last year. As we mentioned last quarter, we're seeing some impact from state mix, but we're still seeing a largely positive funding environment. Given these dynamics, we expect to finish the year down 1% to 2% in revenue per enrollment.

Softness in our Adult Learning business continues, and we finished the quarter with revenue down $6.1 million from last year to $19.8 million.

Gross margins for the quarter were 40.8%, up 100 basis points from last year. We still expect to see gross margins improve 100 to 200 basis points for the full year.

Selling, general and administrative expenses decreased marginally to $114.8 million. While we've seen declining SG&A spend in the first half of the year, as I mentioned in the first quarter, I expect to see some increase in the back half of the year. We should finish the year up slightly compared to FY '24.

Stock-based compensation for the quarter was $7.9 million. We now expect to finish the year with stock-based compensation in the range of $33 million to $37 million.

Adjusted operating income for the quarter was $135.6 million, up 43% from last year. Adjusted EBITDA was $160.4 million, up 36%. Interest expense for the quarter was $2.7 million. Our effective tax rate for the quarter was 25.7%.

Diluted earnings per share for the quarter were $2.03. Our EPS calculation includes incremental shares related to our convertible notes on an as-is converted basis for GAAP reporting purposes. These shares are included in our diluted share count, but are not yet issued. However, some of the dilutive impacts of these shares will be offset by the capped call transaction we completed at the time of the note issuance up to an upper strike price of $86.17 per share. We're now including a table in our quarterly investor presentation that shows the potential dilution from our convertible note at various share prices as well as the offset from the capped call.

Turning to our balance sheet and cash flow. Capital expenditures for the quarter were $14.8 million, up from $12.7 million last year. Free cash flow, defined as cash from operations less CapEx, was $208.6 million, up $48 million from the prior year period. We finished the quarter with cash and cash equivalents of $515.1 million.

Given the continued growth in enrollments and margin improvements, we are raising our full year revenue and profit guidance and now expect revenue in the range of $2.320 billion to $2.355 billion, up from $2.225 billion to $2.3 billion last quarter; adjusted operating income between $430 million and $450

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million, up from $395 million to $425 million last quarter; capital expenditures between $60 million and $65 million, unchanged from last quarter; and an effective tax rate between 24% and 26%, also unchanged from last quarter.

For the third quarter, we are forecasting revenue in the range of $585 million to $600 million; adjusted operating income between $130 million and $140 million; and capital expenditures between $15 million and $17 million.
Thank you so much for your time this evening. And now I'll turn the call over to the operator for Q&A.

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Question and Answer

Operator

[Operator Instructions] We'll go first to Jason Tilchen, Canaccord Genuity.

Jason Ross Tilchen
Canaccord Genuity Corp., Research Division

Congrats on the strong results. I have two if there's time. The first, I'm just wondering if you can unpack some of that enrollment momentum a little bit. Maybe talk about some of the differences in the funnels you're seeing for Career Learning and General Education and how some of the enrollment numbers on a gross basis are trending versus how retention has been compared to last year.

James J. Rhyu
Chair of the Board & CEO

Yes. Jason, it's James. I think the basic trend we continue to see is across the board strength in our enrollment funnel. I think we've been, I think, a little bit surprised by how strong it continues to be year-over-year. We're in our third year of year-over-year growth. And I think we're executing well against it, but I actually think a lot of the underlying demand that we see at least has been just really strong. It's been pretty broad-based across the board. And I think if there's, I'll say, a weak spot, which we have said repeatedly, that the incremental career funnel has not materialized as strong as we would have thought. We think that longer term, that continues to be an opportunity for us, but I would say fairly weak, and that would probably be it.

Jason Ross Tilchen
Canaccord Genuity Corp., Research Division

Great. That's really helpful. And just one follow-up. You recently announced the rollout of K-12 tutoring nationwide. I'm just wondering if you could share any early learnings from that rollout and sort of any additional color on sort of how the go-to-market is going to develop there, when you expect sort of more material contribution from that on the overall business.

James J. Rhyu
Chair of the Board & CEO

Yes. I think for us, it's a clearly adjacent business. The way that -- I mean, just kind of where the way the accounting works on it, if you think about other businesses, like a DoorDash or something like that, that has gross merchandise value and then sort of net revenue, we have sort of a similar mechanic or dynamic with our tutoring business where we have sort of gross tutor value, but we really record everything on a net basis.

So in the context of our financial statements, I think, for some very long period of time, it's just going to be immaterial. But strategically for us, I think it can be very important because one is we know that high-dose tutoring is effective for learning. And we have a terrific pool of educators within our network. We can leverage those for the platform. It also gives those teachers opportunities to earn more. So we think it's a really good platform to assist teachers within our network, earn more money. And we've already seen numerous cases, both within our programs and outside of our programs, in district programs, where they're using our tutoring product and are very satisfied and are getting tremendous outcomes.

So while I don't know in the short term if it'll be financially significant, I do think it continues to be strategically significant. We're going to continue to invest in that product. And I think unlike other tutoring companies out there, and I think this is in most cases, where tutoring is their only product, they have to make margin to survive. We actually don't. We can invest in this product, grow the product. We can test it out, I think, for some different innovation around the product on our platform. We recently rolled out a sort of AI summary feature, which we've got terrific feedback on. So we're pretty happy.

Operator

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And we'll take the next question from Jeff Silber, BMO Capital Markets.

Jeffrey Marc Silber
BMO Capital Markets Equity Research

Just wanted to drill down a bit on the prior question. There's not a lot of good industry data out there. But from what we've been able to see, you guys have really been dramatically outperforming the industry. Is there anything specific that you're doing that maybe some of your competitors are not to drive that outperformance?

James J. Rhyu
Chair of the Board & CEO

Jeff, so yes, I think I have to sort of -- I mean, I tend to agree with you. I hate to say it this way, but the data that we would see would, I think, suggest that we're probably over-indexing on industry performance. I sort of hate to say it because I want all of our competitors actually to do well. I want the industry to grow. I think that will be our primary goal is to see the entire industry grow and let all boats rise. But I think I would have to agree with you.

I really credit, I think, to -- the team has really, I think, honed in on their execution. You may remember, and it was just a couple of years ago, where I got on this same call and talked about how we had execution issues that was hampering our ability to grow and that if we can fix those issues, we should be able to accelerate growth. And I think we have. I think that the team we've got in place now is executing much better. And I think that is -- I think when you execute well in any industry and any company, you have the opportunity to take share from some of your competitors, and I think that's probably a little bit of what's happening.

The good news for us, I think, and I won't sort of speak for the industry here, is that I see -- while we are executing better, I do think that overall, we still have a lot of opportunity to even perform better. So I don't think we're sitting here resting on our laurels and finished with the trajectory that we did put ourselves on.

Jeffrey Marc Silber
BMO Capital Markets Equity Research

All right. That's helpful. If I could switch gears and talk about the funding environment. We've been seeing a lot of noise out of Washington in terms of freezes or pauses, et cetera. I know you don't get a dramatic amount of revenues directly from the federal government. But is there anything maybe that indirectly comes to you from Washington through the states? I'm just wondering what kind of exposure you might have.

James J. Rhyu
Chair of the Board & CEO

Yes. So our exposure is pretty limited, is very limited. I think, without getting into specific numbers, I think I've said previously around a similar question that it's well less than 5%. I think we saw the same thing that maybe some of you saw today, before getting on today, we did validate that it continues to be, for this year, well less than 5%. So I think our exposure is pretty limited.

Listen, I think what I will say is that regardless of what the administration announces, I want to believe, and I think I do believe, that the intent is, and I want to encourage everybody to focus on the intent is, to help students. And I don't want to get into a political discussion or debate here. I have faith that the administration is going to try to do the things that are going to help students. And I think that's what hopefully all of our political governments are trying to do. That's what we're trying to do. And whatever impact it has to us, we're going to manage through it. If it's negative, we'll take it on the chin and just keep marching forward. If it's positive, I think hopefully, it can help our business.

But I do think the administration is trying to figure out ways just ultimately to help students. And I think that the downstream impact that people maybe aren't yet seeing is maybe an approach or philosophy to

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empower states. I think that's sort of some of the state goals that this administration has talked about. And we support things that are going to help students.

Operator

We'll take the next question from Alex Paris, Barrington Research.

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

First off, I'd like to ask you a couple of clarifying questions. In the first question, James, you responded about strength across the board in enrollment. I'm presuming you're talking about new student enrollment. The question would be how has retention been faring?

James J. Rhyu
Chair of the Board & CEO

Yes. So retention, I think a couple of years ago, I think we talked about how we saw sort of what we believe was a structural improvement in retention post pandemic. I think, generally speaking, that trend continues. I think year-over-year, we're seeing retention numbers that are sort of plus or minus within the same ballpark. So we're not seeing ongoing dramatic improvements like we saw a couple of years ago.

But I think for us, the retention game is also a slightly longer-term game, meaning what we're doing is we're identifying structural areas of the program that we can see, based on all of the feedback that we get, in areas that we can improve the program that we believe will have structural long-term benefits to retention. And that is things that I think most people would expect. People, they think that sometimes there's a lack of socialization in virtual programs. That is true. That's a very valid feedback. We're investing in platforms that allow kids to safely interact with each other in an environment, we call it, the K-12 zone where they can go in and they can meet on a virtual playground, they can play games, they can have communication with each other. And so we're investing in those types of things that we think attack the thematic elements of why students and families may attrit.

But year-over-year, I don't think we're seeing right now any sort of major plus or minus difference. But I do think longer term, over the next 3 to 5 years, the structural things like the one I mentioned are going to provide some longer-term benefit in our retention numbers.

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

Great. That's helpful. And then on that same question, the final comment you made was you said something about incremental career funnel has not materialized as strongly as we expected or hoped. But then I look at the Career Learning enrollment, up 31% year-over-year. Did I misunderstand your response? Or perhaps you could offer some more color?

James J. Rhyu
Chair of the Board & CEO

No, I think you understood the response correctly. I think that in spite of what I think the strong numbers suggest, it's my very strong and long-held belief that if our career programs are operated well, applied well, they can put kids on a trajectory to be career-ready when they graduate high school. I think increasingly, the macro trends around education support that as a larger need. I think the industry dialogue, if you will, not education industry but corporate industry dialogue, supports that. And so I think that the market opportunity for those programs indicate something much larger than what we're seeing and doing. And so I think that there's just a lot more upside opportunity there if we can effectively go to market with it and capture it. I don't think we've done that effectively yet. And so I think that presents even more upside for us.

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

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Great. Good to hear. Last question, and I hate to pick at the only negative thing in this report. Adult revenues were soft, $19.8 million, a little bit below where they were in the first quarter. I guess the first question on that is, what's the makeup of that segment now? I realize there's 2 boot camps and MedCerts, maybe a proportion. MedCerts, I'm assuming it's the largest. But whatever color you could give there would be helpful. I know it's very small as a percentage of the total, I think 4% on a last 12-month basis, but I was just curious.

James J. Rhyu
Chair of the Board & CEO

Yes. I think that we're not going to break out the percentages exactly for I don't think that's productive for any of us. I think that we're disappointed in the softness in the business, that's for sure. I think one of the factors, and this is in no way, shape or form an excuse because we didn't think it was going to be this soft as we go through this transition, but particularly for the MedCerts business, longer term, that business is a structurally better business for us and for our customers if it's structured as more of a B2B type of business. It's historically been a primarily B2C type of business. And so we are pivoting that business into a much more sort of B2B-focused business.

It doesn't mean that we're abandoning the B2C side of it. It's just that when you have a B2B business, one is, obviously, you don't have to deal with the daily customer churn as much. You have much more stable contracts. It's much more recurring revenue. It actually happens to be higher margin, generally speaking.

And so we're still very bullish about the business. I think there is -- and I don't know exactly how long it's going to be, but there's going to be some period of time as we transition through. As you said, it's immaterial. If it continues to decline for some period of time, I don't think it materially impacts our overall trajectory of the company or our ability to continue to grow in spite of those kinds of declines. But we remain invested in those businesses, and we are going to continue to invest behind them. And we do think there's long-term value creation for our shareholders with those businesses.

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

Great. And then just one more clarification question came into my mind. In answering the question about federal funding, you've said before, it's well less than 5% of revenue. Is this ESSER we're talking about? Or are there other things in there like Title 1 and so on?

James J. Rhyu
Chair of the Board & CEO

Yes. So it's a good clarifying question. There are other things in there. Like, the ESSER now at this point, I mean, it's basically nothing. So I don't even think that we should be talking about ESSER. It's not a thing for us anymore. But there is other very small revenue streams that sort of flowed through from federal dollars, again, well less than 5%. And yes, so I think it's -- so it is more than just what was historically ESSER.

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

Congratulations on the strong quarter.

Operator

[Operator Instructions] We'll go next to Stephen Sheldon, William Blair.

Matthew R. Filek
William Blair & Company L.L.C., Research Division

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James and Donna, you have Matt Filek on for Stephen. Great results this quarter. Has your optimism about being able to open new schools in new states changed at all, especially with the President pushing for universal school choice? Just curious how you're thinking about that.

James J. Rhyu
Chair of the Board & CEO

Yes. So again, I try to keep us focused either way. You heard this 4 years ago, you heard this 8 years ago, you're going to hear it now. Trying not to be too swayed in how we run the business either way, given changes in administration, predominantly, it's a state-level business anyway for us. I do think that the general tone and tenor of this current administration supports school choice and the types of programs that we run. I think broadly speaking, that is and can be a positive halo effect on our business.

I don't see that the administration is going to specifically advocate for us or our programs in any given state. And I don't know that it will have a tailwind in opening new programs or states. To the extent that there is a tailwind from it, we will absolutely try to take advantage of that tailwind. I just don't know that I see that materializing right now. So I don't want anybody to believe that -- and by the way, I mean I hope in whatever period of time in the future, if it's a different type of administration, people understand the flip side of this commentary, which is we believe that this is a state business. And it historically and predominantly has been a state-run business. And we respect the state's views and the way that they manage these businesses. And I think the current administration also does, and we're supportive of that.

And I think above and beyond that, by the way, my understanding is that the current administration is also looking for other ways to, again, help students. And to me, that's positive for the country. So that to me is the commentary from my view is, if the government is here to step in and try to help students from their vantage point, that's a good thing. If it helps our business or not, it's almost secondary at this point. We're focused on running our business well whatever conditions we're given.

Matthew R. Filek
William Blair & Company L.L.C., Research Division

Got it. That's a helpful explanation, James. And then I wanted to ask one on Career Learning. I think you have talked about your desire to build out pilot programs for skilled trades like plumbers, HVAC repair. So can you talk a little bit more about that and what that opportunity could look like?

James J. Rhyu
Chair of the Board & CEO

Yes. So we have run a couple of tests already actually. I think the early indications of the tests suggest that we still have a lot to learn. Clearly, and you can see this in other public market comps out there, that overall demand for skilled trades appears to be growing. I think that's a good thing. I think the country needs it. I think that there's just a phenomenal career trajectory for a lot of people, without having to incur college debt, to earn very, very lucrative living doing skilled trades.

We continue to think there's opportunity for us. I think we've got to figure out where we can effectively play in that space. We're going to continue to explore it. But we want to be -- we want to proceed cautiously about how we explore it because the last thing we want is to make big bets on something that don't materialize for us because we haven't tested it properly. And so I don't think it's a trend that's going away tomorrow. I think that there's time for us to try to figure it out and see what we can explore in the space. But yes, we have already begun the testing of it, and I think we still have a lot to learn.

Matthew R. Filek
William Blair & Company L.L.C., Research Division

Okay. Sounds good. And then lastly, I just wanted to quickly confirm, are there any schools that are currently getting close to hitting enrollment caps, especially in light of the strong enrollment growth in the recent quarters?

James J. Rhyu
Chair of the Board & CEO

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Well, we're always dealing with programs that have enrollment caps actually, like it's not a new thing. The good news is that, in most of the programs, the enrollment caps are generally not long-term fixed. So there's two flavors of enrollment caps, generally speaking. One is, I'll say, the government-imposed cap, i.e., state-imposed enrollment cap, in a certain state for a certain program. And the other is, I'll say, sort of a partner-imposed cap or one of our partners, for whatever good reason they have, imposed a cap. And in both of those cases, over time, generally speaking, there is a conversation to be had to raise caps when necessary.

We historically have been reasonably successful in raising caps when the demand warrants it, meaning if there is an excessive amount of demand for a program, we go with the data to whoever, whichever counterparty it is, and we show them the data that suggests that there's strong demand, it's being unmet and where there's a need. And we usually go with the sort of the stories, if you will, of need, meaning these are usually families that don't have other alternatives for one reason or another. They are very valid alternatives -- or sorry, they're very valid reasons to not have other alternatives. And we want to just -- we want to be able to serve students. And where students in states aren't being served through another mechanism, and we may be the only mechanism through which they can be served, we think it's justified to raise caps. And we've been fairly successful in our history, and we think we can continue to be successful, in having those conversations with our partners or with state government agencies to do that for the benefit of students.

Operator
And that does conclude our question-and-answer session. That also concludes our conference for today. We would like to thank you all for your participation. You may now disconnect.

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