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Q2 2023 Franklin Covey Co Earnings Call

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## PRESENTATION

### Operator

Good day, and thank you for standing by. Welcome to the Second Quarter 2023 Franklin Covey Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Derek Hatch, Corporate Controller.

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### **Derek Hatch** *Franklin Covey Co. - Corporate Controller of Central Services - Finance*

Thank you. Good afternoon, everyone. On behalf of Franklin Covey, I want to welcome you to our earnings call for the second quarter of fiscal 2023 and want to hope that your family -- your families are enjoying some nice warm, wet spring weather as on today as well.

Before we begin, we'd like to remind everybody that this presentation contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based upon management's current expectations and are subject to various risks and uncertainties, including, but not limited to, the ability of the company to stabilize and grow revenues, the acceptance of and renewal rates of our subscription offerings, including the All Access Pass and Leader in Me memberships, the duration and recovery from the COVID-19 pandemic.

The ability of the company to hire productive sales professionals, general economic conditions, competition in the company's targeted marketplace, market acceptance of new offerings or services and marketing strategies, changes in the company's market share, changes in the size of the overall market for the company's product, changes in the marketing and the training and spending policies of the company's clients and other factors identified and discussed in the company's most recent annual report on Form 10-K and other periodic reports filed with the Securities and Exchange Commission.

Many of these conditions are beyond our control or influence, any one of which may cause future results to differ materially from the company's current expectations. And there can be no assurance that the company's actual future performance will meet management's expectations. These forward-looking statements are based upon management's current expectations. We undertake no obligation to update or revise these forward-looking statements to reflect events or circumstances after the date of today's presentation, except as required by law.

With that out of the way, we'd like to turn the time over to Mr. Paul Walker, our Executive Officer. Paul?

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### **Paul S. Walker** *Franklin Covey Co. - President & CEO*

Thank you, Derek. Hello, everyone. Thanks for joining us today. I do hope you're doing well. I'm joined here today by Steve Young, our CFO; Jen Colosimo, President of our Enterprise Division; Sean Covey, President of our Education Division and several members of our executive team. We're happy to have Colleen Dom here, our Head of Operations as well. We're also happy to have Bob Whitman, our Executive Chairman with us also.

In the midst of an increasingly uncertain economic environment, we're pleased to report that our second quarter revenue was \$61.8 million or 9% higher than prior year. In constant currency, our second quarter revenue grew approximately 11% to \$62.7 million, even

after lower-than-anticipated sales in China, and the decrease in rental income, which combined made up an additional \$1.1 million of impact. We're also pleased to report that adjusted EBITDA for the fourth quarter was \$8.2 million. In constant currency, adjusted EBITDA for the quarter was \$8.4 million and would have been even higher if not for China and the absence of the rental income.

The current economic environment obviously continues to be a challenging one for both companies and investors. Everyone is hiking in deeper snow now than they were even 90 days ago. Based on the strength of the quarter and year-to-date results and our confidence in the strength of our pipelines, even in this environment, we're pleased to be able to reiterate our full year adjusted EBITDA guidance in constant currency of between \$47 million and \$49 million. As to revenue compared to our estimate at the beginning of the year of \$294 million, we expect revenue to be impacted by approximately \$3.5 million due to FX, an additional \$2.5 million because of slower-than-expected recovery of sales in China and Japan and by an additional \$4 million to reflect the expected impact of the deeper snow through which our clients are now hiking.

Importantly, as you know, Franklin Covey's strategy, business model and approach were really developed and refined with times like these in mind. Specifically, 5 key elements of Franklin Covey's strategy and business model were each designed on one hand to allow us to take advantage of opportunities, the kinds of opportunities we continue to see, and on the other hand, to build in resilience and to enable us to achieve strong growth in revenue, adjusted EBITDA and cash flow even in challenging economic circumstances.

The individual and collective strength of these 5 strategic elements, which you can see shown on Slide 4, is being reflected in our second quarter year-to-date and latest 12-month results. These 5 elements of our strategy and business model as follows: the first is that we've chosen to help clients -- the types of challenges we've chosen to help clients address are mission critical and extremely durable. As you know, we help organizations and schools achieve the kinds of results that require the collective action of significant numbers of people.

These kinds of challenges are mission-critical and extremely durable and they don't become less important or easier when the external environment becomes more difficult. In fact, quite the opposite. As a result, a number of what are now among our largest client relationships were first established during and immediately after the great financial crisis. A key metric, which shows both potential clients ongoing desire to address these challenges and their trust in selecting us as their partner is our ability to win new clients or new logos in both good and more challenging times.

We're pleased that our contracted new logo revenue in the second quarter year-to-date and for the latest 12 months, has remained very strong. A second key element of our strategic strength is the effectiveness of our solutions in helping clients address these challenges. This builds tremendous client commitment and loyalty, which in turn results in achieving strong growth in subscription and subscription services revenue, having a significant percent of clients to enter into multiyear contracts achieving strong levels of contracted revenue and high levels of revenue retention and having clients purchase significant amounts of services to help them achieve their objectives.

We're pleased that even in the current economic environment, all 4 of these metrics remained strong in the second quarter, year-to-date and the latest 12-month period. First, subscription revenue remained very strong in the second quarter year-to-date and for the latest 12 months. As shown in Slide 6, total company subscription and subscription services revenue grew 15% in the second quarter, has grown 18% year-to-date and 22% for the latest 12 months.

With All Access Pass Subscription and Subscription Services revenue growing 11% in the second quarter, which was on top of 29% growth in the second quarter of last year, 15% year-to-date, which was on top of 28% growth year-to-date through the second quarter of last year and 22% for the latest 12 months.

And in our Education business, Leader in Me subscription and subscription services revenue grew 30% in the second quarter, 27% year-to-date and 23% in the latest 12-month period; second, as shown on Slide 7, the percent of our North America All Access Pass subscription contract value represented by multiyear contracts of at least 2 years, has increased significantly from 47% in last year's second quarter to 55% in this year's second quarter, this reflects our clients' long-term commitment to address their big opportunities and challenges utilizing our solutions.

Third, we also achieved strong levels of invoiced revenue and high revenue retention. Again, we're pleased with the significant levels of

revenue that we contracted during the second quarter and the year-to-date and latest 12-month periods. As shown on Slide 8, invoiced revenue in the Education Division grew 30% or \$1.8 million in second quarter, 29% year-to-date and 19% for the latest 12 months, and our balance of deferred Education revenue increased \$3.1 million or 18% to \$20.2 million.

As shown on Slide 9, invoiced revenue in our international licensee partner operations grew 13%, with some partners operating well above prepandemic levels, while others to economies were harder hit are working their way back to prepandemic levels. Invoiced revenue in China and Japan continued to be below prior year but is expected to improve in the back half of this year.

As shown on Slide 10, in the Enterprise Division, in last year's second quarter, we established a new high watermark for the second quarter for the total amount of All Access Pass amounts invoiced with invoiced amounts increasing 25% or \$5.6 million to \$28.5 million, which was somewhat benefited by comparing to the prior year's pandemic impacted results. We're pleased that even against this high watermark and in a more difficult environment, we were able to further increase the total amount of All Access Pass amounts invoiced in this year's second quarter and for the year-to-date and latest 12-month period.

Invoiced amounts grew 4% or \$1.2 million to \$29.8 million in the second quarter, 8% or \$3.4 million year-to-date and 11% or \$9.7 million for the latest 12-month period. We're pleased with the ongoing strength of the total amounts we invoiced during the second quarter and the fact that this growth rate was less than last year's second quarter primarily reflects 2 factors. First, that we were comping against the magnitude of last year's 25% growth. And second, that in this environment, while the number of All Access Pass clients who renewed or expanded their All Access Pass in this year's second quarter increased, these increases were somewhat offset by an increase in the average size of the All Access Pass contracts not able to renew in the second quarter.

Importantly, as shown on Slide 11, for the entire company, our balance of billed and unbilled deferred revenue at the end of the quarter was \$145.8 million, reflecting growth of \$26.5 million or 22% versus last year. Of this \$26.5 million increase in total deferred revenue, \$5.8 million was growth in deferred subscription revenue, representing growth of 8% with the other \$20.7 million, reflecting 42% growth in unbilled deferred revenue, which has not yet been invoiced, but which will be invoiced with 100% surety in the coming quarters. This growth in unbilled deferred increases visibility and predictability into future revenue and provides a meaningful tailwind for growth in our invoiced amounts in the coming quarters.

Fourth, as shown on Slide 12, purchases of All Access Pass subscription services also grew in the quarter. The amount of All Access Pass subscription services revenue in the Enterprise Division has grown significantly over the years, increasing from 44% of total subscription sales in fiscal 2020 to 52% in fiscal 2021 and then increased significantly to 62% of subscription sales in fiscal 2022, which again was somewhat benefited by comping against the prior year's pandemic impacted results and has remained at this high level through this year's second quarter.

In last year's second quarter sales of subscription services in the quarter grew a very significant \$3.9 million or 53%. We're pleased that even against this difficult comp and in a more difficult environment, we were able to achieve growth in the amount of services purchased in this year's second quarter of \$200,000 or 2%. This reflects the ongoing commitment our clients have in solving their must-win challenges even in this difficult environment.

The third element of our strategy is the significant diversity in our base of clients in the industries and segments in which we operate in the Enterprise Division and that our Education Division serves a completely different market. This diversity provides a strong foundation for growth and can limit the extent of concentrated impact of economic storms that may occur. No individual client accounts for more than 2% of our revenue. And as you can see on Slide 14, we have no significant concentration of revenue in any particular industry.

Fourth, the strength of our subscription business model is driving strong growth in revenue, adjusted EBITDA and cash flow. Three key factors underlie the strength and growth of our subscription business and its ability to drive strong growth in adjusted EBITDA and cash flow. First is that the lifetime customer value of a typical subscription contract is large and growing. For example, as shown on Slide 16 and as we showed last quarter, the typical All Access Pass contract with its relatively large initial value, high annual revenue retention, strong gross margins and significant amount of recurring All Access Pass subscription services ultimately becomes an asset worth hundreds of thousands of dollars.

Second is that the increasing duration of our subscription contracts further increases their durability and their value. And third -- the third point is that our constant -- our cost of acquiring a new All Access Pass subscription is not only much less than the contract's lifetime value, but even less than the client's first year All Access Pass spend. The combination of these factors allow us for the achievement of significant growth in All Access Pass and Leader in Me revenue with high flow-through of incremental revenue to increases in adjusted EBITDA and cash flow.

Finally, our significant liquidity provides us the flexibility to take advantage of opportunities for accelerated growth. Over the years, we've built up and maintained significant liquidity and have no net debt. As a result, subject to a rigorous budgeting and investment processes, we've been able to consistently make investments in 3 important areas. First, we've always been able to make significant ongoing investments and growing our business through organic investments and growing our sales force, building our client-facing teams and investing in content and technology; second, we've also utilized our liquidity to make a series of tuck-in acquisitions that have provided us with key strategic capabilities.

And at the same time, over the years, we've returned almost 200 million -- \$200 million to shareholders in the form of stock repurchases. We're pleased that even after investing \$25 million of excess liquidity for stock repurchases in the last 4 quarters, which includes approximately \$3.8 million of stock repurchases in the second quarter, we ended the second quarter with \$55.1 million in cash and with our full \$15 million revolving credit facility undrawn. During the second quarter, our Board of Directors both replenished our stock repurchase authorization and increased it to \$50 million.

In addition, subsequent to the end of the quarter, we entered into a new credit facility at an attractive rate that increases our revolving credit amount from \$15 million to \$62.5 million, providing us with significant flexibility for both repurchasing stock and making strategic acquisitions. The individual and collective power of these 5 key elements has been very evident in the strength of our business over the past years and in our continuing strength in the second quarter, year-to-date and latest 12-month periods.

As a result of this ongoing strength, as we'll discuss in our guidance section in a few minutes, we expect to generate adjusted EBITDA between \$47 million and \$49 million in constant currency in fiscal '23, and in constant currency to be able to achieve our targets of \$57 million in adjusted EBITDA in fiscal '24 and \$67 million in fiscal '25.

I'd now like to ask Steve to share some headlines on key revenue and profitability metrics and to review our performance for the quarter and year-to-date periods.

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**Stephen D. Young *Franklin Covey Co. - CFO & Corporate Secretary***

Thank you, Paul. Good afternoon, everyone. It's nice to be with you. As Paul said, I'd like to start by sharing some headlines regarding our revenue. As Paul mentioned and as you can also see on Slide 18, our revenue growth in the second quarter continued to be strong with revenue increasing 9% to \$61.8 million compared to the \$56.6 million in last year's second quarter. In constant currency, our revenue grew and even more rapidly 11% even after lower-than-anticipated sales in China and a decrease in rental income, which combined, made up an additional \$1.1 million impact.

As also shown, our revenue growth year-to-date through the second quarter was 11% with growth of 14% in constant currency, and for the last 12 months through the second quarter, revenue grew 12% and grew 15% in constant currency. Our subscription and subscription services revenue grew even more rapidly. As you can also see on Slide 18, total subscription and subscription services revenue grew 15% in the second quarter, 18% year-to-date and 22% in the last 12-month period, with All Access Pass subscription and subscription revenue growing 11% in the second quarter. And as Paul mentioned, on top of 29% growth last year, and growing 15% year-to-date on top of 28% of year-to-date growth last year and growing 22% in the last 12 months, and Leader in Me subscription and subscription services revenue growing 30% in the second quarter, 27% year-to-date and 23% in the latest 12-month period.

Durability of our revenue is also continuing to increase, and our visibility into future revenue growth continued to expand. As also shown on Slide 18, our balance of deferred subscription revenue billed and unbilled at the end of the second quarter increased \$26.5 million or 22% to \$145.8 million. And finally, as also shown on Slide 18, for the last 12 months through the second quarter in our North America

Enterprise operations, the percentage of our total All Access Pass invoiced revenue represented by multiyear contracts of at least 2 years, increased to 55%, up from 47% last year.

I'd also like to share some headline profitability metrics. As shown on Slide 19, our gross margin percentage in the second quarter remained very strong at 76.4%, representing the combination of 46 basis point increase in gross margin in the Enterprise Division and a 150 basis point decrease in gross margin overall, primarily reflecting an approximately 500 basis point decline in Education Division gross margin percentage resulting primarily from conducting several large in-person marketing events during the quarter.

The 150 basis point decrease in gross margin in the quarter is consistent with the year-to-date gross margin decrease of 159 basis points and 163 basis point decrease for the latest 12 months. Operating SG&A as a percentage of sales continued to improve in the second quarter, decreasing another 54 basis points to 63.2% compared to 63.5% in last year's second quarter and improving 133 basis points to 61.2% year-to-date, and for -- 242 basis points for the latest 12-month period to 60.2%.

Adjusted EBITDA in last year's second quarter increased \$2.9 million or 57% to a record \$8 million. We are pleased that even after significantly increasing our investment in hiring new salespeople at the end of last year and expanding our other client-facing teams and making significant investments in completing the development of our Impact Platform, as expected, adjusted EBITDA in this year's second quarter increased further from the \$8 million to \$8.2 million, which is \$8.4 million in constant currency.

Year-to-date, adjusted EBITDA increased \$1.7 million or 9% to \$19.7 million and in constant currency increased \$2.7 million or 15% to \$20.6 million. For the latest 12 months, adjusted EBITDA grew \$6.8 million or 18% to \$43.9 million and in constant currency grew 24% to \$46 million.

Our cash provided by operating activities during the first half of this year was \$11.2 million compared with \$23.2 million in the first 2 quarters last year. The difference was primarily attributable to changes in working capital during the year related to more cash used to pay accounts payable and accrued liabilities, plus changes in the growth of deferred revenue compared to the prior year.

During the first 2 quarters of FY '23, our collection of accounts receivable remained strong, and provided the necessary cash to support our operations, payer obligations and make critical investments. We expect our cash flow from operating activities in the back half of the year to be strong and even stronger than the back half of last year.

As Paul noted, even after investing \$25 million of our excess liquidity for stock repurchases in the last 4 quarters, including \$3.8 million in stock repurchase in the second quarter, we ended the quarter with \$55.1 million in cash and with our full \$15 million revolving credit facility undrawn.

Our strong and increasing liquidity adds Franklin Covey optionality as we continue to invest in our business, evaluate potential acquisition opportunities and continue to look at ways to further enhance shareholder value. Finally, to make a little more detail -- provide a little more detail on the factors underlying the strong performance focusing on the results of key areas of our company, specifically in our Enterprise business in North America, in our Enterprise business internationally, both in our direct offices and international licensee partner operations and in our Education business, almost all of which is in North America.

First, as shown on Slide 20, results in our Enterprise business in North America were strong in the second quarter year-to-date and in the latest 12 months. Revenue in North America, which accounts for about 73% of total Enterprise Division revenue grew 8% in the second quarter, 12% year-to-date and 15% in the latest 12-month period. Our U.S./Canada area of business grew at a strong 11% in the quarter, but was tempered by an 11% softening in our government revenue.

Subscription and subscription services revenue in North America grew 7% in the quarter, 13% year-to-date and 19% for the latest 12 months. Our balance of deferred revenue billed and unbilled in North America grew 22% compared to last year's second quarter balance. And the percentage of North America's All Access Pass invoiced revenue represented by multiyear contracts increased to 55% for the latest 12 months, as we said before, in the second quarter, up from 47% last year.

Second, as shown in Slide 21, revenue growth was strong in our offices in the U.K., Ireland, Germany, Austria, Switzerland and Australia countries, which together make up approximately 48% of total international sales and where All Access Pass makes up a substantial portion of those sales. Revenue in these offices grew 8% in the second quarter, 10% year-to-date and 20% in the latest 12-month period. All Access Pass subscription and subscription services sales, which make up approximately 83% of total sales in these countries grew 4% in the quarter, 9% year-to-date and 22% for the latest 12-month period.

In our offices in China and Japan, which account for approximately 52% of total international sales, widespread COVID-related lockdowns in China over the past 18 months, which started to loosen in the second quarter together with a very cautious and slow return to normalcy post-COVID in Japan and the negative impact of FX impacted results in these 2 countries as revenue declined by 17% in the second quarter, 12% year-to-date and 23% in the latest 12-month period.

Our strong overall company results were after absorbing these impacts in China and Japan. These pressures appear to be easing and we are expecting growth in these countries in the third quarter and beyond. As also shown in Slide 21, our international licensee partner revenue increased 13% in the second quarter, 11% year-to-date and 16% in the last 12 months. Our licensee partners operations continue to strengthen despite world economic conditions.

Finally, as shown in Slide 22, the results of our Education business, which account for approximately 24% of the total company revenues were very strong, with Education revenue growing 28% or \$3.1 million in the second quarter. Excluding approximately \$600,000 of low-margin Symposium marketing revenue where our clients and prospective clients gather to hear best practices and techniques [astounding] the Leader in Me process, revenue still grew \$2.5 million or 23%.

Education revenue increased 25% year-to-date and 20% in the last 12 months. Education subscription and subscription services revenue growth was very strong, increasing 30% in the second quarter, 27% year-to-date and 23% in the last 12 months. Education's balance of deferred subscription revenue grew 18% in the second quarter. And our year-over-year retention of Leader in Me schools remained very high at approximately 90% for the latest 12 months.

So Paul, I'll turn it back to you.

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**Paul S. Walker Franklin Covey Co. - President & CEO**

Thank you, Steve. Thanks for taking us through that. Maybe just stepping back for just a minute before we move to guidance and outlook. In this environment, we're often asked a couple of questions. First, whether organizations and schools are still engaging us on major behavioral change initiatives. And second, how we're thinking about the ongoing growth of our revenue-generating client-facing roles, including client partners.

The answer to the first question, whether organizations of schools are still engaging us on major behavioral change initiatives is an emphatic yes. While it's true that some organizations are hunkering down has occurred during the early stages of the pandemic, many others see this as a critical time to strengthen their organizations by putting extraordinary focus on major strategic objectives, increasing the capability of their leaders, by building more strength into their culture and by increasing the effectiveness of every individual to narrow focus to the most important organizational priorities.

Last week, we convened a group of Chief Human Resource Officers and Chief Learning Officers from 17 of the largest companies in the country. Collectively, they employ more than 2 million people. We spent the entire day discussing the areas in which they and their CEOs are most focused and how they're organizing to drive collective action on their most important objectives. Over and over, we heard these leaders discuss the high correlation between leadership capability and financial performance, the importance of culture and the power of focusing and aligning organizations to improve execution.

Franklin Covey is a trusted partner to our clients in each of these areas. As shown on Slide 23, I'd like to briefly touch on a few recent client wins that illustrate the type of positive momentum we're seeing across the majority of our client base right now. First is a recent new client win with a large organization who is engaging us on a major sales transformation initiative that will touch more than 5,000 of their sales professionals around the world. This is a 5-year All Access Pass contract. The second is a large multinational information

technology consultancy, whose All Access Pass actually expired 6 months ago, resulting in a nonrenewal at that time, as the client wrestled with what was an uncertain economy and what that might mean for their business. However, in the second quarter just ended, we won this client back for a new 3-year contract with significant subscription services attached.

A third of the large transportation company that expanded All Access Pass seats from 1,500 to 9,000 in the second quarter so that we can now help them address the entirety of their leadership population globally. And maybe just one more from our Enterprise Division, a leading global food and beverage company renewed their pass in the second quarter and at the same time, expanded their All Access Pass seats so that they can scale our project management unconscious bias and 7 Habits solution further into their organization.

And also importantly, in our Education Division, where the team has successfully been pivoting from selling Leader in Me not only to individual schools but also to entire districts and states, we won our second state-funded contracts and have closed district-wide sales with more than twice the number of districts this year that we have the same point last year.

To answer the second question, how are we thinking about the ongoing growth of our revenue-generating client-facing sales roles, including client partners. The answer is that we continue to see this as a significant piece of our all growth strategy. As you can see shown in the chart on Slide 24, since the end of fiscal 2012 through the end of fiscal '22, we've grown the size of our sales force by 250% from 120 client partners to 300 client partners. And of these additions, at least 1/3 have been added in just the past 4 years, meaning we have a significant portion of our sales force who are still in ramp, many of whom are in the early stages of that ramp.

These ramping client partners represent a significant source of future revenue growth as the embedded future revenue from these -- from the successful ramp of these new client partners represent tens of millions of dollars of future revenue growth. While this growth in the number of new client partners has been incurring -- occurring, we've also been growing 2 additional important client-facing revenue-generating roles, our All Access Pass implementation strategists and our Leader in Me coaches.

These 2 groups play a critical part of our account management strategy. They partner with our client partners to expand, add services and ensure the successful renewal of each of our All Access Pass and Leader in Me clients. As you can see shown in the chart on Slide 25, the number of people hired for these roles has also grown steadily since the launch of our subscription business, more than doubling from 70 in fiscal 2016 to 149 at the end of fiscal '22.

As we continue to focus on hiring aggressively to match the magnitude of the big opportunity before us, there's enormous value to making sure each one of these people ramp successfully. Therefore, both generally and particularly in this more difficult environment, we're going to spread the hiring of this and future years hiring a little more evenly rather than bunching them all up at year-end. This will allow us to ensure each of these people receive the right amount of ramp support, both in the current environment and thereafter.

We're pleased that because of our strong solutions and their ability to address must-win objectives for our clients, our compelling subscription business and our strong business model, we're able to make these ongoing investments to accelerate our growth in revenue, while at the same time, accelerating our growth in adjusted EBITDA and cash flow.

I want to express my huge appreciation to our amazing clients and to our teams of amazingly talented and committed people who serve them. They make the impact we're having possible. I'd now like to turn the time to Steve to review our guidance and multiyear outlook. Steve?

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**Stephen D. Young *Franklin Covey Co. - CFO & Corporate Secretary***

Okay. Thank you again, Paul. So everyone might want to refer to Slide 26. So driven by the continued strength, strategic durability and future visibility provided by our All Access Pass and Leader in Me membership subscriptions, which due to their high revenue retention, high lifetime customer value and they're being highly attractive to new customers have resulted in accelerated growth over the past year. They have also driven strong performance through the first 2 quarters of this year. Based upon that, primarily, we are affirming our previously announced guidance that adjusted EBITDA for fiscal 2023 will increase to between \$47 million and \$49 million in constant currency compared with the \$42.2 million in adjusted EBITDA achieved in fiscal 2022.

We expect to achieve this growth even after continuing to make increased investments to add new client partners, other personnel and investments in delivery portals and content and absorbing potentially challenging macroeconomic circumstances. This guidance also assumes that China and Japan will begin their post-COVID-19 recovery in the second half of the year and does include the loss of approximately \$1.4 million of adjusted EBITDA related to the loss in Q2 of a large tenant at our corporate campus.

We remain confident in the strength of the All Access Pass and the Leader in Me membership subscriptions, which have driven Franklin Covey's growth across recent years and which are expected to drive continued growth in FY '23 and in subsequent years. Consistent with our overall guidance of adjusted EBITDA going from \$47 million to \$49 million in constant currency, we expect adjusted EBITDA in the third quarter to be between \$9.5 million and \$10.5 million in constant currency. We feel very good about achieving this result, particularly given that last year's Q3 adjusted EBITDA result of \$10.9 million was itself \$2.3 million or 27% higher than the year before, making this year's Q3 adjusted EBITDA quarter, our second largest Q3 ever, even after absorbing the \$500,000 reduction in EBITDA from the loss of the tenant that we mentioned.

As to revenue, compared to our estimate at the beginning of the year of approximately \$294 million, we expect revenue for the year to be impacted by approximately \$3.5 million due to FX, an additional \$2.5 million because of the slower-than-expected recovery of sales in China and Japan and by an additional \$4 million to reflect the expected impact of the deeper snow through which our clients are hiking.

We expect revenue in the third quarter to be approximately \$70 million in constant currency, reflecting the factors just mentioned and in line with our full year revenue expectation of approximately \$284 million (sic) [\$294 million]. In line with our expectation of \$47 million to \$49 million of adjusted EBITDA in constant currency in FY '23, our adjusted EBITDA targets for FY '24 and FY '25, remain unchanged at approximately \$57 million and \$67 million, respectively. While changes in the world economy and many other factors could impact our expectations. These are our current targets. So Paul, back to you.

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**Paul S. Walker Franklin Covey Co. - President & CEO**

Great. Thank you, Steve. We feel great about our continued momentum and are looking forward to accelerating growth and -- with that, I think we ought to open up to your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from Nehal Chokshi with Northland Capital Markets.

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**Nehal Sushil Chokshi Northland Capital Markets, Research Division - MD & Senior Research Analyst**

Just a little clarification on the EBITDA guidance. The slides are classifying on a constant currency basis. And in the quarter ago period that did not specify on a constant currency basis. So are we going from an as is to a constant currency outlook here?

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**Stephen D. Young Franklin Covey Co. - CFO & Corporate Secretary**

For adjusted EBITDA?

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**Nehal Sushil Chokshi Northland Capital Markets, Research Division - MD & Senior Research Analyst**

Yes.

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**Stephen D. Young Franklin Covey Co. - CFO & Corporate Secretary**

Fair question. Specially, I think we've always -- that was probably a miss on our part in the slide last quarter. We typically always try to give our guidance in constant currency.

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**Nehal Sushil Chokshi Northland Capital Markets, Research Division - MD & Senior Research Analyst**

Okay. Excellent. And I think what you guys are trying to communicate here is that over the last 3 months, you have seen incremental headwinds to EBITDA and you're absorbing those incremental headwinds. Can you quantify exactly those incremental headwinds on an EBITDA basis as opposed to a revenue basis that you have already provided?

**Stephen D. Young Franklin Covey Co. - CFO & Corporate Secretary**

So no, we really haven't talked about a number that the change -- that the headwinds related to revenue have flown to adjusted EBITDA but it would be at a pretty high flow-through rate, meaning that if we had pick whatever your number is \$2 million, \$3 million, \$4 million of additional revenue, that, would have flown through at a pretty -- at a very high rate to adjusted EBITDA.

**Nehal Sushil Chokshi Northland Capital Markets, Research Division - MD & Senior Research Analyst**

Got it. Okay. Great. Two other quick questions here. So bookings in the quarter is up only 2% year-over-year, although the All Access Pass invoicing is up [5%] year-over-year. That's versus mid-teens prior 4 quarters and 23% in the November quarter. So a pretty significant deceleration in your bookings, what's the narrative behind that deceleration there?

**Paul S. Walker Franklin Covey Co. - President & CEO**

Yes, it's a good question. So I think -- so stepping back for just a second, as we looked at the quarter and as we talked about just a minute ago, there were -- there are a number of actual positive things really happened in the quarter relative to bookings. We had the number of clients who expanded, renewed and expanded their All Access Pass was greater in the second quarter than it was a year ago. So it wasn't that, that we had more clients sign multiyear contracts this year than did a year ago. So we felt great about that. New logo sales continue to be strong in the quarter for the year-to-date and for the latest 12 months.

And so those were all positive on the -- weighing against that were, as we mentioned, there were -- while about the same percentage of clients who don't renew in any given quarter didn't renew, there were some larger clients in there who didn't renew this quarter and that weighed to the point where it almost mostly offsets the gains on the other side. So I think that's what happened in the quarter. It was some really positive things. Then we did have those clients who are a little bit larger facing their own headwinds didn't renew, we hope that we'll win them back.

From a growth standpoint, then the other point we made is we're comping against what was our largest percentage growth quarter last year in the second quarter that we've had in our subscription business, which itself was a little bit benefited by the comp last year being a little bit easier over the COVID impact. And so we're up against that and comping there as well. But generally speaking, we feel like the level of execution, what we're seeing happening with our clients apart from those who were a little bit larger than we're able to renew is still quite consistent with what we were seeing a year ago.

**Nehal Sushil Chokshi Northland Capital Markets, Research Division - MD & Senior Research Analyst**

Okay. And my last question is, can you explain to me what you guys mean by deeper snow?

**Paul S. Walker Franklin Covey Co. - President & CEO**

So in Utah -- it sounds a little funny. It's been snowing like crazy in Utah. So we were trying to think of what would be a good metaphor that -- so if a year ago -- and by the way, a year ago, it wasn't like the economy was all roses either. We're starting to be some signs and there were starting to be some concern and maybe a little bit of pullback.

But we're seeing -- we see a little more of that now from our clients where if there was not a lot of snow on the ground a year ago, there is a bit more snow on the ground. And while the same unit of effort doesn't yield the same mild hikes per day for some of our clients. And so as they're facing a little bit more headwind and a little bit deeper snow on their end, that does have some spillover back into us. And I think we saw that with those clients who while about the same percent they don't renew in a typical quarter, some of them are a little bit larger reflective of that, more headwinds for them or deeper snow for them.

**Operator**

Our next question comes from Jeff Martin with ROTH MKM.

**Jeffrey Michael Martin ROTH MKM Partners, LLC, Research Division - Co-Director of Research & Senior Research Analyst**

Thanks for all the details, very helpful. Steve and Paul, I wanted to dive into the industry mix a little bit, and ask if you're seeing any particular trends by some of your larger industry categories, manufacturing, financial services, government, tech -- in terms of client renewals, is there a pattern from within the larger pieces of the pie even though none of them is overwhelmingly large.

**Paul S. Walker Franklin Covey Co. - President & CEO**

Yes. That's a great question. Maybe I'll ask -- I'll have -- I'll just make a quick comment and then have Jen Colosimo speak to that specifically. But in short answer, it's not a -- doesn't vary much by industry. But Jen, I know your team has been kind of really digging into that. Any thoughts you have?

Jen, might be trying to come off mute.

**Jennifer C. Colosimo Franklin Covey Co. - President of Enterprise Division**

I came off mute. There you go. Thanks for the question, Jeff. The simplest way to answer that is no. We are not seeing a trend by industry. The best way I could explain it is based on the challenges that we address with our clients, particularly as you think about leadership culture, executing on strategy, many of our clients are reinvesting in that, even if they may be having a smaller workforce -- even if they have a smaller workforce, they're reinvesting with those that remain. So as we look at it, as you might expect in this economy, decision-making often moves up. In my case, now making a case to Steve Young, you have -- you need to make more of an economic case, and we have clients that are making that economic case. And we have some that it is delaying decision-making.

And so it's frankly just an uncertain environment where many of the things that Paul said. We have all of these great things happening. And in fact, the same percentage renewing and to your question, even within industry, it's just that we had a few that were larger revenue amounts that did not, and we hope to win them back but there just isn't an industry trend.

**Paul S. Walker Franklin Covey Co. - President & CEO**

Yes, Jeff, good to hear -- yes, Jeff, maybe we did report that government was down (inaudible) results in North America down just a little bit in the quarter. I think that has been a slightly softer, but I don't expect that's a long-term trend. It's just kind of a due to one particular client actually one agency. So that would just be one thing to note.

**Jeffrey Michael Martin ROTH MKM Partners, LLC, Research Division - Co-Director of Research & Senior Research Analyst**

Okay. And then I was intrigued by your wording where clients were "not able to renew rather than chose not to renew", is there something in particular that stands out and led you to phrase the statement that way?

**Paul S. Walker Franklin Covey Co. - President & CEO**

No. Trying to remember where I said that...

**Jeffrey Michael Martin ROTH MKM Partners, LLC, Research Division - Co-Director of Research & Senior Research Analyst**

Okay. Well, let me just ask a second part to that question. It's noticeable that your unbilled deferred revenue growth far outsized your deferred subscription billed in the quarter. And that suggests that the longer-term contracts are overwhelmingly outpacing the shorter-term contracts.

That to me says your more loyal, higher-value clients are renewing at multiyear and past expansion levels relative to maybe some of the shorter-term clients. Maybe you could comment with respect to some of the shorter-term clients? And are those traditionally your more valued clients? Or is there much of a difference between those that purchase longer-term subscriptions?

**Paul S. Walker Franklin Covey Co. - President & CEO**

Yes. Yes. So great, I think maybe they're not able to renew. We have a -- oftentimes when clients -- clients are very committed to us and very committed to what they're trying to achieve. And oftentimes, that discussion is like the one -- I shared the example of the one that was -- that did not renew in the fourth quarter and came back and renewed.

Oftentimes, if you were in those discussions, you'd hear the clients, they say, hey, we're just -- we're not able to do this for this reason at this moment, but we're -- that's not going to the long-term permanent stay here. So they are just sometimes where the environment for the client, and that's not just a Q2 thing that happens.

Every company goes into -- or not every company, but it's not uncommon for a company to go through a period where things get more

difficult for them. And so it usually is, hey, we're not able to do this at this point, not a, hey, we're leaving you guys forever kind of things, maybe that color my language a little bit. But to your question, we've been really pleased for a number of years now at the continued steady growth in those clients who want to enter into multiyear contracts.

We've reported on past calls that typically, it will be upon the renewal of their first year or even their second or the third year where they'll step across and add multiple years. But it's usually in that -- after year 1 going into year 2. And I think that's happening because of the nature of the problems that we're solving. We're dealing with the kinds of issues and challenges and topics that are important and don't get solved in 1 quarter or even in 12 months. To change the entire culture or change the level of productivity of an entire team or department is a longer-term kind of thing.

And so I think we see that in clients generally deciding to make the commitment to multiyear more and more, and we certainly saw that in the second quarter. And so yes, where you do see your -- to the extent that there is greater churn, you see that with those clients after their first year. And then as those cohorts become more and more established, it's like laying down road base where you get these very mature cohorts that now have very little churn or very little transition 8 years later that have been there all those years.

And so the most noise and the most chop is actually on the -- those that are coming out of their first year as we're still getting to know them and work with them and then oftentimes, they'll go multiyear.

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**Jeffrey Michael Martin ROTH MKM Partners, LLC, Research Division - Co-Director of Research & Senior Research Analyst**

Great. And then I know in the past couple of quarters, you've talked about revenue growth acceleration. Obviously, in the current environment, that's going to take a bit of a pause. Just maybe give us a sense of your degree of confidence if it's -- if it shifted or if it's changed at all relative to some of the targets that you've previously outlined in getting to the mid-teens and ultimately upper teens revenue growth once the economy kind of is back in stable growth mode?

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**Paul S. Walker Franklin Covey Co. - President & CEO**

Yes. Great. So maybe first point, that's slightly related but not exactly, the answer to that is that we've built a business model that generates significant increases in adjusted EBITDA and cash flow, independent of whether -- when and whether we get to the mid-teens and then all the way to the high teens. So there's -- it's a business model that continues to be what you've always recognize it to be, which is a great business model.

To your specific question related to growth rates, we also have this powerful -- these 2 powerful subscription engines that have been driving more and more growth, faster and faster growth. And it's absolutely still our view that this is a business that's on its way to low teens, mid-teens and then eventually high teens, like we've said. The current environment means that the timing of when we get there might be a little bit more elongated.

But we still -- we're still very excited and pleased with what we're seeing in the way the subscription businesses are behaving in both divisions. As I think you alluded to it, Jeff. I think there's a bit of timing thing there given kind of the current economic environment that might slow slightly pace at which we move to low, mid and then high, but I suspect -- strongly suspect that's where we're headed.

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**Operator**

Our next question comes from Dave Storms with Stonegate.

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**David Joseph Storms Stonegate Capital Markets, Inc., Research Division - Director of Research**

Perfect. My first question is coming from Slide 16. Paul, you had mentioned the deeper snow that a lot of your clients are seeing. Would we expect that average annual client spend to be greater than the \$77,000 going forward still? Or will that number come down as clients pare back the scope of what they're asking from you guys?

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**Paul S. Walker Franklin Covey Co. - President & CEO**

Yes. Great question. I think -- so that has a number -- that is a number, and we went into quite a bit of detail last quarter on this that has increased quite significantly over the years. And we would -- I think we would expect that number to continue to increase. And the

reasons for that are, one, as we mentioned a minute ago, even in the second quarter, more clients expanded, more clients added multiyear. We still -- even on the tougher comp, we still grew services over the prior year.

So I think all those things point to clients deepening their relationship with us, expanding our whole model is built, as you know, to land and expand. And I think another vector on that is just the relatively still low client penetration rate that we have as great as we're doing and as much expansion has occurred to that number of \$77,000, it wasn't that long ago that it was in the \$40,000s. And so as much as that has grown, there's still a tremendous amount of headroom even in the clients we have today, where we're still just addressing roughly 10% of the addressable population.

So I think we saw that expansion in the second quarter. We have a lot of headroom to grow and would expect that, that will continue to inch its way up.

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**David Joseph Storms Stonegate Capital Markets, Inc., Research Division - Director of Research**

That's very helpful. My second question and Steve touched on this, but with operating SG&A steadily growing slower than revenue, which is a great sign. Is there anything specific to highlight what's driving this? Or is that just more product of economies of scales and general increased efficiencies?

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**Stephen D. Young Franklin Covey Co. - CFO & Corporate Secretary**

I think there are efficiencies we hope in many places in the company, but that decrease can be driven significantly by the fact that a lot of our costs are either fixed cost or grow at a rate slower than our revenue growth and expected revenue growth. So areas that are not client facing, like central overhead, all of those types of costs, we expect to grow at a rate lower -- slower than revenue for quite some time.

So we would expect to have our client-facing costs in SG&A grow at a rate pretty similar to our revenue growth as we support that -- as we support the growth and look for accelerating growth that Paul just talked about. But again, a lot of the back-end operations, we believe, are able to grow at a slower rate, and that will increase the -- that will decrease the percentage of SG&A versus revenue as time goes on.

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**David Joseph Storms Stonegate Capital Markets, Inc., Research Division - Director of Research**

That's very helpful. One more for me if I could go ahead.

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**Stephen D. Young Franklin Covey Co. - CFO & Corporate Secretary**

No, in fact, I would say that as we go -- as our adjusted EBITDA, we expect to grow up into the targets that we've talked about in future years that growth is primarily the relationship of the fixed cost to revenue.

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**Paul S. Walker Franklin Covey Co. - President & CEO**

I think what you're also seeing, Dave, in here is that our cost to acquire a customer is actually not only less than the lifetime value of that customer, but even less than the first year value of that customer. And so as we're acquiring more customers, that revenue is growing faster than the cost to even acquire them. So, I think, the combination of all those factors is -- maybe back to Nehal's question is why also while revenue could be at one level and adjusted EBITDA can still be growing at the levels that we originally projected for the year end in the future.

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**David Joseph Storms Stonegate Capital Markets, Inc., Research Division - Director of Research**

So really, it's just a hotchpotch strong execution. That's great. Okay. One more, if I could. I know, Paul, you mentioned that your space now bringing on new client partners throughout the year. So it's not as backloaded. Have you guys discussed or would you be wanting to give us a target on what new -- number of new client partners would look like by the end of the year?

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**Paul S. Walker Franklin Covey Co. - President & CEO**

So we don't -- I don't have a number for you today. We were still -- we've got -- as you know, we've bulked up the number of recruiters a year ago so that we could get more -- we could be more on top of hiring and hiring more people. We've made meaningful adds to our sales enablement capability to our management structure to support more client partners. So over time, we've gone from adding 10 a

year to 20 a year to 30 a year.

We're expecting to continue to grow that. I don't know exactly what the number will be at year-end. But consistent with what we've said in the past, we're going to -- we'll add a significant number of client partners between now and the end of the year and into next fiscal year as well. We think in this environment that there's an opportunity to get really great salespeople.

We're doing well. We're making investments in our business. We think that we can attract and win some really good talent. We want to make sure we get the best talent. And then once we get that best talent, we want to make sure that our system of supporting and ramping them gives them the very, very best chance of being really successful here and just want to match that up as well as we can over the next -- the back half of this year, and that might extend a little bit into the first part of next year as well.

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#### **Operator**

Our next question comes from Samir Patel with Askeladden Capital Management.

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#### **Samir Patel Askeladden Capital Management LLC - Founder & Portfolio Manager**

I wanted to ask a little bit about the new credit facility, \$70 million is a pretty big amount, especially when combined with the cash on your balance sheet. Your largest acquisition to date, I think, was Strive, which wasn't really that big compared to that facility. So I was wondering, Paul, if you could just dive a little bit deeper into how you think about capital allocation over the next few years, whether that facility is just sort of there is a nice to have in case or if there's actually something you kind of tend to use it for?

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#### **Paul S. Walker Franklin Covey Co. - President & CEO**

Yes. Samir, good to hear from you. So first of all, a big thanks to Derek Hatch for getting all of that put in place. We didn't just go for an increase in our credit facility to have -- we're expected to generate a lot of cash, as you know, and weren't just looking for a larger credit facility just to have the comfort of having a larger credit facility. We think that there's an opportunity in this environment to be potentially more acquisitive.

And of course, we have a great organic growth story and strategy, I believe, a lot of the other numbers we're talking about that we believe we can achieve would -- we don't think really require a lot of M&A. And at the same time, there could be some opportunities to do some things that could be exciting and could really be accelerants to what we're doing. And so we wanted to get ready so that if things are in place if and when we were to find and discuss some things like that.

And then we also -- we're grateful to our Board that we were able to replenish our authorization to repurchase shares. And we've done a decent amount of that over the last 4 quarters as well and would expect that we would continue to use our cash wisely for that, for M&A and also just to fund operations to make sure we're making all the best decisions possible to grow revenue. So nothing to share with you today other than we're glad we have that in place. And hopefully have more to talk about the future.

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#### **Samir Patel Askeladden Capital Management LLC - Founder & Portfolio Manager**

Okay. And then I don't think -- I'm sure you're going to disclose it in a filing, but Steve, do you have the spread of SOFR on that facility?

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#### **Derek Hatch Franklin Covey Co. - Corporate Controller of Central Services - Finance**

Those will be on our 8-K tomorrow.

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#### **Stephen D. Young Franklin Covey Co. - CFO & Corporate Secretary**

Yes. The 8-K is coming out tomorrow on that. It's a varying amount depending on some of the covenants. But it's like -- we're going to be like the 175 bps, 185 bps. It's like we start out a SOFR plus 150 bps, that's where we anticipate being. And then it goes based on our leverage ratio, it will go up from there, like SOFR plus 175 bps to SOFR [plus 2]. But -- we will start at SOFR plus 150 bps.

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#### **Samir Patel Askeladden Capital Management LLC - Founder & Portfolio Manager**

Okay. That makes sense. And Paul, going back to the M&A comment. I mean, how do you think about sort of financial guardrails that you're going to spend that much capital on M&A, right? I think you guys have talked about this, but if you run a DCF on your stock, it

should be worth [\$1,800] or something like that. Obviously, there's a tremendous amount of accretion to be had just by buying back your stock.

I kind of understand the rationale or doing strategic deals like Strive. But just going back to the size of that credit facility kind of relative to the size of acquisitions you've made, I mean, that just seems like a lot of money, right? Like, I'm just curious how you think about sort of the returns from like what your hurdle rates are, how you think about the financial aspect of M&A?

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**Paul S. Walker *Franklin Covey Co. - President & CEO***

Yes. Yes, great question. So yes, sorry it's my earlier response of not trying to leave the impression that we're going to go out and do some major multi-hundreds of millions of dollars, acquisition or anything like that. I think more likely, you would see us do things that are more consistent with what we've done with Strive and others where we're adding an important piece of capability to our clients or maybe adding some content here or there. Even to add content, we don't necessarily need to acquire we can license a lot of that.

And so -- I think having access to that additional liquidity, we think is a good thing. We were able to get that, we don't necessarily intend to use all of that.

It gives us the maximum amount of flexibility to do -- to pursue any number of different avenues that we think would be valuable to our shareholders. It could be in the form of some tuck-in M&A or strategic M&A and it could also be in the form of expanded share repurchases in the quarters ahead. But I don't think we -- yes, I don't think we're intending to go out and lever up or do anything significant.

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**Samir Patel *Askeladden Capital Management LLC - Founder & Portfolio Manager***

That makes sense. And I know the details are going to come out tomorrow, but I just -- I know one of your previous facilities had some restrictions on returning capital to shareholders. I'm just going to assume given that you just authorized \$50 million put that in place that it's probably -- that at the current time you would see that facility having any restrictions as long as you stay with them the kind of EBITDA covenants and things like that?

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**Derek Hatch *Franklin Covey Co. - Corporate Controller of Central Services - Finance***

Yes. This particular -- one of the things -- that was one of the things. With our old covenants, we could actually break the covenants by purchasing shares of stock with \$50 million of cash in the bank. And so one of the things that we were going out to negotiate a new deal is we wanted some flexibility to be able to use our capital without breaking covenants. So this particular -- you're right.

This particular credit agreement does have some restrictions on distributions that you'll see. However, it has a great amount of flexibility as long as our leverage ratio is below 2.0 to 1. We don't have to count purchases of treasury stock as part of our distributions in that distribution. And we don't anticipate our leverage ratio getting above 2.0. So again there is a huge amount of flexibility to buy shares as we see fit without breaking our debt covenants.

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**Stephen D. Young *Franklin Covey Co. - CFO & Corporate Secretary***

So Samir, you're always very prospective. So the answer is yes. The last agreement -- as you know, we're able to buy a lot of shares under that agreement. And this agreement is -- gives us more flexibility to acquire larger amounts.

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**Operator**

And this concludes the Q&A session. I'd now like to turn the call back over to Paul for any closing remarks.

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**Paul S. Walker *Franklin Covey Co. - President & CEO***

Well, thank you, and thanks, everybody, for your time today. We appreciate you. Thanks for tuning in. Thanks for your great questions, and we look forward to talking to you again soon. Have a good evening.

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**Operator**

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

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