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Q1 2024 Franklin Covey Co Earnings Call

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## PRESENTATION

### Operator

Hello, and thank you for standing by. Welcome to Franklin Covey Q1 2024 Earnings Conference Call. (Operator Instructions) I would now like to hand the conference over to Derek Hatch. Sir, you may begin.

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

Thank you. Hello, everyone. On behalf of Franklin Covey, I would like to wish everyone a happy new year and hopes for a peaceful and prosperous 2024.

Before we begin today's call festivities, I would 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 grow revenues, the acceptance of and renewal rates for our subscription offerings, including the All Access Pass and Leader in Me memberships, the ability of the company to hire productive sales and other client-facing 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 products, changes in 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 the company's actual future performance will meet management's expectations. These forward-looking statements are based on management's current expectations, and 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 CEO and President.

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

Thank you, Derek. Hello, everyone. Happy new year. Thanks for joining us today. We're glad to have the opportunity to talk to you, and we just want to start out by expressing our appreciation to you, and we're grateful to be with you today.

Joining me on the call are Steve Young, our CFO; Jennifer Colosimo, President of the Enterprise Division; Sean Covey, President of the Education Division, as well as other members of our executive team.

We're pleased that though the results in the first quarter were essentially even with last year's first quarter, both revenue and adjusted EBITDA came in stronger than forecasted. Even though we also expect the second quarter revenue to again be about even with or

slightly above prior year, we expect to achieve a significant growth in revenue in the back half of the year with a high flow-through of this revenue driving growth in adjusted EBITDA, to our target of between \$54.5 million and \$58 million.

We expect this growth in the back half to be driven by several key factors, including the following: first, that we're entering the back half of the year with a lot more billed and unbilled deferred revenue on our balance sheet than a year before. At the end of the first quarter, the sum of our billed and unbilled deferred revenue was \$169.7 million, a level \$18 million higher than at the same time last year. A meaningful portion of this will flow through into revenue in the back half of fiscal '24 and into fiscal '25.

Second is that our invoiced subscription revenue is increasing. After flattish All Access Pass invoice subscription growth in the second and third quarters last year, which as I remind you, was flattish on top of significant double-digit growth the prior year, our invoiced All Access Pass subscription revenue grew significantly in the fourth quarter and again in Q1 this year. We expect this growth will continue in Q2 and for the remainder of this year and beyond, resulting in additional amounts of deferred revenue going on to the balance sheet and flowing through to revenue in fiscal '24 and beyond.

Third is that we expect our subscription services attach rate to improve. We expect our subscription services attach rate, which declined from 66.5% to 61.5% in the back half of last year and through the first quarter of this year, we expect that it will return to its historic rate of around 66.5% in Q3 and Q4 of this year, driven by a combination of services delivered to new schools that were brought on late in last year's fourth quarter and by the impact of the launch of the 3.0 and 5.0 versions of the Speed of Trust and 7 Habits, 2 of our historic blockbuster solutions, as well as the launch of our new solution on difficult conversations.

I'd like to now provide a little bit of additional context about the first quarter itself. As shown on Slide 4, our total revenue for the quarter came in at a higher-than-expected \$68.4 million. Revenue for the latest 12 months grew \$8.6 million or 3% to \$279.6 million, and our rolling 2-year growth is a very strong \$42.4 million or 18%.

Adjusted EBITDA also came in at a higher-than-expected \$11 million. With this, adjusted EBITDA for the latest 12 months through this year's first quarter grew \$3.8 million or 9% to \$47.6 million. And again, our rolling 2-year growth in adjusted EBITDA is \$13.4 million or 39%.

Our subscription and subscription services sales in the first quarter reached \$54.8 million, a level 4% higher than prior year. Subscription and subscription services sales were \$224.7 million for the latest 12 months ended Q1, which is \$13.6 million or 6% higher than the same period of the prior year. And again, our rolling 2-year growth was an extraordinarily strong \$56.7 million or 34%. And finally, our balance of billed and unbilled deferred revenue increased \$18 million or 12%, to \$169.7 million from the end of the first quarter last year, and grew \$48.5 million or 40% over the last 2-year period.

Stepping up a level. Our results in the first quarter put an exclamation point on 3 key strengths we've been building for years. As you can see shown on Slide 5, the first of these is the strength of our unique strategic position in the marketplace. We focus on the most important, strategic and durable position in our space, specifically that of helping organizations achieve results that require the collective action of their people. And we help organizations achieve these results with a combination of best-in-class content delivered through a broad range of delivery modalities, and world-class coaching and facilitation that's very difficult to replicate.

The most important thing on the minds and priority list of CEOs is achieving the type of results that require the collective action of their entire organization. It's the point I'd like to come back to in just a minute.

Our second key strength, as you can see shown there on the slide, is the power of our revenue-generating engine. As previously noted, despite being up against some extremely strong post-pandemic accelerated comps over the past 4 quarters, which have impacted our reported year-over-year percentage growth in those quarters, the continued strength of our underlying revenue generating engine is reflected in the following 4 key metrics: first, growth in revenue on a rolling 2-year basis, again, to normalize; second, growth of revenue compared to our pre-pandemic high; third, growth of our strategically important subscription and subscription services revenue; and fourth, growth in our balances of deferred subscription revenue, both billed and unbilled.

The third key strength is that of our powerful business model, a model where a combination of increasing revenue per client, high revenue and client retention, high contribution margins, upfront invoicing, low capital intensity, and disciplined reinvestment for growth, all combined to drive significant growth in both adjusted EBITDA and free cash.

I'd like to address each of these 3 key strengths in just a bit more detail and with some data.

First is shown on Slide 6, the strength of our strategic position. As I just noted, the most important strategic and durable position in our space is that of helping organizations achieve the kind of seismic results that can result from mobilizing the large-scale collective action of their people. Why is this so strategically powerful? Because almost all of the key strategic and operational results on which CEOs are focused, require just that kind of collective action.

As shown on Slide 7, each year, the conference board, the advisory board, McKinsey and others conduct surveys to identify the most important things on CEO's minds and priority lists. Excluding macroeconomic and geopolitical issues, the vast majority of CEO's top priorities are those areas that require the collective action of the entire organization. I'd like to give you just 3 examples of this where we're working with clients to support them today.

The first is we're working with the CEO of a large and rapidly growing manufacturing company to develop their top 500 global leaders. They're partnering with us to help them build a high trust and agile culture that can support the rapid growth they've achieved in which they expect to continue to achieve in the future. They recognize that culture is established by the collective behavior of leaders, and they've chosen Franklin Covey as their sole leadership development partner. They've done this in large part due to the impact of our powerful principle-based content, its direct relevance to building the type of winning culture they desire and our ability to scale our solutions across their global population.

A second example is where we're partnering with the Chief Human Resource Officer of a large 100,000-person firm to deploy multiple Franklin Covey solutions across the entire organization. They've chosen us as their partner because of the powerful way in which our content shifts mindsets and behaviors versus simply teaching people to check off to dos from a checklist. They want us to develop with our help, common mindset, skill sets and a consistent language across the entire organization, or what we refer to as collective action, and we're their partner in doing this.

And the third example is where we're partnering with a large transportation company that has a very clear strategy for winning in their chosen market. However, like so many organizations, they've had a difficult time translating that strategy from the boardroom to the actions of those in the front line of the organization. This client is engaging us to equip their leaders with the skills and tools to create a culture of execution where people at the front line are engaged to execute the critical priorities that will translate strategy into results.

As shown on Slide 8, being our clients' partner of choice for addressing opportunities and challenges like those just noted, translates into a number of powerful outcomes for Franklin Covey, including consistently winning new logos or new clients, achieving a strong attachment of subscription services to help clients achieve performance breakthroughs, retaining substantially all of our subscription revenue, increasing our average contract size, increasing the percentage of logos and revenue under multiyear contracts and achieving a high and growing lifetime customer value.

For the latest 12-month period through this year's first quarter, we're really pleased to have continued to achieve strong results on each of these key outcomes. In the sales of All Access Pass to new logos in the Enterprise Division and Leader in Me subscriptions to new schools in the Education Division remained strong in the first quarter and for the latest 12-month period.

Our revenue retention levels remained very high in the first quarter and for the latest 12 months. In the Enterprise Division in North America, in the first quarter, we achieved All Access Pass subscription revenue retention levels greater than 90%, and in the Education Division, we continue to achieve high levels of school retention.

An increasing percentage of clients are also entering into multiyear contracts, as you can see, shown on Slide 9, the percentage of clients, All Access Pass clients entering into multiyear contracts increased even further from its already high levels. In the first quarter,

54% of All Access Pass clients entered into multiyear contracts of at least 2 years, up from 48% at the end of Q1 fiscal '23.

Importantly, an even higher 60% of All Access Pass subscription revenue is now under multiyear contracts of at least 2 years, up from 55% at the end of the first quarter last year. Our clients commit to these multiyear agreements because of the importance and the ongoing nature of the opportunities and challenges they face that require the collective action of their people, and because of the value they're receiving from a long-term partnership with Franklin Covey. These long-term contracts provide a tremendous foundation for both the predictability and acceleration of future revenue growth.

As shown on Slide 10, the second key strength I'd like to focus on today is the power of our revenue-generating engine. As noted, the strength of our underlying revenue generating engine is reflected in 4 key metrics, which we've summarized on Slide 11.

First, the tremendous growth in revenue achieved over the past 2 years. This 2-year look helped to normalize for periods which benefited from comping to pandemic-impacted quarters. As shown over the past 2 years, our latest 12 months revenue has grown a very strong \$42.4 million or 18%.

Second is the significant growth of our revenue compared to our pre-pandemic high, our latest 12 months revenue through this year's first quarter increased to \$279.6 million, which represents growth of \$54.2 million or 24% compared to our pre-pandemic high in fiscal 2019.

Third is the even more rapid growth of our strategically important subscription and subscription services revenue. For the latest 12-month period through this year's first quarter, our subscription and subscription services revenue grew \$13.6 million or 6%. And importantly, our 2-year growth was \$56.7 million or 34%, and subscription and subscription services growth remarkably is more than \$100 million or 81% compared to our pre-pandemic high.

And fourth is the tremendous growth in our balances of deferred subscription revenue, both billed and unbilled. In this year's first quarter, our balance of deferred subscription revenue, billed and unbilled, increased to \$169.7 million, reflecting year-over-year growth of \$18 million or 12%. Our 2-year growth of \$48.5 million was 40%, and our balance of deferred subscription revenue, billed and unbilled, has grown by \$81.5 million or 92.5% compared to our pre-pandemic level. This dramatic growth in deferred subscription revenue on both a dollar and percentage basis establishes a very strong foundation for continued strong revenue growth in the coming quarters and years.

And finally, the third point, you can see as shown on Slide 12, the third key strength is the strength of our business model. As you know, our business model results in a significant portion of incremental revenue flowing through to increases in adjusted EBITDA and free cash flow.

I'd like to briefly review the key elements of our business model that drives this. As shown on Slide 13, these factors include increasing revenue per client, high revenue retention, high contribution margins, upfront invoicing, low capital intensity and disciplined reinvestment for growth. I'll briefly touch on each of these drivers to show how their interplay drives high and increasing adjusted EBITDA and cash flow.

First, as it relates to increasing revenue per client. As shown on Slide 14, our revenue per All Access Pass client has grown from \$54,000 in fiscal 2018, to more than \$83,000 in fiscal '23, compounded growth of 9%. This strong increase in average revenue per client results from a combination of continuing to increase the percent of total populations through which we serve inside a typical client, and the pricing power we gain as a result of the impact our solutions provide to our clients.

The second point is our high revenue retention and client retention. In the Enterprise Division in North America, in Q1, All Access Pass subscription revenue, as I mentioned, exceeded 90%. In the Education Division, as we reported at the end of Q4 fiscal '23, Leader in Me retention remains at a remarkably high level of greater than 85%.

The third key element of our business model is our increasing adjusted EBITDA margins. As shown in Slide 15, the combination of strong

gross margins and declining operating SG&A as a percent of sales has resulted in steadily increasing adjusted EBITDA margins, reaching 17% for the latest 12-month period.

Fourth is our upfront invoicing. With upfront invoicing, working capital is actually a source of cash for us. Subscription contracts are built at the start of the contract term, and cash is collected long before the subscription contract's full revenue is realized. Multiyear contracts are generally billed one year in advance and are noncancelable, and the timing of collections and cash outflows is a durable aspect of our business model.

Fifth is our low capital intensity. Historically, as you know, our CapEx spending is a small percentage of our overall revenue and is primarily related to technology infrastructure and a small amount for real estate improvements.

And finally, the sixth key element of our business model is disciplined reinvestment for growth. Our largest growth investments are in our sales force in order to capture our vast underpenetrated addressable market, all of which, by the way, is fully funded through our P&L, and investments in content and innovations, which is amortized and flows through the P&L in the form of cost of goods sold. We managed sales costs to grow about in line with revenue over time, offsetting wage inflation with pricing.

As a result of this business model, we've generated significant growth in adjusted EBITDA and free cash flow. In fact, as shown on Slide 16, in the 8 years since the beginning of our conversion to subscription in fiscal 2016, through this year's first quarter, we've generated cumulative adjusted EBITDA of \$210.6 million and cumulative free cash flow of \$204.3 million.

As also shown on Slide 16, we've invested approximately \$32.7 million of this free cash flow for tuck-in acquisitions such as Jhana and Strive, which have broadened our ability to deliver our solutions flexibly and at scale and have returned a substantial amount of the remaining free cash flow to shareholders.

Specifically, during this 8-year period, we've returned more than \$143.5 million or just over 70% of the free cash flow we generated. We've returned this to shareholders through the repurchase of more than 5.3 million shares of common stock, including more than \$51 million over the past 12 months and \$72 million over the past 24 months.

Importantly, this is on top of the \$102.9 million we utilized to purchase shares prior to fiscal 2016. In total, since 2002, we've invested more than \$246 million in purchasing shares and reduced the company's net share count outstanding, net of stock-based compensation by more than 14.1 million shares. This reduction in shares is more than the number of shares we currently have outstanding today. These shares have been purchased at a weighted average price per share of \$17.43. We're really pleased that so many of you have been purchasing shares right along with the company and have achieved similarly attractive returns.

As we noted in last quarter's report, we expect to achieve continued growth in adjusted EBITDA and free cash flow in the years to come. In fact, in the coming years alone, we expect to generate in the neighborhood of approximately an additional \$150 million of free cash flow. After making our normal ongoing growth investments in the business, we would expect to be able to return substantial portions of this cash flow in continued stock repurchases.

Why do we have such high conviction in repurchasing our stock, something we know is shared by many of you as well. Two simple reasons. First, because we have high confidence in the market opportunity before us and our ability to execute it. And second, because we believe repurchasing our stock even at significantly higher than current prices has a very compelling investment thesis. That being first that we believe that we are and would be purchasing shares at a significant discount relative to the net present value of our expected cash flows.

As just noted, we believe that both our recent purchases and our purchases over the years reflect this. And because we believe that a much smaller than typical percent of the net present value of our company's cash flows is attributable to reliance on the residual exit value of these cash flows. Because, one, purchasing shares at or near our current market cap provides a high free cash flow yield, and we expect free cash flow to grow substantially in the coming years. The combination of these factors gives us confidence in investing excess cash flow in the business and in share repurchases can generate significant additional value for shareholders in the coming years.

In conclusion, I would just say that we expect the combined power of these 3 key strengths: the strength of our strategic position, the strength of our revenue-generating engine and the strength of our business model to continue to generate strong and accelerating growth in revenue, adjusted EBITDA and free cash flow. And specifically, as noted previously, we believe that the combination of having a lot more billed and unbilled revenue on our balance sheet than ever before, achieving accelerated growth in our subscription revenue and returning our subscription services attach rate to its historic average will result in adjusted EBITDA increasing to between \$54.5 million and \$58 million in fiscal '24.

I'd now like to turn some time over to Steve to discuss our results for the first quarter and the latest 12 months in a bit more detail, and Steve will also review our guidance. Steve?

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

Thank you, Paul. Good afternoon, everyone. It's a pleasure to be with you today. I would like to briefly provide more detail on the factors underlying this performance, focusing on the results in 3 key areas of the company, specifically our Enterprise business in North America. The Enterprise business internationally in both our direct offices and licensees and our Education business which is also primarily in North America.

As shown on Slide 17, results in our Enterprise business in North America continued to be strong in the first quarter and the latest 12-month periods. Reported sales in North America, which account for 43% of total Enterprise Division sales were \$38.4 million in the first quarter, a level almost equal to the prior year, and this on top of a strong 16% growth achieved in the first quarter of FY '23.

For the latest 12 months, revenue grew 2%, on top of 17% growth in the prior year. And we are pleased with the results we have achieved in the Enterprise business in North America over the past 2 years. We expect the beginning in Q3 of FY '24, our year-over-year comparisons will normalize.

Subscription and subscription services sales in North America or even with prior year in the quarter, on top of the 20% growth achieved in last year's first quarter. For the latest 12 months, growth was 4% on top of 24% in the prior year, and we're pleased with these growth rates.

Our balance of deferred revenue billed and unbilled in North America continued to be strong, growing 7% in the quarter on top of 25% in last year's first quarter, establishing, as Paul said, a strong foundation for next year's growth. And the percentage of North America's All Access Pass clients that were for multiyear periods, increased to 54% from 48% in the first quarter last year, and the percentage of invoice sales represented by multiyear contracts increased to 60% from 55% in the first quarter last year.

As shown on Slide 18, revenue from our international operations which account for approximately 17% of our total Enterprise Division revenue, decreased by \$0.6 million or 7% in the quarter primarily due to declining Legacy, which is non-All Access Pass-related sales. Sales in these offices have grown 4% or \$1.3 million in the latest 12 months.

Also on Slide 18, our international licensee partner sales increased 3% in the quarter on top of 9% in last year's first quarter, and for the latest 12 months, sales were up 8% on top of the 15% in the prior year.

Finally, as shown on Slide 19, the results in our Education business, which accounts for approximately 25% of the total company sales, grew 3% for the quarter on top of the 23% growth achieved in the first quarter last year. Sales grew 9% for the latest 12 months on top of 21% latest 12-month growth in the previous year.

Education subscription and subscription services sales were flat in the quarter but strong in the latest 12 months, growing \$4.6 million or 8% on top of \$11.8 million or 25% last year. Education's balance of deferred subscription revenue billed and unbilled increased 29% in the quarter.

Now just a little bit more about the Education Division. As you recall, not many years ago, the Education Division was small and had a



traditional service and materials business model. We are pleased that as shown on Slide 20, since the launch of the Leader in Me subscription in Education Division, revenue has grown substantially from just over \$3 million in its first year to more than \$70 million over the latest 12 months. And the business model has transformed to closely mirror that of Enterprise, with approximately 90% of Education revenue now represented by subscription and subscription services revenue, a level that is very similar to that of Enterprise Division. We also expect that after years of accelerated investment, the Education Division's adjusted EBITDA margins will also expand in FY '24 and beyond.

Now a little bit more about cash flows and balance sheet. As shown on Slide 21, our cash flows from operating activities was \$17.4 million at the end of the first quarter compared to \$3 million in Q1 last year. Our free cash flow in the first quarter increased to \$13.7 million compared with \$0.8 million for the prior year, reflecting the changes in the elements of working capital were very favorable in Q1 this year compared to Q1 last year, particularly referring to accounts receivable, accounts payable, accrued liabilities and deferred revenue.

In Q1, we invested \$16.3 million to purchase 409,000 shares. Over the past 4 quarters, as Paul said, we've invested \$51 million to purchase shares. We ended the quarter still with \$96.5 million of total liquidity, including \$34 million in cash and \$62.5 million available under the revolving credit facility, even after investing this \$16.3 million in stock purchases this quarter.

Compared to Q1 of FY '23, the sum of billed and unbilled deferred subscription revenue increased 12% to almost \$170 million, giving us increased visibility into future sales results. The deferred subscription revenue increased 14% to \$87 million, while the unbilled deferred revenue increased 10% to \$82.5 million. Adjusted EBITDA in the quarter, as I said, was a strong \$11 million.

Now guidance. As you know, Franklin Covey's financial strategy is to consistently grow revenue and at the same time, experience a high flow-through of that increased revenue to increased adjusted EBITDA and free cash flow. Consistent with that strategy, we affirm our previously issued guidance for FY '24, that adjusted EBITDA will increase by approximately 17% at the midpoint of the range to between \$54.5 million and \$58 million, in constant currency, compared to the \$48.1 million achieved in FY '23.

This guidance reflects our expectation of achieving low double-digit net sales growth in the back half of the year, stable or improving world economic conditions, strengthening results in our international operations, particularly strong financial results in Q4 in our Education Division and increased subscription add-on services. This FY '24 guidance reflects our expectation that we will achieve particularly strong results in Q3 and Q4 of FY '24.

Our second quarter guidance is that adjusted EBITDA will be between \$6.2 million and \$7.2 million, strong but lower than last year's very strong adjusted EBITDA of \$8.2 million, particularly reflecting a lower services attach rate during the second quarter that is expected to increase during the third and fourth quarters.

In as much as we expect to achieve strong revenue and gross margin, the expectation that the second quarter's adjusted EBITDA performance will be slightly lower than last year is due primarily to our investment in growth this year and benefits in certain accruals last year, like accounts receivable provision. We expect our second quarter revenue to be at least even with or to increase slightly over the prior year and could be our highest second quarter revenue ever achieved.

As discussed, this guidance obviously reflects the fact that we expect net sales growth rate to accelerate significantly in Q3 and Q4, as I mentioned. While many economic and other factors could impact these expectations, we're excited about our future financial position. So back to Paul.

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

Thank you, Steve. Thanks for going through that. And again, we feel quite good about the first quarter and about what we see out ahead. And with that, we'd like to ask the operator to open up the line for your questions.

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## QUESTIONS AND ANSWERS



**Operator**

(Operator Instructions) Our first question comes from the line of Dave Storms with Stonegate.

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

Good afternoon. Happy new year, everyone.

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

Yes, you too. Thanks, Dave.

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

Appreciate it. So it looked like calendar year 2023 turned out to be the year without a recession, but just curious how you see clients reacting after a lot of aggressive belt-tightening in the majority of 2023? And if you see any additional bump in demand during calendar '24?

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

Yes, it's a great question. I would say it did turn out to be the year without a recession, it's interesting times for sure. I would say that what we're seeing right now has been pretty consistent for the last number of months in that our clients, they -- their budget, they have their budgets, they know their budgets, they're moving forward, they've got their plans. And we feel relatively good about the environment that we're selling into right now.

I think there's a -- feels like there's more certainty in the fact that clients do have budgets and are -- and do have plans they're moving forward with, which you recall we reported in Q2 last year, there was some of our clients that were a little bit more uncertain at that time, and that seems to have subsided for the most part. And I think behind all of that though, is the driver that in all times, particularly times that are may be uncertain or where there's -- where growth is more difficult for companies, they're looking for solutions like those that we provide, right?

Right now, people are very focused on, do I have the leadership capability inside my organization to execute what it is we're trying to execute? Is our culture such that we can attract and retain in a tighter labor market, the kind of talent we're going to need? Do we know how to engage people and can we, is our organization adaptable and change-ready and can it thrive? And so those types of challenges that are on the minds of CEOs and leaders inside our clients. And so we're fortunate to have the kinds of solutions to those problems. And I think that gives us confidence as we move forward here.

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

Understood. Very helpful. And then just one more, and this might be more for Sean. If I remember correctly, there was some funding that need to be renewed at the end of 2023 for the education business. Just wondering if we could get a quick status update on how that all shook out.

**Michael Sean Merrill Covey Franklin Covey Co. - President of Franklin Covey Education**

Yes. Can you -- I'm not exactly sure what funding you're referring to?

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

I believe it was the ESSER funding that you mentioned (inaudible).

**Michael Sean Merrill Covey Franklin Covey Co. - President of Franklin Covey Education**

Sure. Okay, sure. Yes. Well, the ESSER funding, which is the emergency relief funding the government gave out during COVID, that is -- that's been out since COVID began and it's been out and it goes until the end of this year. And about 2/3 of it has been spent. So about 1/3 is remaining. So there's still a lot of spending going on right now and will be for this year. We have a lot of our schools and districts that have signed up with multiyear contracts using some of this funding. But as we look to next year and when this funding runs out, we fall back on Title I and Title II grants, which had been there for decades and will remain -- and we also, as I shared before, we have a large foundation that's dedicated to starting up Leader in Me districts in schools. That's actually funding and helping schools get started

with millions of dollars, and there will be hundreds of schools that will be funded through them. So yes, so that's where that stands. Is that responsive to your question?

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

Absolutely, that's very helpful. I appreciate you shedding some light on that. Good luck in the next quarter.

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

Thanks, Dave.

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**Operator**

Our next question comes from the line of Nehal Chokshi with Northland Capital Markets.

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

Yes. Thank you for the question, and good to hear that you're seeing an inflection, I believe you talked about in, what was it, subscription invoice bookings, I think. But look, the key thing that I want to key on here is free cash flow. So in the quarter, you had a -- it looks like a pretty strong cash from operations, but I just want to make sure that how did that actually perform relative to the expectations at the prior earnings call that you had for this same quarter here, for the November quarter, I'm sorry.

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

You want to...

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

Yes. So Nehal, as you know, our free cash flow in the first quarter last year was a lot lower than it was this year. When -- during the first part, we did talk in prior quarters about the fact that we expected our free cash flow to rebound significantly and it did. And the areas where free cash flow improved was not only related to operations, but also in the working capital balances, accounts receivable, accounts payable, accrued liabilities and deferred revenue had a very positive change in this year's first quarter compared to last year's first quarter.

So we were very pleased with our free cash flow in the first quarter, and it was good, and it was even more than we expected because all of those working capital elements that impact cash flow at the end of Q1 were positive in our direction and all went positive quite a bit. So we thought it was a very good free cash flow quarter.

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

Okay. Great. That's helpful. And then fiscal 4Q was a poor free cash flow quarter. And so I believe that benefited your fiscal 1Q, but do you expect these working capital accounts to continue to tilt back favorably as we work through the remainder of fiscal year '24 and therefore, help us think about modeling free cash flow relative to your EBITDA guidance for fiscal year '24.

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

Yes. So we haven't really, as you know, given free cash flow guidance. The changes in the elements of working capital that were significant in Q1, we expect those changes to remain, but not necessarily change again at those same rates each quarter. We do expect to have a significant amount of additional key free cash flow this year compared to last year based upon the operations of the business, the cash that comes in from our subscription business and these elements of working capital behaving meaningfully. We expect to have a good free cash flow for the year.

Now Nehal, I'm sure you remember that last year, our second half of the year as we predicted through -- after Q2, was significantly more than Qs 1 and 2. And we wouldn't expect that amount of increase in the second half of this year compared to the first half, because the first half is going to be a good free cash flow half. But overall, it will be significantly safe in saying without giving an actual forecast that it will be significantly higher than last year.

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

Okay. I mean when I look at fiscal year '19 and fiscal year '22, your free cash flow has systemically been above your adjusted EBITDA. I think what you're trying to signal here while fiscal year '23 was a clear deviation from that fiscal year '19 to fiscal year '22 trend, do you expect an improvement from that fiscal year '23 level, but perhaps not quite to the free cash flow to EBITDA ratios that you're achieving in fiscal year '19 to fiscal year '22. Is that correct?

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

Yes. I think in our future years, we will reestablish a clear relationship between adjusted EBITDA and free cash flow that will generally be maintained. But yes, we would model out free cash flow to be a bit lower than adjusted EBITDA.

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

For fiscal year '24, specifically?

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

Yes.

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

Yes. And then how would you think about beyond fiscal year '24 then?

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

Again, I think and if you look at the elements of adjusted EBITDA versus the elements of free cash flow, will always be -- well, not always because of the elements of working capital move around. But the relationship between adjusted EBITDA and free cash flow will be that free cash flow will be modeled at a lower level than adjusted EBITDA.

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

Is that largely because you expect to be saturating on the percent of customers that are going to be paying upfront?

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

No. I think the percentage paying upfront will be maintained. It's more like if you just model it out, if you look at adjusted EBITDA and compared to adjusted -- compared to the amounts that are included in adjusted EBITDA compared to free cash flow, you have investment, CapEx and CAPD spending as an example.

So while the expense for CAPD, our CapEx is in depreciation. The expense for CAPD is in cost of sales, but has a delay to it. So an increase in our spending and the amount we're spending in CapEx and CAPD, our amounts that are on the income statement are below adjusted EBITDA. So those are the kind of things that just create the theoretical or mathematical difference between them.

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

Yes. Understood. Moving to a different topic, and then I'll let someone else speak. But why are you expecting the services attached to remain depressed in Q2? And then what will drive that improvement in Q3 and Q4?

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

Yes. Great question. So as far as what will drive the improvement in Q3 and Q4, as I mentioned earlier, primarily a couple of factors. One, the delivery of services of coaching and delivery days to schools that signed up late in Q4. Last year, we talked about that last quarter as those roll through and we're able to get those scheduled and delivered. Much of that delivery happens later in the year with the timing of schools and when they're out for the summer, et cetera. So that's why it would shift into the back half of the year.

And then second, we're bringing -- we're excited about 3 new solutions that are coming out. We typically see bumps in services, delivery for new solutions, and we've launched Leading and Working at the Speed of Trust that launched last month in the end of November, and then 7 Habits 5.0 is coming out late Q3 and early Q4 and then Difficult Conversations, which we think is one that our clients will want to utilize a lot of services for, that will be coming out here in the next month or so.

So I think that's what helps shift it in the back half. As related to the first half, why have they been down? Why were they down a little bit towards the end of last year and the first quarter of this year? One is that we launched a solution a couple of years ago called Unconscious Bias. It's a great solution. We launched it actually prior to some of the events that unfolded in the U.S. that drove a lot of big DEI initiatives, and we rode a wave for a while there and had a bit of a tailwind because our solution was really good. It was in high demand by our clients, and it was a solution that our clients didn't feel comfortable delivering on that topic themselves. They wanted the expertise.

So Franklin Covey, somebody coming in from the outside to facilitate that inside the organization for them. The solution is still great today, but the environment has changed quite substantially in the country around that topic. And that has happened late -- started to happen kind of late last year for us and into the first part of this year, and so as we talked about that service attach rate going down, a portion of that is related to the demand for that particular solution, which we still love the solution. It's just not quite as in demand. And so that's driven a bit of that. And we kind of anniversary against that here coming out of Q2, which is why Q1 and Q2 were depressed a bit.

Fortunately, because we look at the rest of our portfolio, we don't really have any other solutions like that. That was something we built. We weren't thinking actually we were building it for -- we thought we'd just have it as a general offering. We didn't think it would perform like it performed. And like I said, unfortunately, there were some circumstances that happened that caused that solution to be in quite high demand and now that demand has come back down. The rest of our solutions around leadership development and trust and strategy execution, we think there's a lot of durability there and great demand for those. So that Nehal, a little bit about why we're positive about Q3, Q4 and a little bit of an explanation for why Q1, Q2 have been a bit soft and Q4 was a bit soft as well.

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#### Operator

Our next question comes from the line of Jeff Martin with ROTH MKM.

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

So Paul, I wanted to drill down a little bit. There's -- on Slide 28 of your presentation, there's a total contract signed figure, \$51.6 million. I was curious if you could give a little bit of insight there. It looks like it was down 23.6% year-over-year.

Looking back over time, it looks like that's the first time it's really declined. So trying to dig in a little bit and understand what's going on there? Do you think it's more macro environment? Is it something else? Is it that DEI-related headwind? Maybe just help shed some light there.

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

Yes. Thanks. Great question. So not macro-related, not related to the DEI thing I just talked about. It's related to a contract. So contract -- so we signed a contract in the first quarter of last year. That was -- it was a fantastic contract. It was a large contract for multiple years. It was a 5-year contract for around \$10 million that had a lot of services embedded in it as well. And of course, it's contracted, so we only get to count that one time in the contracted number. And then we'll, of course, that will flow into our invoice and our reported revenue annually over the next 5 years.

So we're thrilled to have gotten the contract. This quarter, we didn't sign another \$10 million contract. However, the base of contracts that we did sign this quarter was like what we would have expected and very consistent with what a normal quarter, a normal Q1 would look like. So the base, if you'll think of it that way, was very stable and just like what we would have always expected. And last year, we're just comping against this one large contract that was contracted in the first quarter last year. We don't have anything like that, that we're up against in Q2, Q3 or Q4 that I can think of. And so I think it is kind of a onetime thing that therefore shows up as a decline here.

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

Okay. And then I was just curious if you could characterize kind of the sales environment in terms of lead flow, pipeline, conversion, et cetera?

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

Yes. Dave asked a similar question a minute ago. I would say the environment is pretty good. I mean it's -- our clients are -- our solutions are in demand. They're looking to address and wanting to address the types of challenges we're focused on. We're seeing, as we do during these times where our execution business, clients, CEOs and C-level leaders are looking to figure out how to execute their strategies as effectively as they can. We're seeing good demand there. We've just launched a new sales performance solution this fiscal year, an upgrade to the one we had. We're excited about that and the initial interest there.

We just, as I mentioned, launched the 3.0 version of Leading at the Speed of Trust, and we created a companion version of that called Working at the Speed of Trust. We never had a solution -- a trust solution that was geared to the nonmanagement population, and yet trust is one of these topics that you need to run through the entire organization. There's been really good demand for that new solution. And so I would say we're having great attendance at our marketing events. You'll recall that we were all live in-person marketing event, pre-pandemic. We shifted all the way to live online. And now we're enjoying kind of a dual marketing event structure where we do live -- we do online ones, and we do in-person events. They're very well attended. Client -- people love -- people that are working at home love to get out of their office, come to these live in-person events. There's been great interest there.

So pipeline, pipeline conversion continues to be strong. I think what's supporting that point is what we've seen here in Q4 and then in Q1 is this growing invoice subscription amounts I talked to a few minutes ago that we're seeing that pick back up after Q2 and Q3 were a bit flattish. Again, on top of big comps the year before, but even Q4 and Q1, Q4 of this last year and Q1 of this year are also on top of pretty good comps as well, and we've seen nice growth in that invoice subscription business. So we feel good about the general environment and what we're seeing out here and what we're hearing from our clients.

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

Great. And then just one thing that I discussed with your team earlier in December, was penetration into lower areas of an organization and how that might affect future subscription services related services attach rates? And maybe you could just give us your view there. It seems like you are seeing demand there from clients at levels lower in the organization?

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

Yes, it's a great question. So we -- a couple of thoughts I would just say. One, we do talk about the attach rate as a percentage. I think that percentage could go up or down a little bit over time. And what might cause -- but the dollars themselves will continue to go up, right? The percentage could go down if we -- as we expand to larger and larger populations and they choose to, at the front line, deploy some of our solutions in asynchronous modality ways.

At the same time, the percentage could go up as we do a better job of addressing the leader populations. Again, we've talked before about our penetration rates inside the average customer, we're still 10%, 15%, 20% of the way penetrated even within the leadership population inside the organizations that we face. And so I think the attach rate will continue to be strong. I think whether the attach rate, the percentage goes up or not, the dollars will continue to go up because I suspect we'll continue to attach at about the same rate. And I think the rate will be higher in the back half of this year, but that rate will be on an increasing base of subscription. And we are excited about some of these solutions that we're bringing to market that are built to scale even more broadly across organizations.

Again, we're the collective action company trying to create common language, introduce common ways of thinking and behaving and leaders need that. They need to drive that down through the organization. And so as we develop these solutions, we want to make sure that we have solutions that are built to do that. But I think services will continue to be an important part and the dollars will continue to increase. I imagine the rates probably stay about where it has been but that could go up too. I continue to be pleasantly surprised at the multiyear contracts, and that rate continues to increase year after year.

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**Operator**

Our next question comes from the line of Alex Paris with Barrington Research.

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**Alexander Peter Paris Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst**

Can you hear me?

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

Yes, Alex.

**Alexander Peter Paris Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst**

Congrats on the strong quarter. I'll be quick, we're late in the call here, and I just have a few cats and dogs to follow up on. First of all, in your prepared comments, you didn't speak to China and Japan. That's been a topic of conversation. It's roughly 50%, as I recall, of international sales. There has been an improving trend in China coming out of COVID for the third time, I suppose. I just wondered for a little update there.

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

Yes. Great. Great question. So in -- things continue to improve there. In Japan, Japan had a relatively nice quarter. As you -- first of all, stepping back, as you know, both these areas as they come back out of COVID, we're putting a big focus on making sure that what they're selling is subscription. So these are kind of the last 2 parts of the world to convert their businesses from the legacy model to the subscription model. And so -- and that's going well in both of those countries.

As that occurs, of course, that depresses reported revenues slightly as more of that revenue goes out on the balance sheet in the form of subscription. But we are intently working on that with them as they return. Japan almost got back last year to its pre-pandemic high, and we expect that it will get back above that this year. So that's been a long time coming. China has been up and down when they've been in and out of COVID, and that business is coming back as well. I think we feel relatively generally good about what's happening in both those countries.

**Alexander Peter Paris Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst**

Great. And then looking back at Q2 of 2023, deep snow, renewals were not quite -- well, I guess the renewal rate was good. The retention rate was consistent with prior quarters. But you did not sign a couple of large clients. I'm wondering about those large clients that didn't renew on a timely basis. And I know it's your expectation that they come back at some point. Have they come back yet? And what are you doing to increase the odds that they will come back?

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

Good question, good memory. Yes. So we have -- to that point, one of them has, one of them hasn't come back. And there were a handful. I don't know if I can give you an exact answer on the hand -- the full handful. We do have -- we have a category of clients we call win-backs. And so when a client doesn't renew on time, they go into a category of win-backs. We have a special effort that we put in place on those clients. And so we're -- fortunately, we don't have a lot of those, but when we do, we have a process we run because our mantra around here, we throw around is clients for life. We don't ever want to lose the clients. And so we take the approach that, well, if we lost them, it's a temporary thing. We're going to get them back. And so we're doing that on those clients from Q2, and we'll continue to do so.

**Alexander Peter Paris Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst**

Great. That's helpful. And then this was probably for Sean. You had a record year in signing new schools of fiscal 2023. One of the issues in the fourth quarter that contributed to the revenue shortfall was the inability to deliver the services, the onboarding services associated with it. And then when you miss it in the summer, when do you get it back based on earlier questions, it sounds like you don't get it back until next summer. Is that right?

**Michael Sean Merrill Covey Franklin Covey Co. - President of Franklin Covey Education**

Yes. Yes, that's typically what happens because professional development usually takes place. Most of it takes place during the summer. So a new school comes on, there's usually 2 or 3 days of professional development per school, right? And if it's too late in the year, then they say, well, we'll do coaching throughout the year as we start the school year, but the professional development that goes deeper with everyone in the same room at the same time, we'll have to delay until next summer.

So that will -- it hurt us last year, it will help us this year. And the momentum across the board is really good. We've got lots of large new contracts in the pipeline. We've got 3 states talking to us right now about some big deals. So we expect that services will have a nice second half of the year for the reason of last year coming in late as well as a really nice building pipeline for this year.

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**Alexander Peter Paris Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst**

Excellent. Yes. So not only was there a shortfall because of that last year, there'll be a little bit of a doubling up on some of those onboarding activities this coming summer?

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**Michael Sean Merrill Covey Franklin Covey Co. - President of Franklin Covey Education**

Yes, I think so. And we're also pushing everyone hard to get in early this year. Nice to (inaudible) schools as we can. It's always better to bring them on sooner than later.

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**Alexander Peter Paris Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst**

For sure. Okay. Great. And then 2 last ones. I think the target for this year, Paul, is 40 new client partners and other support roles. How many did you hire in the first quarter? And is it going to be level loaded? Or is it more back half loaded?

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

Yes. It will be a bit back half loaded. So we ended the first quarter with 300 client partners and then roughly 150 or so of the other client-facing roles, so about the same 450 that we reported on at the end of Q4. And we are still committed to adding the number for the year, and those will be back loaded, but not all at the very end, they'll come back more towards back half of the year.

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**Alexander Peter Paris Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst**

Okay. And then maybe this one is for Jen. The Impact Platform at the end of -- I think it was end of Q4, you said the vast majority of English-speaking clients are on the platform, but you're in the process of rolling out additional languages. Where are we in that process? And how penetrated are you with clients now?

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

Alex, we are thrilled that as of October, we had launched in all of our, what we call core languages and about 25 languages have launched the Impact Platform. It was a really effective launch, and we're seeing more and more of our clients globally move to the Impact Platform. Obviously, it makes a big difference to our client base in the U.S. as well, because they can deploy scalably in multiple languages. So deployment went extremely well. There's a couple of our more -- our less used languages that haven't yet deployed but the majority in what was targeted happened in October.

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**Alexander Peter Paris Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst**

Great. And what can we hope for or expect from the rollout of Impact Platform? Is it a higher initial selling price? Is it higher retention rates? Both?

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

The primary benefit, I think, is the value proposition that we are changing -- we're driving collective behavior change. So in terms of the Impact Platform, we always had great content. We always have the modalities, but having the seamlessness to be able to bring this to an



enterprise at scale, particularly as many of our buyers don't have a lot of people in the department, and this makes it much more scalable. What we're seeing with those that have deployed is we're better able to track that behavior change, we can track pre and post, the skills, the movement.

One of our latest case studies, the primary thing that the buyers love is the metrics and the ability to scale with lower staff.

**Operator**

We have a follow-up question from the line of Nehal with Northland Capital Markets.

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

Yes. Paul, at the beginning of your prepared remarks, you talked about how invoice subscription value was flattish in fiscal 3Q and 4Q, but (inaudible) in fiscal 1Q. What was actually the precise level in fiscal 1Q? And do you expect that to continue to influx up in fiscal 2Q?

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

So your question -- just to make sure I've got your question there because I cut out just for a second at the end. Could you just repeat it one more time. I think it's about invoice subscription levels Q2, Q3 versus Q4, Q1. Is that your question?

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

Yes. Well, and into Q2 of this fiscal year '24.

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

Yes. Great. Okay. So invoice subscription levels, U.S./Canada (inaudible) were flattish in Q2 and Q3, if memory serves, they were up about 8% in Q4 and then up around 13% in Q1. And then we expect that they'll continue to be good in Q2.

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

Okay. Great. And then Steve, real quickly, do you have thoughts on EBITDA for the February quarter?

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

EBITDA, I'm sorry, again?

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

EBITDA for this quarter.

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

Yes. So we talked about adjusted EBITDA being between \$6.2 million and \$7.2 million.

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

Okay. (inaudible). And what about the currency headwind for the full year on EBITDA?

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

Well, our constant -- our impact of currency was insignificant in Q1. If we stayed exact -- if the rates stayed exactly what they are now, we would have some impact through the remainder of the year, but we don't know what's going to happen with the exchange rate, so we don't know what that would be. That might impact revenue like \$1 million if rates stayed exactly as they are now. But there was no -- there was an insignificant impact on adjusted EBITDA and an insignificant impact on sales in Q1.

**Operator**

I'm showing no further questions in the queue. I would now like to turn the call back over to Paul for closing remarks.

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

Okay. Well, thank you, everyone, for joining. Thanks for your great question. Thanks for your time that you take to understand the business and for the thoughts you shared with us. We appreciate you and hope you have a wonderful evening and a great start to 2024.

**Operator**

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.

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