

Franklin Covey Co. (Q2 2025 Earnings)
April 2, 2025

Corporate Speakers

- Derek Hatch; Franklin Covey Co.; Corporate Controller
- Paul Walker; Franklin Covey Co.; Chief Executive Officer
- Stephen D. Young; Franklin Covey Co.; Chief Financial Officer

Participants

- Alexander Paris; Barrington Research; President and Senior Managing Director
- Jeff Martin; ROTH Capital Markets; Co-Director of Research
- David Storms; Stonegate Capital Partners; Director of Equity Research
- Nehal Chokshi; Northland Capital Markets; Managing Director

PRESENTATION

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

Derek Hatch^ Thank you. Hello, everyone. And thanks so much for joining us today. We appreciate having the opportunity to connect with you. As we get started, please remember 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 revenue, 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 such as governmental contracting actions that are 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 Chief Executive Officer and President.

Paul Walker^ Thank you, Derek. Good afternoon, everyone. We're happy to have the opportunity to speak with you today and to share an update on the continued progress of the business. The current external economic environment is turbulent and uncertain. We're not entirely immune to what's going on in the broader economic and political environment.

However, we are pleased, first, that the importance of the opportunities and challenges we help organizations achieve are mission-critical to them, and our business and business model are strong.

Second, we're pleased that the traction we're already achieving in the implementation of our go-to-market transformation in our Enterprise North America business is significant. And third, we're pleased that our Education business continues to be strong.

As a result, we continue to be confident in the actions we've undertaken to accelerate future revenue growth. And with this growth in revenue, we also expect to achieve significant growth in adjusted EBITDA and cash flow.

Over the next few minutes, I'd like to briefly address the following questions you can see shown on Slide 4. The first question is, what are the areas in which we have been seeing some impact from the external environment? And I want to lay those out.

Second, what are the key metrics that reflect both the continued underlying strength and durability of our business model and the significant traction we're already achieving in the implementation of our new go-to-market acceleration actions in our North America Enterprise business? And then the third question I want to answer -- lay out and answer is, what are the key factors that are driving the continued strength and growth in our Education business?

So let's get into each of these. First, what are the areas in which we've been seeing some impact from the external environment? While we feel good about progress across the vast majority of our business, we are experiencing direct and indirect impact from the actions being taken by the federal government and by the resultant economic uncertainty. And while this impact is on the margin for our overall business, nevertheless, it is impacting our revenue growth in the year and is the primary reason why our results will be down this year compared to expectations. We're seeing the effect primarily in the areas you can see shown on Slide 5.

The first is in our government business. Roughly 6%, or \$17 million of our total business is in some way tied to governmental entities such as the Department of Defense, Veterans Affairs and

state and local entities. Approximately \$5 million in government revenue has already been canceled or postponed as the federal government looks to cut spending in nearly every category.

We expect government revenues to be down by at least \$5 million this year compared to the low end of our original guidance. The second area in which we're seeing some impact from these same government actions and trade tensions is in our international direct and licensee operations.

A significant portion of this impact is being felt in China, where the threat of escalating tariffs and other potential factors and political factors is causing a sensitivity by national and even local companies in China to being viewed as doing business with U.S. firms.

In a small number of cases, we've also had clients in Europe and Canada postpone or cancel engagements either as a defensive or nationalistic response to the threat, or the reality of tariff actions, or as a response to the uncertainty of the economic conditions in their own country.

While these pressures have not been widespread, they are having an impact on the margin, and we expect that they could result in our international revenues being down by as much as \$4 million compared to the low end of our guidance this year. Third, we see the potential for some impact in our Education business.

To date, we've seen little measurable impact from concerns about the potential disruption of the Department of Education. And I think it's important to note that almost all of our education revenue comes from state-level funding. We sell to schools and districts and not to the Department of Education.

However because the Department of Ed has historically provided approximately 14% of state-level education funding, we're mindful that uncertainty about potential federal level changes within the Department of Ed could cause some uncertainty at the state level, which could slow down schools' speed of decision-making this spring.

We think this could have as much as a \$3 million impact to education revenue. While we haven't yet experienced any real negative impact here, we are monitoring the situation closely.

Looking out a little bit of the future, ultimately, it appears that any funding changes at the federal level are likely to be reallocated to the state level, and from there to the locals and school districts -- local schools and districts to which we sell. But short-term disruption is a possibility.

Finally, the same government-related actions also have the potential to create some headwinds for some of our clients and in the United States, and we think that this could create an approximately \$3 million of additional impact here. So let me now speak to how this translates into our revised guidance for the year.

First, I would just say that the objectives of our go-to-market transformation that we've talked about in the last few calls remain unchanged. Despite the on-the-margin interruptions in revenue

in our government and international operations that I just described, the engines in our Enterprise Division in North America and in our Education business remain strong and durable.

Our go-to-market transformation is tracking a bit ahead of expectation, and I want to talk about that here in a minute. And our go-to-market transformation is expected to drive significant acceleration of our overall company revenue growth, moving us from single-digit to double-digit revenue growth in the coming years and with significant -- a significant flow-through of this incremental revenue to increases in adjusted EBITDA and cash flow.

With that said, due to the impacts of the government actions just outlined, we are adjusting our guidance for this fiscal year. As shown on Slide 6, last year, we achieved revenue of \$287.2 million, generating adjusted EBITDA of \$55.3 million.

Our original guidance for fiscal '25 provided that at the low end, we would grow revenue by approximately \$8 million and generate adjusted EBITDA of \$40 million, with the reduction from the prior year, reflecting the \$16 million of incremental growth investments being made this year. Due to the impact of government actions we just discussed, we now expect revenue will come in between \$275 million and \$285 million, or \$7 million, or 2.5% lower than last year and \$15 million, or 5% lower than the low end of our original guidance in constant currency.

With this, we expect adjusted EBITDA to be between \$30 million and \$33 million, primarily reflecting the gross profit we expect to be lost related to the decline in revenue, again, related to the government actions previously discussed.

While the \$16 million of incremental growth investments were always going to have a direct impact on this year's adjusted EBITDA, we expected they would establish a solid foundation for accelerated future growth, and we still do.

As noted, we're pleased with the traction we're getting and both fully committed to these investments and confident they will do exactly what they were expected to do, which is to accelerate our growth.

We, of course, did not anticipate the impact of the government actions, but are taking quick action to reduce our cost structure in government, in our international operations and other areas of our business.

We expect these actions will partially offset some of the government-related impact and resulted in an even higher percentage of incremental revenue flowing through to adjusted EBITDA next year. Therefore, we expect this will be an approximate 1-year step back, and that next year, adjusted EBITDA will be back to approaching where we thought it would be this year. We'll provide specific fiscal '26 revenue and adjusted EBITDA guidance in November, which has been our pattern.

So having talked about the external environment and our updated guidance for the year, I'd now like to turn to a different topic, which is to address the strength we're seeing across the majority of our business right now. Despite the potential near-term impact in the areas just discussed, the strategic strength of our overall business and our business model continues to be evident.

We're also pleased with the significant early traction, as I mentioned, that we're achieving in our new go-to-market in our Enterprise North America. I'd like to first address the strength of our strategic position and business model.

Our strategic strength derives from the importance of the opportunities and challenges we help organizations address, opportunities and challenges which are very durable for clients in good times and in more challenging times. This strategic strength and the strength of our business model continue to be reflected in the following metrics in our North America Enterprise business, as you can see shown on Slide 7.

First, our revenue continues to renew at high rates. Apart from the government action-related headwinds we've addressed, a majority of our clients continue to expand and renew even amid a more uncertain environment. This strong retention is driven in part by our clients' continued interest in expanding the duration of their contracts with us to ensure the ongoing achievement of their critical objectives.

At the end of the second quarter, 61% of our subscription revenue is under a multiyear contract, equaling the high percentage we'd achieved at this same point last year. Second, our clients continue to expand with us.

Over time the average revenue per All Access Pass client has expanded significantly from \$39,000 to more than \$85,000, reflecting both the growth of the populations being served within our clients and the expansion of incremental offerings that they purchase. The third area of strength is that our clients are continuing to purchase significant amounts of services to help them achieve their mission-critical objectives. Despite the uncertainty, it is significant that excluding our government business, in our business in the United States and Canada, our advanced bookings for new services have increased 5% year-to-date over the same period last year. This reflects our clients' commitments to achieving a performance outcome.

Importantly, this momentum in bookings will translate into increases in services revenue in the coming quarters. Fourth, we're pleased with the indicators of significant traction we're already achieving in the implementation of our new go-to-market acceleration in our Enterprise business in North America, and I'd like to talk about this here just for a couple of minutes. This is an initiative into which, as previously discussed, we've invested an incremental \$16 million this year.

It's been just 90 days since we launched our transition and the traction and early results we're seeing are very encouraging. The focus of our go-to-market transition is on achieving significant increases in two key outcomes which will drive our accelerated growth.

The first objective is to significantly increase our new logo sales, and this is off to a very good start. We won more new logos in the second quarter, both in terms of dollars generated and number of clients than in any of the last five quarters, and we expect another strong quarter ahead in Q3.

We exceeded our new logo plan by more than 50% in the second quarter. And while we did not start the transition until the second quarter, we're pacing to achieve approximately 40% growth in new logo sales for the year.

Importantly, we've also had a higher purchase of services by new All Access Pass clients this past quarter than we've seen in previous quarters. I'm going to come back and touch on that in just a second.

Our second objective is to increase our expansion within existing client organizations. This is also off to a strong start. The second quarter was a strong quarter in terms of client expansion, and we beat our planned expansion target by 8%. Underpinning the strength of this early traction are two important factors.

First, that our new go-to-market organizational structure is fully aligned, fully staffed and working. Every role is filled, and we've added top-tier talent in critical roles to go along with the already tremendous talent we had in place. All 44 of our new logo salespeople are in place today. 42 of the 44 were in place by December 1st, and the other 2, so all 44 were in place by February 1st, which is a full month ahead of what our planned staffing plan indicated. 21 of the 24 brand-new new logo hunting salespeople closed business in the second quarter.

21 of 24 closed business in the second quarter, which is their first quarter. That's an unprecedented ramp speed for us. And our new logo pipeline exceeded plan by 30% and our conversion rates were 300 basis points above our targeted conversion rates in the second quarter. The second factor underpinning our traction and momentum is that the important investments we've been making into content, technology and delivery capabilities over the past years are enabling us to serve even more clients more broadly and more effectively than ever before.

As I mentioned a minute ago, we're also seeing a strong attachment rate of services to new logo wins, and this is a bit of a shift for us. We're intentionally driving this with these new logo sellers. And this is not only increasing deal size, but we anticipate it will also boost client retention as our clients who buy services renew at higher rates.

I'd like to share a quick win story from the second quarter that highlights -- the win of a new logo that also had more of these services attached. We closed a large hospital system in the Midwest for \$253,000 in annual contract value. So that's a very nice new logo win for us.

And this contract had -- it was \$144,000 All Access Pass subscription with \$109,000 in services attached to that subscription. The deal -- this is interesting, the deal began with interest from the

hospital system's CEO, and he'd asked for a single keynote on the speed of trust, and we quickly expanded that initial interest into a rollout that covered a few hundred of their leaders to instill trust across teams and within patients in each of their hospitals. This deal was closed in just 44 days by one of our new logo sellers who is new enroll. And it was her third month in seat.

Finally, I'd like to, as I touched briefly on a minute ago, just discuss for a second, the ongoing strength we're seeing in our Education business. As shown on Slide 8, Education revenue grew 3% in the second quarter and is up 7% year-to-date. Importantly, year-to-date invoiced amounts in education are up 13%, positioning us well for the seasonally stronger second half.

We're seeing strong demand for Leader in Me driven by success in delivering the outcomes that educators, parents and communities care about, such as leadership development, student engagement and character building. This strong demand is fueling our transition from selling initially to individual schools to selling to entire districts, and we now in a handful of cases, are serving state-wide contracts.

We're pleased there are now 7,800 Leader in Me schools around the world, and we're just getting started in growing that number to even larger heights. So we feel quite good about the progress that's being made with the transformation of our North America operation.

We feel good about the continued momentum in education. And with that, I'd like to turn the time over to Steve and ask Steve to share a little bit more detail on our financial results, also share a little bit of specific Q3 guidance.

Stephen D. Young^ Thank you, Paul. Good afternoon, everyone. It's a pleasure to be with you today. You'll find on Slides nine through 12 and in the appendix, the second quarter financial details I've typically shared verbally on these calls. But today, I'll take the time to highlight a few encouraging trends we're seeing in the business that continue to support our confidence moving forward.

First, a few high-level financial results. The second quarter revenue was \$59.6 million or \$60.1 million in constant currency, slightly below the \$61.3 million we achieved in Q2 last year, with more than all of the difference reflecting the impact of the government-related cancellations in the last 60 days. Adjusted EBITDA for the quarter was \$2.1 million or \$2.6 million in constant currency, landing at the top end of our expectations despite the government disruptions. Gross margin and SG&A were in line with projections including the second quarter share of our \$16 million in incremental growth investments in North America.

We feel good about the results given the canceled government revenue and the related shortfall in international sales, and it being the first quarter of our go-to-market transformation, Paul just described. Second, I'd like to highlight that we're seeing continued strength in the number and value of multiyear contracts being signed.

In fact, additional -- additions to unbilled deferred revenue, which reflects multiyear contracts secured but not yet invoiced, was up 10% in the second quarter and is also up 10% for the first half of this year compared to the first half last year. This momentum is also evident in our All Access Pass contracts in North America.

As of the end of Q2, the percentage of All Access Pass contracts that are multiyear was a strong 55%. And as Paul mentioned, the percentage of our subscription revenue associated with this multiyear agreements was also a strong 61%. These results reflect our clients' long-term commitment and belief in the value and strategic impact of our solutions.

In the midst of a more challenging macroeconomic environment, we're also pleased that the vast majority of our clients are renewing their contracts, expanding their usage and expressing confidence in the work we're doing together. This gives us continued confidence in both the future trajectory of the business and the early returns we're seeing from our go-to-market transformation. Third, as Paul mentioned, we're -- our services booking rate in the United States and Canada, excluding government, is up 5% year-over-year. This is a strong indicator that we're not only landing new clients, but that we are a trusted partner in delivering solutions that drive real outcomes and lasting value.

Fourth, we're seeing good momentum in our Education business, particularly in the number of large state and district level opportunities we're actively pursuing. This pipeline strength, together with the base of 7,800 schools, gives us confidence in the demand for the kind of outcomes our Leader in Me solution delivers, and provides confidence in continued growth as we move through the second half of the year, which is historically Education's strongest period.

Finally, our business continues to produce strong, reliable cash flow. And today, we still have more than \$100 million in liquidity. We've continued to use this strength to return value to shareholders.

From 2022 to today, we have invested approximately \$105 million or 83% of free cash flow to purchase 2.6 million shares. In the first half of this year, we've invested \$14.7 million to purchase 397,000 shares.

We expect to continue allocating excess cash toward accelerating growth, M&A activities and share repurchases. We remain committed to being disciplined steward of capital while staying focused on driving long-term value creation. Now just a little bit more on guidance.

As Paul shared earlier, our revenue guidance for the year is to be between \$275 million and \$285 million, with adjusted EBITDA between \$30 million and \$33 million in constant -- both in constant currency.

Our guidance for the third quarter is that revenue will be between \$67 million and \$71 million and adjusted EBITDA will be between \$4 million and \$6.5 million, reflecting both the expected continued revenue disruption from government-related activities impacting our direct

government, international, education and other revenues as well as the third quarter's portion of our growth investments. So Paul, back to you.

Paul Walker^ Thanks, Steve. Thanks for taking us through that. And we'll now invite the operator to open the line for questions, as we do. Just want to again thank everybody for being here today and look forward to answering your questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) And our first question will come from the line of Alex Paris of Barrington Research.

Alexander Paris^ I guess, we'll start with the external impacts, DOGE and tariff related and so on. I think I understand it. There's direct federal government agencies in [lost] business. There's impact on your international business because of the response to the increased tariff talk from this end. And there's an expected impact on your education business as well.

So focusing first on the federal government. I think you said in your prepared comments that it's - - 6% or \$17 million is government revenue on a full year basis, DoD, VA and then state and local. Is that correct?

Paul Walker^ Yes. With the majority of it being federal. Yes.

Alexander Paris^ Okay. That's what I was going to ask. The majority is federal. And you called out DoD and VA. Are there any other agencies that we should be aware of?

Paul Walker^ Yes. So we do work with -- USAID has been an agency we've had a long relationship with in the past. We've done stuff with Health and Human Services. We've had a nice government business for a long time doing work across a number. We do work with the Treasury and work with Congress in the past. So it's been fairly broad over the years, Alex.

Alexander Paris^ Got you. And then you said -- I think Steve said that the entire year-over-year decline in revenue was due to canceled government contracts and then the related impact on your other businesses?

Paul Walker^ Yes.

Stephen D. Young^ Yes.

Paul Walker^ Yes. That's right.

Stephen D. Young^ Yes. Particularly the impact was reflected in Q2 of the cancellations just in the last 60 days.

Paul Walker^ That's right.

Alexander Paris^ Got you. All right. And then on the education -- and -- obviously there's nothing you can do about that. Are there hopes to win the business back in the future? Certainly, your guidance assumes that you don't win it back this year.

Paul Walker^ Yes. Yes. So staying on government for a second. Our guidance and our -- the view right now is that we don't win that back this year. I don't see a scenario where that happens.

And so what we're doing -- one of the things we're doing is we're just taking a look at that government business and saying, okay. Over the next bit of time here, assuming the trajectory of what's happening in -- within the government doesn't change, how do we structure that business so that we can be as profitable there as possible on less revenue.

So that's an action we're taking immediately. Longer term, as things settle down, I mean a big part of what we do as a company is we help organizations become more efficient, get more out of their people, do more with less. Like we have a whole set of offerings, as you know around execution. There could be an opportunity to get back in and help on some of those things.

Right now the environment is such that there's not a lot of appetite to buy anything new in the government. But I think that we'll see as we go into next year, whether that looks different. But at the moment, that's how we see it.

Alexander Paris^ Got you. And then on the education side, 86% of funding comes from state and local governments. Only a small component, 14% comes from the federal government. Overall, I'm not saying your revenue. And that would be things like Title I and individuals with disability. What percentage of your Education division revenue comes from the Department of Education?

Paul Walker^ So we don't -- the Department of Education for us is not actually a client. And so they dole out -- 14% of the state's budget comes through them. And like you said, it is directed towards Title I, towards some of those programs that you mentioned. And so we're not selling to them.

We don't have a relationship with the Department of Education, never had. The fact that, that agency is being cut, cut in half, whatever, however far it gets cut back, that itself doesn't have any impact on us.

It's -- and we don't actually think, Alex, over time there's -- from everything that we can see right now the dollars that have been flowing from the Department of Education to the states, we expect those dollars are still going to flow. They might come from a different agency than the Department of Ed. They might be -- as the administration is trying to actually shut down the Department of Ed. And so long-term, we don't actually see that creating a funding challenge for us.

What we're trying to highlight here in this call is it just so happens that it might throw just a bit of sand in the gears in our third and fourth quarter, which is the time of the year when schools are making decisions to start Leader in Me, right? The second half has always been our biggest half of the year. And so it's just the -- the thought that there might be just enough uncertainty during our third and fourth quarter as the dollars are being shifted from the federal government to states that it might cause some slippage in the timing of decisions. Decisions in that business are usually made in school Board meetings. And so if you miss a school Board meeting, you're up for the next one.

And there could just be enough of that. Right now we're not seeing it really widespread at all at the moment. We're just trying to highlight that there's a possibility there could be a few million dollars of impact there. Generally speaking, it's really on the margin. That business is doing quite well and we expect that it will continue to be. But highlighting there is that risk, that potential.

Alexander Paris^ Just a couple more. So if I understand it correctly, some of these internal impacts are kind of masking the success and the traction and the trajectory resulting from your North American enterprise sales force restructuring. Just to be clear, I think in Q1, of that \$16 million incremental investment, I think you spent a little bit less than \$3 million in the first quarter. And I think you were expecting to spend a little bit more than \$4 million in the second quarter and then \$4.5 million in each Q3 and Q4 to get us to \$16 million. Are we still pretty much on that schedule in terms of incremental spending?

Paul Walker^ We are like really right on that schedule. I'm looking at Steve here, he's nodding. Yes. So that set of bets, those investments are right on track. We've made those investments.

So the people are -- it's primarily people. The people are here, they're enroll. And so that penciling out you just did of around \$3 million going to \$4 million, and then \$4 million going to \$4.5 million and \$4.5 million -- those are with us now. And that's a conscious decision we're making here. We're saying we like the early momentum that we're seeing, the traction that we're beginning to see.

We're only 90 days in, but we like what we're seeing, and that's -- though that's not an area where we want to cut back. That's the area we believe. That's the engine that pulls the company's overall growth rate higher and higher that we've talked about and that we're excited about. And so, we see making some -- doing some trimming in some other places, but we don't want to trim there. We're quite pleased with what we're seeing in the early days here.

Alexander Paris^ Great. And then the last couple would be regarding guidance. So you kind of spelled out the guidance there and the delta from previous guidance and year-over-year. You gave third quarter guidance, so we have implied guidance for the fourth quarter.

In the text of the press release, you said that the company expects this to be a one-year step back and the company's adjusted EBITDA will approach 2025 -- original 2025 expectations in 2026.

So that suggests there's been a reduction in expectations in 2026 given these external factors. And then what does that do to '27 and '28 because you had given long-term guidance through 2028 previously?

Paul Walker^ Yes. It's a great question. I would say, we will -- as has been our pattern, we're going to go ahead and update that in November as we kind of see how the next couple of quarters play out. I will say that -- just two more comments on your question there.

One, we -- as we take -- as we expect to accelerate some of our invoicing growth and whatnot in the back half of this year, and we take some of the cost -- we take a look at some of the costs that aren't related to our growth.

We do see ourselves next year, even on modest revenue growth, getting pretty good flow-through on that, having had a big investment year this year and not needing to make anywhere near the same level of incremental investments next year, plus the flow-through on some of the things we would do on the cost side in the back half of this year, setting ourselves up for a good flow-through year next year, a flow-through like we used to have, like you've been accustomed to us having.

And that's the comment about setting up next year to getting back -- to approaching getting back to where we would have been this year on the adjusted EBITDA side. As far as the longer term outlook on revenue and adjusted EBITDA, we'll give a good update on what we think in November.

I will say that fundamentally, as we think about just the underlying thesis here, we still do very much believe that this is a business that there's great demand for what we're selling. Our clients need what we have.

We have good strength in this business and the transformation we're making in our North America enterprise operation, coupled with the good momentum we've had for a long time in education, that over time this -- the revenue growth accelerates.

And with that, we drop through revenue to increases in adjusted EBITDA and cash flow. And that underlying thesis remains intact. And we'll -- as we get a little more visibility, we'll share more about what that -- when and by how much. But that's the trajectory where we still think we're on.

Alexander Paris^ Okay. Got you. And then lastly, I guess, again, the positive effects are somewhat masked by the external impacts. I think you said on the last conference call the things we should look for in terms of milestones would be size of pipeline, that's where it would show up first. Growth in invoice sales, that's where we'd see it second.

I think it was down still in Q2. I realize we're only 90 days in. And then ultimately, reported revenues. I wonder if you could just give comment on those three milestones or a little additional color?

Paul Walker^ You bet. So yes, growth in pipelines and just a couple of comments there. As we mentioned in our North American business, our -- we exceeded our pipeline target by about 30% in the second quarter. We had a better close rate than we thought.

So I think if you think about the new logo side for a minute, the factors that drive new logo are, can we -- can our marketing organization generate more leads, more pipeline, more opportunity? Can our sales organization qualify that, advance it and close it? We saw that in the second quarter at rates that were above what our plan suggested we would have been great success.

So we were ahead on those. And then on the other side, it's, can we take the -- on the expand side, can we take those clients who've now landed at greater rates and can we expand them and retain them. And we had good -- we beat our expansion plan by 8% in the quarter as well. That's -- those happened even with the noise we saw with some of our contracts and some of the -- government is part of North America.

So despite some of the headwinds we saw in the quarter -- began to see in the second quarter, our second quarter happened to be January, February -- December, January, February -- the leading indicators were positive. And as you mentioned, we're only 90 days in, and we look forward to reporting on that again as we get to Q3, Q4. We'll just keep reporting on those as we go along here.

Alexander Paris^ And has there been any impact on the commercial side of the business within enterprise, like extended sales cycles due to uncertainty, tariffs, recession worries, things like that?

Paul Walker^ I think that's what -- so certainly, as we alluded to, we're seeing that -- we've seen that internationally. In fact, in three of the countries in which we operate in our international direct offices, they've had Snap elections in the last 90 days.

So there's some uncertainty there. And -- so we see some of the prolonged decision-making happening in international, and that's why we've tried to reflect that in our updated guidance. And then we've provided a little bit of -- in the U.S., expecting a little bit of headwind there as well which is where the -- we've also accounted for about \$3 million of potential headwind there in the U.S. as well. So haven't seen a lot of it yet, but expecting that we might see a little bit of that.

Alexander Paris^ And that's in guidance?

Paul Walker^ That's in guidance, yes.

Operator^ And our next question will be coming from the line of Jeff Martin of ROTH Capital Markets.

Jeff Martin^ So Paul, I was just curious if you could clarify the \$17 million in government-related revenue, 6% of revenue? Does that include non-government organizations that are influenced by government agencies? Or is that incremental to that? And are you seeing any impact there?

Paul Walker^ Yes. The \$17 million is governmental agency, direct -- the \$17 million is direct. The broader -- as far as government representing a good share of the GDP and how that spills over to companies who do a lot of work with the government, et cetera, et cetera, that's what we're trying to point to in the \$3 million or so of impact we might see in the U.S. and Canada.

So not yet seeing a lot. I think we're not seeing a lot of that yet. We're obviously directing our sales forces -- our sales force towards those organizations that -- trying to assign them to highest and best use to the types of accounts that we think will do well in these times. But haven't seen a lot of that yet, Jeff.

Jeff Martin^ Yes. Okay. And then I was curious if you could characterize the project starts among your clients who are subscription purchasers? Are those largely starting on time? Are they starting to infuse some delays related to uncertainties, need to focus on other areas of the business, the impact of tariffs, et cetera?

Paul Walker^ We -- As we mentioned, in the second quarter, we actually had a better new logo quarter. And so for us, the -- when we sell -- when we bring on a new client, we sell a new logo, we're starting right away with them. Their subscription starts, the clock is running on that first year subscription. And so we're seeing -- we haven't seen any slowdown in terms of project starts, Jeff, at this point.

Jeff Martin^ Okay. That's encouraging. And then if the economy does roll into a recession here -- I know in the past, you've spoken about the durability of the subscription model. Obviously moving to multiyear contracts helps.

But how do you see that in terms of potential impact on new logos? I know you just had a really strong first 90 days under the new go-to-market strategy. But just was curious if you have the same level of conviction if the economy does do roll into a recession here?

Paul Walker^ Yes. So you highlighted two important things. First, I would say, the subscription business helps us in a situation like that where we -- to roll into a recession in that we've got all of the clients that -- we've got that portion of clients that are on a multiyear contract.

So about 55% of our contracts are multiyear, meaning two years or longer. 61% of the subscription revenue is under a multiyear contract, again, two years or longer. So you get a nice -- there's a bridging effect there. A lot of the base is bridged and in place in that experience.

In the past, when we've seen a downturn like that, usually, there's a couple of quarters where there's a lot of uncertainty. And so we've got some good built-in durability there just in those multiyear contracts.

We also -- for all those clients that are on a multiyear, they're on a one-year contract. And so you've got a good number -- a good percentage of clients that are in their first quarter, second quarter, they're only a portion of the way into even the single year.

So there's some increased strength and durability built into just the way that All Access Pass and Leader in Me are contracted in the form of minimum 1-year contracts. To your second question around new logo, I think -- so again, we were -- I was pleased in the second quarter.

It wasn't like the second quarter didn't have some external noise in it, and we had a good quarter. We -- right now our pipelines and the early indicators for Q3, even in this environment, suggests that Q3 is going to be another good, strong new logo quarter for us. And we feel good about that right now.

We are -- of course, as we've done in the past, we direct our sales force even a little bit more to the solutions like the four disciplines of execution, our sales performance solutions, those topics that we fortunately cover, that really become even more critical and important to clients and to organizations when they're trying to grow their own businesses. And so we'll direct our sales forces there and it remains to be seen. But right now we're encouraged by what we saw in Q2 and the early indicators for Q3 on new logo.

Jeff Martin^ Okay. And then last for me is your guidance implies roughly, this is roughly speaking, \$14 million to \$16 million of adjusted EBITDA in Q4. Just curious of your level of conviction, what could happen to exceed that number? Or what could you foresee that might pressure that number?

Paul Walker^ Steve, do you want to make any comments on that?

Stephen D. Young^ Since any subscription sale, only a portion of that is recorded to actual revenue. The fourth quarter especially is impacted a lot by the amount of services that we deliver and the amount of coaching days that we deliver, especially in education. So one of the important areas that Paul talked about related to the fourth quarter is that there isn't something that we cannot imagine that would significantly impact the education days.

We don't see that, and we don't anticipate it, but that's the kind of thing that could be a disruption. And then the improvement could be simply that, again, in education and in everywhere else, some of the disruption that we're anticipating might happen just doesn't.

And that the need -- there is a need for those delivered days and the services and the content and the companies just go ahead with what they need, would be an improvement to what we're projecting.

Paul Walker^ And just on that -- I think that's a great point, Steve. So far, of all the -- of the factors that we -- that I walked through, that kind of give the basis for the new guidance, the government piece, there is lost business we've already incurred there. The others are just -- as we look out in the future and try to think about what we think might happen, but we're working every day to figure out how to do better than -- and what that might be.

So international, where we think we might be down as much as \$4 million compared to plan this year, no one is going to be happy that we hit the number we just gave out today. We're trying to -- we'll do everything we can to do better than that. And hopefully, we'll be able to beat what we shared here today, and that's certainly our expectation.

Operator^ And our next question will be coming from the line of Dave Storms of Stonegate.

David Storms^ Just wanted to start, while we're looking at the external environment, is there any ability or appetite to maybe batten down the hatches a little bit and shift focus a little more internally towards -- more focus on product development, more focus on enhancing AI capabilities, any internal projects like that?

Paul Walker^ So we are -- we have a great product development roadmap. On that product development roadmap includes how we're going to incorporate AI into our products, and we're already doing that. We've talked about that in the past. Internally, there's also an opportunity to just continue to make our own internal operations more efficient, more streamlined. I think there's an obviously the ability for AI to help with that.

One of the things I mentioned in my remarks was just that, hey, we recognize that we're taking our EBITDA guidance down as well primarily the function of the revenue going down and then not wanting to cut the \$16 million of growth investments.

We will look for other places that aren't tied to the things that are going to grow the business in the future and try to look for ways to become as efficient as we can. And we've done that for years, and we'll continue to certainly do that and look inward on those things, Dave.

David Storms^ Understood. Very helpful. And then just looking at some of your go-to-market strategy kind of outpacing goals, it does look like, as you mentioned, the new logos is up 150% over goals, where the expanders is up, call it, like 108%.

Looking past the market uncertainty, do you see a point where you will need to hire more expanders faster than landers? And I guess kind of how are you thinking about the balance between those two roles?

Paul Walker^ Yes. It's a great question. So first of all, stepping back for a second, long-term, as we zoom out for a second and think about what happens over the long period of time we've done a nice job of expanding -- once we land a new client, expanding that client and we take them on a

journey. The journey to date has been to move from an average of \$39,000 over time to an average of a little over \$85,000, and we expect that to continue. Even if that didn't grow by a lot more, and they just went from \$39,000 to \$85,000, the fact that we could be landing a lot more new clients in the future, that's going to generate a lot of growth.

And so we do expect in the coming years, next year and going into the years after that to grow the landing side of the organization and continue to grow that. That -- there are about 16 million potential clients we could sell to. That includes SMB, but there's a huge market of clients out there to which we should be selling to, who could be users of our content and our solutions. And so we see a lot of headroom to keep growing on the land side.

So those account executives who are out hunting for new business, and we expect to do that. We also will, as we're successful, need to grow the expand side but not at the same rate. Those expanders, the way -- we've got capacity there.

In fact, we don't think we need to actually expand -- add any -- very many, if any, expanders this next year because of the capacity that's there to receive the accounts we're throwing over to them. And so, yes, over time we'll need to, but I think the expand side we'll be able to grow at a slower rate than the land side.

We also have on the expand side the customer success organization, the implementation strategists we've talked about in the past that help provide some of those account management duties so that those expanders can focus on looking for new opportunities to expand the average - our -- the usage of our solutions inside our existing accounts.

So both will grow, but I think we'll be growing the land side even ahead of the expand side. And therefore, we ought to get even better flow-through on those existing clients because our cost structure doesn't have to change -- won't have to change as much on that side. You remember that those -- one more point here, sorry, that those expanders used to have the responsibility to also land new business. Now their full job is to take care of the existing clients and try to expand them. And so we can increase the number of accounts per expander without disrupting that expansion play.

Operator^ And our next question will be coming from the line of Nehal Chokshi of Northland Capital Markets.

Nehal Chokshi^ Congrats on the strong land and expand metrics within the quarter. Clearly, the big topic, though, is the fiscal year revenue reduction. On Slide 5, you did have a line item here of \$3 million additional impact in the year. I didn't hear any color on what that additional impact is. Could you repeat it, if you already did talk about it?

Paul Walker^ Sorry, yes, it's just the spillover of the government actions, tariff-related news, things like that, that will create -- we expect some headwinds for our clients here in the U.S. and

just the presumption and expectation that there'll be some of that this year that will be up against the back half of the year.

Nehal Chokshi^ Okay. And so the way I kind of understand this guidance (inaudible), is that \$9 million has been realized already and \$6 million is being anticipated.

Stephen D. Young^ I think so.

Paul Walker^ Yes. The \$5 million has been realized. The \$4 million isn't fully realized yet. It's the expectation of what we think happens across the year in international. And then add -- and the additional headwinds.

So it's -- yes, it's laying out the \$15 million, but the \$5 million is lost business already in the federal government. The others are just kind of our view into what we think could happen here in the future. And again, we'll try to do better than that certainly.

Nehal Chokshi^ Right. Okay. All right. And then moving on to the EBITDA guidance. The EBITDA guidance is cut 70% at the low end of the revenue cut, while the high end of the EBITDA cut is only cut -- 50% of the revenue cut, right? So the amount of flow-through is less as we go to the more extreme portion of the new guidance range. Why is that?

Stephen D. Young^ So Nehal, yes, so the --

Nehal Chokshi^ I'm sorry, it's the other way around. The amount of the guidance cut is less as we go through -- go to the lower end of the new revenue and EBITDA ranges. That's what I meant to say, sorry.

Stephen D. Young^ Yes, Nehal, we see it the same as you do, and that is we clearly identified that the numbers, the difference that we're talking about is related to the low end of the guidance versus the full guidance. And if we did the calculation based upon the high end of the guidance, it would be a different level of growth.

So we're agreeing with exactly with what you said. And we did the comparison to the low end of the ranges just because knowing -- clearly identifying it, so anybody wanted to do the calculation based upon the high end, all the numbers are available to easily do that. But we see it the same way you see it, Nehal.

Nehal Chokshi^ Okay. And what I was trying to say was that the low end of the new guidance range relative to the high end of the new guidance range for the EBITDA, the EBITDA cut is not as severe as a percentage of the revenue cut as it is for the high end. And so you're expecting not as much of a profitability impact as you get to a more extreme revenue cut scenario here. So that was the question, which baseline to utilize?

Stephen D. Young^ Yes, Nehal, if I understand it correctly, I think the thing included there is we're including an anticipation of having some reasonable controls of our SG&A. So those SG&A adjustments to adjusted EBITDA are the same, whether they're talking about the low end or the high end of the range. It's the same number rather than a proportional adjustment based upon the change in revenue. And I think that's what's changing the different percentage. Does that make sense?

Nehal Chokshi^ Got it. Yes. That makes a lot of sense. Yes. That makes 100% sense. Okay. And then it looks like in the quarter you did have negative free cash flow. What's the driver of that?

Stephen D. Young^ Well there's a couple of things going on with free cash flow. And obviously Nehal, as you look, you'll see that free cash flow is meaningfully below last year. A couple of significant things going on there. One is that we paid over \$6 million in taxes this year that we normally haven't paid. We've signaled that for quite some time that those tax payments were coming because we're out of net operating loss carryforwards and foreign tax credits.

So we had an increase in cash paid for taxes. And we also last year had a meaningful amount of customer deposits added to our cash flows. And those are really lumpy. And that's because we don't often have customers prepay for their services.

But sometimes in education and especially at the state and district level, if they have cash available, then they can make a pretty significant prepayment to us. And that affects our cash flow meaningfully.

So there's like a \$7 million difference in the deposits that we received. And then net income is the other part. So those are the things that are primarily -- the level of profitability -- and then that -- the sales level impacts our accounts receivable and our deferred revenue. But the things that are really different is the profitability of the company, the customer deposits and the taxes.

Nehal Chokshi^ Okay. That's really helpful. And then clearly, you guys are signaling high confidence in the business fundamentals by deploying about \$8 million in buybacks during the quarter. Can you give us a sense as to whether or not you will continue to do so given where the stock is indicating here?

Stephen D. Young^ Nehal, as you know we never really say exactly what we're going to do. But we do look at the share price, and we have shown a willingness to buy back shares.

So I think that's an indication that our strategy going forward will be similar to the past. And that is we hope in any scenario to be actually generating positive cash flow even at these reduced levels. And if we can have a meaningful acquisition activity that will really increase the value of the company over a longer term, then we'll look seriously at that.

And then we'll all -- and amid all of that, we'll obviously look at the share price and other factors that we can see and the cash that we have available and look at buying back shares.

Nehal Chokshi^ Okay. What's your degree of confidence that the remaining EBITDA that you expect to generate for this year will generate positive free cash flow?

Stephen D. Young^ We think it will be positive free cash flow. We don't -- as you know we don't give an estimate on that. We think even with these reduced forecasts, we'll have positive free cash flow for the year.

Nehal Chokshi^ For the full fiscal year, or are you talking about for fiscal 2H '25?

Stephen D. Young^ For the full year and some additions in -- additions to the first half in the second half, maybe not that much, but still some free cash flow for the year and most likely a little bit in the second half, even given these numbers.

Operator^ And that does conclude today's Q&A session. I would like to go ahead and turn the call back over to Paul for closing remarks. Please go ahead, Paul.

Paul Walker^ Thank you. Thanks again, everyone, for joining today. It's great to be with you and to share an update on where the business is. We're pleased with what's happening in our go-to-market transformation and also what's happening in our Education business and look forward to talking to you again in the quarter. Have a great afternoon.

Operator^ Thank you all for joining today's conference call. You may now disconnect.