FRANKLIN COVEY CO
Form 10-Q
April 12, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 3, 2007

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to __________

Commission file no. 1-11107

FRANKLIN COVEY CO.
(Exact name of registrant as specified in its charter)

Utah (State of incorporation)	87-0401551 (I.R.S. employer identification number)
2200 West Parkway Boulevard Salt Lake City, Utah (Address of principal executive offices)	84119-2099 (Zip Code)
Registrant's telephone number, Including area code	(801) 817-1776

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	o	Accelerated filer	x	Non-accelerated filer	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock as of the latest practicable date:

19,412,421 shares of Common Stock as of April 2, 2007

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

FRANKLIN COVEY CO.

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)

	March 3, 2007	August 31, 2006
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 28,620	$ 30,587
Accounts receivable, less allowance for doubtful accounts of $656 and $979	24,678	24,254
Inventories	23,402	21,790
Deferred income taxes	3,884	4,130
Other current assets	6,387	6,359
Total current assets	86,971	87,120
Property and equipment, net	35,054	33,318
Intangible assets, net	77,725	79,532
Deferred income taxes	364	4,340
Other assets	13,965	12,249
	$ 214,079	$ 216,559
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt and financing obligation	$ 598	$ 585
Accounts payable	10,211	13,769
Income taxes payable	2,659	1,924
Accrued liabilities	30,538	32,170
Total current liabilities	44,006	48,448
Long-term debt and financing obligation, less current portion	33,209	33,559
Other liabilities	1,017	1,203
Total liabilities	78,232	83,210
Shareholders' equity:		
Preferred stock - Series A, no par value; 4,000 shares authorized, 1,494 shares issued and outstanding; liquidation preference totaling $38,278	37,345	37,345
Common stock - $0.05 par value; 40,000 shares authorized, 27,056 shares issued and outstanding	1,353	1,353
Additional paid-in capital	186,288	185,691

Common stock warrants		7,611		7,611
Retained earnings		18,337		14,075
Accumulated other comprehensive income		669		653
Treasury stock at cost, 7,386 and 7,083 shares		(115,756)		(113,379)
Total shareholders' equity		135,847		133,349
	$	214,079	$	216,559

See notes to condensed consolidated financial statements.

FRANKLIN COVEY CO.

CONDENSED CONSOLIDATED INCOME STATEMENTS
(in thousands, except per share amounts)

	Quarter Ended		Two Quarters Ended	
	March 3, 2007	February 25, 2006	March 3, 2007	February 25, 2006
	(unaudited)		(unaudited)	
Net sales:				
Products	$ 45,283	$ 50,841	$ 87,391	$ 94,244
Training and consulting services	31,593	27,492	65,014	56,440
	76,876	78,333	152,405	150,684
Cost of sales:				
Products	19,436	22,288	37,910	40,952
Training and consulting services	10,251	7,872	20,909	17,152
	29,687	30,160	58,819	58,104
Gross profit	47,189	48,173	93,586	92,580
Selling, general, and administrative	36,666	35,488	77,514	73,255
Gain on sale of manufacturing facility	(1,227)	-	(1,227)	-
Depreciation	1,366	1,221	2,403	2,629
Amortization	900	908	1,802	2,003
Income from operations	9,484	10,556	13,094	14,693
Interest income	357	316	557	645
Interest expense	(675)	(660)	(1,336)	(1,303)
Legal settlement	-	873	-	873
Income before provision for income taxes	9,166	11,085	12,315	14,908
Provision for income taxes	(4,452)	(1,872)	(6,186)	(2,462)
Net income	4,714	9,213	6,129	12,446
Preferred stock dividends	(934)	(1,139)	(1,867)	(2,518)
Net income available to common shareholders	$ 3,780	$ 8,074	$ 4,262	$ 9,928
Net income available to common shareholders per share:				
Basic	$ .19	$ .40	$ .22	$ .49
Diluted	$ .19	$ .39	$ .21	$ .48
Weighted average number of common shares:				
Basic	19,589	20,311	19,750	20,321
Diluted	20,026	20,634	20,109	20,638

See notes to condensed consolidated financial statements.

FRANKLIN COVEY CO.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Two Quarters Ended March 3, 2007	February 25, 2006
	(unaudited)	
Cash flows from operating activities:		
Net income	$ 6,129	$ 12,446
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,977	5,571
Deferred income taxes	4,218	-
Gain on disposals of property and equipment	(1,210)	-
Share-based compensation expense	622	235
Changes in assets and liabilities:		
Increase in accounts receivable, net	(433)	(774)
Increase in inventories	(1,616)	(1,974)
Decrease (increase) in other assets	728	(134)
Decrease in accounts payable and accrued liabilities	(5,196)	(5,569)
Decrease in other long-term liabilities	(175)	(102)
Increase in income taxes payable	743	1,526
Net cash provided by operating activities	8,787	11,225
Cash flows from investing activities:		
Purchases of property and equipment	(5,377)	(2,422)
Curriculum development costs	(3,163)	(961)
Proceeds from sales of property and equipment	2,258	-
Net cash used for investing activities	(6,282)	(3,383)
Cash flows from financing activities:		
Principal payments on long-term debt and financing obligation	(297)	(822)
Change in restricted cash	-	699
Proceeds from sales of common stock from treasury	137	173
Proceeds from management stock loan payments	-	134
Redemption of preferred stock	-	(20,000)
Purchases of treasury shares	(2,539)	(224)
Payment of preferred stock dividends	(1,867)	(3,018)

Net cash used for financing activities		(4,566)		(23,058)
Effect of foreign exchange rates on cash and cash equivalents		94		(120)
Net decrease in cash and cash equivalents		(1,967)		(15,336)
Cash and cash equivalents at beginning of the period		30,587		51,690
Cash and cash equivalents at end of the period	$	28,620	$	36,354
Supplemental disclosure of cash flow information:				
Cash paid for interest	$	1,324	$	1,337
Cash paid for income taxes	$	1,270	$	1,093
Non-cash investing and financing activities:				
Accrued preferred stock dividends	$	934	$	934
Capital lease financing of property and equipment purchases		-		109

See notes to condensed consolidated financial statements.

FRANKLIN COVEY CO.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1 - BASIS OF PRESENTATION

Franklin Covey Co. (hereafter referred to as us, we, our, or the Company) provides integrated consulting, training, and performance enhancement solutions to organizations and individuals in strategy execution, productivity, leadership, sales force effectiveness, effective communications, and other areas. Each integrated solution may include components of training and consulting, assessment, and other application tools that are generally available in electronic or paper-based formats. Our products and services are available through professional consulting services, public seminars, retail stores, catalogs, and the internet at www.franklincovey.com. Historically, the Company's best-known offerings include the FranklinCovey Planner™ and a suite of individual-effectiveness and leadership-development training products based on the best-selling book, *The 7 Habits of Highly Effective People*. We also offer a range of training and assessment products to help organizations achieve superior results by focusing and executing on top priorities, building the capability of knowledge workers, and aligning business processes. These offerings include the popular workshop *FOCUS: Achieving Your Highest Priorities*™, *The 4 Disciplines of Execution*™, *The 4 Roles of Leadership*™, *Building Business Acumen: What the CEO Wants You to Know*™, the Advantage Series communication workshops, and the *Execution Quotient* (*xQ*™) organizational assessment tool. During fiscal 2007 we have also introduced a new leadership program based upon principles found in *The 7 Habits of Highly Effective People*.

The accompanying unaudited condensed consolidated financial statements reflect, in the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position and results of operations of the Company as of the dates and for the periods indicated. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to Securities and Exchange Commission (SEC) rules and regulations. The information included in this quarterly report on Form 10-Q should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended August 31, 2006.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

The Company utilizes a modified 52/53-week fiscal year that ends on August 31 of each year. Corresponding quarterly periods generally consist of 13-week periods that will end on December 2, 2006, March 3, 2007, and June 2, 2007 during fiscal 2007. Under the modified 52/53-week fiscal year, the quarter ended March 3, 2007 had one fewer business day compared to the quarter ended February 25, 2006 and the two quarters ended March 3, 2007 had four additional business days compared to the two quarters ended February 25, 2006.

The results of operations for the quarter and two quarters ended March 3, 2007 are not necessarily indicative of results expected for the entire fiscal year ending August 31, 2007.

NOTE 2 - INVENTORIES

Inventories are stated at the lower of cost or market, cost being determined using the first-in, first-out method, and were comprised of the following (in thousands):

	March 3, 2007	August 31, 2006
Finished goods	$ 19,994	$ 18,464
Work in process	523	706
Raw materials	2,885	2,620
	$ 23,402	$ 21,790

NOTE 3 - CANADIAN LINE OF CREDIT

In addition to the lines of credit described in Note 10, we obtained a CDN $500,000 (approximately $425,300) revolving line of credit with a Canadian Bank through our wholly owned Canadian subsidiary (the Canadian Line of Credit) during the quarter ended March 3, 2007. The Canadian Line of Credit bears interest at the Canadian prime rate and is a revolving line of credit that may be repeatedly borrowed against and repaid during the life of the agreement. The Canadian Line of Credit may be used for general corporate purposes and requires our Canadian subsidiary to maintain a specified financial covenant for minimum debt service coverage or the payment of the loan may be accelerated. As of March 3, 2007 we had not yet drawn upon the Canadian Line of Credit.

In connection with the Canadian Line of Credit, the interest rate on a previously existing mortgage agreement with the same Canadian Bank was reduced from the Canadian prime rate plus one percent to the Canadian prime rate. All other terms on the existing Canadian mortgage remained the same and the Company does not believe that the one percent decrease in the interest rate represents a material modification to terms of the loan.

NOTE 4 - SHAREHOLDERS' EQUITY

During the quarter ended March 3, 2007, we purchased 328,000 shares of our common stock for $2.5 million under the terms of a previously approved $10.0 million common stock purchase plan. Through March 3, 2007, we have purchased a total of 1,009,300 shares of our common stock for $7.6 million as part of this purchase plan.

NOTE 5 - SALE OF MANUFACTURING FACILITY

In August 2006, we initiated a project to reconfigure our printing operations to improve our printing services' efficiency, reduce operating costs, and improve our printing services' flexibility in order to increase external printing service sales. Our reconfiguration plan includes moving our printing operations a short distance from its existing location to our corporate headquarters campus and the sale of the manufacturing facility and certain printing presses. Other existing presses will be moved to the new location as part of the reconfiguration plan. Because the manufacturing facility and printing presses were not available for immediate sale as defined by Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, these assets were not classified as held for sale in our condensed consolidated balance sheets at December 2, 2006 or August 31, 2006.

During the quarter ended March 3, 2007, we completed the sale of the manufacturing facility. The sale price was $2.5 million and, after deducting customary closing costs, the net proceeds to the Company from the sale totaled $2.3

million in cash. The carrying value of the manufacturing facility at the date of sale was approximately $1.1 million and accordingly, we recognized a $1.2 million gain on the sale of the manufacturing facility during the quarter. The manufacturing facility assets sold were primarily reported as a component of corporate assets for segment reporting purposes. Due to a lower-than-expected sale price on one of the printing presses to be sold, we recorded an impairment charge totaling $0.3 million during the quarter ended March 3, 2007 to reduce the carrying value of the printing press to its anticipated sale price. The impairment charge was included as a component of depreciation expense in our condensed consolidated income statements for the quarter and two quarters ended March 3, 2007.

NOTE 6 - INCOME TAXES

In order to determine our quarterly provision for income taxes, we use an estimated annual effective tax rate, which is based on expected annual income and statutory tax rates in the various jurisdictions in which we operate. Certain significant or unusual items are separately recognized in the quarter during which they occur and can be a source of variability in the effective tax rate from quarter to quarter.

During the fourth quarter of fiscal 2006, we determined that it was appropriate to reverse substantially all of the valuation allowances on our deferred income tax assets. Prior to the reversal of these valuation allowances, our income tax provisions were affected by reductions in our deferred income tax valuation allowance as we utilized net operating loss carryforwards. Accordingly, our income tax provision was $4.5 million in the second quarter of fiscal 2007 and was $6.2 million for the two quarters ended March 3, 2007. Our effective tax rate for the two quarters ended March 3, 2007 of approximately 50 percent was higher than statutory combined rates primarily due to the accrual of taxable interest income on the management stock loan program and withholding taxes on royalty income from foreign licensees.

NOTE 7 - COMPREHENSIVE INCOME

Comprehensive income is based on net income and includes charges and credits to equity accounts that were not the result of transactions with shareholders. Comprehensive income for the Company was calculated as follows (in thousands):

	Quarter Ended		Two Quarters Ended	
	March 3, 2007	February 25, 2006	March 3, 2007	February 25, 2006
Net income	$ 4,714	$ 9,213	$ 6,129	$ 12,446
Other comprehensive income (loss) items, net of tax:				
Foreign currency translation adjustments	(80)	145	16	(220)
Comprehensive income	$ 4,634	$ 9,358	$ 6,145	$ 12,226

NOTE 8 - EARNINGS PER SHARE

Basic earnings per common share (EPS) is calculated by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is calculated by dividing net income available to common shareholders by the weighted-average number of common shares outstanding plus the assumed exercise of all dilutive securities using the treasury stock method or the “as converted” method, as appropriate. Due to the modifications to our management stock loan program made during the fourth quarter of fiscal 2006, we determined that the shares of management stock loan participants which were placed in the escrow account are participating securities as defined by Emerging Issues Task Force (EITF) Issue 03-6, *Participating Securities and the Two-Class Method under FASB Statement No. 128*, because they continue to have equivalent common stock dividend rights. Accordingly, these management stock loan shares are included in our basic EPS calculation during periods of net income and excluded from the basic EPS calculation in periods of net loss.

The following table presents the computation of our EPS for the periods indicated (in thousands, except per share amounts):

	Quarter Ended		Two Quarters Ended	
	March 3, 2007	February 25, 2006	March 3, 2007	February 25, 2006
Numerator for basic and diluted earnings per share:				
Net income	$ 4,714	$ 9,213	$ 6,129	$ 12,446
Preferred stock dividends	(934)	(1,139)	(1,867)	(2,518)
Net income available to common shareholders	$ 3,780	$ 8,074	$ 4,262	$ 9,928
Denominator for basic and diluted earnings per share:				
Basic weighted average shares outstanding(1)	19,589	20,311	19,750	