

FRANKLIN COVEY CO  
Form 10-K  
November 12, 2010

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

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Form 10-K  
\_\_\_\_\_

b ANNUAL REPORT PURSUANT TO  
SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED AUGUST  
31, 2010.

OR

.. TRANSITION REPORT PURSUANT TO  
SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM  
\_\_\_ TO \_\_\_

Franklin Covey Co.  
(Exact name of registrant as specified in its charter)

|   |                          |  |
|---|--------------------------|--|
| Utah  | 1-11107                  | 87-0401551                                 |
| (State or<br>other<br>jurisdiction of<br>incorporation<br>or<br>organization) | (Commission<br>File No.) | (IRS<br>Employer<br>Identification<br>No.) |

2200 West Parkway Boulevard  
Salt Lake City, Utah 84119-2331

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(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (801) 817-1776

Securities registered pursuant to Section 12(b) of the Act:

| Title of Each Class           | Name of Each Exchange on Which Registered |
|-------------------------------|---|
| Common Stock, \$.05 Par Value | New York Stock Exchange                   |

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large  Accelerated   
accelerated filer

Non-accelerated  (Do not check if a Smaller   
filer smaller reporting reporting  
company) company

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

As of February 26, 2010, the aggregate market value of the Registrant's Common Stock held by non-affiliates of the Registrant was approximately \$77.1 million, which was based upon the closing price of \$5.85 per share as reported by the New York Stock Exchange.

As of November 1, 2010, the Registrant had 17,037,070 shares of Common Stock outstanding.

#### DOCUMENTS INCORPORATED BY REFERENCE

Parts of the Registrant's Definitive Proxy Statement for the Annual Meeting of Shareholders, which is scheduled to be held on January 14, 2011, are incorporated by reference in Part III of this Form 10-K.



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## PART I

### ITEM 1. BUSINESS

#### Disclosure Regarding Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), relating to our operations, results of operations, and other matters that are based on our current expectations, estimates, assumptions, and projections. Words such as “may,” “will,” “should,” “likely,” “anticipates,” “expects,” “intends,” “plans,” “p,” “believes,” “estimates,” and similar expressions are used to identify these forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties, and assumptions that are difficult to predict. Forward-looking statements are based upon assumptions as to future events that might not prove to be accurate. Actual outcomes and results could differ materially from what is expressed or forecast in these forward-looking statements. Risks, uncertainties, and other factors that might cause such differences, some of which could be material, include, but are not limited to, the factors discussed below under the section entitled “Risk Factors.”

#### General

Franklin Covey Co. (the Company, we, us, our, or FranklinCovey) is a leading global provider of execution, leadership, and personal-effectiveness training with over 600 employees worldwide delivering principle-based curriculum and effectiveness tools to our customers. Our consolidated net sales for the fiscal year ended August 31, 2010 totaled \$136.9 million and our shares of common stock are traded on the New York Stock Exchange (NYSE) under the ticker symbol “FC.”

We operate globally with one common brand and business model designed to enable us to provide clients around the world with the same high level of service. To achieve this level of service we operate four regional sales offices in the United States; wholly owned subsidiaries in Australia, Japan, and the United Kingdom; and contract with licensee partners who deliver our curriculum and provide services in over 140 other countries and territories around the world.

Our business-to-business service utilizes our expertise in training, consulting, and technology that is designed to help our clients define great performance and execute at the highest levels. We also provide clients with training in management skills, relationship skills, and individual effectiveness, and can provide personal-effectiveness literature and electronic educational solutions to our clients as needed.

Our fiscal year ends on August 31 of each year. Unless otherwise noted, references to fiscal years apply to the 12 months ended August 31 of the specified year.

During fiscal 2010, we sold the product sales component of our wholly owned subsidiary in Japan to an unrelated Japan-based paper products company. The sale closed on June 1, 2010 and the total sale price was JPY 305.0 million, or approximately \$3.4 million. In addition, the sale agreement provides for a three percent passive royalty on annual sales, which we believe will not be significant to our future operations. We believe that the sale of this division will further align our Japanese operations with our overall strategic focus on training and consulting sales. As a consequence of the sale, we determined that the operating results of the Japan product sales component qualified for discontinued operations presentation and we have presented the operating results of the Japan product sales component as discontinued operations for all periods presented in this report on Form 10-K.

During the fourth quarter of fiscal 2008, we sold substantially all of the assets of our Consumer Solutions Business Unit (CSBU) to a newly formed entity, Franklin Covey Products, LLC (Refer to Note 3 of our consolidated financial

statements in Item 8 for further details on this transaction). The CSBU was primarily responsible for the sale of our products such as planners, binders, software, totes, and related accessories. Following the sale of the CSBU, our efforts have been focused on providing superior training, consulting, and other services that will enable our clients to achieve greatness.

## Services Overview

Our mission is to enable greatness in people and organizations everywhere. To that end, we have developed industry-leading content, tools, and methodologies to help organizations achieve four outcomes:

1. **Sustained Superior Performance.** Great organizations succeed financially and operationally in both the short and long term relative to their market and strategic potential.
2. **Intensely Loyal Customers.** Great organizations earn not only the “satisfaction” of their customers, but their true loyalty.
3. **Highly Engaged and Loyal Employees.** The people who work in great organizations are energized and passionate about what they do.
4. **Distinctive Contribution.** Great organizations do more than “business as usual”—they fulfill a unique mission that sets them apart from the crowd.

Our content, tools, and methodologies are organized into key practice areas or product lines, each offering targeted solutions that drive these four outcomes. Our primary practice areas and product lines include:

1. Execution
2. Leadership
3. Individual Effectiveness
4. Winning Customer Loyalty
5. Trust
6. Sales Performance
7. Education Solutions
8. E-Learning
9. Custom Solutions
10. Media Publishing

The following is a description of our primary practice areas and curriculum.

### 1. Execution

Execution remains one of the toughest challenges organizations face today. Our internal studies show that only 13 percent of public companies meet yearly financial expectations, 70 percent of strategic initiatives either fail or are abandoned, and only 19 percent of workers say they can effectively translate the company’s top goals into the work they do.

We believe our Execution practice addresses these challenges. We work directly with leadership teams to help them clarify the “wildly important goals” that their strategy requires, identify key measures that lead to the achievement of these goals, create clear and compelling scoreboards, and build a culture and cadence of accountability so that the goals are achieved. Our key execution offerings include:

#### The 4 Disciplines of Execution®: Manager Certification

The purpose of Manager Certification includes helping managers not only develop specific skills, but to also create actual work plans. We help managers leave the session with clearly identified goals and measures, a draft scoreboard for their team, and an accountability plan to help everyone move forward on the goals.



The 4 Disciplines of Execution®: Skills Workshop and Team Work Session

The purpose of the one- or two-day work session is to help teams understand the methods and develop the skills of consistent execution. We help teams clarify their goals, refine key measures, and generate new and better ways of achieving the goals through peer-to-peer accountability.

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### Execution Quotient® (xQ) Assessment

This offering allows organizations to measure their overall ability to execute their most important goals. The xQ is a culture-wide assessment based on factors that contribute to consistent and successful execution. This assessment helps leaders identify areas where their goals may be at risk.

### What the CEO Wants You to Know: Building Business Acumen™

This training supports the Execution disciplines by helping individuals and teams better understand the financial engine of their business and how they can positively affect it. The material is based on the popular book What the CEO Wants You to Know, by leading CEO and executive coach Ram Charan.

## 2. Leadership

Leadership has a profound impact on performance, and is a key lever that mobilizes teams to produce results.

We help organizations develop leaders who build great teams through these 4 imperatives:

1. Inspire Trust: Build credibility as a leader so that people will contribute their highest efforts.
2. Clarify Purpose: Define a clear and compelling purpose that motivates people to offer their best to achieve the organizational goals.
3. Align Systems: Create systems of success that support the purpose and goals of the organization, enable people to do their best work, operate independently of management, and sustain superior performance over time.
4. Unleash Talent: Develop a winning team, where people's unique talents are leveraged against clear performance expectations in a way that encourages responsibility and growth.

Each of our Leadership offerings addresses these imperatives or provides in-depth training in one of these areas.

### Leadership: Great Leaders, Great Teams, Great Results™

This comprehensive offering contains the entire core content of FranklinCovey's Leadership practice. During the program, leaders learn the 4 Imperatives of Great Leaders and take specific actions to carry them out. The workshop features award-winning videos that present the latest on our own research and thinking, along with the best thinking of other leadership experts including:

- Jack Welch, Winning
- Fred Reichheld, The Ultimate Question
- Clayton Christensen, The Innovator's Solution
  - Stephen R. Covey, The 8th Habit
- Stephen M. R. Covey, The Speed of Trust
- Ram Charan, What the CEO Wants You to Know

### Leadership Foundations™

Our Leadership Foundations workshop is designed to prepare emerging leaders to take on significant roles and responsibilities in the future. Participants gain skills to improve trust and influence with peers and superiors, link their work to a clear and compelling team purpose, implement a system for executing critical priorities, and leverage the talents of peers and co-workers to achieve unprecedented results.

### Leadership Modular Series™

Drawn from the content of our leadership-development program, the Leadership Modular Series comprises seven stand-alone modules that teach imperatives leaders can apply immediately to create a work environment that addresses the needs of the knowledge worker. For leaders who cannot attend multiple days of training, the Leadership Modular Series lets them focus on one

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specific leadership competency, three to four hours at a time. The series includes the following instructor-led training modules:

1. The 4 Imperatives of Great Leaders™
  2. Inspiring Trust
3. Clarifying Your Team's Purpose and Strategy
  4. Closing the Execution Gap
  5. Building Process Excellence
  6. Unleashing Talent
  7. Leading Across Generations

### The 7 Habits for Managers®

FranklinCovey's The 7 Habits for Managers solution teaches the fundamentals of leading today's mobile knowledge worker. Both new and experienced managers acquire a set of tools to help them meet today's management challenges, including conflict resolution, prioritization, performance management, accountability and trust, execution, collaboration, and team and employee development. We help participants in our The 7 Habits for Managers program to:

- Increase resourcefulness and initiative.
- Define the contribution they want to make in their role as manager.
- Manage performance through a balance of accountability and trust.
  - Give constructive feedback.
- Improve team decision-making skills by embracing diverse viewpoints.

### Executive Coaching

We offer senior executives a coaching experience created in partnership with Columbia University, which includes methodologies approved by the International Coach Federation (ICF). We leverage content, methodology, and tools to guide leaders in discovering and unleashing the potential they already possess. In one-on-one or team sessions, our executive coaches help senior-level executives work through complex issues, helping them establish initiatives that are clear, defined, and actionable, and provide supportive accountability until their goals are reached. We also offer one-on-one executive coaching in leadership development, strategy, goal execution, and personal work/life areas.

### 3. Individual Effectiveness

Effective organizations are characterized by highly effective individuals—individuals who take initiative, set and achieve important goals, manage themselves well and are highly productive, work well with others, solve problems, and create new and valuable ideas.

Individual effectiveness and resilience are particularly valuable in a difficult economic environment. In such an environment, we believe that our approaches to personal and interpersonal effectiveness are perhaps more critical than ever.

### The 7 Habits of Highly Effective People®—Signature Program

Based on the principles found in Dr. Stephen R. Covey's best-selling business book, The 7 Habits of Highly Effective People, this program drives organizational success by helping participants gain the paradigms and behaviors of effective people. Participants gain hands-on experience, applying principles that yield greater productivity, improved communication, strengthened relationships, increased influence, and focus on critical priorities. Participants learn how to take initiative, identify and balance key priorities, improve interpersonal communication, leverage creative collaboration and problem solving, and build their personal resilience and capability.

The 7 Habits of Highly Effective People®: Introductory Workshop for Associates

This workshop for employees at all levels is designed to tap the best they have to give. We help employees become empowered with new knowledge, skills, and tools to confront issues, work as a team, increase accountability, and raise the bar on what they can achieve. Participants discover

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how to maximize performance by avoiding dependence on others, gaining appropriate independence, and moving on to where real success lies: being successfully interdependent and collaborative with others.

#### FOCUS: Achieving Your Highest Priorities™

Our time-management workshop presents principles that help participants identify and clarify their values, set goals, and plan weekly and daily to accomplish what really counts. We help participants discover how to clearly define goals and break them down into key tasks, eliminate unnecessary activities to reduce stress, balance work and life priorities, and master information management with a proven planning system.

#### FOCUS: Achieving Your Highest Priorities—Microsoft® Outlook® Edition

This practical workshop teaches participants to apply the principles from our productivity training while using Microsoft Outlook as their scheduling tool. We teach them how to prioritize tasks, messages, and appointments to achieve what is most important to the organization and themselves. In addition, we teach participants how to gain control of competing demands on their time from email, voice mail, meetings, and interruptions, plus we teach them a goal-setting process to become more motivated and productive.

#### FOCUS: Achieving Your Highest Priorities—IBM® Lotus Notes® Edition

The same as the workshop for Microsoft Outlook above, this workshop also teaches participants to apply the principles from our productivity training while using IBM Lotus Notes as their scheduling tool. Participants learn to stay focused and effective by integrating IBM Lotus Notes, paper, and PDA-type productivity tools together; apply a planning process that gets better business results; reduce stress by recognizing and eliminating distractions and low-priority activities; and achieve balance and renewal, while avoiding burnout and frustration.

#### Project Management™ (One- and Two-Day Program)

Our Project Management solution teaches a four-step process for managing projects, large or small. This approach helps project managers and their teams craft and deliver high-quality projects on time and within budget. This solution is taught as a one- or two-day, facilitator-led process, and encourages attendees to focus on their own current projects for a hands-on experience.

#### Writing Advantage™

The FranklinCovey Writing Advantage program teaches participants how to set quality writing standards that help people increase productivity, resolve issues, avoid errors, and heighten credibility. Participants learn a four-step process to improve their writing skills. They learn how to write faster with more clarity, and gain skills for revising and fine-tuning every style of document.

#### Technical Writing Advantage™

FranklinCovey's Technical Writing Advantage program teaches participants the skills to improve the quality, clarity, structure, and expected results of their technical communication. This program teaches participants to take complex ideas and make them understandable and memorable in written form.

#### Presentation Advantage™

With our Presentation Advantage solution, participants learn how to craft presentations around essential objectives, present key concepts and ideas with power and enthusiasm, design and present effective visuals, and employ techniques for polishing and mastering presentation delivery.

#### Meeting Advantage™

The FranklinCovey Meeting Advantage solution teaches participants to plan effectively by frontloading before a meeting, focusing productively during the meeting, and following through successfully after the meeting.

## 4. Winning Customer Loyalty®

Our Winning Customer Loyalty practice helps leaders of multiunit organizations create a culture where employees are engaged and equipped to deliver great customer experiences. To do this,

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customer loyalty specialists draw from an array of offerings to craft a solution that works with each company's culture, operating environment, and strategic vision. A typical solution includes these components:

- Customer scores. Customer-satisfaction and loyalty scores for every unit, every month.
- Employee scores. A targeted employee survey that gauges each unit's "Execution Quotient" (xQ), or the conditions required for an engaged and focused workforce.
- Loyalty Portal. A Web-based dashboard that allows every unit to see their scores, reach out to customers, and manage their team's focus on the key activities that drive customer loyalty.
- "Lead measure" identification. Our most senior consultants guide the senior team through a "lead measure" identification process where, through a combination of best practices and strategic assessments, key activities are identified that become the drivers of a memorable customer experience.
- Systems alignment. We help the senior team to align compensation, training, and other systems around the most critical goals and remove operational barriers to execution.
- Manager certification. Unit-level managers are certified to engage their teams around their scores, lead measures, and key activities.
- Frontline training. We provide training in key areas such as scoreboarding, focus and execution, leadership, and creating a culture of service. Much of this training, as well as supportive tools, is delivered to each unit through the Loyalty Portal.

## 5. Trust

We believe that trust is the hallmark of effective leaders, teams, and organizations. Trust-related problems like bureaucracy, fraud, and excessive turnover discourage productivity, divert resources, and chip away at a company's brand. On the other hand, leaders who make building trust an explicit goal of their job gain strategic advantages—accelerating growth, enhancing innovation, improving collaboration and execution, and increasing shareholder value. Our Trust practice is built on The New York Times best-selling book, *The Speed of Trust* by Stephen M. R. Covey, and includes offerings to help leaders and team members develop the competencies to make trust a strategic advantage.

### Leading at the Speed of Trust™

This program engages leaders at all levels in identifying and closing the trust gaps in their organization. Instead of paying "trust taxes," organizations can begin to realize "trust dividends." We believe that doing business at the "speed of trust" lowers costs, speeds up results, and increases profits and influence. Our Leading at the Speed of Trust solution is designed to help leaders:

- Make building trust an explicit goal of their work.
- Learn how others perceive their trustworthiness from their personal tQ™ (Trust Quotient) Report.
  - Understand the real, measurable "trust taxes" they may be paying without realizing it.
- Change "trust taxes" to "trust dividends," which are the benefits that come from growing relationships of trust.
  - Make action plans to build trust accounts with all key stakeholders.
  - Begin using the language of trust as an important cultural lever.

### Working at the Speed of Trust™—For Associates

This workshop helps individual contributors identify and address "trust gaps" in their personal credibility and in their relationships at work. Using examples from their work and focusing on real-world issues, participants discover how to communicate transparently with peers and managers, improve their track record of keeping commitments, focus on improving internal "customer service" with others who depend on their work, and much more. Our Working at the Speed of Trust solution is designed to help associates:

- Increase personal credibility.



- Exhibit behaviors that increase trust.
- Increase trust with key stakeholders.
- Create an environment of high trust that will increase creativity, innovation, and a greater commitment to achieving results.

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### 6. Sales Performance

We believe that sales performance is about helping clients succeed. FranklinCovey provides an approach that delivers the “what to do” and “how to do” for mutual seller/buyer benefits. Through consulting, training, and coaching, our Sales Performance practice helps sales leaders and salespeople act as genuine trusted business advisors who create value and help clients succeed.

Helping clients succeed is a mind-set, skill-set, and tool-set for becoming client-centered. It is a way of thinking, being, and behaving. We believe that it removes the stigmas that come with sales, and we believe that it removes the adversarial interplay between sellers and buyers. It is also a process for creating candid dialogue, fresh thinking, innovative collaboration, insightful decision making, and robust execution—with clients and within an organization.

The acronym INORDER represents the underlying sales methodology we use in Helping Clients Succeed. Each module in the methodology represents a different stage in the sales process, starting from the front end with Initiating New Opportunities (INO) and Qualifying Opportunities (ORD), then closing at the back end with Winning and Growing Opportunities (ER). With our suite of consultative sales-training solutions, we believe clients can transform their salespeople into trusted business advisors who focus on helping their clients succeed, resulting in increased sales, shortened sales cycles, improved margins, and satisfied clients.

### 7. Education Solutions

The FranklinCovey Education Solutions practice is dedicated to helping educational organizations build the culture that will produce great results. Our offerings address all grade levels and help faculty and students develop the critical leadership and effectiveness skills they will need to succeed in a knowledge-based, networked world.

#### Primary Education Solutions: The Leader in Me®

The Leader in Me process is designed to be integrated into a school’s core curriculum and everyday language. The methodology is designed to become part of the culture, gain momentum, and help to produce improved results year after year. We believe the methodology benefits schools and students in the following ways:

- Develops students who have the skills and self-confidence to succeed as leaders in the 21st century.
  - Decreases discipline referrals.
- Teaches and develops character and leadership through existing core curriculum.
  - Improves academic achievement.
- Raises levels of accountability and engagement among both parents and staff.

The Leader in Me process also helps create a common language within a school, built on principle-based leadership skills found in Dr. Stephen R. Covey’s best-selling book *The 7 Habits of Highly Effective People*, and is designed to produce a holistic school-wide experience for primary school teachers and their classrooms that proceeds in several phases:

#### Phase 1: Faculty Development

Through facilitated peer-to-peer discussion, videos, and learning exercises, teachers and administrators will:

- Explore and create a guiding vision for what “greatness” means within the culture of their school.
- Learn and internalize the 7 Habits and understand how to apply the principles in their classrooms.
  - Study other schools that have integrated the 7 Habits and other leadership and quality tools.
- Become certified to deliver *The 7 Habits of Highly Effective People*® training as a means of ongoing professional development.



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### Phase 2: Implementation Training

In this phase, teachers and administrators will learn how to:

- Integrate the 7 Habits and other leadership principles into the school's curriculum and culture.
- Apply The Leader in Me process to develop the specific 21st-century competencies students will need to succeed at school, in their future careers, and in life.

### Phase 3: Classroom Implementation

The Leader in Me includes several tools to assist educators, students, and parents in implementation during the first year, as well as reinforcing the process in following years.

- The Leader in Me Web Community— [www.TheLeaderInMe.org](http://www.TheLeaderInMe.org)—features cross-curricular lesson plans, award-winning videos, assessments, and a forum for educators, as well as fun activities for students.
  - Student Activity Guides for Lower/Upper Elementary and Annotated Teacher's Editions.
    - The 7 Habits of Happy Kids™ poster set.
    - The 7 Habits of Happy Kids book by Sean Covey.
    - The Leader in Me book by Stephen R. Covey.

### Secondary Education Solutions: The 7 Habits of Highly Effective Teens®

The Introduction to The 7 Habits of Highly Effective Teens® workshop from FranklinCovey, based on the best-selling book of the same name by Sean Covey and the No. 1 best-selling business book The 7 Habits of Highly Effective People, gives young people a set of tools to deal with life's challenges. The training is a means for educators, administrators, and superintendents to help improve student performance; reduce conflicts, disciplinary problems, and truancy; and enhance cooperation and teamwork among parents, teens, and teachers.

The 7 Habits of Highly Effective Teens are essentially seven characteristics that many happy and successful teens the world over have in common. The training provides students with a step-by-step framework for boosting self-image, building friendships, resisting peer pressure, achieving goals, improving communication and relationships with parents, and much more. The habits build upon each other and foster behavioral change and improvement from the inside out.

We also offer a workshop built around the book The 6 Most Important Decisions You'll Ever Make, also by Sean Covey. This book helps students work through important and life-changing questions. This workshop is designed to be flexible so it can fit a classroom or school-wide schedule.

### Higher Education Solutions: Introduction to the 7 Habits of Highly Effective College Students™

We believe that undergraduates who start their freshman year with a plan are more likely to complete their education and have successful careers. The 7 Habits of Highly Effective College Students helps students succeed by discovering their personal mission, setting goals, prioritizing tasks, and teaming with others.

This workshop contains eight hours of instructional material, which can be taught in a one day or modular format. Facilitators lead programs through instruction, multimedia presentations, and activities that provide students with a forum in which to reflect individually, apply the content, and get to know each other. Clients can become licensed to train their own students onsite, or have our facilitators present a custom program on their campus.

## 8. E-Learning

Our E-Learning practice brings the best of FranklinCovey to clients in innovative ways that transcend traditional e-learning solutions. Clients get the quality experience they expect from FranklinCovey in ways that allow them to reach their employees throughout the world.



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### FranklinCovey InSights™

We believe that some of the best development happens when leaders teach their own teams. FranklinCovey InSights represents a new paradigm of “Teach to Learn” leadership. This library of bite-sized, Web-based learning modules is built around our award-winning video presentations that leaders can use to motivate their teams to improve performance. Designed to address generational learning styles, the modules teach people to see and do things differently, enabling teams to produce better results and make changes over time.

### LiveClicks™

LiveClicks is our webinar delivery platform that allows clients to reach more people at less cost with high-quality live training. LiveClicks webinar workshops utilize our award-winning videos, interactive activities, and live instruction. LiveClick webinars are offered to the public with our consultants and client facilitators, who can also become certified to teach LiveClicks webinars inside their organizations.

The LiveClicks platform allows clients to train more people, reach remote workers, and attract a new generation of workers. Finally, LiveClicks can help organizations stay green by reducing the carbon impact of travel. Our LiveClicks titles include:

- Time Management for Microsoft® Outlook®: Increasing Your Productivity Through the Effective Use of Outlook™
- Time Management for IBM® Lotus Notes®: Increasing Your Productivity Through the Effective Use of IBM Lotus Notes™
  - Resolving Generational Conflict: Understanding and Navigating Generational Differences at Work™
    - The Diversity Advantage: Leveraging Differences at Work for Great Results™
      - The Speed of Trust® Series—Relationship Trust
        - The Speed of Trust® Series—Self Trust
        - The 7 Habits® for Managers Series
    - Be Proactive®: Using Your Resourcefulness and Initiative to Get Things Done
      - The 7 Habits® for Managers Series
  - Begin With the End in Mind®: Defining Your Contribution and Leading With Purpose
    - Project Management Fundamentals: Managing Projects That Succeed™
    - Business Writing Skills: Getting Your Point Across With Power and Influence™

### The 7 Habits Interactive® Edition

The award-winning 7 Habits of Highly Effective People—Interactive Edition helps employees, regardless of work location, to increase their effectiveness and productivity and feel a stronger sense of cohesion. The 7 Habits Interactive Edition heightens learning by helping participants to apply principles that are designed to yield greater productivity, improved communication, strengthened relationships, increased influence, and an improved focus on critical priorities. During the three-hour online instruction, participants engage in interactive exercises that illustrate how to use the 7 Habits in real work situations. Participants can then test their new skills in a virtual simulation that shows the real-world triumphs and challenges associated with the choices they have made. Participants can also join a live one-day application workshop to study the content in more depth, and practice what they have learned.

## 9. Custom Solutions

Whether clients need a program customized, or require a new product developed for their organization, our Custom Client solutions has the process to build the solution. Customization builds upon our existing content and clients’ unique content by using a specific process to deliver results. Our five-step process, as outlined below, lowers development costs and strives to improve our clients’ return on investment:

### Diagnose

- Identify key stakeholder needs.

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- Identify challenges and logistics.
- Identify audience, culture, budget, timeline, and success measures.

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### Design

- Clarify learning objectives and priorities.
- Confirm audience and stakeholder needs.
- Brainstorm content alignment with learning objectives.

### Develop

- Create content for all deliverables.
  - Facilitate client reviews.
  - Incorporate changes.
  - Prepare final materials.

### Deliver

- Training delivered by training professionals.

### Learn

- Gather post-project feedback.
- Define areas of improvement and incorporate into the process.

## 10. Media Publishing

Our Media Publishing practice extends our influence into both traditional publishing and new media channels. FranklinCovey Media Publishing offers books, e-books, audio products, downloadable and paper-based tools, and content-rich software applications for smart phones and other handheld devices (like the Apple® iPhone®) to consumer and corporate markets.

### Industry Information

According to the Training Magazine 2010 Training Industry Survey, the total size of the U.S. training industry is estimated to be \$52.8 billion, which is up slightly compared to the prior year. We are engaged in the performance skills segment of the training industry. One of our competitive advantages in this highly fragmented industry stems from our fully integrated training curricula, measurement methodologies, and implementation tools to help organizations and individuals measurably improve their effectiveness. This advantage allows us to deliver not only training to both corporations and individuals, but also to implement the training through the use of powerful behavior changing tools with the capability to then measure the impact of the delivered training and tools.

Over our history, we have provided products and services to 97 of the Fortune 100 companies and more than 75 percent of the Fortune 500 companies. We also provide products and services to a number of U.S. and foreign governmental agencies, as well as numerous educational institutions. In addition, we provide training curricula, measurement services and implementation tools internationally, either through directly operated offices, or through independent licensed providers.

### Segment Information

Prior to the sale of CSBU in the fourth quarter of fiscal 2008, our business was organized in two segments: (1) the CSBU, which was designed to sell products to individual consumers and small businesses; and (2) the Organizational Solutions Business Unit (OSBU), which was designed to serve organizational clients. Following the sale of CSBU, the Company's operations are grouped into one operating segment. The following table sets forth, for the fiscal periods indicated, the Company's sales to external customers based on prior segments for comparability purposes (in thousands):





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| YEAR ENDED<br>AUGUST 31,                   | 2010       | Percent<br>change<br>from prior<br>year | 2009       | Percent<br>change<br>from prior<br>year | 2008       |
|--|------------|---|------------|---|------------|
| Organizational Solutions<br>Business Unit: |            |   |            |   |            |
| Domestic                                   | \$ 98,344  | 18                                      | \$ 83,193  | (16 )                                   | \$ 99,308  |
| International                              | 35,309     | (3 )                                    | 36,385     | (16 )                                   | 43,060     |
|  | 133,653    | 12                                      | 119,578    | (16 )                                   | 142,368    |
| Consumer Solutions Business<br>Unit:       |            |   |            |   |            |
| Total operating units                      | 133,653    | 12                                      | 119,578    | (52 )                                   | 249,603    |
| Leasing                                    | 3,221      | (9 )                                    | 3,556      | 44                                      | 2,471      |
| Consolidated sales                         | \$ 136,874 | 11                                      | \$ 123,134 | (51 )                                   | \$ 252,074 |

Additional financial information related to our operating segments, as well as geographical information can be found in the notes to our consolidated financial statements (Note 18).

### Clients

We have a relatively broad base of organizational and individual clients. Worldwide, we have more than 4,200 organizational clients consisting of corporations, governmental agencies, educational institutions, and other organizations. We have additional organizational clients throughout the world, and we believe that our products, workshops, and seminars encourage strong client loyalty. Employees in each of our domestic and international distribution channels focus on providing timely and courteous responses to client requests and inquiries. Due to the nature of our business, we do not have a significant backlog of firm orders.

### Competition

We operate in a highly competitive and rapidly changing global marketplace and compete with a variety of organizations that offer services comparable with those that we offer. Competition in the performance skills training and education industry is highly fragmented with few large competitors. Based upon our fiscal 2010 consolidated sales of \$136.9 million, we believe that we are a leading competitor in the organizational training and education market. Other significant competitors in the training market are Development Dimensions International, Institute for International Research (IIR), Organizational Dynamics Inc., American Management Association, Wilson Learning, Forum Corporation, EPS Solutions, and the Center for Creative Leadership.

We derive our revenues from a variety of companies with a broad range of sales volumes, governments, educational institutions, and other institutions. We believe that the principal competitive factors in the industry in which we compete include the following:

- Quality of services and solutions
- Skills and capabilities of people
- Innovative training and consulting services combined with effective products
  - Ability to add value to client operations
    - Reputation and client references
    - Price
- Availability of appropriate resources

- Global reach and scale

Given the relative ease of entry in our training market, the number of our competitors could increase, many of whom may imitate existing methods of distribution, or could offer similar products and seminars at lower prices. Some of these competitors may have greater financial and other resources than us. However, we believe our curriculum based upon best-selling books, which encompasses relevant high-quality video segments, has become a competitive advantage. This

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advantage is strengthened and enhanced by our ability to easily train individuals within organizations to become client facilitators who in turn can effectively relay our curriculum throughout their organization. Moreover, we believe that we are a market leader in the United States in execution, leadership, and individual effectiveness training, consulting and products. Increased competition from existing and future competitors could, however, have a material adverse effect on our sales and profitability.

### Seasonality

Our quarterly results of operations reflect minor seasonal trends primarily because of the timing of corporate training, which is not typically scheduled as heavily during holiday and vacation periods.

Quarterly fluctuations may also be affected by other factors including the introduction of new offerings, the addition of new organizational customers, and the elimination of underperforming offerings.

### Manufacturing and Distribution

Following the sale of CSBU in fiscal 2008, we no longer manufacture a significant portion of our products. We purchase our training materials and related products from various vendors and suppliers located both domestically and internationally, and we are not dependent upon any one vendor for the production of our training and related materials as the raw materials for these products are readily available. We currently believe that we have good relationships with our suppliers and contractors.

During fiscal 2001, we entered into a long-term contract with HP Enterprise Services (HP, formerly Electronic Data Services) to provide warehousing and distribution services for our training products and related accessories. HP maintains a facility at our headquarters as well as at other locations throughout North America.

### Trademarks, Copyrights, and Intellectual Property

Our success has resulted in part from our proprietary curriculum, methodologies, and other intellectual property rights. We seek to protect our intellectual property through a combination of trademarks, copyrights, and confidentiality agreements. We claim rights for over 270 trademarks in the United States and have obtained registration in the United States and many foreign countries for many of our trademarks including FranklinCovey, The 7 Habits of Highly Effective People, Principle-Centered Leadership, The 4 Disciplines of Execution, PlanPlus, The 7 Habits, and The 8th Habit. We consider our trademarks and other proprietary rights to be important and material to our business.

We own sole or joint copyrights on our planning systems, books, manuals, text and other printed information provided in our training seminars and other electronic media products, including audio tapes and video tapes. We license, rather than sell, facilitator workbooks and other seminar and training materials in order to protect our intellectual property rights therein. We place trademark and copyright notices on our instructional, marketing, and advertising materials. In order to maintain the proprietary nature of our product information, we enter into written confidentiality agreements with certain executives, product developers, sales professionals, training consultants, other employees, and licensees. Although we believe the protective measures with respect to our proprietary rights are important, there can be no assurance that such measures will provide significant protection from competitors.

### Employees

One of our most important assets is our people. The diverse and global makeup of our workforce allows us to serve a variety of clients on a worldwide basis. We are committed to attracting, developing, and retaining quality personnel and actively strive to reinforce our employees' commitments to our clients, culture, and values through creation of a

motivational and rewarding work environment.

At August 31, 2010, we had over 600 full- and part-time associates located in the United States of America, Canada, Japan, the United Kingdom, and Australia. During fiscal 2001, we outsourced a significant part of our information technology services, customer service, distribution and

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warehousing operations to HP. A number of our former employees involved in these operations are now employed by HP to provide those services to FranklinCovey. None of our associates are represented by a union or other collective bargaining group. Management believes that its relations with its associates are good and we do not currently foresee a shortage in qualified personnel needed to operate our business.

Available Information

The Company's principal executive offices are located at 2200 West Parkway Boulevard, Salt Lake City, Utah 84119-2331, and our telephone number is (801) 817-1776.

We regularly file reports with the Securities Exchange Commission (SEC). These reports include, but are not limited to, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and security transaction reports on Forms 3, 4, or 5. The public may read and copy any materials that the Company files with the SEC at the SEC's Public Reference Room located at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains electronic versions of the Company's reports, proxy and information statements, and other information that the Company files with the SEC on its website at [www.sec.gov](http://www.sec.gov).

The Company makes our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, current reports on Form 8-K, and other reports filed or furnished with the SEC available to the public, free of charge, through our website at [www.franklincovey.com](http://www.franklincovey.com). These reports are provided through our website as soon as is reasonably practicable after we file or furnish these reports with the SEC.

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ITEM 1A. RISK FACTORS

Our business environment, current domestic and international economic conditions, and other specific risks may affect our future business decisions and financial performance. The matters discussed below may cause our future results to differ from past results or those described in forward-looking statements and could have a material adverse effect on our business, financial condition, liquidity, results of operations, and stock price, and should be considered in evaluating our Company.

The risks included here are not exhaustive. Other sections of this report may include additional risk factors which could adversely affect our business and financial performance. Moreover, we operate in a very competitive and rapidly changing global environment. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

We operate in an intensely competitive industry and our competitors may develop courses that adversely affect our ability to sell our offerings.

The training and consulting services industry is intensely competitive with relatively easy entry. Competitors continually introduce new programs and services that may compete directly with our offerings or that may make our offerings uncompetitive or obsolete. Larger and better capitalized competitors may have superior abilities to compete for clients and skilled professionals, reducing our ability to deliver quality work to our clients. In addition, one or more of our competitors may develop and implement training courses or methodologies that may adversely affect our ability to sell our curricula and products to new clients. Any one of these circumstances could have a material adverse effect on our ability to obtain new business and successfully deliver our services and solutions.

Our results of operations could be adversely affected by economic and political conditions and the effects of these conditions on our clients' businesses and their levels of business activity.

Global economic and political conditions affect our clients' businesses and the markets in which they operate. Our financial results are somewhat dependent on the amount that current and prospective clients budget for training. A serious and/or prolonged economic downturn (slow recovery) combined with a negative or uncertain political climate could adversely affect our clients' financial condition and the amount budgeted for training by our clients. These conditions may reduce the demand for our services and solutions or depress the pricing of those services and have a material adverse impact on our results of operations. Changes in global economic conditions may also shift demand to services for which we do not have competitive advantages, and this could negatively affect the amount of business that we are able to obtain. Such economic, political, and client spending conditions are influenced by a wide range of factors that are beyond our control and that we have no comparative advantage in forecasting. If we are unable to successfully anticipate these changing conditions, we may be unable to effectively plan for and respond to those changes, and our business could be adversely affected.

Our business success also depends in part upon continued growth in the use of training and consulting services in business by our current and prospective clients. In challenging economic environments, our clients may reduce or defer their spending on new services

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and consulting solutions in order to focus on other priorities. At the same time, many companies have already invested substantial resources in their current means of conducting their business and they may be reluctant or slow to adopt new approaches that could disrupt existing personnel and/or processes. If the growth in the general use of training and consulting services in business or our clients' spending on these items declines, or if we cannot convince our clients or potential clients to embrace new services and solutions, our results of operations could be adversely affected.

In addition, our business tends to lag behind economic cycles and, consequently, the benefits of an economic recovery following a period of economic downturn may take longer for us to realize than other segments of the economy.

Our results of operations may be negatively affected if we cannot expand and develop our services and solutions in response to client demand or if newly developed or acquired services have increased costs.

Our success depends upon our ability to develop and deliver services and consulting solutions that respond to rapid and continuing changes in client needs. We may not be successful in anticipating or responding to these developments on a timely basis, and our offerings may not be successful in the marketplace. The implementation, acquisition, and introduction of new programs and solutions may reduce sales of our other existing programs and services and may entail more risk than supplying existing offerings to our clients. Newly developed or acquired solutions may also require increased royalty payments or carry significant development costs that must be expensed. In addition, the introduction of new or competing offerings by current or future competitors may render one or more of our offerings obsolete. Any one of these circumstances may have an adverse impact upon our business and results of operations.

Our business could be adversely affected if our clients are not satisfied with our services.

The success of our business model significantly depends on our ability to attract new work from our base of existing clients, as well as new work from prospective clients. Our business model also depends on the relationships our senior executives and sales personnel develop with our clients so that we can understand our clients' needs and deliver services and solutions that are specifically tailored to those needs. If a client is not satisfied with the quality of work performed by us, or with the type of services or solutions delivered, then we may incur additional costs to remediate the situation, the profitability of that work might be decreased, and the client's dissatisfaction with our services could damage our ability to obtain additional work from that client. In particular, clients that are not satisfied might seek to terminate existing contracts prior to their scheduled expiration date and could direct future business to our competitors. In addition, negative publicity related to our client relationships, regardless of its accuracy, may further damage our business by affecting our ability to compete for new contracts with current and prospective clients.

Our profitability could suffer if we are unable to control our operating costs.

Our future success and profitability depend in part on our ability to achieve an appropriate cost structure and to improve our efficiency in the highly competitive services industry in which we compete. We regularly monitor our operating costs and develop initiatives and business models that impact our operations and are designed to improve our profitability. Our recent initiatives have included revisions to existing processes and procedures, asset sales, headcount reductions, exiting non-core businesses, redemptions of preferred stock, and other internal initiatives designed to reduce our operating costs. If we are unable to



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achieve targeted business model cost levels and manage our costs and processes to produce additional efficiencies, our competitiveness and profitability could decrease.

Our profitability will suffer if we are not able to maintain our pricing and utilization rates.

Our profit margin on our services and solutions is largely a function of the rates we are able to recover for our services and the utilization, or chargeability, of our trainers, client partners, and consultants. Accordingly, if we are unable to maintain sufficient pricing for our services or an appropriate utilization rate for our training professionals without corresponding cost reductions, our profit margin and overall profitability will suffer. The rates that we are able to recover for our services are affected by a number of factors, including:

- Our clients' perceptions of our ability to add value through our programs and products
  - Competition
  - General economic conditions
  - Introduction of new programs or services by us or our competitors
- Our ability to accurately estimate, attain, and sustain engagement sales, margins, and cash flows over longer contract periods

Our utilization rates are also affected by a number of factors, including:

- Seasonal trends, primarily as a result of scheduled training
- Our ability to forecast demand for our products and services and thereby maintain an appropriate headcount in our employee base
  - Our ability to manage attrition

During recently completed periods we have maintained favorable utilization rates. However, there can be no assurance that we will be able to maintain favorable utilization rates in future periods. Additionally, we may not achieve a utilization rate that is optimal for us. If our utilization rate is too high, it could have an adverse effect on employee engagement and attrition. If our utilization rate is too low, our profit margin and profitability may suffer.

If our pricing structures do not accurately anticipate the cost and complexity of performing our services, our contracts may become unprofitable.

We negotiate pricing terms with our clients utilizing a range of pricing structures and conditions. Depending on the particular contract and service to be provided, these terms include time-and-materials pricing, fixed-price pricing, and contracts with features of both of these pricing models. Our pricing is highly dependent on our internal forecasts and predictions about our projects and the marketplace, which might be based on limited data and could turn out to be inaccurate. If we do not accurately estimate the costs and time necessary to deliver our work, our contracts could prove unprofitable for us or yield lower profit margins than anticipated. There is a risk that we may under price our contracts, fail to accurately estimate the costs of performing the work, or fail to accurately assess the risks associated with potential contracts. In particular, any increased or unexpected costs, delays or failures to achieve anticipated cost savings, or unexpected risks we encounter in connection with the performance of our work, including those caused by factors outside our control, could make these contracts less profitable or unprofitable, which could have an adverse effect on our profit margin.

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Our results of operations and cash flows may be adversely affected if Franklin Covey Products LLC is unable to pay the working capital settlement, reimbursable acquisition costs, or reimbursable operating expenses.

According to the terms of the agreements associated with the sale of the Consumer Solutions Business Unit (CSBU) assets to Franklin Covey Products, LLC (Franklin Covey Products) that closed in the fourth quarter of fiscal 2008, we were entitled to receive a \$1.2 million payment for working capital delivered on the closing date of the sale and to receive \$2.3 million as reimbursement for specified costs necessary to complete the transaction. Payment for these costs was originally due in January 2009, but we extended the due date of the payment at Franklin Covey Products' request and obtained a promissory note from Franklin Covey Products for the amount owed, plus accrued interest.

At the time we received the promissory note from Franklin Covey Products, we believed that we could obtain payment for the amounts owed, based on prior year performance and forecasted financial performance in 2009. However, the financial position of Franklin Covey Products deteriorated significantly late in fiscal 2009 and the deterioration accelerated subsequent to August 31, 2009 and continued throughout fiscal 2010. As a result of its deteriorating financial position, we reassessed the collectibility of the promissory note. Based on revised expected cash flows and other operational issues, we determined that the promissory note should be impaired at August 31, 2009. Accordingly, we recorded a \$3.6 million impaired asset charge and reversed \$0.1 million of interest income that was recorded during fiscal 2009 from the working capital settlement and reimbursable transaction cost receivables.

We receive reimbursement for certain operating costs, such as warehousing and distribution costs, which are billed to us by third party providers. At August 31, 2010 and 2009 we had \$3.4 million and \$2.0 million receivable from Franklin Covey Products, which have been classified in other current assets. If Franklin Covey Products fails to reimburse us for these costs, and we fail to obtain payment on the promissory note, our future cash flows will be adversely affected.

Our results of operations and cash flows may be adversely affected if Franklin Covey Products LLC is unable to pay its retail store leases.

Based on the terms of the agreements associated with the sale of the CSBU assets, we assigned the benefits and obligations relating to the leases of our retail stores to Franklin Covey Products, an entity in which we own approximately 19 percent. However, we remain secondarily liable for these leases and may have to fulfill the obligations contained in the lease agreements, including making lease payments, if Franklin Covey Products is unable to fulfill its obligations pursuant to the terms of the lease agreements. Any default by Franklin Covey Products in its lease payment obligations could provide us with certain remedies against Franklin Covey Products, including potentially allowing us to terminate the Master License Agreement. If Franklin Covey Products is unable to satisfy the obligations contained in the lease agreements and we are unable to obtain adequate remedies, our results of operations and cash flows may be adversely affected.

If we are unable to attract, retain, and motivate high-quality employees, including training consultants and other key training representatives, we will not be able to compete effectively and will not be able to grow our business.

Our success and ability to grow are dependent, in part, on our ability to hire, retain, and motivate sufficient numbers of talented people with the increasingly diverse skills needed to serve our clients and grow our business. Competition for skilled personnel is intense at all

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levels of experience and seniority. To address this competition, we may need to further adjust our compensation practices, which could put upward pressure on our costs and adversely affect our profit margins. At the same time, the profitability of our business model is partially dependent on our ability to effectively utilize personnel with the right mix of skills and experience to effectively deliver our programs and content. There is a risk that at certain points in time and in certain geographical regions, we will find it difficult to hire and retain a sufficient number of employees with the skills or backgrounds we require, or that it will prove difficult to retain them in a competitive labor market. If we are unable to hire and retain talented employees with the skills, and in the locations, we require, we might not be able to deliver our content and solutions services. If we need to re-assign personnel from other areas, it could increase our costs and adversely affect our profit margins.

In order to retain key personnel, we continue to offer a variable component of compensation, the payment of which is dependent upon our sales performance and profitability. We adjust our compensation levels and have adopted different methods of compensation in order to attract and retain appropriate numbers of employees with the necessary skills to serve our clients and grow our business. We may also use equity-based performance incentives as a component of our executives' compensation, which may affect amounts of cash compensation. Variations in any of these areas of compensation may adversely impact our operating performance.

We depend on key personnel, the loss of whom could harm our business.

Our future success will depend, in part, on the continued service of key executive officers and personnel. The loss of the services of any key individuals could harm our business. Our future success also depends on our ability to identify, attract, and retain additional qualified senior personnel. Competition for such individuals in our industry is intense, and we may not be successful in attracting and retaining such personnel.

Our global operations pose complex management, foreign currency, legal, tax, and economic risks, which we may not adequately address.

We have Company-owned offices in Australia, Japan, and the United Kingdom. We also have licensed operations in numerous other foreign countries. As a result of these foreign operations and their impact upon our results of operations, we are subject to a number of risks, including:

- Restrictions on the movement of cash
- Burdens of complying with a wide variety of national and local laws
- The absence in some jurisdictions of effective laws to protect our intellectual property rights
  - Political instability
  - Currency exchange rate fluctuations
  - Longer payment cycles
- Price controls or restrictions on exchange of foreign currencies

We may experience foreign currency gains and losses.

Our sales outside of the United States totaled \$39.6 million, or 28.9 percent of total sales, for the year ended August 31, 2010. If our international operations grow and become a larger component of our overall financial results, our revenues and operating results may be adversely affected when the dollar strengthens relative to other currencies and may be

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positively affected when the dollar weakens. In order to manage a portion of our foreign currency risk, we make limited use of foreign currency derivative contracts to hedge certain transactions and translation exposure. There can be no guarantee that our foreign currency risk management strategy will be effective in reducing the risks associated with foreign currency transactions and translation.

Our global operations expose us to numerous and sometimes conflicting legal and regulatory requirements, and violation of these regulations could harm our business.

Because we provide services to clients in many countries, we are subject to numerous, and sometimes conflicting, legal regimes on matters as diverse as import/export controls, content requirements, trade restrictions, tariffs, taxation, sanctions, government affairs, internal and disclosure control obligations, data privacy, and labor relations. Violations of these regulations in the conduct of our business could result in fines, criminal sanctions against us or our officers, prohibitions on doing business, and damage to our reputation. Violations of these regulations in connection with the performance of our obligations to our clients also could result in liability for monetary damages, fines and/or criminal prosecution, unfavorable publicity, restrictions on our ability to process information, and allegations by our clients that we have not performed our contractual obligations. Due to the varying degrees of development of the legal systems of the countries in which we operate, local laws might be insufficient to protect our rights.

In many parts of the world, including countries in which we operate, practices in the local business community might not conform to international business standards and could violate anticorruption regulations, including the United States Foreign Corrupt Practices Act, which prohibits giving anything of value intended to influence the awarding of government contracts. Although we have policies and procedures to ensure legal and regulatory compliance, our employees, licensee operators, and agents could take actions that violate these requirements. Violations of these regulations could subject us to criminal or civil enforcement actions, including fines and suspension or disqualification from United States federal procurement contracting, any of which could have a material adverse effect on our business.

We have only a limited ability to protect our intellectual property rights, which are important to our success.

Our financial success depends, in part, upon our ability to protect our proprietary methodologies and other intellectual property. The existing laws of some countries in which we provide services might offer only limited protection of our intellectual property rights. To protect our intellectual property, we rely upon a combination of trade secrets, confidentiality policies, nondisclosure and other contractual arrangements, as well as patent, copyright, and trademark laws to protect our intellectual property rights. The steps we take in this regard might not be adequate to prevent or deter infringement or other misappropriation of our intellectual property, and we might not be able to detect unauthorized use of, or take appropriate and timely steps to enforce, our intellectual property rights, especially in foreign jurisdictions.

The loss of proprietary methodologies or the unauthorized use of our intellectual property may create greater competition, loss of revenue, adverse publicity, and may limit our ability to reuse that intellectual property for other clients. Any limitation on our ability to provide a service or solution could cause us to lose revenue-generating opportunities and require us to incur additional expenses to develop new or modified solutions for future engagements.

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Our work with governmental clients exposes us to additional risks that are inherent in the government contracting process.

Our clients include national, provincial, state, and local governmental entities, and our work with these governmental entities has various risks inherent in the governmental contracting process. These risks include, but are not limited to, the following:

- Governmental entities typically fund projects through appropriated monies. While these projects are often planned and executed as multi-year projects, the governmental entities usually reserve the right to change the scope of or terminate these projects for lack of approved funding and at their discretion. Changes in governmental priorities or other political developments could result in changes in scope or in termination of our projects.
- Governmental entities often reserve the right to audit our contract costs, including allocated indirect costs, and conduct inquiries and investigations of our business practices with respect to our government contracts. If the governmental entity finds that the costs are not reimbursable, then we will not be allowed to bill for those costs or the cost must be refunded to the client if it has already been paid to us. Findings from an audit also may result in our being required to prospectively adjust previously agreed upon rates for our work, which may affect our future margins.
- If a governmental client discovers improper activities in the course of audits or investigations, we may become subject to various civil and criminal penalties and administrative sanctions, which may include termination of contracts, forfeiture of profits, suspension of payments, fines and suspensions or debarment from doing business with other agencies of that government. The inherent limitations of internal controls may not prevent or detect all improper or illegal activities, regardless of their adequacy.
- Political and economic factors such as pending elections, revisions to governmental tax policies and reduced tax revenues can affect the number and terms of new governmental contracts signed.

The occurrences or conditions described above could affect not only our business with the particular governmental agency involved, but also our business with other agencies of the same or other governmental entities. Additionally, because of their visibility and political nature, governmental projects may present a heightened risk to our reputation. Any of these factors could have a material adverse effect on our business or our results of operations.

Our strategy to focus on training and consulting services may not be successful and may not lead to the desired financial results.

During the fourth quarter of fiscal 2008, we sold substantially all of the assets of our Consumer Solutions Business Unit (CSBU) to a newly formed entity, Franklin Covey Products. Although we believe the sale of the CSBU assets will allow us to focus our resources and abilities on our services and solutions offerings, many of the aspects of this plan, including future economic conditions and the business strength of our clients, are not within our control, and we may not achieve our expected financial results within our anticipated timeframe.

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If we are unable to collect our accounts receivable on a timely basis, our results of operations and cash flows could be adversely affected.

Our business depends on our ability to successfully obtain payment from our clients of the amounts they owe us for services performed. We evaluate the financial condition of our clients and usually bill and collect on relatively short cycles. We maintain allowances against our receivables and unbilled services that we believe are adequate to reserve for potentially uncollectible amounts. However, actual losses on client balances could differ from those that we currently anticipate and, as a result, we might need to adjust our allowances. In addition, there is no guarantee that we will accurately assess the creditworthiness of our clients. Macroeconomic conditions could also result in financial difficulties for our clients, and as a result could cause clients to delay payments to us, request modifications to their payment arrangements that could increase our receivables balance, or not pay their obligations to us. Timely collection of client balances also depends on our ability to complete our contractual commitments and bill and collect our invoiced revenues. If we are unable to meet our contractual requirements, we might experience delays in collection of and/or be unable to collect our client balances, and if this occurs, our results of operations and cash flows could be adversely affected. In addition, if we experience an increase in the time to bill and collect for our services, our cash flows could be adversely affected.

Our strategy of outsourcing certain functions and operations may fail to reduce our costs for these services and may increase our risks.

We have an outsourcing contract with HP Enterprise Systems (HP and formerly Electronic Data Systems) to provide warehousing, distribution, and information system operations. Under the terms of the outsourcing contract and its addendums, HP provides warehousing and distribution services and supports our various information systems. Due to the nature of our outsourced operations, we are unable to exercise the same level of control over outsourced functions and the actions of HP employees in outsourced roles as our own employees. As a result, the inherent risks associated with these outsourced areas of operation may be increased.

Our outsourcing contracts with HP also contain early termination provisions that we may exercise under certain conditions. However, in order to exercise the early termination provisions, we would have to pay specified penalties to HP depending upon the circumstances of the contract termination.

We have significant intangible asset, goodwill, and long-term asset balances that may be impaired if cash flows from related activities decline.

At August 31, 2010 we had \$65.2 million of intangible assets, which were primarily generated from the fiscal 1997 merger with the Covey Leadership Center. These intangible assets are evaluated for impairment based upon cash flows (definite-lived intangible assets) and estimated royalties from revenue streams (indefinite-lived intangible assets). We also have goodwill and other long-term assets that may become impaired if the corresponding cash flows associated with these assets declines in future periods. Although our current sales and cash flows are sufficient to support the carrying basis of these long-lived assets, if our sales and corresponding cash flows decline, we may be faced with significant asset impairment charges that would have an adverse impact upon our operating margin and overall results of operations.

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In addition, our stock price is considered to be an indicator of the reliability or risks associated with future cash flows, and we may incur impairment charges on these intangible assets in future periods based upon our market capitalization.

Our business could be negatively affected if we incur legal liability in connection with providing our solutions and services.

If we fail to meet our contractual obligations, fail to disclose our financial or other arrangements with our business partners, or otherwise breach obligations to clients, we could be subject to legal liability. We may enter into non-standard agreements because we perceive an important economic opportunity or because our personnel did not adequately adhere to our guidelines. We may also find ourselves committed to providing services that we are unable to deliver or whose delivery will cause us financial loss. If we cannot, or do not, perform our obligations, we could face legal liability, and our contracts might not always protect us adequately through limitations on the scope of our potential liability. If we cannot meet our contractual obligations to provide services and solutions, and if our exposure is not adequately limited through the terms of our agreements, then we might face significant legal liability, and our business could be adversely affected.

Failure to comply with the terms and conditions of our credit facility may have an adverse effect upon our business and operations.

Our line of credit facility requires us to be in compliance with customary non-financial terms and conditions as well as specified financial ratios. Failure to comply with these terms and conditions or maintain adequate financial performance to comply with specific financial ratios entitles the lender to certain remedies, including the right to immediately call due any amounts outstanding on the line of credit. Such events would have an adverse effect upon our business and operations as there can be no assurance that we may be able to obtain other forms of financing or raise additional capital on terms that would be acceptable to us.

We may need additional capital in the future, and this capital may not be available to us on favorable terms or at all.

We may need to raise additional funds through public or private debt offerings or equity financings in order to:

- Develop new services, programs, or offerings
- Take advantage of opportunities, including expansion of the business
  - Respond to competitive pressures

At August 31, 2010 our line of credit has a remaining maturity of less than one year and is therefore classified as a current obligation on our consolidated balance sheet. In order to obtain a more favorable interest rate on the line of credit facility, the credit facility requires an annual renewal. We currently believe that we will be successful in obtaining a new or extended line of credit from our lender prior to the expiration of the current credit facility in March 2011 to ensure available liquidity in future periods. Additional potential sources of liquidity include factoring receivables, issuance of additional equity, or issuance of debt from public or private sources. However, no assurance can be provided that we will obtain a new or extended line of credit or obtain additional financing from other sources on terms that would be acceptable to us. If necessary, we will evaluate all of these options and select

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one or more of them depending on overall capital needs and the associated cost of capital. If we are unsuccessful in obtaining a renewal or extension of our line of credit, or additional financing, we believe that cash flows from operations combined with a number of initiatives we would implement in the months preceding the due date will create sufficient liquidity to pay down the required outstanding balance on the line of credit. These initiatives include deferral of capital purchases for externally developed curriculum and uncommitted capital expenditures; deferral of executive team compensation; deferral of certain related party contractual royalties and earnout payments; substantial reduction of associate salaries; reduction of operating expenses, including non-critical travel; and deferral of payments to other vendors in order to generate sufficient cash. However, there can be no assurance that we will successfully implement these initiatives.

Any additional capital raised through the sale of equity could dilute current shareholders' ownership percentage in us. Furthermore, we may be unable to obtain the necessary capital on terms or conditions that are favorable to us, or at all.

We are the creditor for a management common stock loan program that may not be fully collectible.

We are the creditor for a loan program that provided the capital to allow certain management personnel the opportunity to purchase shares of our common stock. For further information regarding our management common stock loan program, refer to the notes to our consolidated financial statements as found in Item 8 of this Annual Report on Form 10-K. Our inability to collect all, or a portion, of these receivables could have an adverse impact upon our financial position and cash flows compared to full collection of the loans.

We may have exposure to additional tax liabilities.

As a multinational company, we are subject to income taxes as well as non-income based taxes in both the United States and various foreign tax jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes and other tax liabilities. In the normal course of a global business, there are many intercompany transactions and calculations where the ultimate tax determination is uncertain. As a result, we are routinely subject to audits by various taxing authorities. Although we believe that our tax estimates are reasonable, we cannot guarantee that the final determination of these tax audits will not be different from what is reflected in our historical income tax provisions and accruals. In addition, recently proposed legislation in the United States would change how U.S. multinational corporations are taxed on their foreign income. If such legislation is enacted, it may have a material adverse impact on our tax rate and in turn, our profitability.

We are also subject to non-income taxes such as payroll, sales, use, value-added, and property taxes in both the United States and various foreign jurisdictions. We are routinely audited by tax authorities with respect to these non-income taxes and may have exposure from additional non-income tax liabilities.

We could have liability or our reputation could be damaged if we do not protect client data or if our information systems are breached.

We are dependent on information technology networks and systems to process, transmit, and store electronic information and to communicate among our locations around the world and with our clients. Security breaches of this infrastructure could lead to shutdowns or disruptions of our systems and potential unauthorized disclosure of confidential



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information. We are also required at times to manage, utilize, and store sensitive or confidential client or employee data. As a result, we are subject to numerous U.S. and foreign jurisdiction laws and regulations designed to protect this information, such as the various U.S. federal and state laws governing the protection of health or other individually identifiable information. If any person, including any of our associates, negligently disregards or intentionally breaches our established controls with respect to such data or otherwise mismanages or misappropriates that data, we could be subject to monetary damages, fines, and/or criminal prosecution. Unauthorized disclosure of sensitive or confidential client or employee data, whether through systems failure, employee negligence, fraud, or misappropriation could damage our reputation and cause us to lose clients.

International hostilities, terrorist activities, and natural disasters may prevent us from effectively serving our clients and thus adversely affect our operating results.

Acts of terrorist violence, armed regional and international hostilities, and international responses to these hostilities, natural disasters, global health risks or pandemics, or the threat of or perceived potential for these events, could have a negative impact on our directly owned or licensee operations. These events could adversely affect our clients' levels of business activity and precipitate sudden significant changes in regional and global economic conditions and cycles. These events also pose significant risks to our people and to physical facilities and operations around the world, whether the facilities are ours or those of our alliance partners or clients. By disrupting communications and travel and increasing the difficulty of obtaining and retaining highly skilled and qualified personnel, these events could make it difficult or impossible for us or our licensee partners to deliver services to clients. Extended disruptions of electricity, other public utilities, or network services at our facilities, as well as system failures at, or security breaches in, our facilities or systems, could also adversely affect our ability to serve our clients. While we plan and prepare to defend against each of these occurrences, we might be unable to protect our people, facilities, and systems against all such occurrences. We generally do not have insurance for losses and interruptions caused by terrorist attacks, conflicts, and wars. If these disruptions prevent us from effectively serving our clients, our operating results could be adversely affected.

Our future quarterly operating results are subject to factors that can cause fluctuations in our stock price.

Historically, our stock price has experienced significant volatility. We expect that our stock price may continue to experience volatility in the future due to a variety of potential factors that may include the following:

- Fluctuations in our quarterly results of operations and cash flows
  - Increased overall market volatility
- Variations between our actual financial results and market expectations
  - Changes in our key balances, such as cash and cash equivalents
    - Currency exchange rate fluctuations
    - Unexpected asset impairment charges
  - Lack of, or increased, analyst coverage

In addition, the stock market has recently experienced substantial price and volume fluctuations that have impacted our stock and other equity issues in the market. These factors, as well as general investor concerns regarding the credibility of corporate financial statements, may have a material adverse effect upon our stock price in the future.

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We may fail to meet analyst expectations, which could cause the price of our stock to decline.

Our common stock is publicly traded on the New York Stock Exchange, and at any given time various securities analysts follow our financial results and issue reports on us. These periodic reports include information about our historical financial results as well as the analysts' estimates of our future performance. The analysts' estimates are based on their own opinions and are often different from our estimates or expectations. If our operating results are below the estimates or expectations of public market analysts and investors, our stock price could decline. If our stock price is volatile, we may become involved in securities litigation following a decline in prices. Any litigation could result in substantial costs and a diversion of management's attention and resources that are needed to successfully run our business.

Ineffective internal controls could impact our business and operating results.

Our internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Even effective internal controls can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. If we fail to maintain the adequacy of our internal controls, including any failure to implement required new or improved controls, or if the Company experiences difficulties in their implementation, our business and operating results may be harmed and we could fail to meet our financial reporting obligations.

New or more stringent governmental regulations could adversely affect our business.

Increased government regulations to limit carbon dioxide and other greenhouse gas emissions as a result of concern over climate change may result in increased compliance costs and other financial obligations for us. We rely on the ability of our consultants and salespeople to travel to client destinations using automobiles and jet aircraft, which use fossil fuels. Legislation, regulation, or additional taxes affecting the cost of these inputs could materially affect our profitability.

The Company's use of accounting estimates involves judgment and could impact our financial results.

Our most critical accounting estimates are described in Management's Discussion and Analysis found in Item 7 of this report under the section entitled "Use of Estimates and Critical Accounting Policies." In addition, as discussed in various footnotes to our financial statements as found in Item 8, we make certain estimates for loss contingencies, including decisions related to legal proceedings and reserves. Because, by definition, these estimates and assumptions involve the use of judgment, our actual financial results may differ from these estimates.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

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ITEM 2. PROPERTIES

Franklin Covey's executive offices are located in Salt Lake City, Utah. The following is a summary of our properties and facilities utilized in the operation of our business. Our leases primarily consist of sales and administrative offices both in the United States and various countries around the world. As of August 31, 2010, all of our facilities are leased. Our corporate headquarters lease is accounted for as a financing arrangement and all other facility lease agreements are accounted for as operating leases that expire at various dates through the year 2025.

Corporate Facilities

Corporate Headquarters and Administrative Offices:

Salt Lake City, Utah (7 buildings)

Domestic Sales Offices

Regional Sales Offices:

United States (4 locations)

Administrative Offices:

United States (2 locations)

International Facilities

International Administrative/Sales Offices:

Australia (3 locations)

England (1 location)

Japan (1 location)

International Distribution Facilities:

Australia (1 location)

England (1 location)

Japan (1 location)

New Zealand (1 location)

We consider our existing facilities to be in good condition and suitable for our current and anticipated level of operations in the upcoming fiscal year.

A significant portion of our corporate headquarters campus located in Salt Lake City, Utah is subleased to several unrelated entities.

ITEM 3. LEGAL PROCEEDINGS

On April 20, 2010, Moore Wallace North America, Inc. dba TOPS filed a complaint against Franklin Covey Products, LLC (Franklin Covey Products) in the Circuit Court of Cook County, Illinois, for breach of contract. The complaint also named us as a defendant and alleged that we should be liable for Franklin Covey Products' debts under the doctrine of alter ego or fraudulent transfer. We are still in the early stages of this litigation and any potential liability is not currently estimable. We believe that we have meritorious defenses against this action, and we will continue to vigorously defend it.

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The Company is also the subject of certain other legal actions, which we consider routine to our business activities. At August 31, 2010, we believe that, after consultation with legal counsel, any potential liability to the Company under these other actions will not materially affect our financial position, liquidity, or results of operations.

## ITEM 4. RESERVED

## PART II

ITEM MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS, AND  
5. ISSUER PURCHASES OF EQUITY SECURITIES

FranklinCovey common stock is listed and traded on the New York Stock Exchange (NYSE) under the symbol "FC." The following table sets forth the high and low sale prices per share for our common stock, as reported by the NYSE, for the fiscal years ended August 31, 2010 and 2009.

|                   | High    | Low     |
|-------------------|---------|---------|
| Fiscal Year Ended |         |         |
| August 31, 2010:  |         |         |
| Fourth Quarter    | \$ 7.52 | \$ 5.35 |
| Third Quarter     | 8.19    | 5.75    |
| Second Quarter    | 6.39    | 5.06    |
| First Quarter     | 6.44    | 4.76    |
| Fiscal Year Ended |         |         |
| August 31, 2009:  |         |         |
| Fourth Quarter    | \$ 7.24 | \$ 5.30 |
| Third Quarter     | 5.69    | 3.20    |
| Second Quarter    | 6.05    | 3.61    |
| First Quarter     | 9.45    | 4.02    |

We did not pay or declare dividends on our common stock during the fiscal years ended August 31, 2010 or 2009. We currently anticipate that we will retain all available funds to repay our line of credit obligation, finance future growth and business opportunities, and to purchase shares of our common stock.

As of November 1, 2010, the Company had 17,037,070 shares of common stock outstanding, which were held by 724 shareholders of record.

## Purchases of Common Stock

The following table summarizes Company purchases of common stock during the fiscal quarter ended August 31, 2010:

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| Period                               | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price Paid<br>Per Share | Total<br>Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Dollar<br>Value of<br>Shares<br>That May<br>Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs<br>(in<br>thousands) |
|--------------------------------------|---|------------------------------------|--|--|
| May 30, 2010 to<br>July 3, 2010      | 3   | \$ 7.02                            | none   | \$ 2,413   |
| July 4, 2010 to July<br>31, 2010     | -   | -                                  | none   | 2,413  |
| August 1, 2010 to<br>August 31, 2010 | 15  | 6.16                               | none   | 2,413 (1)  |
| Total Common<br>Shares               | 18  | \$ 6.30                            | none   |  |

(1) In January 2006, our Board of Directors approved the purchase of up to \$10.0 million of our outstanding common stock. All previous authorized common stock purchase plans were canceled. Following the approval of this common stock purchase plan, we have purchased a total of 1,009,300 shares of our common stock for \$7.6 million through August 31, 2010 under the terms of this plan, which does not have an expiration date.

## Performance Graph

The following graph shows a comparison of cumulative total shareholder return indexed to August 31, 2005, calculated on a dividend reinvested basis, for the five fiscal years ended August 31, 2010 for Franklin Covey Co. common stock, the S&P SmallCap 600 Index, and the S&P Commercial & Professional Services Index. We were previously included in the S&P 600 SmallCap Index and were assigned to the S&P Diversified Commercial and Professional Services Index within the S&P 600 SmallCap Index. However, during fiscal 2009, the Diversified Commercial Services Index was discontinued, and we have determined that the S&P 600 Commercial & Professional Services Index is appropriate for comparative purposes. We believe that if we were included in an index we would be included in the indices where we were previously listed, which would include the Commercial & Professional Services Index. We are no longer a part of the S&P 600 SmallCap Index, but we believe that the S&P 600 SmallCap Index and the Commercial and Professional Services Index continue to provide appropriate benchmarks with which to compare our stock performance.



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## ITEM 6. SELECTED FINANCIAL DATA

The selected consolidated financial data presented below should be read in conjunction with the consolidated financial statements of Franklin Covey and the related footnotes as found in Item 8 of this report on Form 10-K.

In the fourth quarter of fiscal 2010, we sold the product sales component of our wholly owned subsidiary in Japan to an unrelated Japan-based paper products company. We determined that the operating results of the Japan product sales component qualified for discontinued operations presentation and we have presented the operating results of the Japan product sales component as discontinued operations for all periods presented in this report and have adjusted the financial statement information presented below to be consistent with the discontinued operations presentation.

During fiscal 2008, we sold substantially all of the assets of our Consumer Solutions Business Unit (CSBU), which was primarily responsible for the sale of our products to consumers. Based upon applicable accounting guidance, the operations of CSBU did not qualify for discontinued operations presentation, and therefore, no prior periods were adjusted to reflect the sale of the CSBU assets.

| August 31,   | 2010       | 2009       | 2008       | 2007       | 2006       |
|--|------------|------------|------------|------------|------------|
| In thousands, except per share data                              |            |            |            |            |            |
| <b>Income Statement Data:</b>                                    |            |            |            |            |            |
| Net sales  | \$ 136,874 | \$ 123,134 | \$ 252,074 | \$ 276,660 | \$ 271,463 |
| Income (loss) from operations                                    | 4,038      | (11,840 )  | 14,204     | 16,133     | 11,492     |
| Net income (loss) from continuing operations before income taxes | 1,180      | (14,862 )  | 11,278     | 13,714     | 11,077     |
| Income tax benefit (provision)(1)                                | (2,484 )   | 3,814      | (6,738 )   | (7,172 )   | 16,017     |
| Income (loss) from continuing operations                         | (1,304 )   | (11,048 )  | 4,540      | 6,542      | 27,094     |
| Income from discontinued operations, net of tax                  | 548        | 216        | 987        | 923        | 1,439      |
| Gain on sale of discontinued operations, net of tax              | 238        | -          | -          | -          | -          |
| Net income (loss)(1)   | (518 )     | (10,832 )  | 5,527      | 7,465      | 28,533     |
| Net income (loss) available to common shareholders(1)            | (518 )     | (10,832 )  | 5,527      | 5,250      | 24,148     |
| <b>Earnings (loss) per share:</b>                                |            |            |            |            |            |
| Basic  | \$ (.01 )  | \$ (.81 )  | \$ .28     | \$ .27     | \$ 1.20    |
| Diluted  | \$ (.01 )  | \$ (.81 )  | \$ .28     | \$ .26     | \$ 1.17    |
| <b>Balance Sheet Data:</b>                                       |            |            |            |            |            |
| Total current assets   | \$ 48,616  | \$ 40,142  | \$ 66,661  | \$ 69,653  | \$ 87,056  |
| Other long-term assets   | 9,396      | 11,608     | 11,768     | 14,542     | 12,249     |
| Total assets   | 147,343    | 143,878    | 177,677    | 196,181    | 216,495    |
| Long-term obligations  | 32,988     | 32,191     | 38,762     | 35,178     | 35,347     |
| Total liabilities  | 76,308     | 74,874     | 99,500     | 95,476     | 83,185     |

|                      |        |        |        |         |         |
|----------------------|--------|--------|--------|---------|---------|
| Preferred stock(2)   | -      | -      | -      | -       | 37,345  |
| Shareholders' equity | 71,035 | 69,004 | 78,177 | 100,705 | 133,310 |

- (1) Net income in fiscal 2006 includes the impact of deferred tax asset valuation allowance reversals totaling \$20.3 million.
- (2) During fiscal 2007, we redeemed all remaining outstanding shares of preferred stock at its liquidation preference of \$25 per share plus accrued dividends.



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ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

INTRODUCTION

The following management's discussion and analysis is intended to provide a summary of the principal factors affecting the results of operations, liquidity and capital resources, contractual obligations, and the critical accounting policies of Franklin Covey Co. (also referred to as the Company, we, us, our, and Franklin Covey, unless otherwise indicated) and subsidiaries. This discussion and analysis should be read together with our consolidated financial statements and related notes, which contain additional information regarding the accounting policies and estimates underlying the Company's financial statements. Our consolidated financial statements and related notes are presented in Item 8 of this report on Form 10-K.

Franklin Covey is a leading global provider of execution, leadership, and personal-effectiveness training with over 600 employees worldwide that deliver principle-based curriculum and effectiveness tools to our customers. Our training, consulting services, and related accessories are designed to help organizations and individuals transform the way they conduct their business and personal lives to enable them to achieve greatness. We operate globally with one common brand and business model designed to enable us to provide clients around the world with the same high level of service. To achieve this level of service, we operate four regional sales offices in the United States; wholly owned subsidiaries in Australia, Japan, and the United Kingdom; and contract with licensee partners who deliver our curriculum and provide services in over 140 other countries and territories around the world. Our business-to-business service utilizes our expertise in training, consulting, and technology that is designed to help our clients define great performance and execute at the highest levels. We also provide clients with training in management skills, relationship skills, and individual effectiveness, and can provide personal-effectiveness literature and electronic educational solutions to our clients as needed.

Historically, our solutions included products and services that encompassed training and consulting, assessment, and various application tools that were generally available in electronic or paper-based formats. Our products and services were available through professional consulting services, public workshops, retail stores, catalogs, and the Internet at [www.franklincovey.com](http://www.franklincovey.com), and our best-known offerings in the marketplace have included 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*.

Over the past several years, the strategic focus of our Consumer Solutions Business Unit (CSBU), which was focused primarily on sales of our products, and our Organizational Solutions Business Unit (OSBU), which was focused on the development and delivery of training, consulting, and related services, changed significantly. As a consequence of these changes in strategic direction, we determined that the extent of overlap between our training and consulting offerings and our products had diminished. After significant analysis and deliberation, it became apparent that these business units would be able to operate more effectively as separate companies, each with clear and distinct strategic objectives, market definitions, and competitive products and services. This conclusion persuaded us to sell substantially all of the operations of the CSBU, and during the fourth quarter of our fiscal year ended August 31, 2008, we completed the sale of the CSBU to a newly formed entity, Franklin Covey Products, LLC.

Following the sale of the CSBU, we have been able to focus our full resources on the continued expansion of our training, consulting, content-rich media, and thought leadership businesses. Our business now primarily consists of training, consulting, assessment services, and products to help organizations and individuals achieve superior results by focusing on and executing on top priorities, building the capability of knowledge workers, and aligning business processes.

The sale of the CSBU had a significant impact on our financial statements since the CSBU and corresponding product sales represented a substantial portion of our total sales, and the business dynamics of a training company are considerably different than a consumer products company. Based on relevant accounting

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literature, we were unable to present the operational results of the CSBU in a discontinued operations format, which makes comparisons of fiscal 2010 and fiscal 2009 financial results to fiscal 2008 results difficult.

The key factors that influence our operating results include the number of organizations that are active customers; the number of people trained within those organizations; the availability of budgeted training spending at our clients and prospective clients, which is significantly influenced by general economic conditions; and our ability to manage operating costs necessary to develop and provide meaningful training and related products to our clients.

Our fiscal year ends on August 31, and unless otherwise indicated, fiscal 2010, fiscal 2009, and fiscal 2008 refer to the twelve-month periods ended August 31, 2010, 2009, and 2008 and so forth.

## RESULTS OF OPERATIONS

### Overview of the Fiscal Year ended August 31, 2010

Our operating results for fiscal 2010 marked a significant improvement over fiscal 2009 financial results. We believe that slowly stabilizing economic conditions in the United States, and in many of the countries which we operate, helped to improve corporate earnings and increase training budgets at many of our existing and newly acquired clients. During fiscal 2010 we experienced broad-based improvements in our training and consulting sales at nearly all of our regional offices and directly owned international offices as well as from most of our international licensees. Nearly all of our major practices and content groups had increased sales and we believe that our investments in curriculum development will allow us to maintain this favorable momentum. In addition, during the fourth quarter of fiscal 2010 we were awarded a contract to provide training and consulting services to a governmental entity, which significantly improved our sales in the fourth quarter compared to the prior year. We started fiscal 2011 with approximately \$11.5 million more in our pipeline of booked days and awarded revenue at August 31, 2010 to be delivered in future periods compared to the same time last year. We believe that the combination of stabilized economic conditions and increased booked training days as we enter fiscal 2011 will enable us to achieve improved financial results in fiscal 2011.

During fiscal 2010, we sold the product sales component of our wholly owned subsidiary in Japan to an unrelated Japan-based paper products company. The sale included the disposition of inventories, certain intangibles assets, and other current assets. The sale closed on June 1, 2010, and the total sale price was JPY 305.0 million, or approximately \$3.4 million. In addition, the sale agreement provides for a three percent passive royalty on annual sales, which we believe will not be significant to our future operations. We believe that the sale of this division will further align our Japanese operations with our overall strategic focus on training and consulting sales. As a consequence of the sale, we determined that the operating results of the Japan product sales component qualified for discontinued operations presentation, and we have presented the operating results of the Japan product sales component as discontinued operations for all periods presented in this report on Form 10-K. The following management's discussion and analysis is presented on a comparative continuing operations presentation as shown in our consolidated statements of operations, which is found in Item 8.

For the year ended August 31, 2010, our consolidated sales (from continuing operations) increased 11 percent to \$136.9 million compared to \$123.1 million in fiscal 2009. Increased sales and an improved gross margin percentage contributed to improved operating results and in fiscal 2010 we recognized income from operations of \$4.0 million compared to a loss from operations of \$11.8 million in fiscal 2009. Our income from continuing operations before taxes was \$1.2 million, compared to a loss of \$14.9 million in fiscal 2009. We recorded a \$2.5 million income tax provision (refer to discussion below) during fiscal 2010 compared to a \$3.8 million income tax benefit in the prior year, primarily due to increased pre-tax earnings. After accounting for discontinued operations, our net loss for fiscal

2010 was \$0.5 million, or (\$0.04) per share, compared to a \$10.8 million loss, or (\$0.81) per share, recognized in fiscal 2009.

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The following information is intended to provide an overview of the primary factors that influenced our financial results for the fiscal year ended August 31, 2010:

- **Sales Performance** – Our consolidated sales from continuing operations increased \$13.7 million, or 11 percent, compared to fiscal 2009. We continue to be encouraged by revenue growth from our government services group, in our practices, at most of our U.S./Canadian regional sales offices, from our international licensee partners, and from our directly owned offices in Australia and the United Kingdom. Growth in these areas was partially offset by decreased sales in Japan. Sales in Japan were impacted by an intellectual property licensing arrangement in fiscal 2009 that did not repeat in fiscal 2010 and by weak economic conditions in that country. Looking forward, our booking pace continues to improve over the prior year, and in fiscal 2010 we were awarded several training contracts that had a favorable impact on the fourth quarter of fiscal 2010 and which we believe will strengthen sales during fiscal 2011.
- **Gross Profit** – Consolidated gross profit increased to \$89.1 million in fiscal 2010 compared to \$77.9 million in fiscal 2009 primarily due to increased sales as described above. Our gross margin, which is gross profit stated as a percentage of sales, improved to 65.1 percent compared to 63.2 percent in the prior year.
- **Operating Costs** – Our operating costs decreased by \$4.7 million compared to fiscal 2009, which was the net result of a \$1.8 million increase in selling, general, and administrative costs; a \$2.0 million decrease in restructuring costs; a \$3.6 million decrease in impaired asset charges; and a \$0.9 million decrease in depreciation expense. During fiscal 2010, we did not initiate a restructuring plan or have impaired asset charges.
- **Income Taxes** – Our income tax provision attributed to continuing operations for the fiscal year ended August 31, 2010 totaled \$2.5 million on pre-tax earnings of \$1.2 million. Our effective tax rate on continuing operations of approximately 210 percent is higher than statutory combined rates primarily due to foreign withholding taxes for which we cannot utilize a foreign tax credit, the accrual of taxable interest income on the management stock loan program, disallowed executive compensation, and actual and deemed dividends from foreign subsidiaries for which we also cannot utilize foreign tax credits. These items and other differences added approximately \$2.0 million to our income tax provision for fiscal 2010. However, due to the utilization of net operating loss carryforwards, our income tax expense is not indicative of the actual cash paid for income taxes.

Further details regarding these items can be found in the comparative analysis of fiscal 2010 compared to fiscal 2009 as discussed in this management’s discussion and analysis.

The following table sets forth, for the fiscal years indicated, the percentage of total sales represented by the line items through income or loss before income taxes in our consolidated statements of operations:

| YEAR ENDED<br>AUGUST 31,         | 2010   | 2009   | 2008   |
|----------------------------------|--------|--------|--------|
| Sales:                           |        |        |        |
| Training and consulting services | 94.6 % | 93.3 % | 54.8 % |
| Products                         | 3.1    | 3.8    | 44.2   |
| Leasing                          | 2.3    | 2.9    | 1.0    |
| Total sales                      | 100.0  | 100.0  | 100.0  |
| Cost of sales:                   |        |        |        |
| Training and consulting services | 32.1   | 33.1   | 17.7   |
| Products                         | 1.6    | 2.1    | 19.2   |

|  |        |          |        |
|--|--------|----------|--------|
| Leasing  | 1.2    | 1.6      | 0.6    |
| Total cost of sales  | 34.9   | 36.8     | 37.5   |
| Gross profit   | 65.1   | 63.2     | 62.5   |
|  |        |          |        |
| Selling, general, and administrative                         | 56.7   | 61.6     | 55.4   |
| Gain on sale of CSBU   | -      | -        | (3.6 ) |
| Restructuring costs  | -      | 1.7      | 0.8    |
| Impairment of assets   | -      | 2.9      | 0.6    |
| Depreciation   | 2.7    | 3.6      | 2.3    |
| Amortization   | 2.7    | 3.0      | 1.4    |
| Total operating expenses                                     | 62.1   | 72.8     | 56.9   |
| Income (loss) from operations                                | 3.0    | (9.6 )   | 5.6    |
| Interest income  | 0.0    | 0.0      | 0.1    |
| Interest expense   | (2.1 ) | (2.5 )   | (1.2 ) |
| Income (loss) from continuing operations before income taxes | 0.9 %  | (12.1 )% | 4.5 %  |

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## FISCAL 2010 COMPARED TO FISCAL 2009

## Sales

We offer a variety of training courses, consulting services, and training related products that are focused on leadership, productivity, strategy execution, sales force performance, trust, and effective communications that are provided both domestically and internationally through our sales force or through international licensee partners. The following table sets forth sales data from continuing operations by category and by our primary delivery channels (in thousands):

| YEAR ENDED                       |            | Percent    |            | Percent    |            |
|----------------------------------|------------|------------|------------|------------|------------|
| AUGUST 31,                       | 2010       | change     | 2009       | change     | 2008       |
|                                  |            | from prior |            | from prior |            |
|                                  |            | year       |            | year       |            |
| Sales by Category:               |            |            |            |            |            |
| Training and consulting services | \$ 129,462 | 13         | \$ 114,910 | (17 )      | \$ 138,112 |
| Products                         | 4,226      | (9 )       | 4,668      | (96 )      | 111,491    |
| Leasing                          | 3,186      | (10 )      | 3,556      | 44         | 2,471      |
|                                  | \$ 136,874 | 11         | \$ 123,134 | (51 )      | \$ 252,074 |
| Sales by Channel:                |            |            |            |            |            |
| U.S./Canada direct               | \$ 68,707  | 21         | \$ 56,898  | (23 )      | \$ 73,709  |
| International direct             | 26,110     | (6 )       | 27,747     | (16 )      | 32,972     |
| International licensees          | 9,198      | 5          | 8,732      | (13 )      | 10,091     |
| National account practices       | 19,447     | 32         | 14,711     | 109        | 7,042      |
| Self-funded marketing            | 8,075      | (19 )      | 9,954      | (43 )      | 17,390     |
| Other                            | 5,337      | 5          | 5,092      | 40         | 3,635      |
| CSBU channels                    | -          | -          | -          | (100 )     | 107,235    |
|                                  | \$ 136,874 | 11         | \$ 123,134 | (51 )      | \$ 252,074 |

Our consolidated sales increased by \$13.7 million, or 11 percent, compared to fiscal 2009. The following analysis of our sales performance for the fiscal year ended August 31, 2010 is based on activity through our primary delivery channels as shown above.

U.S./Canada Direct – This channel includes our four regional field offices that serve our clients in the United States and Canada and our government services group. During fiscal 2010, we had improved sales performance in this channel primarily due to increased sales from our government services group, improved sales at three of our four regional offices, increased revenue per training day, and decreased cancellation rates compared to fiscal 2009. Sales through our government services group increased primarily due to a governmental services contract obtained during the fourth quarter of fiscal 2010. We recognized \$6.7 million from this contract during the fourth quarter of fiscal 2010. Sales through our regional sales offices increased \$2.9 million compared to fiscal 2009

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and bookings are currently strong for the first quarter of fiscal 2011.

**International Direct** – Our three directly owned international offices are located in Australia, Japan, and the United Kingdom. The decrease in international direct sales was due to reduced sales in Japan, which declined \$4.9 million (on a continuing operations basis) compared to fiscal 2009. This decrease was partially offset by sales increases in Australia and the United Kingdom. Sales in Japan were impacted by a \$0.8 million intellectual property sale in fiscal 2009 that did not repeat in fiscal 2010 and by economic conditions in that country. We believe that continued economic weakness in Japan was the primary factor in decreased sales, which resulted in decreased training and consulting sales and decreased book publishing sales compared to fiscal 2009.

**International Licensees** – In countries or foreign locations where we do not have a directly owned office, our training and consulting services are delivered through independent licensees, which may translate and adapt our curriculum to local preferences and customs, if necessary. During the fiscal year ended August 31, 2010, nearly all of our foreign licensees had increased sales compared to the prior year. We believe that increased licensee royalties were indicative of stabilizing economic conditions in many countries around the world.

**National Account Practices** – Our national account practices are comprised of programs that are not typically offered in our regional field offices and includes Helping Clients Succeed from the sales performance group, The Leader In Me curriculum designed for students from our education practice, and Winning Customer Loyalty from our customer loyalty practice. During fiscal 2010, each of our major components of this channel had increased sales compared to the prior year.

**Self-Funded Marketing** – This group includes our public programs, book and audio sales, and speeches. The decrease in sales was primarily due to decreased speeches delivered and reduced public program sales resulting from the decision to offer fewer programs during the fiscal year.

**Other** – Our other sales are comprised primarily of leasing and shipping and handling revenues. The decrease in other sales was primarily due to reduced leasing revenues as certain lease contracts at our corporate headquarters expired. We are actively seeking new tenants for available property and believe that we will be successful in attracting new tenants to occupy vacant space at our corporate campus.

**Gross Profit**

Gross profit consists of net sales less the cost of services provided or the cost of goods sold. Our cost of sales includes the direct costs of conducting seminars, materials used in the production of training products and related accessories, assembly and manufacturing labor costs, freight, and certain other overhead costs. Gross profit may be affected by, among other things, the mix of training and consulting courses provided, prices of materials, labor rates, changes in product discount levels, production efficiency, and freight costs.

Our consolidated gross profit from continuing operations increased to \$89.1 million in fiscal 2010 compared to \$77.9 million in fiscal 2009. Our consolidated gross margin, which is gross profit stated in terms of a percentage of sales, was 65.1 percent of sales in fiscal 2010 compared to 63.2 percent in fiscal 2009.

Gross margin on our training and consulting sales, which represented approximately 95 percent of our consolidated sales in fiscal 2010, was 66.1 percent compared to 64.5 percent in fiscal 2009. The increase was primarily due to sales from a government services contract that included intellectual property, which have higher margins than other types of training and consulting sales; increased international licensee royalty revenues, which have virtually no cost of sales; and an increase in training and consulting sales as





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a percent of our consolidated sales as training and consulting sales generally have higher gross margins than product or leasing sales.

Operating Expenses

Selling, General and Administrative – Our selling, general, and administrative (SG&A) expenses increased by \$1.8 million compared to the prior year. However, as a percent of sales, consolidated SG&A expense decreased to 56.7 percent of sales in fiscal 2010 compared to 61.6 percent in the prior year. The increase in SG&A expenses was primarily due to increased sales and the corresponding increase in commissions, severance costs, reimbursement of airfare costs previously paid by the Company's CEO for business travel, and costs associated with the forgiveness of certain management stock loans. Due to the significant increase in sales during our fourth quarter of fiscal 2010, our commissions also increased as many of our sales personnel substantially exceeded sales goals, which provides for special bonus compensation. However, as our sales performance improves, annual sales goals are adjusted higher, which we believe provides incentive for continued growth. Of the \$3.3 million increase in associate costs, we believe that \$1.7 million was attributable to these special commissions. During the fourth quarter of fiscal 2010, it was mutually determined that our co-Chief Operating Officers would terminate their employment with the Company. As a result of this decision, we paid the former co-Chief Operating Officers severance according to our corporate policy, which totaled \$0.9 million. During fiscal 2010 we also expensed \$0.7 million for the reimbursement of airfare costs previously paid by the Company's CEO for business travel pursuant to a change in policy approved by the Board of Directors. We also expensed \$0.3 million related to bonuses for the income tax consequences resulting from the forgiveness of certain management stock loans during the fiscal year.

In previous fiscal years, we have implemented cost reduction efforts that reduced virtually every aspect of our spending. These initiatives included a restructuring plan that reduced the number of our domestic regional sales offices, decentralized certain sales support functions, reduced our headcount, closed our Canadian office, and made other changes to our operations in Canada. Increased SG&A expenses as described above were partially offset by the decreases in the following areas: 1) our advertising and promotional expenses decreased \$2.2 million primarily due to the decision to reduce the number of public programs held and strategic reductions in our overall marketing expenses; 2) our telephone and overall utility charges decreased by \$0.6 million primarily due to cost savings initiatives; 3) our spending on computer, office, and other related items declined by \$0.5 million; and 4) we experienced reduced expenses in various other areas of our operations resulting from our cost cutting efforts.

Depreciation – Depreciation expense decreased \$0.9 million compared to the prior year. The decrease was primarily due to impaired accounting software costs that resulted in an additional \$0.5 million depreciation charge during the fourth quarter of fiscal 2009 (which did not repeat in fiscal 2010) and the full depreciation of other capital assets during the year. Based upon anticipated capital asset acquisitions in fiscal 2011 and previous depreciation expense levels, we expect depreciation expense to total approximately \$3.6 million during fiscal 2011.

Amortization – Amortization expense from definite-lived intangible assets was flat compared to the prior year. We currently expect that intangible asset amortization expense will total \$3.5 million in fiscal 2011.

FISCAL 2009 COMPARED TO FISCAL 2008

Sales

Training and Consulting Services and Leasing (continuing channels) – Our consolidated training and consulting service sales decreased by \$23.2 million compared to the prior year, which was attributable to unfavorable performance from the majority of our domestic and international delivery channels. We



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believe that the decrease in sales was primarily due to unfavorable economic conditions, which eroded business confidence and led to decreased training budgets and the deferral of scheduled programs. The effects of the economic downturn were widespread and led to economic contraction and reduced sales in many countries where we operate through direct offices or through our licensees. These conditions led to the following results in our primary delivery channels:

**U.S./Canada Direct** – During fiscal 2009, our sales decreased at all of our regional offices, primarily due to the economic factors described above. These factors led to cancelations or deferral of scheduled programs, reduced on-site training days, and overall decreased sales. Partially offsetting decreased sales at our regional offices was improved government services sales, which increased \$1.4 million compared to fiscal 2008.

**International Direct** – Consistent with sales performance in the United States, sales at all of our directly owned international offices declined compared to fiscal 2008. In addition, the translation of foreign sales was adversely affected by changes in the exchange rates as these sales were translated to United States dollars. The translation of foreign sales to United States dollars had a net \$0.4 million unfavorable impact on our consolidated sales during the fiscal year ended August 31, 2009.

**International Licensees** – During the fiscal year ended August 31, 2009, nearly all of our foreign licensees had decreased sales compared to the prior year. We believe that decreased licensee royalties were indicative of deteriorating economic conditions in many countries around the world throughout late 2008 and the majority of fiscal 2009.

**National Account Practices** – Our national account practices are comprised of programs that are not typically offered in our regional field offices and includes Helping Clients Succeed from the sales performance group, The Leader In Me curriculum designed for students from our education practice, and Winning Customer Loyalty from our customer loyalty practice. During fiscal 2009, each of our major components of this channel had increased sales compared to the prior year primarily because most of these offerings were relatively new to the marketplace and gained momentum in fiscal 2009.

**Self-Funded Marketing** – This group includes our public programs, book and audio sales, and speeches. The decrease in sales was primarily due to 1) reduced public seminar sales resulting from the decision to reduce the number of events scheduled during the year and from the decision to license the delivery rights of certain public programs to a third party, which resulted in the Company recording a licensee fee from these programs rather than the gross sale amount previously recorded; and 2) lower books and audio sales as fiscal 2008 sales were favorably impacted by the release of The Leader in Me book by Dr. Stephen R. Covey.

**Other** – Our other sales are comprised primarily of leasing and shipping and handling revenues. The improvement over fiscal 2008 was due to increased leasing sales totaling \$1.1 million primarily due to the addition of new leasing contracts that are generated from various arrangements to lease office space at our Salt Lake City, Utah headquarters campus.

**Product Sales (primarily CSBU channels)** – Consolidated product sales, which were primarily sold through our CSBU channels, declined \$107.0 million compared to the prior year primarily due to the sale of our CSBU during the fourth quarter of fiscal 2008.

### Gross Profit

Prior to the sale of CSBU assets in fiscal 2008, we recorded the costs associated with operating our retail stores, call center, and Internet site as part of our consolidated selling, general, and administrative expenses. Therefore, our consolidated gross profit may not be comparable with the gross profit of other companies that include similar costs in

their cost of sales.

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Our consolidated gross profit decreased to \$77.9 million in fiscal 2009 compared to \$157.5 million in fiscal 2008. The decrease in gross profit was primarily attributable to decreased product sales resulting from the sale of the CSBU. Our consolidated gross margin from continuing operations was 63.2 percent of sales in fiscal 2009 compared to 62.5 percent in the prior year.

Our training and consulting services gross margin was 64.5 percent compared to 67.6 percent in fiscal 2008. The decrease was primarily attributable to decreased licensee royalty revenues, which have virtually no corresponding cost of sales, increased royalty costs on certain programs sold, and increased amortization of capitalized curriculum development costs.

Gross margin on product sales decreased to 43.9 percent compared to 56.6 percent in the prior year. The decrease was primarily due to the sale of the CSBU, which eliminated virtually all of our domestic product sales.

### Operating Expenses

**Selling, General and Administrative** – Our SG&A expenses decreased \$63.8 million compared to the prior year. The decrease in SG&A expenses was primarily due to: 1) the sale of the CSBU, which reduced consolidated SG&A by approximately \$51.7 million compared to the prior year; 2) a \$7.5 million decrease in compensation costs resulting from lower sales and corresponding reductions to commissions and other variable compensation elements; 3) a \$2.9 million decrease in advertising costs, primarily related to a decrease in the number of public programs held; 4) \$0.7 million of reduced travel and conference costs, primarily due to the cancellation of our annual sales and delivery conference and focused cost cutting measures; and 5) the favorable impacts of our restructuring plan on various areas of our operations. These decreases were partially offset by \$1.4 million of increased warehousing costs that were previously charged to CSBU cost centers, and \$0.7 million of increased share-based compensation costs due to reversals of share-based compensation expense in the prior year that did not repeat in fiscal 2009.

**Restructuring Costs** – Following the sale of our CSBU, we initiated a restructuring plan that reduced the number of our domestic regional sales offices, decentralized certain sales support functions, and significantly changed the operations of our Canadian subsidiary. The restructuring plan was intended to strengthen the remaining domestic sales offices and reduce our overall operating costs, and this effort continued into fiscal 2009. During fiscal 2009 we expensed \$2.0 million for anticipated severance costs necessary to complete the restructuring plan.

**Impairment of Assets** – Based on the terms of the sale of CSBU assets, we were entitled to receive a \$1.2 million adjustment for working capital delivered on the closing date of the sale and to receive \$2.3 million as reimbursement for specified costs necessary to complete the transaction. Payment for these costs was originally due in January 2009, but we extended the due date of the payment at Franklin Covey Products' request and obtained a promissory note from Franklin Covey Products for the amount owed, plus accrued interest. At the time we received the promissory note from Franklin Covey Products, we believed that we could obtain payment for the amounts owed, based on prior year performance and forecasted financial performance in 2009. However, the financial position of Franklin Covey Products deteriorated significantly late in fiscal 2009 and the deterioration accelerated subsequent to August 31, 2009. As a result of this deterioration, the Company reassessed the collectibility of the promissory note. Based on revised expected cash flows and other operational issues, we determined that the promissory note should be impaired at August 31, 2009. Accordingly, we recorded a \$3.6 million impaired asset charge and reversed \$0.1 million of interest income that was recorded during fiscal 2009 from the working capital settlement and reimbursable transaction cost receivables.

**Depreciation** – Depreciation expense decreased by \$1.2 million compared to the prior year. The decrease was primarily due to the sale of the CSBU. During the fourth quarter of fiscal 2009, we impaired certain software costs due to the decision to replace our primary general ledger accounting



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system in fiscal 2010 and recorded an additional \$0.5 million depreciation charge. We also recorded impairment charges totaling \$0.6 million for two software applications that did not function as anticipated and were written off during fiscal 2008.

Amortization – Consolidated amortization expense increased by \$0.2 million compared to the prior year due to the acquisition of CoveyLink, which was purchased in fiscal 2009.

Income Taxes

Our income tax benefit from continuing operations for fiscal 2009 was \$3.8 million compared to a \$6.7 million provision in fiscal 2008. The income tax benefit was primarily due to a pre-tax loss recognized in fiscal 2009 compared to pre-tax income in the prior year. Our effective tax benefit rate of approximately 26 percent was lower than statutory combined rates primarily due to foreign withholding taxes for which we cannot utilize a foreign tax credit, the accrual of taxable interest income on the management stock loan program, and actual and deemed dividends from foreign subsidiaries for which we also cannot utilize foreign tax credits.

SEGMENT REVIEW

Prior to the sale of the CSBU, we had two operating segments: the OSBU and the CSBU. Following the sale, our operations constitute one reportable segment. However, to improve comparability, the amounts presented in the table below reflect fiscal 2008 operating results based upon the previously defined segments and include the impact of the sale of the CSBU, which closed during the fourth quarter of fiscal 2008. The following is a description of the previously reported operating segments, their primary operating components, and their significant business activities:

Organizational Solutions Business Unit – The OSBU was primarily responsible for the development, marketing, sale, and delivery of strategic execution, productivity, leadership, sales force performance, and communication training and consulting solutions directly to organizational clients, including other companies, the government, and educational institutions. The OSBU included the financial results of our domestic sales force, public programs, and certain international operations. The domestic sales force remains responsible for the sale and delivery of our training and consulting services in the United States and Canada. Our international sales group includes the financial results of our directly owned foreign offices and royalty revenues from licensees.

Consumer Solutions Business Unit – This business unit was primarily focused on sales to individual customers and small business organizations and included the results of our domestic retail stores, consumer direct operations (primarily Internet sales and call center), wholesale operations, international product channels in certain countries, and other related distribution channels, including government product sales and domestic printing and publishing sales. The CSBU results of operations also included the financial results of our paper planner manufacturing operations. Although CSBU sales primarily consisted of products such as planners, binders, software, totes, and related accessories, virtually any component of our leadership, productivity, and strategy execution solutions may have been purchased through the CSBU channels.

The following table sets forth sales data by our operating segments for the periods indicated. For further information regarding our reporting segments and geographic information, refer to Note 18 to our consolidated financial statements as found in Item 8 of this report on Form 10-K (in thousands).



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| YEAR ENDED<br>AUGUST 31,<br>Organizational Solutions<br>Business Unit: | 2010       | Percent<br>change<br>from prior<br>year | 2009       | Percent<br>change<br>from prior<br>year | 2008       |
|--|------------|---|------------|---|------------|
| Domestic   | \$ 98,344  | 18                                      | \$ 83,193  | (16 )                                   | \$ 99,308  |
| International  | 35,309     | (3 )                                    | 36,385     | (16 )                                   | 43,060     |
| Total OSBU   | 133,653    | 12                                      | 119,578    | (16 )                                   | 142,368    |
| Consumer Solutions   |            |   |            |   |            |
| Business Unit:   | -          | -                                       | -          | (100 )                                  | 107,235    |
| Total operating units  | 133,653    | 12                                      | 119,578    | (52 )                                   | 249,603    |
| Corporate and eliminations   | 3,221      | (9 )                                    | 3,556      | 44                                      | 2,471      |
| Consolidated   | \$ 136,874 | 11                                      | \$ 123,134 | (51 )                                   | \$ 252,074 |

## QUARTERLY RESULTS

The following tables set forth selected unaudited quarterly consolidated financial data for the years ended August 31, 2010 and 2009. The quarterly consolidated financial data reflects, in the opinion of management, all adjustments necessary to fairly present the results of operations for such periods. Results of any one or more quarters are not necessarily indicative of continuing trends.

YEAR ENDED AUGUST 31, 2010  
(unaudited)

|  | November<br>28 | February<br>27 | May 29    | August 31 |
|--|----------------|----------------|-----------|-----------|
| In thousands, except per share amounts                       |                |                |           |           |
| Net sales  | \$ 31,926      | \$ 29,751      | \$ 30,496 | \$ 44,701 |
| Gross profit   | 20,620         | 19,299         | 19,204    | 29,948    |
| Selling, general, and administrative expense                 | 17,275         | 18,464         | 17,530    | 24,335    |
| Depreciation   | 974            | 1,012          | 915       | 768       |
| Amortization   | 962            | 940            | 929       | 929       |
| Income (loss) from operations                                | 1,409          | (1,117 )       | (170 )    | 3,916     |
| Income (loss) from continuing operations before income taxes | 694            | (1,850 )       | (902 )    | 3,238     |
| Income (loss) from continuing operations                     | 116            | (417 )         | 263       | (1,266 )  |
| Income (loss) from discontinued operations, net of tax       | 132            | 36             | (128 )    | 508       |
| Gain on sale of discontinued operations, net of tax          | -              | -              | -         | 238       |
| Net income (loss)  | 248            | (381 )         | 135       | (520 )    |
| Net income (loss) per share:                                 |                |                |           |           |
| Basic and diluted  | \$ .01         | \$ (.03 )      | \$ .01    | \$ (.04 ) |

YEAR ENDED AUGUST 31, 2009  
(unaudited)

|  | November<br>29 | February<br>28 | May 30    | August 31 |
|--|----------------|----------------|-----------|-----------|
| In thousands, except per share amounts                 |                |                |           |           |
| Net sales  | \$ 32,455      | \$ 27,773      | \$ 29,492 | \$ 33,414 |
| Gross profit   | 20,259         | 17,839         | 18,665    | 21,119    |
| Selling, general, and administrative expense           | 20,114         | 19,634         | 16,798    | 19,267    |
| Restructuring costs                                    | -              | -              | 843       | 1,204     |
| Impairment of assets                                   | -              | -              | -         | 3,569     |
| Depreciation   | 903            | 906            | 994       | 1,729     |
| Amortization   | 902            | 903            | 995       | 961       |
| Loss from operations                                   | (1,660 )       | (3,604 )       | (965 )    | (5,611 )  |
| Loss from continuing operations before income taxes    | (2,435 )       | (4,124 )       | (1,910 )  | (6,393 )  |
| Loss from continuing operations                        | (908 )         | (314 )         | (5,542 )  | (4,284 )  |
| Income (loss) from discontinued operations, net of tax | 339            | (319 )         | 489       | (293 )    |
| Net loss   | (569 )         | (633 )         | (5,053 )  | (4,577 )  |
| Net loss per share:                                    |                |                |           |           |
| Basic and diluted                                      | \$ (.04 )      | \$ (.05 )      | \$ (.38 ) | \$ (.34 ) |

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Training sales are moderately seasonal because of the timing of corporate training, which is not typically scheduled as heavily during holiday and vacation periods. Quarterly fluctuations may also be affected by other factors including the introduction of new offerings, the addition of new organizational customers, and the elimination of underperforming offerings.

## LIQUIDITY AND CAPITAL RESOURCES

### Summary

At August 31, 2010 we had \$3.5 million of cash and cash equivalents compared to \$1.7 million at August 31, 2009 and our net working capital (current assets less current liabilities) increased significantly to \$4.6 million compared to a deficit of \$3.2 million at August 31, 2009. Our primary sources of liquidity are cash flows from the sale of services in the normal course of business and proceeds from our revolving line of credit. Our primary uses of liquidity include payments for operating activities, capital expenditures, working capital, and debt repayment.

During the second quarter of fiscal 2010, we obtained a modification to our existing line of credit facility (the Fourth Modification). The Fourth Modification Agreement affected the following terms of our existing line of credit agreements:

- **Loan Amount** – The line of credit will continue to allow up to \$13.5 million of borrowing capacity until December 31, 2010, when the loan amount will be reduced to \$10.0 million.
  - **Maturity Date** – The maturity date of the credit facility has been extended one year to March 14, 2011.
- **Interest Rate** – The effective interest rate will be based upon the calculation of the Funded Debt to EBITDAR Ratio and the Fixed Charge Coverage Ratio. If our Funded Debt to EBITDAR Ratio is less than 2.5 to 1.0 and the Fixed Charge Coverage Ratio is greater than 2.0 to 1.0, the interest rate will be LIBOR plus 2.6 percent. If the ratios are in excess of these amounts, but still in compliance with the terms of the line of credit facility, the interest rate will be LIBOR plus 3.5 percent.
- **Financial Covenants** – The Funded Debt to EBITDAR Ratio was modified for the twelve month periods to be less than (a) 3.75 to 1.00 as of the end of the fiscal quarter ending on February 27, 2010, (b) 3.50 to 1.00 as of the end of the fiscal quarter ending on May 29, 2010, and (c) 3.00 to 1.00 as of the end of the fiscal quarter ending on August 31, 2010 and each fiscal quarter thereafter. The Fixed Charge Coverage Ratio is required to be greater than 1.5 to 1.0 for all periods and the minimum net worth was revised to \$67.0 million. The capital expenditure limitations remain unchanged.

We may use the line of credit facility for general corporate purposes as well as for other transactions, unless specifically prohibited by the terms of the line of credit agreement. The line of credit also contains customary representations and guarantees as well as provisions for repayment and liens. At August 31, 2010, we had \$9.5 million outstanding on our line of credit.

In addition to customary non-financial terms and conditions, our line of credit requires us to be in compliance with specified financial covenants, as described above. In the event of noncompliance with these financial covenants and other defined events of default, the lenders are entitled to certain remedies, including acceleration of the repayment of amounts outstanding on the line of credit. At August 31, 2010, we believe that we were in compliance with the terms and financial covenants of our line of credit facility.



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In addition to our \$13.5 million line of credit facility, we have a long-term lease on our corporate campus that is accounted for as a long-term financing obligation.

The following table summarizes our cash flows from operating, investing, and financing activities for the past three years (in thousands):

| YEAR ENDED AUGUST<br>31,                            | 2010     | 2009        | 2008     |
|---|----------|-------------|----------|
| Total cash provided by<br>(used for):               |          |             |          |
| Operating activities                                | \$ 7,024 | \$ 5,282    | \$ 7,868 |
| Investing activities                                | (2,002)  | (3,203 )    | 18,520   |
| Financing activities                                | (3,617)  | (16,248)    | (16,159) |
| Effect of exchange rates<br>on cash                 | 391      | (47 )       | (451 )   |
| Increase (decrease) in cash<br>and cash equivalents | \$ 1,796 | \$ (14,216) | \$ 9,778 |

The following discussion is a description of the primary factors affecting our cash flows and their effects upon our liquidity and capital resources during the fiscal year ended August 31, 2010.

#### Cash Flows from Operating Activities

Our cash provided by operating activities totaled \$7.0 million in fiscal 2010 compared to \$5.3 million during fiscal 2009. The increase was primarily due to improved operating results from increased sales during fiscal 2010 compared to the prior year. Our primary source of cash from operating activities was the sale of goods and services to our customers in the normal course of business. The primary uses of cash for operating activities were payments to suppliers for materials used in products sold, payments for direct costs necessary to conduct training programs, and payments for selling, general, and administrative expenses. Cash provided by or used for changes in working capital during fiscal 2010 was primarily related to:

- Increased accounts receivable resulting from significantly increased sales during the fourth quarter of fiscal 2010;
- Increased accrued liabilities resulting primarily from increased sales and a corresponding increase in commissions and bonuses; and
  - Reduced inventory balances resulting from improved forecasting and purchasing processes.

We continue to strive to optimize our working capital balances by, among other things, improving our collections of accounts receivable, maintaining proper levels of inventory, and control spending for prepaid and other assets. Combined with existing and future sales growth programs and cost-reduction initiatives, we hope to improve our cash flows from operating activities in future periods. However, the success of these efforts, and their eventual contribution to our cash flows, is dependent upon numerous factors, many of which are not within our control.

#### Cash Flows from Investing Activities and Capital Expenditures

During the fiscal year ended August 31, 2010 we used \$2.0 million of net cash for investing activities. Our primary uses of cash for investing activities were the payment of the first of five potential earnout payments to the former owners of CoveyLink, purchases of property and equipment, and additional spending on curriculum development. During fiscal 2010, we paid \$3.3 million to the former owners of CoveyLink based on earnings growth over the specified earnings period. The former owners of CoveyLink include a son of our Vice-Chairman of the Board of Directors. Our purchases of property and equipment, which totaled \$1.4 million, consisted primarily of

computer hardware and software. During fiscal 2010, we also spent \$0.7 million for further investment in curriculum development activities. These uses of cash were partially offset by the receipt of \$3.4 million from the sale of our product sales component of our Japan subsidiary.

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During fiscal 2011, we expect to spend approximately \$1.0 million on purchases of property and equipment and \$2.9 million on curriculum development activities. Purchases of property and equipment are expected to consist primarily of new computer hardware, software, and in other areas as deemed necessary. However, actual capital spending is based upon a variety of factors and may differ from these estimates.

### Cash Flows from Financing Activities

Net cash used for financing activities during the fiscal year ended August 31, 2010 totaled \$3.6 million. Our uses of cash for financing activities primarily consisted of \$3.4 million of cash used to reduce our line of credit balance and \$0.7 million used for principal payments on our financing obligation. These uses were partially offset by \$0.3 million of cash received from participants in the employee stock purchase plan to purchase shares of our common stock, and \$0.2 million of cash received from a management stock loan participant to repay their loan.

### Sources of Liquidity

Going forward, we will continue to incur costs necessary for the operation and potential growth of the business. We anticipate using cash on hand, cash provided by the sale of goods and services to our clients on the condition that we can continue to generate positive cash flows from operating activities, proceeds from our line of credit, and other financing alternatives, if necessary, for these expenditures. In order to obtain a more favorable interest rate on the line of credit facility, the facility requires an annual renewal. We currently believe that we will be successful in obtaining a new or extended line of credit from our lender prior to the expiration of the current credit facility in March 2011 to ensure available liquidity in future periods. Additional potential sources of liquidity include factoring receivables, issuance of additional equity, or issuance of debt from public or private sources. However, no assurance can be provided that we will obtain a new or extended line of credit or obtain additional financing from other sources on terms that would be acceptable to us. If necessary, we will evaluate all of these options and select one or more of them depending on overall capital needs and the associated cost of capital. If we are unsuccessful in obtaining a renewal or extension of our line of credit, or additional financing, we believe that cash flows from operations combined with a number of initiatives we would implement in the months preceding the due date would create sufficient liquidity to pay down the required outstanding balance on the line of credit. These initiatives include deferral of capital purchases for externally developed curriculum and uncommitted capital expenditures; deferral of executive team compensation; deferral of certain related party contractual earnout payments; substantial reduction of associate salaries; reduction of operating expenses, including non-critical travel; and deferral of payments to other vendors in order to generate sufficient cash.

Considering the foregoing, we anticipate that our existing capital resources should be adequate to enable us to maintain our operations for at least the upcoming twelve months. However, our ability to maintain adequate capital for our operations in the future is dependent upon a number of factors, including sales trends, our ability to contain costs, levels of capital expenditures, collection of accounts receivable, and other factors. Some of the factors that influence our operations are not within our control, such as economic conditions and the introduction of new technology and products by our competitors. We will continue to monitor our liquidity position and may pursue additional financing alternatives, as described above, to maintain sufficient resources for future growth and capital requirements. However, there can be no assurance such financing alternatives will be available to us on acceptable terms, or at all.

### Contractual Obligations

The Company has not structured any special purpose or variable interest entities, or participated in any commodity trading activities, which would expose us to potential undisclosed liabilities or create adverse consequences to our liquidity. Required contractual payments primarily consist of lease payments resulting from the sale of our corporate campus (financing obligation); payments to HP Enterprise Services (HP) for outsourcing services related to

information systems, warehousing, and distribution services; minimum rent payments for office and warehouse space; the repayment of our line of credit



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obligation, which matures in fiscal 2011; and short-term purchase obligations for inventory items and other products and services used in the ordinary course of business. Our expected payments on these obligations over the next five fiscal years and thereafter are as follows (in thousands):

|   | Fiscal    | Fiscal   | Fiscal   | Fiscal   | Fiscal   |            |           |
|---|-----------|----------|----------|----------|----------|------------|-----------|
| Contractual Obligations                                     | 2011      | 2012     | 2013     | 2014     | 2015     | Thereafter | Total     |
| Required lease payments on corporate campus                 | \$ 3,116  | \$ 3,178 | \$ 3,242 | \$ 3,307 | \$ 3,373 | \$ 36,858  | \$ 53,074 |
| Minimum required payments to HP for outsourcing services(1) | 4,138     | 4,138    | 4,138    | 4,138    | 4,138    | 2,969      | 23,659    |
| Minimum operating lease payments(2)                         | 1,853     | 1,923    | 1,376    | 1,248    | 1,210    | 1,067      | 8,677     |
| Line of credit  | 9,532     | -        | -        | -        | -        | -          | 9,532     |
| Purchase obligations  | 3,220     | -        | -        | -        | -        | -          | 3,220     |
| Total expected contractual obligation payments              | \$ 21,859 | \$ 9,239 | \$ 8,756 | \$ 8,693 | \$ 8,721 | \$ 40,894  | \$ 98,162 |

- (1) Our obligation for outsourcing services contains an annual escalation based upon changes in the Employment Cost Index, the impact of which was not estimated in the above table. We are also contractually allowed to collect amounts from Franklin Covey Products that reduce the amounts shown in the table above.
- (2) The operating agreement with Franklin Covey Products provides for reimbursement of a portion of the warehouse leasing costs, the impact of which is not included in the lease obligations in the table above.

Our contractual obligations presented above exclude unrecognized tax benefits of \$3.9 million for which we cannot make a reasonably reliable estimate of the amount and period of payment. For further information regarding the application of FASC 740-10-05, refer to the Notes to the consolidated financial statements as presented in Item 8 of this report on Form 10-K.

## Other Items

Franklin Covey Products is contractually obligated to pay us for rented warehouse and office space, a portion of the fixed costs for warehousing and distribution facilities, and is primarily liable for leasing costs at its retail stores. In the event that Franklin Covey Products is unable to pay these items, our cash flows and operating results may be adversely affected.

The Company is the creditor for a loan program that provided the capital to allow certain management personnel the opportunity to purchase shares of our common stock. For further information regarding our management common stock loan program, refer to the notes to our consolidated financial statements as found in Item 8 of this report on Form 10-K. The inability of the Company to collect all, or a portion, of these receivables could have an adverse impact upon our financial position and future cash flows compared to full collection of the loans.

#### USE OF ESTIMATES AND CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America. The significant accounting policies that we used to prepare our consolidated financial statements are primarily outlined in Note 1 to the consolidated financial statements, which are presented in Part II, Item 8 of this Annual Report on Form 10-K. Some of those accounting policies require us to make assumptions and use judgments that may affect the amounts reported in our consolidated financial statements. Management regularly evaluates its estimates and assumptions and bases those estimates and assumptions on historical experience, factors that are believed to be reasonable under the circumstances, and requirements under accounting principles generally accepted in the United States of America. Actual results may differ from these estimates under different assumptions or conditions, including changes in economic and political conditions and other circumstances that are not in our control, but which may have an impact on these estimates and our actual financial results.

The following items require the most significant judgment and often involve complex estimates:

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### Revenue Recognition

We derive revenues primarily from the following sources:

- **Training and Consulting Services** – We provide training and consulting services to both organizations and individuals in leadership, productivity, strategic execution, goal alignment, sales force performance, and communication effectiveness skills.
- **Products** – We sold planners, binders, planner accessories, handheld electronic devices, and other related products that were primarily delivered through our CSBU channels prior to the fourth quarter of fiscal 2008. We continue to sell products, such as books, audio products, and other related items.

We recognize revenue when: 1) persuasive evidence of an agreement exists, 2) delivery of product has occurred or services have been rendered, 3) the price to the customer is fixed or determinable, and 4) collectibility is reasonably assured. For training and service sales, these conditions are generally met upon presentation of the training seminar or delivery of the consulting services. For product sales, these conditions were generally met upon shipment of the product to the customer or by completion of the sales transaction in a retail store.

Some of our training and consulting contracts contain multiple deliverable elements that include training along with other products and services. For transactions that contain more than one element, we recognize revenue in accordance with the guidance for multiple element arrangements. When fair value exists for all contracted elements, the overall contract consideration is allocated among the separate units of accounting based upon their relative fair values. Revenue for these units is recognized in accordance with our general revenue policies once it has been determined that the delivered items have standalone value to the customer. If fair value does not exist for all contracted elements, revenue for the delivered items is recognized using the residual method, which generally means that revenue recognition is postponed until the point is reached when the delivered items have standalone value and fair value exists for the undelivered items. Under the residual method, the amount of revenue considered for recognition under our general revenue policies is the total contract amount, less the aggregate fair value of the undelivered items. Fair value of the undelivered items is based upon the normal pricing practices for our existing training programs, consulting services, and other products, which are generally the prices of the items when sold separately.

Our international strategy includes the use of licensees in countries where we do not have a wholly-owned operation. Licensee companies are unrelated entities that have been granted a license to translate our content and curriculum, adapt the content and curriculum to the local culture, and sell our training seminars and products in a specific country or region. Licensees are required to pay us royalties based upon a percentage of their sales to clients. We recognize royalty income each period based upon the sales information reported to us from our licensees. Royalty revenue is reported as a component of training and consulting service sales in our consolidated statements of operations.

Revenue is recognized as the net amount to be received after deducting estimated amounts for discounts and product returns.

### Share-Based Compensation

Our shareholders have approved a performance based long-term incentive plan (the LTIP) that provides for annual grants of share-based performance awards to certain managerial personnel and executive management as directed by the Organization and Compensation Committee (the Compensation Committee) of the Board of Directors. The number of common shares that are vested and issued to LTIP participants is variable and is based entirely upon the achievement of specified financial performance objectives during a defined performance period. Due to the variable

number of common shares that may be issued under the LTIP, we reevaluate our LTIP grants on a quarterly basis and adjust the number of shares expected to be awarded based upon actual and estimated financial results of the

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Company compared to the performance goals set for the award. Adjustments to the number of shares awarded, and to the corresponding compensation expense, are made on a cumulative basis at the adjustment date based upon the estimated probable number of common shares to be awarded.

The analysis of our LTIP awards contain uncertainties because we are required to make assumptions and judgments about the eventual number of shares that will vest in each LTIP grant. The assumptions and judgments that are essential to the analysis include forecasted sales and operating income levels during the LTIP service periods. The evaluation of LTIP performance awards and the corresponding use of estimated amounts may produce additional volatility in our consolidated financial statements as we record cumulative adjustments to the estimated number of common shares to be awarded under the LTIP grants as described above.

During fiscal 2010 we granted options to purchase shares of our common stock that have a share price, or market based, vesting condition. As a result, we used a Monte Carlo simulation to determine the fair value of these stock options. The Monte Carlo option pricing model required the input of subjective assumptions, including items such as the expected term of the options. If factors change and we use different assumptions for estimating share-based compensation expense related to stock options, our share-based compensation expense may differ materially from that recorded in the current period.

### Accounts Receivable Valuation

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts represents our best estimate of the amount of probable credit losses in the existing accounts receivable balance. We determine the allowance for doubtful accounts based upon historical write-off experience and current economic conditions and we review the adequacy of our allowance for doubtful accounts on a regular basis. Receivable balances over 90 days past due, which exceed a specified dollar amount, are reviewed individually for collectibility. Account balances are charged off against the allowance after all means of collection have been exhausted and the probability for recovery is considered remote. We do not have any off-balance sheet credit exposure related to our customers.

Our allowance for doubtful accounts calculations contain uncertainties because the calculations require us to make assumptions and judgments regarding the collectibility of customer accounts, which may be influenced by a number of factors that are not within our control, such as the financial health of each customer. We regularly review the collectibility assumptions of our allowance for doubtful accounts calculation and compare them against historical collections. Adjustments to the assumptions may either increase or decrease our total allowance for doubtful accounts. For example, a 10 percent increase to our allowance for doubtful accounts at August 31, 2010 would increase our reported loss from operations by approximately \$0.1 million.

### Inventory Valuation

Following the sale of CSBU, our inventories are comprised primarily of training materials and training related accessories. Inventories are stated at the lower of cost or market with cost determined using the first-in, first-out method. Inventories are reduced to their fair market value through the use of inventory loss reserves, which are recorded during the normal course of business.

Our inventory loss reserve calculations contain uncertainties because the calculations require us to make assumptions and judgments regarding a number of factors, including future inventory demand requirements and pricing strategies. During the evaluation process we consider historical sales patterns and current sales trends, but these may not be indicative of future inventory losses. While we have not made material changes to our inventory reserves methodology during the past three years, our inventory requirements may change based on projected customer demand, technological and product life cycle changes, longer or shorter than expected usage periods, and other factors

that could affect the valuation of our inventories. If our estimates regarding consumer demand and other factors are inaccurate, we may be exposed to losses that may have a materially adverse impact upon our financial position and results of

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operations. For example, a 10 percent increase to our inventory reserves at August 31, 2010 would increase our reported loss from operations by \$0.1 million.

### Indefinite-Lived Intangible Assets and Goodwill

Intangible assets that are deemed to have an indefinite life and goodwill balances are not amortized, but rather are tested for impairment on an annual basis, or more often if events or circumstances indicate that a potential impairment exists. The Covey trade name intangible asset was generated by the merger with the Covey Leadership Center and has been deemed to have an indefinite life. This intangible asset is tested for impairment using the present value of estimated royalties on trade name related revenues, which consist primarily of training seminars and international licensee royalties. Our goodwill at August 31, 2010 was generated by the acquisition of CoveyLink during the second quarter of fiscal 2009 and the subsequent payment of the first of five potential earnout payments contained in the acquisition agreement.

Our impairment evaluation calculations for goodwill and the Covey trade name contain uncertainties because they require us to make assumptions and apply judgment in order to estimate future cash flows, to estimate an appropriate royalty rate, and to select a discount rate that reflects the inherent risk of future cash flows. Our valuation methodology for the Covey trade name has remained unchanged during the past three years. However, if forecasts and assumptions used to support the carrying value of our indefinite-lived intangible asset change in future periods, significant impairment charges could result that would have an adverse effect upon our results of operations and financial condition. The valuation methodologies for both indefinite-lived intangible assets and goodwill are also dependent upon the share price of our common stock and corresponding market capitalization, which may differ from estimated royalties used in our annual impairment testing. Based upon the fiscal 2010 evaluation of the Covey trade name and goodwill, our trade-name related revenues, licensee royalties, and overall sales levels would have to suffer significant reductions before we would be required to impair them. However, future declines in our share price may trigger additional impairment testing and may result in impairment charges.

### Impairment of Long-Lived Assets

Long-lived tangible assets and definite-lived intangible assets are reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. We use an estimate of undiscounted future net cash flows of the assets over their remaining useful lives in determining whether the carrying value of the assets is recoverable. If the carrying values of the assets exceed the anticipated future cash flows of the assets, we calculate an impairment loss. The impairment loss calculation compares the carrying value of the asset to the asset's estimated fair value, which may be based upon discounted cash flows over the estimated remaining useful life of the asset. If we recognize an impairment loss, the adjusted carrying amount of the asset becomes its new cost basis, which is then depreciated or amortized over the remaining useful life of the asset. Impairment of long-lived assets is assessed at the lowest levels for which there are identifiable cash flows that are independent from other groups of assets.

Our impairment evaluation calculations contain uncertainties because they require us to make assumptions and apply judgment in order to estimate future cash flows, forecast the useful lives of the assets, and select a discount rate that reflects the risk inherent in future cash flows. Although we have not made any material changes to our long-lived assets impairment assessment methodology during the past three years, if forecasts and assumptions used to support the carrying value of our long-lived tangible and definite-lived intangible assets change in the future, significant impairment charges could result that would adversely affect our results of operations and financial condition.

### Income Taxes

We regularly evaluate our United States federal and various state and foreign jurisdiction income tax exposures. We account for certain aspects of our income tax provision using the provisions of FASC



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740-10-05 (formerly FIN 48), which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. We may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon final settlement. The provisions of FASC 740-10-05 also provide guidance on de-recognition, classification, interest, and penalties on income taxes, accounting for income taxes in interim periods, and require increased disclosure of various income tax items. Taxes and penalties are components of our overall income tax provision.

We record previously unrecognized tax benefits in the financial statements when it becomes more likely than not (greater than a 50 percent likelihood) that the tax position will be sustained. To assess the probability of sustaining a tax position, we consider all available evidence. In many instances, sufficient positive evidence may not be available until the expiration of the statute of limitations for audits by taxing jurisdictions, at which time the entire benefit will be recognized as a discrete item in the applicable period.

Our unrecognized tax benefits result from uncertain tax positions about which we are required to make assumptions and apply judgment to estimate the exposures associated with our various tax filing positions. The calculation of our income tax provision or benefit, as applicable, requires estimates of future taxable income or losses. During the course of the fiscal year, these estimates are compared to actual financial results and adjustments may be made to our tax provision or benefit to reflect these revised estimates. Our effective income tax rate is also affected by changes in tax law and the results of tax audits by various jurisdictions. Although we believe that our judgments and estimates discussed herein are reasonable, actual results could differ, and we could be exposed to losses or gains that could be material.

### ACCOUNTING PRONOUNCEMENTS ISSUED NOT YET ADOPTED

Revenue Recognition – In October 2009, the Financial Accounting Standards Board issued guidance on revenue recognition that will be effective for us beginning September 1, 2010. The new guidance amends existing guidance on multiple element revenue arrangements to improve the ability of entities to recognize revenue from the sale of delivered items that are part of a multiple-element arrangement when other items have not yet been delivered. One of the current requirements is that there must be objective and reliable evidence of the standalone selling price of the undelivered items, which must be supported by vendor-specific objective evidence (VSOE) or third-party evidence (TPE). The new guidance eliminates the requirements that all undelivered elements have VSOE or TPE before an entity can recognize the portion of an overall arrangement that is attributable to items that have already been delivered. The “residual method” of allocating revenue is thereby eliminated and entities are required to allocate the arrangement consideration at the inception of the arrangement to all deliverables using the relative selling price method. We have not completed our evaluation of the impact of this guidance.

### REGULATORY COMPLIANCE

The Company is registered in states in which we do business that have a sales tax and collects and remits sales or use tax on retail sales made through its stores and catalog sales. Compliance with environmental laws and regulations has not had a material effect on our operations.

### INFLATION AND CHANGING PRICES

Inflation has not had a material effect on our operations. However, future inflation may have an impact on the price of materials used in the production of training products and related accessories, including paper and related raw

materials. We may not be able to pass on such increased costs to our customers.

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SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain written and oral statements made by the Company in this report are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934 as amended (the Exchange Act). Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate, or imply future results, performance, or achievements, and may contain words such as “believe,” “anticipate,” “expect,” “estimate,” “project,” or words or phrases of similar meaning. In our reports and filings we may make forward looking statements regarding our expectations about future sales levels, future training and consulting sales activity, anticipated expenses, the adequacy of existing capital resources, the ability of the Company to obtain a renewal or extension of its line of credit agreement, projected cost reduction and strategic initiatives, our expectations about the effect of the sale of the CSBU on our business, our expectations about our restructuring plan, expected levels of depreciation and amortization expense, expectations regarding tangible and intangible asset valuation expenses, the seasonality of future sales, the seasonal fluctuations in cash used for and provided by operating activities, expected improvements in cash flows from operating activities, future compliance with the terms and conditions of our line of credit, the ability to borrow on our line of credit, expected repayment of our line of credit in future periods, estimated capital expenditures, and cash flow estimates used to determine the fair value of long-lived assets. These, and other forward-looking statements, are subject to certain risks and uncertainties that may cause actual results to differ materially from the forward-looking statements. These risks and uncertainties are disclosed from time to time in reports filed by us with the SEC, including reports on Forms 8-K, 10-Q, and 10-K. Such risks and uncertainties include, but are not limited to, the matters discussed in Item 1A of this report on Form 10-K for the fiscal year ended August 31, 2010, entitled “Risk Factors.” In addition, such risks and uncertainties may include unanticipated developments in any one or more of the following areas: unanticipated costs or capital expenditures; difficulties encountered by HP in operating and maintaining our information systems and controls, including without limitation, the systems related to demand and supply planning, inventory control, and order fulfillment; delays or unanticipated outcomes relating to our strategic plans; dependence on existing products or services; the rate and consumer acceptance of new product introductions; competition; the number and nature of customers and their product orders, including changes in the timing or mix of product or training orders; pricing of our products and services and those of competitors; adverse publicity; and other factors which may adversely affect our business.

The risks included here are not exhaustive. Other sections of this report may include additional factors that could adversely affect our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors may emerge and it is not possible for our management to predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any single factor, or combination of factors, may cause actual results to differ materially from those contained in forward-looking statements. Given these risks and uncertainties, investors should not rely on forward-looking statements as a prediction of actual results.

The market price of our common stock has been and may remain volatile. In addition, the stock markets in general have experienced increased volatility. Factors such as quarter-to-quarter variations in revenues and earnings or losses and our failure to meet expectations could have a significant impact on the market price of our common stock. In addition, the price of our common stock can change for reasons unrelated to our performance. Due to our low market capitalization, the price of our common stock may also be affected by conditions such as a lack of analyst coverage and fewer potential investors.

Forward-looking statements are based on management’s expectations as of the date made, and the Company does not undertake any responsibility to update any of these statements in the future except as required by law. Actual future performance and results will differ and may differ materially from that contained in or suggested by forward-looking statements as a result of the factors set forth in this Management’s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in our filings with the SEC.



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## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

## Market Risk of Financial Instruments

We are exposed to financial instrument market risk primarily through fluctuations in foreign currency exchange rates and interest rates. To manage risks associated with foreign currency exchange and interest rates, we make limited use of derivative financial instruments. Derivatives are financial instruments that derive their value from one or more underlying financial instruments. As a matter of policy, our derivative instruments are entered into for periods consistent with the related underlying exposures and do not constitute positions that are independent of those exposures. In addition, we do not enter into derivative contracts for trading or speculative purposes, nor are we party to any leveraged derivative instrument. The notional amounts of derivatives do not represent actual amounts exchanged by the parties to the instrument, and, thus, are not a measure of exposure to us through our use of derivatives. Additionally, we enter into derivative agreements only with highly rated counterparties and we do not expect to incur any losses resulting from non-performance by other parties.

## Foreign Exchange Sensitivity

Due to the global nature of our operations, we are subject to risks associated with transactions that are denominated in currencies other than the United States dollar, as well as the effects of translating amounts denominated in foreign currencies to United States dollars as a normal part of the reporting process. The objective of our foreign currency risk management activities is to reduce foreign currency risk in the consolidated financial statements. In order to manage foreign currency risks, we make limited use of foreign currency forward contracts and other foreign currency related derivative instruments. Although we cannot eliminate all aspects of our foreign currency risk, we believe that our strategy, which includes the use of derivative instruments, can reduce the impacts of foreign currency related issues on our consolidated financial statements. The following is a description of our use of foreign currency derivative instruments.

Foreign Currency Forward Contracts – During the fiscal years ended August 31, 2010, 2009, and 2008, we utilized foreign currency forward contracts to manage the volatility of certain intercompany financing transactions and other transactions that are denominated in foreign currencies. Because these contracts did not meet specific hedge accounting requirements, gains and losses on these contracts, which expired on a quarterly basis, were recognized in current operations and were used to offset a portion of the gains or losses of the related accounts. The gains and losses on these contracts were recorded as a component of SG&A expense in our consolidated statements of operations and had the following net impact on the periods indicated (in thousands):

| YEAR ENDED                             |          |          |          |  |
|--|----------|----------|----------|--|
| AUGUST 31,                             | 2010     | 2009     | 2008     |  |
| Losses on foreign exchange contracts   | \$ (240) | \$ (321) | \$ (487) |  |
| Gains on foreign exchange contracts    | -        | 105      | 36       |  |
| Net loss on foreign exchange contracts | \$ (240) | \$ (216) | \$ (451) |  |

At August 31, 2010, we had one open foreign currency sell contract that did not qualify for hedge accounting. The notional amount of this contract was JPY 186.1 million with a contracted value of \$2.0 million. The fair value of this foreign currency forward contract, which was determined using the estimated amount at which the contract could be settled based upon forward market exchange rates, was insignificant.



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Interest Rate Sensitivity

The Company is exposed to fluctuations in interest rates primarily due to our line of credit borrowings. At August 31, 2010, our debt obligations consisted primarily of a long-term lease agreement (financing obligation) associated with the sale of our corporate headquarters facility and a variable-rate line of credit arrangement. Our overall interest rate sensitivity is primarily influenced by amounts borrowed on the line of credit and the prevailing interest rates, which may create additional expense if interest rates increase in future periods. The financing obligation has a payment structure equivalent to a long-term leasing arrangement with a fixed interest rate of 7.7 percent and the line of credit obligation had an effective interest rate of 3.8 percent at August 31, 2010. At August 31, 2010 borrowing levels, a one percent increase in the interest rate on our variable rate line of credit obligation would increase our interest expense over the next year by approximately \$0.1 million.

During the fiscal years ended August 31, 2010, 2009, and 2008, we were not party to any interest rate swap agreements or similar derivative instruments.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
Franklin Covey Co.:

We have audited Franklin Covey Co.'s internal control over financial reporting as of August 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Franklin Covey Co.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Franklin Covey Co. maintained, in all material respects, effective internal control over financial reporting as of August 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.



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We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Franklin Covey Co. and subsidiaries as of August 31, 2010 and 2009, and the related consolidated statements of operations and comprehensive income (loss), shareholders' equity, and cash flows for each of the years in the three-year period ended August 31, 2010, and our report dated November 12, 2010 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Salt Lake City, Utah  
November 12, 2010

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
Franklin Covey Co.:

We have audited the accompanying consolidated balance sheets of Franklin Covey Co. and subsidiaries as of August 31, 2010 and 2009, and the related consolidated statements of operations and comprehensive income (loss), shareholders' equity, and cash flows for each of the years in the three-year period ended August 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Franklin Covey Co. and subsidiaries as of August 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended August 31, 2010, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Franklin Covey Co.'s internal control over financial reporting as of August 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated November 12, 2010 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Salt Lake City, Utah  
November 12, 2010

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CONSOLIDATED BALANCE SHEETS

AUGUST 31, 2010 2009  
In thousands, except per share data

## ASSETS

## Current assets:

|  |            |            |
|--|------------|------------|
| Cash and cash equivalents  | \$ 3,484   | \$ 1,688   |
| Accounts receivable, less allowance for doubtful accounts of \$718 and \$879 | 30,665     | 22,877     |
| Inventories  | 4,470      | 6,770      |
| Deferred income tax assets   | 2,543      | 2,551      |
| Income taxes receivable  | -          | 508        |
| Prepaid expenses and other current assets                                    | 7,454      | 5,748      |
| Total current assets   | 48,616     | 40,142     |
| Property and equipment, net  | 20,330     | 22,629     |
| Intangible assets, net   | 65,240     | 68,994     |
| Goodwill   | 3,761      | 505        |
| Other long-term assets   | 9,396      | 11,608     |
|  | \$ 147,343 | \$ 143,878 |

LIABILITIES AND SHAREHOLDERS'  
EQUITY

## Current liabilities:

|  |        |        |
|--|--------|--------|
| Current portion of financing obligation    | \$ 734 | \$ 621 |
| Line of credit                             | 9,532  | 12,949 |
| Accounts payable                           | 6,847  | 8,758  |
| Income taxes payable                       | 198    | -      |
| Accrued liabilities                        | 26,743 | 20,976 |
| Total current liabilities                  | 44,054 | 43,304 |
| Financing obligation, less current portion | 30,364 | 31,098 |
| Other liabilities                          | 253    | 472    |
| Deferred income tax liabilities            | 1,637  | -      |
| Total liabilities                          | 76,308 | 74,874 |

Commitments and contingencies (Notes 1, 8,  
and 9)

## Shareholders' equity:

|   |           |           |
|---|-----------|-----------|
| Common stock, \$.05 par value; 40,000 shares authorized, 27,056 shares issued | 1,353     | 1,353     |
| Additional paid-in capital  | 183,794   | 183,436   |
| Common stock warrants   | 7,597     | 7,597     |
| Retained earnings   | 13,462    | 13,980    |
| Accumulated other comprehensive income  | 3,014     | 1,961     |
|   | (138,185) | (139,323) |

Treasury stock at cost, 10,041 shares and 10,080 shares

|                            |            |            |
|----------------------------|------------|------------|
| Total shareholders' equity | 71,035     | 69,004     |
|                            | \$ 147,343 | \$ 143,878 |

See accompanying notes to consolidated financial statements.

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## FRANKLIN COVEY CO.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

YEAR ENDED AUGUST 31, 2010 2009 2008

In thousands, except per share amounts

## Net sales:

|                                  |            |            |            |
|----------------------------------|------------|------------|------------|
| Training and consulting services | \$ 129,462 | \$ 114,910 | \$ 138,112 |
| Products                         | 4,226      | 4,668      | 111,491    |
| Leasing                          | 3,186      | 3,556      | 2,471      |
|                                  | 136,874    | 123,134    | 252,074    |

## Cost of sales:

|                                  |        |        |        |
|----------------------------------|--------|--------|--------|
| Training and consulting services | 43,945 | 40,798 | 44,738 |
| Products                         | 2,226  | 2,620  | 48,415 |
| Leasing                          | 1,632  | 1,834  | 1,390  |
|                                  | 47,803 | 45,252 | 94,543 |

Gross profit 89,071 77,882 157,531

Selling, general, and administrative 77,604 75,813 139,616

Gain on sale of consumer solutions business unit - - (9,131 )

Restructuring costs - 2,047 2,064

Impairment of assets - 3,569 1,483

Depreciation 3,669 4,532 5,692

Amortization 3,760 3,761 3,603

Income (loss) from operations 4,038 (11,840 ) 14,204

Interest income 34 27 157

Interest expense (2,892 ) (3,049 ) (3,083 )

Income (loss) from continuing operations before  
income taxes 1,180 (14,862 ) 11,278

Income tax benefit (provision) (2,484 ) 3,814 (6,738 )

Net income (loss) from continuing operations (1,304 ) (11,048 ) 4,540

Income from discontinued operations, net of tax (Note  
2) 548 216 987Gain on sale of discontinued operations, net of tax  
(Note 2) 238 - -

Net income (loss) \$ (518 ) \$ (10,832 ) \$ 5,527

## Income (loss) from continuing operations per share:

Basic and diluted \$ (.10 ) \$ (.82 ) \$ .23

## Net income (loss) per share:

Basic and diluted \$ (.04 ) \$ (.81 ) \$ .28

## Weighted average number of common shares:

Basic 13,525 13,406 19,577

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|  |           |              |          |
|--|-----------|--------------|----------|
| Diluted                                  | 13,525    | 13,406       | 19,922   |
| COMPREHENSIVE INCOME (LOSS):             |           |              |          |
| Net income (loss)                        | \$ (518 ) | \$ (10,832 ) | \$ 5,527 |
| Foreign currency translation adjustments | 1,053     | 955          | 46       |
| Comprehensive income (loss)              | \$ 535    | \$ (9,877 )  | \$ 5,573 |

See accompanying notes to consolidated financial statements.

Table of ContentsFRANKLIN COVEY CO.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

| YEAR ENDED AUGUST 31,  | 2010      | 2009         | 2008      |
|--|-----------|--------------|-----------|
| In thousands   |           |              |           |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |           |              |           |
| Net income (loss)  | \$ (518 ) | \$ (10,832 ) | \$ 5,527  |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |           |              |           |
| Depreciation and amortization  | 7,429     | 8,038        | 9,533     |
| Amortization of capitalized curriculum costs   | 2,083     | 2,263        | 2,124     |
| Gain on sale of discontinued operation   | (1,092 )  | -            | -         |
| Gain on sale of consumer solutions business unit assets                                  | -         | -            | (9,131 )  |
| Deferred income taxes  | 2,406     | (5,476 )     | 4,152     |
| Share-based compensation cost (benefit)  | 1,099     | 468          | (259 )    |
| Loss on disposals of assets  | 75        | 319          | 460       |
| Restructuring charges  | -         | 2,047        | 2,064     |
| Impairment of assets   | -         | 3,569        | 1,483     |
| Changes in assets and liabilities, net of effect of acquired business:                   |           |              |           |
| Decrease (increase) in accounts receivable, net  | (7,597 )  | 5,196        | (6,299 )  |
| Decrease in inventories  | 606       | 2,170        | 2,748     |
| Increase in receivable from equity method investee                                       | -         | -            | (7,672 )  |
| Decrease (increase) in prepaid expenses and other assets                                 | (1,571 )  | 4,136        | 4,985     |
| Increase (decrease) in accounts payable and accrued liabilities                          | 3,398     | (5,368 )     | (1,512 )  |
| Increase (decrease) in income taxes payable/receivable                                   | 699       | (983 )       | (184 )    |
| Increase (decrease) in other long-term liabilities                                       | 7         | (265 )       | (151 )    |
| Net cash provided by operating activities  | 7,024     | 5,282        | 7,868     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |           |              |           |
| Proceeds from the sale of consumer solutions business unit assets, net                   | -         | -            | 28,241    |
| Proceeds from sale of discontinued operation   | 3,350     | -            | -         |
| Purchases of property and equipment  | (1,384 )  | (2,275 )     | (4,164 )  |
| Capitalized curriculum development costs   | (712 )    | (1,762 )     | (4,042 )  |
| Acquisition of business, net of cash acquired  | (3,256 )  | (1,157 )     | -         |
| Investment in equity method investee   | -         | -            | (2,755 )  |
| Proceeds from disposal of consolidated subsidiaries                                      | -         | 201          | 1,180     |
| Proceeds from sales of property and equipment, net                                       | -         | 1,790        | 60        |
| Net cash provided by (used for) investing activities                                     | (2,002 )  | (3,203 )     | 18,520    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |           |              |           |
| Proceeds from line of credit borrowings  | 54,705    | 77,044       | 69,708    |
| Payments on line of credit borrowings  | (58,123 ) | (64,095 )    | (85,707 ) |
| Proceeds from notes payable financing  | 1,154     | -            | -         |
| Payments on notes payable financing  | (1,096 )  | -            | -         |
|  | (654 )    | (1,211 )     | (622 )    |

Principal payments on long-term debt and financing obligation

|  |          |          |           |
|--|----------|----------|-----------|
| Purchases of common stock for treasury                                 | (50 )    | (28,270) | -         |
| Proceeds from sales of common stock held in treasury                   | 288      | 284      | 462       |
| Proceeds from management stock loan payments                           | 159      | -        | -         |
| Net cash used for financing activities                                 | (3,617 ) | (16,248) | (16,159)  |
| Effect of foreign currency exchange rates on cash and cash equivalents | 391      | (47 )    | (451 )    |
| Net increase (decrease) in cash and cash equivalents                   | 1,796    | (14,216) | 9,778     |
| Cash and cash equivalents at beginning of the year                     | 1,688    | 15,904   | 6,126     |
| Cash and cash equivalents at end of the year                           | \$ 3,484 | \$ 1,688 | \$ 15,904 |

Supplemental disclosure of cash flow information:

|                            |        |          |          |
|----------------------------|--------|----------|----------|
| Cash paid for income taxes | \$ 428 | \$ 2,788 | \$ 3,549 |
| Cash paid for interest     | 2,862  | 3,026    | 3,146    |

Non-cash investing and financing activities:

|   |      |      |           |
|---|------|------|-----------|
| Acquisition of treasury stock from tender offer through liabilities | \$ - | \$ - | \$ 28,222 |
| Purchases of property and equipment financed by accounts payable    | 95   | 77   | 314       |

See accompanying notes to consolidated financial statements.



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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

|   | Common<br>Stock<br>Shares | Common<br>Stock<br>Amount | Additional<br>Paid-In<br>Capital | Common<br>Stock<br>Warrants | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Treasury<br>Stock<br>Shares | Treasury<br>Stock<br>Amount |
|---|---------------------------|---------------------------|----------------------------------|-----------------------------|----------------------|---|-----------------------------|-----------------------------|
| In thousands                                  |                           |                           |                                  |                             |                      |   |                             |                             |
| Balance at August 31, 2007                    | 27,056                    | \$ 1,353                  | \$ 185,890                       | \$ 7,602                    | \$ 19,285            | \$ 960  | (7,296 )                    | \$ (114,385)                |
| Issuance of common stock from treasury        |                           |                           | (746 )                           |                             |                      |   | 96                          | 1,234                       |
| Purchase of treasury shares                   |                           |                           |                                  |                             |                      |   | (12 )                       | (103 )                      |
| Treasury shares acquired through tender offer |                           |                           |                                  |                             |                      |   | (3,027 )                    | (28,222 )                   |
| Unvested share award                          |                           |                           | (572 )                           |                             |                      |   | 36                          | 572                         |
| Share-based compensation                      |                           |                           | (259 )                           |                             |                      |   |                             |                             |
| Cumulative translation adjustments            |                           |                           |                                  |                             |                      | 46  |                             |                             |
| Common stock warrant activity                 |                           |                           |                                  | (5 )                        |                      |   |                             |                             |
| Net income                                    |                           |                           |                                  |                             | 5,527                |   |                             |                             |
| Balance at August 31, 2008                    | 27,056                    | \$ 1,353                  | \$ 184,313                       | \$ 7,597                    | \$ 24,812            | \$ 1,006  | (10,203 )                   | \$ (140,904)                |
| Issuance of common stock from treasury        |                           |                           | (424 )                           |                             |                      |   | 57                          | 708                         |
| Unvested share award                          |                           |                           | (921 )                           |                             |                      |   | 66                          | 921                         |
| Additional tender offer costs                 |                           |                           |                                  |                             |                      |   |                             | (48 )                       |
| Share-based compensation                      |                           |                           | 468                              |                             |                      |   |                             |                             |
| Cumulative translation adjustments            |                           |                           |                                  |                             |                      | 955   |                             |                             |
| Net loss                                      |                           |                           |                                  |                             | (10,832)             |   |                             |                             |
| Balance at August 31, 2009                    | 27,056                    | \$ 1,353                  | \$ 183,436                       | \$ 7,597                    | \$ 13,980            | \$ 1,961  | (10,080 )                   | \$ (139,323)                |
| Issuance of common stock from treasury        |                           |                           | (495 )                           |                             |                      |   | 56                          | 783                         |
| Purchase of treasury shares                   |                           |                           | (850 )                           |                             |                      |   | (5 )                        | (29 )                       |
|   |                           |                           |                                  |                             |                      |   | 61                          | 850                         |

|                                    |        |          |            |          |           |          |          |              |
|------------------------------------|--------|----------|------------|----------|-----------|----------|----------|--------------|
| Unvested share award               |        |          |            |          |           |          |          |              |
| Share-based compensation           |        |          | 1,099      |          |           |          |          |              |
| Management stock loan payments     |        |          | 664        |          |           | (84 )    |          | (505 )       |
| NQDC share activity                |        |          | (60 )      |          |           | 11       |          | 39           |
| Cumulative translation adjustments |        |          |            |          |           |          |          | 1,053        |
| Net loss                           |        |          |            |          |           | (518 )   |          |              |
| Balance at August 31, 2010         | 27,056 | \$ 1,353 | \$ 183,794 | \$ 7,597 | \$ 13,462 | \$ 3,014 | (10,041) | \$ (138,185) |

See accompanying notes to consolidated financial statements.

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FRANKLIN COVEY CO.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Franklin Covey Co. (hereafter referred to as us, we, our, or the Company) is a leading global provider of execution, leadership, and personal-effectiveness training. We operate globally with one common brand and business model designed to enable us to provide clients around the world with the same high level of service. To achieve this level of service, we operate four regional sales offices in the United States; wholly owned subsidiaries in Australia, Japan, and the United Kingdom; and contract with licensee partners who deliver our curriculum and provide services in over 140 other countries and territories around the world. Our business-to-business service builds on our expertise in training, consulting, and technology that is designed to help our clients define great performance and execute at the highest levels. We also help clients accelerate great performance through education in management skills, relationship skills, and individual effectiveness, and can provide personal-effectiveness literature and electronic educational solutions to our clients as needed. Our services and products have historically been available through professional consulting services, public workshops, retail stores, catalogs, and the Internet at [www.franklincovey.com](http://www.franklincovey.com), and our best-known offerings in the marketplace have included 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*.

During the fourth quarter of fiscal 2008, we completed the sale of substantially all of the assets of our Consumer Solutions Business Unit (CSBU) to a newly formed entity, Franklin Covey Products, LLC (Note 3). The CSBU was primarily responsible for the sale of our products, including the FranklinCovey Planner™, to consumers through retail stores, catalogs, and our Internet site. Following the sale of the CSBU, our business primarily consists of training, consulting, assessment services, and products to help organizations achieve superior results by focusing on and executing on top priorities, building the capability of knowledge workers, and aligning business processes. Through our organizational research and curriculum development efforts, we seek to consistently create, develop, and introduce new services and products that will help our clients achieve greatness.

Fiscal Year

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 ended on November 28, 2009, February 27, 2010, and May 29, 2010 during fiscal 2010. Unless otherwise noted, references to fiscal years apply to the 12 months ended August 31 of the specified year.

Basis of Presentation

The accompanying consolidated financial statements include the accounts of the Company and our wholly-owned subsidiaries, which consist of Franklin Development Corp., and our offices in Japan, the United Kingdom, and Australia. Intercompany balances and transactions are eliminated in consolidation.

Pervasiveness of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us 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



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statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

## Cash and Cash Equivalents

We consider highly liquid investments with insignificant interest rate risk and original maturities to the Company of three months or less to be cash equivalents. We did not hold a significant amount of investments that would be considered cash equivalent instruments at August 31, 2010 or 2009.

As of August 31, 2010, we had demand deposits at various banks in excess of the \$250,000 limit for insurance by the Federal Deposit Insurance Corporation (FDIC); however, the majority of our cash receipts are used to repay amounts borrowed on our line of credit facility.

## Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts represents our best estimate of the amount of probable credit losses in the existing accounts receivable balance. We determine the allowance for doubtful accounts based upon historical write-off experience and current economic conditions, and we review the adequacy of the allowance for doubtful accounts on a regular basis. Receivable balances past due over 90 days, which exceed a specified dollar amount, are reviewed individually for collectibility. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. We do not have any off-balance sheet credit exposure related to our customers.

## Inventories

Inventories are stated at the lower of cost or market, cost being determined using the first-in, first-out method. Elements of cost in inventories generally include raw materials, direct labor, and overhead. Cash flows from the sales of inventory are included in cash flows provided by operating activities in our consolidated cash flows statements. Following the sale of our Consumer Solutions Business Unit in the fourth quarter of fiscal 2008 and the product sales operations of our Japan office in the fourth quarter of fiscal 2010, our inventories are comprised primarily of training materials, books, and related accessories and consisted of the following (in thousands):

| AUGUST 31,     | 2010     | 2009     |
|----------------|----------|----------|
| Finished goods | \$ 4,366 | \$ 6,542 |
| Raw materials  | 104      | 228      |
|                | \$ 4,470 | \$ 6,770 |

Provision is made to reduce excess and obsolete inventories to their estimated net realizable value. At August 31, 2010 and 2009, our reserves for excess and obsolete inventories totaled \$0.9 million for each year. In assessing the realization of inventories, we make judgments regarding future demand requirements and compare these estimates with current and committed inventory levels. Inventory requirements may change based on projected customer demand, training curriculum life-cycle changes, longer- or shorter-than-expected usage periods, and other factors that could affect the valuation of our inventories.

## Property and Equipment

Property and equipment are recorded at cost. Depreciation expense, which includes depreciation on our corporate campus that is accounted for as a financing obligation (Note 7) and the amortization of assets recorded under capital lease obligations, is calculated using the straight-line method over the lesser of the expected useful life of the asset or

the contracted lease period. We generally use the following depreciable lives for our major classifications of property and equipment:

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| Description   | Useful<br>Lives |
|---|-----------------|
| Buildings   | 15-39<br>years  |
| Machinery and<br>equipment                            | 3-7<br>years    |
| Computer<br>hardware and<br>software                  | 3-5<br>years    |
| Furniture, fixtures,<br>and leasehold<br>improvements | 5-8<br>years    |

Leasehold improvements are amortized over the lesser of the useful economic life of the asset or the contracted lease period. We expense costs for repairs and maintenance as incurred. Gains and losses resulting from the sale of property and equipment are recorded in current operations.

#### Impairment of Long-Lived Assets

Long-lived tangible assets and definite-lived intangible assets are reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. We use an estimate of undiscounted future net cash flows of the assets over the remaining useful lives in determining whether the carrying value of the assets is recoverable. If the carrying values of the assets exceed the anticipated future cash flows of the assets, we recognize an impairment loss equal to the difference between the carrying values of the assets and their estimated fair values. Impairment of long-lived assets is assessed at the lowest levels for which there are identifiable cash flows that are independent from other groups of assets. The evaluation of long-lived assets requires us to use estimates of future cash flows. If forecasts and assumptions used to support the realizability of our long-lived tangible and definite-lived intangible assets change in the future, significant impairment charges could result that would adversely affect our results of operations and financial condition.

#### Indefinite-Lived Intangible Assets and Goodwill

Intangible assets that are deemed to have an indefinite life and acquired goodwill are not amortized, but rather are tested for impairment on an annual basis or more often if events or circumstances indicate that a potential impairment exists. The Covey trade name intangible asset (Note 5) has been deemed to have an indefinite life. This intangible asset is tested for impairment using the present value of estimated royalties on trade name related revenues, which consist primarily of training seminars and work sessions, international licensee sales, and related products. Based on this valuation methodology, we believe the fair value of the Covey trade name substantially exceeds its carrying value and no impairment charges were recorded against the Covey trade name during the fiscal years ended August 31, 2010, 2009, or 2008.

Our reported goodwill resulted from the fiscal 2009 acquisition of CoveyLink, LLC (Note 14) and the fiscal 2010 payment of the first of five annual potential contingent earnout payments. Based on our evaluation, we believe the fair value of the reporting unit, which was defined as our consolidated operations, substantially exceeded its carrying value and no impairment charges to the CoveyLink, LLC acquisition goodwill were recorded during the fiscal years ended August 31, 2010 or 2009.

#### Capitalized Curriculum Development Costs and Impairment of Assets

During the normal course of business, we develop training courses and related materials that we sell to our clients. Capitalized curriculum development costs include certain expenditures to develop course materials such as video segments, course manuals, and other related materials. Generally, curriculum costs are capitalized when there is a major revision to an existing course that requires a significant re-write of the course materials or curriculum. Costs incurred to maintain existing offerings are expensed when incurred. In addition, development costs incurred in the research and development of new curriculum and software products to be sold, leased, or otherwise marketed are expensed as incurred until technological feasibility has been established.

During fiscal 2010, we capitalized costs incurred for the development of new leadership offerings, as well as for various other courses. Capitalized development costs are generally amortized over a five-year



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life, which is based on numerous factors, including expected cycles of major changes to curriculum. Capitalized curriculum development costs are reported as a component of other long-term assets in our consolidated balance sheets and totaled \$5.0 million and \$6.3 million at August 31, 2010 and 2009. Amortization of capitalized curriculum development costs is reported as a component of cost of sales.

In fiscal 2008, we analyzed the expected future revenues and corresponding cash flows expected to be generated from our The 7 Habits interactive program and concluded that the expected future revenues, less direct selling and maintenance costs, were insufficient to cover the carrying value of the corresponding capitalized development costs. Accordingly, we recorded a \$1.5 million impairment charge in the fourth quarter of fiscal 2008 to write the carrying value of this program down to its net realizable value. No impairment charges were recorded in fiscal years 2010 or 2009.

## Accrued Liabilities

Significant components of our accrued liabilities were as follows (in thousands):

| AUGUST 31,                         | 2010      | 2009      |
|------------------------------------|-----------|-----------|
| Accrued compensation               | \$ 7,445  | \$ 4,078  |
| Unearned revenue                   | 4,884     | 3,692     |
| Outsourcing contract costs payable | 3,879     | 2,531     |
| Customer credits                   | 2,373     | 2,384     |
| Other accrued liabilities          | 8,162     | 8,291     |
|                                    | \$ 26,743 | \$ 20,976 |

## Restructuring Costs

Following the sale of our CSBU in the fourth quarter of fiscal 2008, we initiated a restructuring plan that reduced the number of our domestic regional sales offices, decentralized certain sales support functions, closed our Canadian office, and made other changes to our operations in Canada. The restructuring plan was intended to strengthen the remaining domestic sales offices and reduce our overall operating costs. During fiscal 2009 and fiscal 2008, we expensed \$2.0 million and \$2.1 million, respectively, for anticipated severance costs necessary to complete the restructuring plan, of which \$1.3 and \$2.1 million were recorded as components of accrued liabilities at August 31, 2009 and 2008. The composition and utilization of the accrued restructuring charges were as follows at August 31, 2010 (in thousands):

| Description                       | Accrued Restructuring Costs |
|-----------------------------------|-----------------------------|
| Balance at August 31, 2008        | \$ 2,055                    |
| Restructuring charges             | 2,047                       |
| Amounts paid – employee severance | (2,803 )                    |
| Balance at August 31, 2009        | \$ 1,299                    |

|                                   |          |
|-----------------------------------|----------|
| Restructuring charges             | -        |
| Amounts paid – employee severance | (1,299 ) |
| Balance at August 31, 2010        | \$ -     |

#### Foreign Currency Translation and Transactions

The functional currencies of our foreign operations are the reported local currencies. Translation adjustments result from translating our foreign subsidiaries' financial statements into United States dollars. The balance sheet accounts of our foreign subsidiaries are translated into United States dollars using the exchange rate in effect at the balance sheet date. Revenues and expenses are translated using average exchange rates for each month during the fiscal year. The resulting translation gains or losses

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were recorded as a component of accumulated other comprehensive income in shareholders' equity. Foreign currency transaction losses totaled \$0.5 million, \$0.2 million, and \$0.1 million during the fiscal years ended August 31, 2010, 2009, and 2008, and were reported as a component of our selling, general, and administrative expenses.

## Derivative Instruments

During the normal course of business, we are exposed to risks associated with foreign currency exchange rate and interest rate fluctuations. Foreign currency exchange rate exposures result from the Company's operating results, assets, and liabilities that are denominated in currencies other than the United States dollar. In order to limit our exposure to these elements, we have made limited use of derivative instruments. Each derivative instrument that is designated as a hedge instrument is recorded on the balance sheet at its fair value. Changes in the fair value of derivative instruments that qualify for hedge accounting are recorded in accumulated other comprehensive income, which is a component of shareholders' equity. Changes in the fair value of derivative instruments that are not designated as hedge instruments are immediately recognized as a component of selling, general, and administrative expense in our consolidated statements of operations.

## Sales Taxes

We collect sales tax on qualifying transactions with customers based upon applicable sales tax rates in various jurisdictions. We account for sales taxes collected using the net method; accordingly, we do not include sales taxes in net sales reported in our consolidated financial statements.

## Revenue Recognition

We recognize revenue when: 1) persuasive evidence of an agreement exists, 2) delivery of product has occurred or services have been rendered, 3) the price to the customer is fixed or determinable, and 4) collectibility is reasonably assured. For training and service sales, these conditions are generally met upon presentation of the training seminar or delivery of the consulting services. For product sales, these conditions are generally met upon shipment of the product to the customer or by completion of the sales transaction in a retail store.

Some of our training and consulting contracts contain multiple deliverable elements that include training along with other products, services, and intellectual property. For transactions that contain more than one element, we recognize revenue in accordance with the guidance for multiple element arrangements. When fair value exists for all contracted elements, the overall contract consideration is allocated among the separate units of accounting based upon their relative fair values. Revenue for these units is recognized in accordance with our general revenue policies once it has been determined that the delivered items have standalone value to the customer. If fair value does not exist for all contracted elements, revenue for the delivered items is recognized using the residual method, which generally means that revenue recognition is postponed until the point is reached when the delivered items have standalone value and fair value exists for the undelivered items. Under the residual method, the amount of revenue considered for recognition under our general revenue policies is the total contract amount, less the aggregate fair value of the undelivered items. Fair value of the undelivered items is based upon the normal pricing practices for our existing training programs, consulting services, and other products, which are generally the prices of the items when sold separately.

Our international strategy includes the use of licensees in countries where we do not have a wholly-owned operation. Licensee companies are unrelated entities that have been granted a license to translate our content and curriculum, adapt the content and curriculum to the local culture, and sell our training seminars and products in a specific country or region. Licensees are required to pay us royalties based upon a percentage of their sales to clients. We recognize royalty income each period based upon the sales information reported to us from our licensees. Licensee royalty revenues are included as a component of training sales and totaled \$9.2 million, \$8.6

million, and \$10.1 million for the fiscal years ended August 31, 2010, 2009, and 2008.

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Revenue recognition on software sales involving multiple elements, such as software products and support, requires revenue to be allocated to each element based on vendor specific objective evidence (VSOE). Nearly all of our software sales consist of ready to use “off-the-shelf” software products that have multiple elements, including a license and post contract customer support (PCS). Currently, we do not have VSOE for either the license or support elements of our software sales. Accordingly, revenue is deferred until the only undelivered element is PCS and the total arrangement fee is recognized over the support period. Following the sale of the CSBU in the fourth quarter of fiscal 2008, our software sales have been insignificant. However, during fiscal 2008, we had software sales totaling \$2.5 million, which was included as a component of product sales in our consolidated statement of operations for that period.

Revenue is recognized as the net amount to be received after deducting estimated amounts for discounts and product returns.

### Share-Based Compensation

We record the compensation expense for all share based-payments to employees and non-employees, including grants of stock options and the compensatory elements of our employee stock purchase plan, in our consolidated statements of operations based upon their fair values. For more information on our share-based compensation plans, refer to Note 13.

### Shipping and Handling Fees and Costs

All shipping and handling fees billed to customers are recorded as a component of net sales. All costs incurred related to the shipping and handling of products are recorded in cost of sales.

### Advertising Costs

Costs for newspaper, television, radio, and other advertising are expensed as incurred or recognized over the period of expected benefit for direct response and catalog advertising. Direct response advertising costs, which consist primarily of printing and mailing costs for seminar mailers, are charged to expense over the period of projected benefit, which ranges from three to 12 months. Advertising costs included in selling, general, and administrative expenses totaled \$3.3 million, \$5.5 million, and \$15.5 million for the fiscal years ended August 31, 2010, 2009, and 2008. Our direct response advertising costs reported in other current assets totaled \$0.2 million and \$0.1 million at August 31, 2010 and 2009.

### Income Taxes

Our income tax provision has been determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred income taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The income tax provision represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred income taxes result from differences between the financial and tax bases of our assets and liabilities and are adjusted for tax rates and tax laws when changes are enacted. A valuation allowance is provided against deferred income tax assets when it is more likely than not that all or some portion of the deferred income tax assets will not be realized. Interest and penalties related to uncertain tax positions are recognized as components of income tax expense in our consolidated statements of operations.

We provide for income taxes, net of applicable foreign tax credits, on temporary differences in our investment in foreign subsidiaries, which consist primarily of unrepatriated earnings.



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Comprehensive Income

Comprehensive income includes changes to equity accounts that were not the result of transactions with shareholders. Comprehensive income is comprised of net income or loss and other comprehensive income and loss items. Our comprehensive income and losses generally consist of changes in the cumulative foreign currency translation adjustment.

Liquidity

At August 31, 2010 our line of credit has a remaining maturity of less than one year and is therefore classified as a current obligation on our consolidated balance sheet. In order to obtain a more favorable interest rate on the line of credit facility, the facility requires an annual renewal. We currently believe that we will be successful in obtaining a new or extended line of credit from our lender prior to the expiration of the current credit facility in March 2011 to ensure available liquidity in future periods. Additional potential sources of liquidity include factoring receivables, issuance of additional equity, or issuance of debt from public or private sources. However, no assurance can be provided that we will obtain a new or extended line of credit or obtain additional financing from other sources on terms that would be acceptable to us. If necessary, we will evaluate all of these options and select one or more of them depending on overall capital needs and the associated cost of capital. If we are unsuccessful in obtaining a renewal or extension of our line of credit, or additional financing, we believe that cash flows from operations combined with a number of initiatives we would implement in the months preceding the due date would create sufficient liquidity to pay down the required outstanding balance on the line of credit. These initiatives include deferral of capital purchases for externally developed curriculum and uncommitted capital expenditures; deferral of executive team compensation; deferral of certain related party contractual earnout payments; substantial reduction of associate salaries; reduction of operating expenses, including non-critical travel; and deferral of payments to other vendors in order to generate sufficient cash.

Accounting Pronouncements Issued Not Yet Adopted

Revenue Recognition – In October 2009, the Financial Accounting Standards Board issued guidance on revenue recognition that will be effective for us beginning September 1, 2010. The new guidance amends existing guidance on multiple element revenue arrangements to improve the ability of entities to recognize revenue from the sale of delivered items that are part of a multiple-element arrangement when other items have not yet been delivered. One of the current requirements is that there must be objective and reliable evidence of the standalone selling price of the undelivered items, which must be supported by vendor-specific objective evidence (VSOE) or third-party evidence (TPE). The new guidance eliminates the requirements that all undelivered elements have VSOE or TPE before an entity can recognize the portion of an overall arrangement that is attributable to items that have already been delivered. The “residual method” of allocating revenue is thereby eliminated and entities are required to allocate the arrangement consideration at the inception of the arrangement to all deliverables using the relative selling price method. We have not completed our evaluation of the impact of this guidance.

2. SALE OF JAPAN PRODUCT SALES OPERATION

During fiscal 2010, we sold the product sales component of our wholly owned subsidiary in Japan to Nakabayashi Co. Ltd., an unrelated Japan-based paper products company. The sale included the disposition of inventories, certain intangibles assets (including customer lists), and other current assets, which had an aggregate carrying value of \$2.0 million. The sale closed on June 1, 2010 and the total sale price was JPY 305.0 million, or approximately \$3.4 million. We recognized a pre-tax gain from the sale totaling \$1.1 million after normal transaction costs. In addition, the sale agreement provides for a three percent passive royalty on annual sales, which we believe are insignificant to our operations. We believe that the sale of this division will further align our Japanese operations with our overall strategic focus on training and consulting sales. The Japan products sales component was previously reported as a

part of our international operations.

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We determined that the operating results of the Japan product sales component qualify for discontinued operations presentation and we have presented the operating results of the Japan product sales component as discontinued operations for all periods presented in this report. The income recognized from discontinued operations was comprised of the following for the periods presented (in thousands):

| August 31,                                      | 2010     | 2009     | 2008     |
|---|----------|----------|----------|
| Sales   | \$ 5,097 | \$ 6,984 | \$ 7,119 |
| Gross profit                                    | 2,230    | 2,531    | 3,497    |
| Income before income taxes                      | 988      | 401      | 1,795    |
| Income tax provision                            | (440 )   | (185 )   | (808 )   |
| Income from discontinued operations, net of tax | 548      | 216      | 987      |

### 3. SALE OF THE CONSUMER SOLUTIONS BUSINESS UNIT

#### General

During the fourth quarter of fiscal 2008, we joined with Peterson Partners to create a new company, Franklin Covey Products, LLC (Franklin Covey Products). This new company purchased substantially all of the assets of our Consumer Solutions Business Unit with the objective of expanding the worldwide sales of Franklin Covey Products as governed by a comprehensive license agreement between us and Franklin Covey Products. Franklin Covey Products, which is controlled by Peterson Partners, purchased the CSBU assets for \$32.0 million in cash plus a \$1.2 million adjustment for working capital delivered on the closing date of the sale, which was effective July 6, 2008. We also incurred \$3.7 million of direct costs related to the sale of the CSBU assets, a portion of which is reimbursable from Franklin Covey Products.

On the date of the sale closing, the Company invested approximately \$1.8 million to purchase a 19.5 percent voting interest in Franklin Covey Products, made a \$1.0 million priority capital contribution with a 10 percent return, and may have the opportunity to earn contingent license fees if Franklin Covey Products achieves specified performance objectives. However, as prescribed by FASC 845-10-55-28, the excess of net monetary consideration received over the fair value of surrendered assets is required to first reduce the cost of any retained equity method investment in Franklin Covey Products to zero with any remainder being recognized as an additional gain. As a result of this guidance, the basis of the investment in Franklin Covey Products of \$2.8 million was reduced to zero with a corresponding reduction to the gain. We recognized a net gain of \$9.1 million on the sale of the CSBU assets, and a negative basis difference for the amount of the initial investment in Franklin Covey Products. We amortize the negative basis difference over the life of the long-term assets acquired by Franklin Covey Products or when cash is received for payment of the priority contribution.

The carrying amounts of the assets and liabilities of the CSBU that were sold to Franklin Covey Products were as follows (in thousands):

|                           |        |
|---------------------------|--------|
| Description               |        |
| Cash and cash equivalents | \$ 38  |
| Accounts receivable, net  | 6,675  |
| Inventories               | 12,665 |
|                           | 2,291  |

Other current  
assets

|                                |           |
|--------------------------------|-----------|
| Property and<br>equipment, net | 8,435     |
| Other assets                   | 158       |
| Total assets sold              | \$ 30,262 |

|                           |           |
|---------------------------|-----------|
| Accounts payable          | \$ 3,589  |
| Accrued liabilities       | 6,748     |
| Total liabilities<br>sold | \$ 10,337 |

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Accounting for the Investment in Franklin Covey Products

Based upon the guidance found in FASC 205-20-45, FASC 205-20-50, 55, and SAB 103, Topic 5Z4, Disposal of Operation with Significant Interest Retained, we determined that the operations of CSBU should not be reported as discontinued operations because we will continue to have significant influence over the operations of Franklin Covey Products and may participate in their future cash flows. As a result of this determination, we have not presented the financial results of the CSBU as discontinued operations in the accompanying consolidated financial statements, and we do not anticipate discontinued operations presentation in future interim and annual reporting periods.

As a result of Franklin Covey Products' structure as a limited liability company with separate owner capital accounts, we determined that the Company's investment in Franklin Covey Products is more than minor and that we are required to account for our investment in Franklin Covey Products using the equity method of accounting. We record our share of Franklin Covey Products' profit and loss based upon specified allocations as defined in the associated operating agreement. In addition, our ownership interest may be diluted in future periods if ownership shares of Franklin Covey Products granted to certain members of its management vest.

During the fiscal years ended August 31, 2010 and 2009, Franklin Covey Products recognized a net loss. However, we do not have any obligation to fund the losses of Franklin Covey Products and therefore, our portion of their net losses during fiscal 2010 and fiscal 2009 were not recorded in our consolidated statements of operations. Consequently, the net book value of our investment in Franklin Covey Products was zero as of August 31, 2010 and 2009.

We receive reimbursement for certain operating costs, such as warehousing and distribution costs, which are billed to the Company by third party providers. We also make payments to Franklin Covey Products for products that we use for our training and consulting services. At August 31, 2010 and 2009, we had \$3.4 million and \$2.0 million receivable from Franklin Covey Products, which have been classified in other current assets.

Impairment of Working Capital and Reimbursable Transaction Costs Note

Based on the terms of the sale transaction, the Company was entitled to receive a \$1.2 million adjustment for working capital delivered on the closing date of the sale and to receive \$2.3 million as reimbursement for specified costs necessary to complete the transaction. Payment for these costs was originally due in January 2009, but we extended the due date of the payment at Franklin Covey Products' request and obtained a promissory note from Franklin Covey Products for the amount owed, plus accrued interest. The promissory note includes accrued interest through the date of the note, matures on September 30, 2013, and bears interest at 10 percent per year.

At the time we received the promissory note from Franklin Covey Products, we believed that we could obtain payment for the amount owed, based on prior year performance and forecasted financial performance in 2009. However, the financial position of Franklin Covey Products deteriorated significantly late in fiscal 2009, and the deterioration continued subsequent to August 31, 2009. As a result of this deterioration, the Company reassessed the collectibility of the promissory note as of August 31, 2009. Based on revised expected cash flows and other operational issues, we determined that the promissory note should be impaired at August 31, 2009. Accordingly, we recorded a \$3.6 million impaired asset charge and reversed \$0.1 million of interest income that was recorded during fiscal 2009 from the working capital settlement and reimbursable transaction cost receivables.

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## 4. PROPERTY AND EQUIPMENT

Our property and equipment were comprised of the following (in thousands):

| AUGUST 31,                                      | 2010      | 2009      |
|---|-----------|-----------|
| Land and improvements                           | \$ 1,312  | \$ 1,312  |
| Buildings                                       | 32,406    | 32,385    |
| Machinery and equipment                         | 2,387     | 2,333     |
| Computer hardware and software                  | 17,465    | 19,221    |
| Furniture, fixtures, and leasehold improvements | 9,861     | 9,803     |
|   | 63,431    | 65,054    |
| Less accumulated depreciation                   | (43,101)  | (42,425)  |
|   | \$ 20,330 | \$ 22,629 |

In the fourth quarter of fiscal 2009, we completed the sale of our administrative office and distribution facility located in Ontario, Canada to an unrelated entity. The sale price was \$2.0 million and the carrying value of the building at the date of the sale was \$1.9 million. After deducting customary closing costs and other costs necessary to complete the sale of the building, we recorded a \$0.1 million loss, which was recorded as a component of depreciation expense in our consolidated statement of operations for the year ended August 31, 2009. The transaction involving the Canadian property was accounted for as a sale, and we will have no further obligations or responsibilities related to the property that was sold. A portion of the proceeds from the sale of the building was used to repay the mortgage obligation associated with the property.

## 5. INTANGIBLE ASSETS AND GOODWILL

Our intangible assets and goodwill were comprised of the following (in thousands):

| AUGUST 31, 2010                    | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
|------------------------------------|-----------------------|--------------------------|---------------------|
| Definite-lived intangible assets:  |                       |                          |                     |
| License rights                     | \$ 27,000             | \$ (11,166 )             | \$ 15,834           |
| Curriculum                         | 58,271                | (32,981 )                | 25,290              |
| Customer lists                     | 15,111                | (13,995 )                | 1,116               |
| Trade names                        | 377                   | (377 )                   | -                   |
|                                    | 100,759               | (58,519 )                | 42,240              |
| Indefinite-lived intangible asset: |                       |                          |                     |
| Covey trade name                   | 23,000                | -                        | 23,000              |
|                                    | \$ 123,759            | \$ (58,519 )             | \$ 65,240           |

AUGUST 31, 2009

Definite-lived intangible

assets:

|                |           |              |           |
|----------------|-----------|--------------|-----------|
| License rights | \$ 27,000 | \$ (10,229 ) | \$ 16,771 |
| Curriculum     | 58,257    | (31,441 )    | 26,816    |
| Customer lists | 15,111    | (12,704 )    | 2,407     |
| Trade names    | 377       | (377 )       | -         |
|                | 100,745   | (54,751 )    | 45,994    |

Indefinite-lived intangible

asset:

|                  |            |              |           |
|------------------|------------|--------------|-----------|
| Covey trade name | 23,000     | -            | 23,000    |
|                  | \$ 123,745 | \$ (54,751 ) | \$ 68,994 |

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Our intangible assets are amortized over the estimated useful life of the asset. The range of remaining estimated useful lives and weighted-average amortization period over which we are amortizing the major categories of definite-lived intangible assets at August 31, 2010 were as follows:

| Category of Intangible Asset | Range of Remaining Estimated Useful Lives | Weighted Average Amortization Period |
|------------------------------|---|--------------------------------------|
| License rights               | 16 years                                  | 30 years                             |
| Curriculum                   | 9 to 16 years                             | 26 years                             |
| Customer lists               | 1 to 2 years                              | 14 years                             |

During fiscal 2009 we acquired the assets of CoveyLink Worldwide, LLC (Note 14). Based upon the purchase price allocation and an evaluation of the assets acquired and liabilities assumed, we recorded a \$0.4 million increase in our intangible assets for the fair value of customer relationships and the practice leader agreement and \$0.5 million of goodwill. The intangible assets were aggregated with our customer list intangibles and are amortized on an accelerated basis that is based on their expected cash flows over the estimated useful lives of the assets, which is approximately three years. In addition, the previous owners of CoveyLink Worldwide, LLC, which includes a son of the Vice-Chairman of our Board of Directors, are also entitled to earn annual contingent payments based upon earnings growth over the next five years. During fiscal 2010, we paid \$3.3 million in cash to the former owners of CoveyLink Worldwide, LLC for the first contingent payment. The fiscal 2010 contingent payment was classified as goodwill in our August 31, 2010 consolidated balance sheet. Our consolidated goodwill consisted of the following at August 31, 2010 (in thousands):

|   |         |
|---|---------|
| Balance at August 31, 2008                            | \$-     |
| Acquisition of CoveyLink Worldwide, LLC               | 505     |
| Impairments   | -       |
| Balance at August 31, 2009                            | \$505   |
| Contingent earnout payment from CoveyLink acquisition | 3,256   |
| Impairments   | -       |
| Balance at August 31, 2010                            | \$3,761 |

Our aggregate amortization expense from definite-lived intangible assets totaled \$3.8 million, \$3.8 million, and \$3.6 million, for fiscal years 2010, 2009, and 2008. Amortization expense for our intangible assets over the next five years is expected to be as follows (in thousands):

YEAR  
ENDING  
AUGUST

31,

|      |         |
|------|---------|
| 2011 | \$3,537 |
| 2012 | 2,495   |
| 2013 | 2,469   |
| 2014 | 2,452   |
| 2015 | 2,443   |

6. LINE OF CREDIT AND SHORT-TERM NOTE PAYABLE

Line of Credit

We have a line of credit borrowing facility with an external lender that provides additional working capital to fund our operations and provide capital for other uses. During fiscal 2010, our previous line of credit agreement expired and we obtained a modification to the previously existing line of credit agreements that extended the due date of the previous agreement (the Fourth Modification). The Fourth Modification Agreement affected the following terms of our previously existing line of credit agreements:

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- Loan Amount – The line of credit will continue to allow up to \$13.5 million of borrowing capacity until December 31, 2010, when the loan amount will be reduced to \$10.0 million.
  - Maturity Date – The maturity date of the credit facility was extended one year to March 14, 2011.
- Interest Rate – The effective interest rate will be based upon the calculation of the Funded Debt to EBITDAR Ratio and the Fixed Charge Coverage Ratio. If our Funded Debt to EBITDAR Ratio is less than 2.5 to 1.0 and the Fixed Charge Coverage Ratio is greater than 2.0 to 1.0, the interest rate will be LIBOR plus 2.6 percent. If the ratios are in excess of these amounts, but still in compliance with the terms of the line of credit facility, the interest rate will be LIBOR plus 3.5 percent.
- Financial Covenants – The Funded Debt to EBITDAR Ratio was modified for the twelve month periods to be less than (a) 3.75 to 1.00 as of the end of the fiscal quarter ending on February 27, 2010, (b) 3.50 to 1.00 as of the end of the fiscal quarter ending on May 29, 2010, and (c) 3.00 to 1.00 as of the end of the fiscal quarter ending on August 31, 2010 and each fiscal quarter thereafter. The Fixed Charge Coverage Ratio is required to be greater than 1.5 to 1.0 for all periods and the minimum net worth was revised to \$67.0 million. The capital expenditure limitations remain unchanged. We believe that we were in compliance with the terms and covenants of the Fourth Modification Agreement at August 31, 2010.

The additional expense related to the Fourth Modification was recorded as a component of interest expense and was immaterial to our consolidated financial statements.

The effective interest rate on our line of credit was 3.8 percent and 2.3 percent at August 31, 2010 and 2009, respectively.

In connection with the original credit agreements, the Company entered into a promissory note, a security agreement, repayment guaranty agreements, and a pledge and security agreement. These agreements remain in place with the remaining lender and pledge substantially all of the Company's assets located in the United States to the lender in the Modified Credit Agreement.

Short-Term Note Payable

On December 1, 2009, we obtained an unsecured short-term loan from a bank in Japan for 100.0 million yen. The loan was due on May 31, 2010 and bore interest at 2.5 percent for the duration of the loan. The note payable was paid in full on the due date; however, at the inception of the loan, the United States dollar equivalent of the loan exceeded the allowable \$1.0 million, which resulted in an instance of non-compliance with our line of credit agreement. This instance of non-compliance was cured and did not increase our outstanding obligation on the line of credit agreement. The Fourth Modification Agreement described above waived the instance of non-compliance with regard to the Japan loan.



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## FINANCING OBLIGATION

Our financing obligation was comprised of the following (in thousands):

| AUGUST 31,  | 2010      | 2009      |
|---|-----------|-----------|
| Financing obligation on corporate campus, payable in monthly installments of \$254, including principal and interest, for the first five years with two percent annual increases thereafter (imputed interest at 7.7%), through June 2025 | \$ 31,098 | \$ 31,719 |
| Less current portion  | (734 )    | (621 )    |
| Total long-term debt and financing obligation, less current portion   | \$ 30,364 | \$ 31,098 |

Future principal maturities of our financing obligation were as follows at August 31, 2010 (in thousands):

| YEAR<br>ENDING<br>AUGUST<br>31, |          |
|---------------------------------|----------|
| 2011                            | \$734    |
| 2012                            | 857      |
| 2013                            | 992      |
| 2014                            | 1,139    |
| 2015                            | 1,298    |
| Thereafter                      | 26,078   |
|                                 | \$31,098 |

In connection with the sale and leaseback of our corporate headquarters facility located in Salt Lake City, Utah, we entered into a 20-year master lease agreement with the purchaser, an unrelated private investment group. The 20-year master lease agreement also contains six five-year renewal options that will allow us to maintain our operations at the current location for up to 50 years. Although the corporate headquarters facility was sold and the Company has no legal ownership of the property, we were prohibited from recording the transaction as a sale since we have subleased a significant portion of the property that was sold. Accordingly, we accounted for the sale as a financing transaction, which required us to continue reporting the corporate headquarters facility as an asset and to record a financing obligation for the sale price. The future minimum payments under the financing obligation for the initial 20 year lease term are as follows (in thousands):

| YEAR<br>ENDING<br>AUGUST<br>31, |         |
|---------------------------------|---------|
| 2011                            | \$3,116 |
| 2012                            | 3,178   |
| 2013                            | 3,242   |
| 2014                            | 3,307   |
| 2015                            | 3,373   |
| Thereafter                      | 36,858  |
|                                 | 53,074  |

|   |          |
|---|----------|
| Total<br>future<br>minimum<br>financing<br>obligation<br>payments               |          |
| Less<br>interest  | (23,288) |
| Present<br>value of<br>future<br>minimum<br>financing<br>obligation<br>payments | \$29,786 |

The difference between the carrying value of the financing obligation and the present value of the future minimum financing obligation payments represents the carrying value of the land sold in the financing transaction, which is not depreciated. At the conclusion of the master lease agreement, the remaining financing obligation and carrying value of the land will be written off of our financial statements.

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## 8. OPERATING LEASES

## Lease Expense

In the normal course of business, we lease office space and warehouse and distribution facilities under non-cancelable operating lease agreements. We rent office space, primarily for international and domestic regional sales administration offices, in commercial office complexes that are conducive to sales and administrative operations. We also rent warehousing and distribution facilities that are designed to provide secure storage and efficient distribution of our training products and accessories. These operating lease agreements generally contain renewal options that may be exercised at our discretion after the completion of the base rental term. In addition, many of the rental agreements provide for regular increases to the base rental rate at specified intervals, which usually occur on an annual basis. At August 31, 2010, we had operating leases that have remaining terms ranging from approximately one year to approximately six years. Following the sale of our CSBU assets, Franklin Covey Products is contractually obligated to pay a portion of our minimum rental payments on certain warehouse and distribution facilities. The following table summarizes our future minimum lease payments under operating lease agreements and the lease amounts receivable from Franklin Covey Products at August 31, 2010 (in thousands):

| YEAR ENDING | Required<br>Minimum<br>Lease<br>Payments | Receivable<br>from<br>Franklin<br>Covey<br>Products | Net<br>Required<br>Minimum<br>Lease<br>Payments |
|-------------|--|---|---|
| AUGUST 31,  |  |   |   |
| 2011        | \$ 1,853                                 | \$ (422 )   | \$ 1,431  |
| 2012        | 1,923                                    | (475 )  | 1,448   |
| 2013        | 1,376                                    | (529 )  | 847   |
| 2014        | 1,248                                    | (584 )  | 664   |
| 2015        | 1,210                                    | (632 )  | 578   |
| Thereafter  | 1,067                                    | (535 )  | 532   |
|             | \$ 8,677                                 | \$ (3,177 )   | \$ 5,500  |

We recognize lease expense on a straight-line basis over the life of the lease agreement. Contingent rent expense is recognized as it is incurred and was insignificant for the periods presented. Total rent expense recorded in selling, general, and administrative expense from operating lease agreements was \$3.0 million, \$3.2 million, and \$8.7 million for the years ended August 31, 2010, 2009, and 2008.

## Lease Income

We have subleased a significant portion of our corporate headquarters office space located in Salt Lake City, Utah to multiple, unrelated tenants as well as to Franklin Covey Products. The cost basis of the office space available for lease was \$33.4 million, which had a carrying value of \$14.9 million at August 31, 2010. Future minimum lease payments due to us from our sublease agreements at August 31, 2010 were as follows (in thousands):

| YEAR<br>ENDING<br>AUGUST<br>31, |          |
|---------------------------------|----------|
| 2011                            | \$ 2,306 |
| 2012                            | 2,392    |
| 2013                            | 2,150    |
| 2014                            | 1,973    |

|            |           |
|------------|-----------|
| 2015       | 1,795     |
| Thereafter | 8,563     |
|            | \$ 19,179 |

Sublease payments made to the Company totaled \$3.2 million, \$3.6 million, and \$2.7 million, during the fiscal years ended August 31, 2010, 2009, and 2008 of which \$0.2 million was recorded as a reduction of rent expense associated with underlying lease agreements in our selling, general, and administrative expense in fiscal 2008.

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## 9. COMMITMENTS AND CONTINGENCIES

## Outsourcing Contract

The Company has an outsourcing contract with HP Enterprise Services (HP and formerly Electronic Data Services) to provide information technology system support and product warehousing and distribution services. During fiscal 2009, primarily as a result of the sale of CSBU assets, we amended the terms of the outsourcing contract with HP. Under terms of the amended outsourcing contract with HP: 1) the outsourcing contract and its addendums will continue to expire on June 30, 2016; 2) Franklin Covey and Franklin Covey Products will have separate information systems services support contracts; 3) we will no longer be required to purchase specified levels of computer hardware technology; and 4) our warehouse and distribution costs will consist of an annual fixed charge, which is partially reimbursable by Franklin Covey Products, plus variable charges for actual activity levels. The warehouse and distribution fixed charge contains an annual escalation clause based upon changes in the Employment Cost Index. The following schedule summarizes our estimated minimum information systems support and fixed warehouse and distribution charges, without the effect of estimated escalation charges, to HP for services over the remaining life of the outsourcing contract (in thousands):

| YEAR ENDING<br>AUGUST 31, | Estimated<br>Gross<br>Minimum<br>and Fixed<br>Charges | Receivable<br>from<br>Franklin<br>Covey<br>Products | Estimated<br>Net<br>Minimum<br>and Fixed<br>Charges |
|---------------------------|---|---|---|
| 2011                      | \$ 4,138  | \$ (2,159 )   | \$ 1,979  |
| 2012                      | 4,138   | (2,159 )  | 1,979   |
| 2013                      | 4,138   | (2,159 )  | 1,979   |
| 2014                      | 4,138   | (2,159 )  | 1,979   |
| 2015                      | 4,138   | (2,159 )  | 1,979   |
| Thereafter                | 2,969   | (1,796 )  | 1,173   |
|                           | \$ 23,659   | \$ (12,591)   | \$ 11,068   |

Our actual payments to HP include a variable charge for certain warehousing and distribution activities and may fluctuate in future periods based upon actual sales and activity levels.

During fiscal years 2010, 2009, and 2008, we expensed \$6.2 million, \$7.1 million, and \$26.7 million for services provided under terms of the HP outsourcing contract. The total amount expensed each year under the HP contract includes freight charges, which are billed to the Company based upon activity. Freight charges included in our total HP costs totaled \$1.5 million, \$1.8 million, and \$8.8 million during the years ended August 31, 2010, 2009, and 2008, respectively.

The outsourcing contracts contain early termination provisions that the Company may exercise under certain conditions. However, in order to exercise the early termination provisions, we would have to pay specified penalties to HP depending upon the circumstances of the contract termination.

## Purchase Commitments

During the normal course of business, we issue purchase orders to various external vendors for products and services. At August 31, 2010, we had purchase commitments totaling \$3.2 million for products and services to be delivered primarily in fiscal 2011. Other purchase commitments for materials, supplies, and other items incident to the ordinary conduct of business were immaterial, both individually and in aggregate, to the Company's operations at

August 31, 2010.

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Legal Matters

On April 20, 2010, Moore Wallace North America, Inc. doing business as TOPS filed a complaint against Franklin Covey Products in the Circuit Court of Cook County, Illinois, for breach of contract. The complaint also named us as a defendant and alleged that we should be liable for Franklin Covey Products' debts under the doctrine of alter ego or fraudulent transfer. We are still in the early stages of this litigation and any potential liability is not currently estimable. We believe that we have meritorious defenses against this action, and we will continue to vigorously defend it.

In August 2005, EpicRealm Licensing (EpicRealm) filed an action in the United States District Court for the Eastern District of Texas against the Company for patent infringement. The action alleged that the Company infringed upon two of EpicRealm's patents directed to managing dynamic web page requests from clients to a web server that in turn uses a page server to generate a dynamic web page from content retrieved from a data source. The Company denied liability in the patent infringement and filed counter-claims related to the case subsequent to the filing of the action in District Court. However, during the fiscal year ended August 31, 2008, we paid EpicRealm a one-time license fee of \$1.0 million for a non-exclusive, irrevocable, perpetual, and royalty-free license to use any product, system, or invention covered by the disputed patents. In connection with the purchase of the license, EpicRealm and the Company agreed to dismiss their claims with prejudice, and we were released from further action regarding these patents.

We are also the subject of certain other legal actions, which we consider routine to our business activities. At August 31, 2010, we believe that, after consultation with legal counsel, any potential liability to us under these other actions will not materially affect our financial position, liquidity, or results of operations.

Franklin Covey Products Store Leases

According to the terms of the agreements associated with the sale of the CSBU assets that closed in the fourth quarter of fiscal 2008 (Note 3), we assigned the benefits and obligations relating to the leases of most of our retail stores to Franklin Covey Products. However, we remain secondarily liable to fulfill the obligations contained in the lease agreements, including making lease payments, if Franklin Covey Products is unable to fulfill its obligations pursuant to the terms of the lease agreements. Any default by Franklin Covey Products in its lease payment obligations could provide us with certain remedies against Franklin Covey Products, including potentially allowing us to terminate the Master License Agreement. If Franklin Covey Products is unable to satisfy the obligations contained in the lease agreements and we are unable to obtain adequate remedies, our results of operations and cash flows may be adversely affected.

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SHAREHOLDERS' EQUITY

Preferred Stock

We have 14.0 million shares of preferred stock authorized for issuance. However, at August 31, 2010, no shares of preferred stock were issued or outstanding.

Common Stock Warrants

Pursuant to the terms of the preferred stock recapitalization plan, in fiscal 2005 we completed a one-to-four forward split of the existing Series A preferred stock and then bifurcated each share of Series A preferred stock into a new share of Series A preferred stock that is no longer convertible into common stock, and a warrant to purchase shares of common stock. Accordingly, we issued 6.2 million common stock warrants with an exercise price of \$8.00 per share

(subject to customary anti-dilution and exercise features), which will be exercisable over an eight-year term that expires in March 2013. These common stock warrants were recorded in shareholders' equity at fair value on the date of the recapitalization as



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determined by a Black-Scholes valuation methodology, which totaled \$7.6 million. During the fiscal years ended August 31, 2010 and 2009, our common stock warrant activity was insignificant.

## Treasury Stock

Following the completion of the sale of CSBU assets (Note 3), we used substantially all of the net proceeds from the sale to conduct a modified “Dutch Auction” tender offer (the Tender Offer) to purchase up to \$28.0 million of our common stock at a price not less than \$9.00 per share or greater than \$10.50 per share, not including transaction costs. The Tender Offer closed fully subscribed on August 27, 2008, and we were able to purchase 3,027,027 shares of our common stock at \$9.25 per share plus normal transaction costs that were added to the cost basis of the shares.

During fiscal 2006, our Board of Directors authorized the purchase of up to \$10.0 million of our currently outstanding common stock and canceled all previously approved common stock purchase plans. Common stock purchases under this approved plan are made at our discretion for prevailing market prices and are subject to customary regulatory requirements and considerations. The Company does not have a timetable for the purchase of these common shares, and the authorization by the Board of Directors does not have an expiration date. Through August 31, 2010, we have purchased 1,009,300 shares of our common stock under the terms of the fiscal 2006 plan for \$7.6 million. We did not purchase any shares of our common stock under this purchase plan during fiscal 2010, fiscal 2009, or fiscal 2008, and at August 31, 2010 we had \$2.4 million remaining for future purchases under the terms of this approved plan.

We have issued shares of treasury stock to participants in our employee stock purchase plan (ESPP) and for stock options and warrants as shown below (in thousands, except for share amounts):

| Fiscal Year | Shares Issued to ESPP Participants | Shares Issued from the Exercise of Stock Options and Warrants | Total Treasury Shares Issued for Options, Warrants and ESPP | Cash Proceeds Received from the Issuance of Treasury Shares |
|-------------|------------------------------------|---|---|---|
| 2010        | 56,475                             | -   | 56,475  | \$ 288  |
| 2009        | 55,448                             | 1,000   | 56,448  | 284   |
| 2008        | 68,702                             | 15,371  | 84,073  | 462   |

In addition to the treasury shares shown above, we issued 61,064; 66,112; and 36,000 shares of our common stock held in treasury in connection with unvested stock awards during fiscal years 2010, 2009, and 2008 (Note 13).

## 11. MANAGEMENT COMMON STOCK LOAN PROGRAM

During fiscal 2000, certain of our management personnel borrowed funds from an external lender, on a full-recourse basis, to acquire shares of our common stock. The loan program closed during fiscal 2001 with 3.825 million shares of common stock purchased by the loan participants for a total cost of \$33.6 million, which was the market value of the shares acquired and distributed to loan participants. The Company initially participated on these management common stock loans as a guarantor to the lending institution. However, in connection with a new credit facility obtained during fiscal 2001, we acquired the loans from the external lender at fair value and are now the creditor for these loans. The loans in the management stock loan program initially accrued interest at 9.4 percent (compounded quarterly), are full-recourse to the participants, and were originally due in March 2005. Although interest continues to

accrue on the outstanding balance over the life of the loans to the participants, the Company ceased recording interest receivable (and related interest income) related to these loans in fiscal 2002.

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In May 2004, our Board of Directors approved modifications to the terms of the management stock loans. While these changes had significant implications for most management stock loan program participants, the Company did not formally amend or modify the stock loan program notes. Rather, the Company chose to forego certain of its rights under the terms of the loans and granted participants the modifications described below in order to potentially improve their ability to pay, and the Company's ability to collect, the outstanding balances of the loans. These modifications to the management stock loan terms applied to all current and former employees whose loans do not fall under the provisions of the Sarbanes-Oxley Act of 2002. Loans to the Company's officers and directors (as defined by the Sarbanes-Oxley Act of 2002) were not affected by the approved modifications and loans held by those persons, which totaled \$0.8 million, were repaid on the original due date of March 30, 2005.

The May 2004 modifications to the management stock loan terms included the following:

**Waiver of Right to Collect** – The Company waived its right to collect the outstanding balance of the loans prior to the earlier of (a) March 30, 2008, or (b) the date after March 30, 2005 on which the closing price of the Company's stock multiplied by the number of shares purchased equals the outstanding principal and accrued interest on the management stock loans (the Breakeven Date).

**Lower Interest Rate** – Effective May 7, 2004, the Company prospectively waived collection of all interest on the loans in excess of 3.16 percent per annum, which was the "Mid-Term Applicable Federal Rate" for May 2004.

**Use of the Company's Common Stock to Pay Loan Balances** – The Company may consider receiving shares of our common stock as payment on the loans, which were previously only payable in cash.

**Elimination of the Prepayment Penalty** – The Company waived its right to charge or collect any prepayment penalty on the management common stock loans.

These modifications, including the reduction of the loan program interest rate, were not applied retroactively and participants remain obligated to pay interest previously accrued using the original interest rate. Also during fiscal 2005, our Board of Directors approved loan modifications for a former executive officer and a former director substantially similar to loan modifications previously granted to other loan participants in the management stock loan program as described above.

Prior to the May 2004 modifications, the Company accounted for the loans and the corresponding shares using a loan-based accounting model. However, due to the nature of the May 2004 modifications, the Company reevaluated its accounting for the management stock loan program. Based upon relevant accounting guidance, we determined that the management common stock loans should be accounted for as non-recourse stock compensation instruments. While this accounting treatment does not alter the legal rights associated with the loans to the employees as described above, the modifications to the terms of the loans were deemed significant enough to adopt the non-recourse accounting model. As a result of this accounting treatment, the remaining carrying value of the notes and interest receivable related to financing common stock purchases by related parties, which totaled \$7.6 million prior to the loan term modifications, was reduced to zero with a corresponding reduction in additional paid-in capital. Since the Company was unable to exercise control over the underlying management common stock loan shares, the loan program shares continued to be included in basic earnings per share (EPS) following the May 2004 modifications.

We currently account for the management common stock loans as equity-classified stock option arrangements. According to share-based accounting rules, additional compensation expense will be recognized only if the Company takes action that constitutes a modification which increases the fair value of the arrangements. This accounting treatment also precludes us from reversing the amounts expensed as additions to the loan loss reserve, totaling \$29.7 million, which were recorded in prior periods.



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During fiscal 2006, the Company offered participants in the management common stock loan program the opportunity to formally modify the terms of their loans in exchange for placing their shares of common stock purchased through the loan program in an escrow account that allows the Company to have a security interest in the loan program shares. The key modifications to the management common stock loans for the participants accepting the fiscal 2006 offer were as follows:

**Modification of Promissory Note** – The management stock loan due date was changed to be the earlier of (a) March 30, 2013, or (b) the Breakeven Date as defined by the May 2004 modifications. The interest rate on the loans increased from 3.16 percent compounded annually to 4.72 percent compounded annually.

**Redemption of Management Loan Program Shares** – The Company has the right to redeem the shares on the due date in satisfaction of the promissory notes as follows:

- On the Breakeven Date, the Company has the right to purchase and redeem from the loan participants the number of loan program shares necessary to satisfy the participant's obligation under the promissory note. The redemption price for each such loan program share will be equal to the closing price of our common stock on the Breakeven Date.
- If our common stock has not closed at or above the breakeven price on or before March 30, 2013, the Company has the right to purchase and redeem from the participants all of their loan program shares at the closing price on that date as partial payment on the participant's obligation.

The fiscal 2006 modifications were intended to give the Company a measure of control of the outstanding loan program shares and to facilitate payment of the loans should the market value of our common stock equal the principal and accrued interest on the management stock loans. If a loan participant declined the offer to modify their management stock loan, their loan will continue to have the same terms and conditions that were previously approved in May 2004 by our Board of Directors, and their loans will be due at the earlier of March 30, 2008 or the Breakeven Date. Consistent with the May 2004 modifications, stock loan participants will be unable to realize a gain on the loan program shares unless they pay cash to satisfy the promissory note obligation prior to the due date. As of the closing date of the extension offer, which was substantially completed in June 2006, management stock loan participants holding approximately 3.5 million shares, or 94 percent of the remaining loan shares, elected to accept the extension offer and placed their management stock loan shares into the escrow account. The Company is currently in the process of collecting amounts due from participants that declined to place their shares in the escrow account during fiscal 2006.

As a result of this modification, the Company reevaluated its accounting treatment regarding the loan shares and their inclusion in Basic EPS. Since the management stock loan shares held in the escrow account continue to have the same income participation rights as other common shareholders, we have determined that the escrowed loan shares are participating securities. As a result, the management loan shares are included in the calculation of basic EPS in periods of net income and excluded from basic EPS in periods of net loss.

During fiscal 2009, the effective interest rate on the management stock loans was reduced to 1.65 percent, compounded annually, which was the "Mid-Term Applicable Federal Rate" on the date of the interest rate change.

M. Sean Covey, David M.R. Covey, and C. Todd Davis were among the approximately 147 participants in our management stock loan program since March 2000 and, under that program, these individuals owed the Company \$759,417 (51,970 shares), \$270,597 (18,518 shares), and \$192,037 (13,142 shares), respectively, in December 2009. To settle the loans, they each surrendered their loan shares, which were valued at market on the date of surrender, to the Company in partial payment of their loans and we collected or forgave the remaining loan balances. David M.R. Covey paid the remaining balance owing on his management loan in cash during the quarter

ended February 27, 2010. To the extent necessary, we

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also paid the listed persons a bonus to cover the related taxes that were incurred as a result of this action. The carrying value of our management stock loans was reduced to zero in our consolidated financial statements during previous periods.

The inability of the Company to collect all, or a portion, of the management stock loans could have an adverse impact upon our financial position and cash flows compared to full collection of the loans.

12. FINANCIAL INSTRUMENTS

Fair Value of Financial Instruments

The book value of our financial instruments at August 31, 2010 and 2009 approximated their fair values. The assessment of the fair values of our financial instruments is based on a variety of factors and assumptions. Accordingly, the fair values may not represent the actual values of the financial instruments that could have been realized at August 31, 2010 or 2009, or that will be realized in the future, and do not include expenses that could be incurred in an actual sale or settlement. The following methods and assumptions were used to determine the fair values of our financial instruments, none of which were held for trading or speculative purposes:

Cash, Cash Equivalents, and Accounts Receivable – The carrying amounts of cash, cash equivalents, and accounts receivable approximate their fair values due to the liquidity and short-term maturity of these instruments.

Other Assets – Our other assets, including notes receivable, were recorded at the net realizable value of estimated future cash flows from these instruments.

Debt Obligations – At August 31, 2010, our debt obligations consisted of a variable-rate line of credit. The interest rate on our line of credit obligation is variable and is adjusted to reflect current market interest rates that would be available to us for a similar instrument. In addition, the line of credit agreement is renewed on an annual basis the terms and conditions are reflective of current market conditions. As a result, the carrying value of the outstanding balance on the line of credit approximates its fair value.

Derivative Instruments

During the normal course of business, we are exposed to fluctuations in foreign currency exchange rates due to our international operations and interest rates. To manage risks associated with foreign currency exchange and interest rates, we make limited use of derivative financial instruments. Derivatives are financial instruments that derive their value from one or more underlying financial instruments. As a matter of policy, our derivative instruments are entered into for periods that do not exceed the related underlying exposures and do not constitute positions that are independent of those exposures. In addition, we do not enter into derivative contracts for trading or speculative purposes, nor were we party to any leveraged derivative instrument. The notional amounts of derivatives do not represent actual amounts exchanged by the parties to the instrument and thus, are not a measure of exposure to the Company through its use of derivatives. Additionally, we enter into derivative agreements only with highly rated counterparties.

Foreign Currency Exposure – Due to the global nature of our operations, we are subject to risks associated with transactions that are denominated in currencies other than the United States dollar, as well as the effects of translating amounts denominated in foreign currencies to United States dollars as a normal part of the reporting process. The objective of our foreign currency risk management activities is to reduce foreign currency risk in the consolidated financial statements. In order to manage foreign currency risks, we make limited use of foreign currency forward contracts and other foreign currency related derivative instruments. Although we cannot eliminate all aspects of our

foreign currency risk, we

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believe that our strategy, which includes the use of derivative instruments, can reduce the impacts of foreign currency related issues on our consolidated financial statements.

During the fiscal years ended August 31, 2010, 2009, and 2008, we utilized foreign currency forward contracts to manage the volatility of certain intercompany financing transactions and other transactions that are denominated in foreign currencies. Because these contracts did not meet specific hedge accounting requirements, gains and losses on these contracts, which expire on a quarterly basis, are recognized in current operations, and are used to offset a portion of the gains or losses of the related accounts. The gains and losses on these contracts were recorded as a component of selling, general, and administrative expense in our consolidated statements of operations and had the following impact on the periods indicated (in thousands):

| YEAR ENDED                               |          |          |          |
|--|----------|----------|----------|
| AUGUST 31,                               | 2010     | 2009     | 2008     |
| Losses on foreign exchange contracts     | \$ (240) | \$ (321) | \$ (487) |
| Gains on foreign exchange contracts      | -        | 105      | 36       |
| Net losses on foreign exchange contracts | \$ (240) | \$ (216) | \$ (451) |

At August 31, 2010, we had one open foreign currency sell contract that did not qualify for hedge accounting. The notional amount of this contract was JPY 186.1 million with a contracted value of \$2.0 million. The fair value of this foreign currency forward contract, which was determined using the estimated amount at which the contract could be settled based upon forward market exchange rates, was insignificant.

Interest Rate Risk Management – Due to the limited nature of our interest rate risk, we do not make regular use of interest rate derivatives, and we were not a party to any interest rate derivative instruments during the fiscal years ended August 31, 2010, 2009, or 2008.

### 13. SHARE-BASED COMPENSATION PLANS

#### Overview

We utilize various share-based compensation plans as integral components of our overall compensation and associate retention strategy. Our shareholders have approved various stock incentive plans that permit us to grant performance awards, unvested stock awards, employee stock purchase plan (ESPP) shares, and stock options. In addition, our Board of Directors and shareholders may, from time to time, approve fully vested stock awards. At August 31, 2010, our stock option incentive plan, which permits the granting of performance awards, unvested stock awards to employees, and incentive stock options had approximately 1,402,000 shares available for granting and our 2004 ESPP plan had approximately 720,000 shares authorized for purchase by plan participants. The total cost of our share-based compensation plans for the fiscal years ended August 31, 2010, 2009, and 2008 were as follows (in thousands):

| YEAR ENDED            |        |      |            |
|-----------------------|--------|------|------------|
| AUGUST 31,            | 2010   | 2009 | 2008       |
| Performance awards    | \$ 327 | \$ - | \$ (1,338) |
| Unvested share awards | 458    | 427  | 969        |

|                                  |          |        |           |
|----------------------------------|----------|--------|-----------|
| Compensation cost<br>of the ESPP | 53       | 41     | 79        |
| Stock options                    | 261      | -      | 31        |
|                                  | \$ 1,099 | \$ 468 | \$ (259 ) |

The compensation cost of our share-based compensation plans was included in selling, general, and administrative expenses in the accompanying consolidated statements of operations, and no share-based

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compensation was capitalized during fiscal years 2010, 2009, or 2008. We generally issue shares of common stock for our share-based compensation plans from shares held in treasury. The following is a description of our share-based compensation plans.

#### Performance-Based Awards

Our shareholders have approved a performance based long-term incentive plan (the LTIP) that provides for annual grants of share-based performance awards to certain managerial personnel and executive management as directed by the Organization and Compensation Committee (the Compensation Committee) of the Board of Directors. The number of common shares that eventually vest and are issued to LTIP participants is variable and is based entirely upon the achievement of specified financial performance objectives during a defined performance period. Due to the variable number of common shares that may be issued under the LTIP, we reevaluate our LTIP grants on a quarterly basis and adjust the number of shares expected to be issued based upon actual and estimated financial results of the Company compared to the performance goals set for the award. Adjustments to the number of shares awarded, and to the corresponding compensation expense, are made on a cumulative basis at the adjustment date based upon the estimated probable number of common shares to be issued.

During fiscal 2010, the Compensation Committee approved the fiscal 2010 LTIP award, which includes the following key terms:

- Target Number of Shares Expected to Vest at August 31, 2012 – 232,576 shares
  - Vesting Dates – August 31, 2012, February 28, 2013, and August 31, 2013
  - Grant Date Fair Value of Common Stock – \$5.28 per share

The fiscal 2010 LTIP has a four-year performance period, but has three vesting dates if certain financial measures are achieved during the performance period. Therefore, we record compensation expense based on the estimated number of shares expected to be issued at each of the vesting dates. During fiscal 2010, the only adjustments made to the expected number of shares that will vest were due to forfeitures resulting from the departure of two participants in the fiscal 2010 LTIP grant.

As we completed our evaluations of the LTIP awards during fiscal 2008, we reduced the number of shares expected to be issued under the fiscal 2007 and fiscal 2006 LTIP grants based on current financial performance and expected future financial performance. As a result of these evaluations, we determined that no shares of common stock were expected to be awarded under any LTIP grant, and all previously recognized share-based compensation expense, which totaled \$1.3 million, was reversed during fiscal 2008. On August 31, 2008, the fiscal 2006 LTIP award expired with no shares issued to participants. There were no awards granted under the terms of the LTIP during the fiscal years ended August 31, 2009 or 2008.

#### Unvested Stock Awards

The fair value of our unvested stock awards is calculated by multiplying the number of shares awarded by the closing market price of our common stock on the date of the grant. The corresponding compensation cost of unvested stock awards is amortized to selling, general, and administrative expense on a straight-line basis over the vesting period of the award, which generally ranges from one to five years. The following is a description of our unvested stock awards granted to certain members of our Board of Directors and to our employees.

Board of Director Awards – The non-employee directors' stock incentive plan (the Directors' Plan) is designed to provide non-employee directors of the Company, who are ineligible to participate in our employee stock incentive plan, an opportunity to obtain an interest in the Company through the acquisition of shares of common stock. For awards granted after fiscal 2008, the Directors' Plan provides for an annual whole-share grant equal to \$40,000 with a

one-year vesting period, which is generally granted in January (following the Annual Shareholders' Meeting) of each year. The Directors'

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Plan also requires a minimum stock ownership requirement for directors. Shares granted under the terms of the Directors' Plan subsequent to fiscal 2008 are ineligible to be voted or participate in any common stock dividends until they are vested.

Under the provisions of the Directors' Plan, we issued 61,064 shares, 66,112 shares, and 36,000 shares of our common stock to eligible members of the Board of Directors during the fiscal years ended August 31, 2010, 2009, and 2008. The fair value of the shares awarded under the Directors' Plan was \$0.3 million during for each of the years ended August 31, 2010, 2009, and 2008, which was calculated on the grant date of the award. The corresponding compensation cost is being recognized over the vesting period of the awards, which ranges from one to three years. The cost of the common stock issued from treasury for these awards was \$0.9 million, \$0.9 million, and \$0.6 million in fiscal years 2010, 2009, and 2008.

Employee Awards – In prior periods, we granted unvested stock awards to certain employees as long-term incentives. These unvested stock awards originally cliff vested five years from the grant date or on an accelerated basis if we achieved specified earnings levels. The recognition of compensation cost was accelerated when we believed that it was probable that we would achieve the specified earnings thresholds and the shares would vest.

In the fourth quarter of fiscal 2008, our Board of Directors accelerated the vesting of all remaining outstanding unvested share awards previously granted to employees. We determined that the accelerated vesting of these awards constituted modifications to the awards that required separate analysis for awards granted to CSBU employees and for awards granted to Organizational Solutions Business Unit (OSBU) and corporate employees. Since the unvested share awards granted to CSBU employees would not have vested under the original terms of the award (due to the sale of CSBU assets), the CSBU awards were revalued on the date of the modification. The fair value of our common stock was higher on the modification date than on the grant date, which resulted in \$0.4 million of additional share-based compensation expense in the fourth quarter of fiscal 2008. We determined that the OSBU and corporate awards would have vested under the original award terms, and we accelerated the remaining unrecognized compensation cost, which increased share-based compensation by \$0.2 million during the fourth quarter of fiscal 2008. Following the accelerated vesting of these awards, we do not have any remaining unrecognized compensation cost for unvested share awards granted to employees.

The following information applies to our unvested stock awards for the fiscal year ended August 31, 2010:

|   | Number of<br>Shares | Weighted-Average<br>Grant-Date Fair<br>Value Per Share |
|---|---------------------|--|
| Unvested stock awards at August<br>31, 2009 | 133,612             | \$ 6.28  |
| Granted                                     | 61,064              | 5.24   |
| Forfeited                                   | -                   | -  |
| Vested                                      | (97,612 )           | 5.83   |
| Unvested stock awards at August<br>31, 2010 | 97,064              | \$ 6.08  |

At August 31, 2010, there was \$0.2 million of total unrecognized compensation cost related to unvested stock awards granted to our Board of Directors, which is expected to be recognized over the weighted-average vesting period of approximately five months. The total recognized tax benefit from unvested stock awards totaled \$0.2 million, \$0.2 million, and \$0.4 million for the fiscal years ended August 31, 2010, 2009, and 2008, respectively. The intrinsic value of our unvested stock awards at August 31, 2010 was \$0.6 million.

## Employee Stock Purchase Plan

We have an employee stock purchase plan (Note 15) that offers qualified employees the opportunity to purchase shares of our common stock at a price equal to 85 percent of the average fair market value of the Company's common stock on the last trading day of the calendar month in each fiscal quarter. We

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determined that the discount offered to employees under the ESPP is compensatory, and the discount amount is therefore expensed at each grant date. During the fiscal year ended August 31, 2010, a total of 56,475 shares were issued to participants in the ESPP.

## Stock Options

The Company has an incentive stock option plan whereby options to purchase shares of our common stock may be issued to key employees at an exercise price not less than the fair market value of the Company's common stock on the date of grant. The term, not to exceed ten years, and exercise period of each incentive stock option awarded under the plan are determined by the Compensation Committee.

During fiscal 2010, the Compensation Committee awarded the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) options to purchase 500,000 shares and 175,000 shares of our common stock, respectively. These stock options have a contractual life of 10 years and are divided into four equal tranches with exercise prices of \$9.00 per share, \$10.00 per share, \$12.00 per share, and \$14.00 per share. The options vest upon resolution of the management common stock loan program, subject to Board of Director approval of the resolution, which was determined to be a market vesting condition based upon our share price. Accordingly, the fair value of these stock options was determined using a Monte Carlo simulation with an embedded Black-Scholes valuation model. The following assumptions were made in estimating the fair value of the CEO and CFO stock options awarded in fiscal 2010:

| Model Input           | Value   |
|-----------------------|---------|
| Grant date            |         |
| share price per share | \$ 5.28 |
| Volatility            | 51.47%  |
| Dividend yield        | 0.0 %   |
| Risk-free rate        | 1.57 %  |

The fair value of these stock options was determined to be \$0.8 million, which is being amortized over 1.8 years. The amortization period was defined as the mean time to vest as calculated by the Monte Carlo simulation model.

Information related to our stock option activity during the fiscal year ended August 31, 2010 is presented below:

|                                | Number of<br>Stock Options | Weighted<br>Avg.<br>Exercise<br>Price Per<br>Share | Weighted<br>Avg.<br>Remaining<br>Contractual<br>Life (Years) | Aggregate<br>Intrinsic<br>Value<br>(thousands) |
|--------------------------------|----------------------------|--|--|--|
| Outstanding at August 31, 2009 | 1,762,000                  | \$ 13.37   |  |  |
| Granted                        | 675,000                    | 11.25  |  |  |
| Exercised                      | -                          | -  |  |  |
| Canceled                       | (1,705,000)                | 13.55  |  |  |
| Outstanding at August 31, 2010 | 732,000                    | \$ 10.99   | 8.7  | \$ -   |
|                                | 57,000                     | \$ 7.95  | 0.4  | \$ -   |

Options vested and  
exercisable at August  
31, 2010

The number of stock options canceled in fiscal 2010 includes 1,602,000 options that were previously granted to the CEO with an exercise price of \$14.00 per share. These options expired on August 31, 2010.

Company policy generally allows terminated employees 90 days from the date of termination to exercise vested stock options. However, in connection with the sale of the CSBU (Note 3) during fiscal 2008, we granted extensions to former CSBU employees, who had vested stock options, which allow the stock options to be exercised up to the original expiration date. We determined that these extensions were

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modifications to the stock options under the applicable accounting guidance. The incremental compensation expense resulting from the modification of these stock options was calculated through the use of a Black-Scholes valuation model and totaled approximately \$31,000, which was expensed during the fourth quarter of fiscal 2008 since the modified stock options were fully vested prior to the modification date.

The following additional information applies to our stock options outstanding at August 31, 2010:

| Range of Exercise Prices | Number Outstanding at August 31, 2010 | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Options Exercisable at August 31, 2010 | Weighted Average Exercise Price |
|--------------------------|---------------------------------------|---|---------------------------------|--|---------------------------------|
| 6.56 – \$ 8.00           | 57,000                                | 0.4   | \$ 7.95                         | 57,000                                 | \$ 7.95                         |
| 9.00 – \$ 14.00          | 675,000                               | 9.4   | 11.25                           | -                                      | -                               |
|                          | 732,000                               |   |                                 | 57,000                                 |                                 |

The Company received proceeds totaling approximately \$7,000 and \$21,000 in fiscal years 2009 and 2008 from the exercise of common stock options. The intrinsic value of stock options exercised was \$2,500 and \$0.1 million for the fiscal years ended August 31, 2009 and 2008, and the fair value of options that vested during fiscal 2008 totaled \$9,375. We did not grant any stock options during the fiscal years ended August 31, 2009 or 2008.

#### 14. ACQUISITION OF COVEYLINK

Effective December 31, 2008, we acquired the assets of CoveyLink Worldwide, LLC (CoveyLink). CoveyLink conducts seminars and training courses and provides consulting based upon the book *The Speed of Trust* by Stephen M.R. Covey, who is the son of our Vice Chairman of the Board of Directors.

We determined that the CoveyLink operation constituted a business, and we accounted for the acquisition of CoveyLink using the guidance found in Statement of Financial Accounting Standards No. 141, Business Combinations. The purchase price was \$1.0 million in cash plus or minus an adjustment for specified working capital and the costs necessary to complete the transaction, which resulted in a total initial purchase price of \$1.2 million. The previous owners of CoveyLink, which includes Stephen M.R. Covey, are also entitled to earn annual contingent payments based upon earnings growth over the next five years. Based upon the preliminary purchase price allocation and evaluation of the assets acquired and liabilities assumed, we recorded a \$0.4 million increase in our intangible assets, for the fair value of customer relationships and the practice leader agreement, and \$0.5 million of goodwill (Note 5). The entire amount of the acquired goodwill is expected to be deductible for income tax purposes. We also acquired \$0.6 million of net accounts receivable, \$0.2 million of other assets, and \$0.5 million of accounts payable and current accrued liabilities on the acquisition date.

During fiscal 2010, we paid \$3.3 million in cash to the former owners of CoveyLink for the first of five potential annual contingent payments. The annual contingent payments are based on earnings growth over the specified earnings period and were classified as goodwill in our consolidated balance sheet.

Prior to the acquisition date, CoveyLink had granted a non-exclusive license to the Company related to *The Speed of Trust* book and related training courses for which we paid CoveyLink specified royalties. As part of the CoveyLink acquisition, an amended and restated license of intellectual property was signed that granted us an exclusive,

perpetual, worldwide, transferable, royalty-bearing license to use, reproduce, display, distribute, sell, prepare derivative works of, and perform the licensed material in any format or medium and through any market or distribution channel.

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15. EMPLOYEE BENEFIT PLANS

Profit Sharing Plans

We have defined contribution profit sharing plans for our employees that qualify under Section 401(k) of the Internal Revenue Code. These plans provide retirement benefits for employees meeting minimum age and service requirements. Qualified participants may contribute up to 75 percent of their gross wages, subject to certain limitations. These plans also provide for matching contributions to the participants that are paid by the Company. The matching contributions, which were expensed as incurred, totaled \$0.9 million, \$0.9 million, and \$1.5 million during the fiscal years ended August 31, 2010, 2009, and 2008. We do not sponsor or participate in any defined benefit pension plans.

Employee Stock Purchase Plan

The Company has an employee stock purchase plan (ESPP) that offers qualified employees the opportunity to purchase shares of our common stock at a price equal to 85 percent of the average fair market value of our common stock on the last trading day of each quarter. A total of 56,475; 55,448; and 68,702 shares were issued to ESPP participants during the fiscal years ended August 31, 2010, 2009, and 2008, which had a corresponding cost basis of \$0.8 million, \$0.7 million, and \$0.9 million, respectively. The Company received cash proceeds from the ESPP participants totaling \$0.3 million, \$0.3 million, and \$0.4 million for fiscal years 2010, 2009, and 2008.

Deferred Compensation Plan

We have a non-qualified deferred compensation (NQDC) plan that provided certain key officers and employees the ability to defer a portion of their compensation until a later date. Deferred compensation amounts used to pay benefits were held in a “rabbi trust,” which invested in insurance contracts, various mutual funds, and shares of our common stock as directed by the plan participants. However, due to legal changes resulting from the American Jobs Creation Act of 2004, we determined to cease compensation deferrals to the NQDC plan after December 31, 2004. Following the cessation of deferrals to the NQDC plan, the number of participants remaining in the plan declined steadily, and during the fourth quarter of fiscal 2009 our Board of Directors decided to partially terminate the NQDC plan.

Due to the partial termination of the plan, all of the NQDC trust assets were liquidated prior to August 31, 2009, except for shares of our common stock that are held for future distribution to plan participants. Subsequent to August 31, 2009, the liquidated assets were distributed to plan participants, and the NQDC plan liability was paid in full. The NQDC plan’s assets were liquidated for \$0.3 million, which was received in cash prior to August 31, 2009. The NQDC plan’s liabilities totaled \$0.5 million at August 31, 2009. At August 31, 2010, the cost basis of the shares of our common stock held by the rabbi trust was \$0.4 million.

We expensed charges totaling \$0.1 million during each of the fiscal years ended August 31, 2009 and 2008 related to insurance premiums and external administration costs for our deferred compensation plan.

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## 16. INCOME TAXES

The benefit (provision) for income taxes from continuing operations consisted of the following (in thousands):

| YEAR ENDED<br>AUGUST 31,      | 2010       | 2009     | 2008       |
|-------------------------------|------------|----------|------------|
| Current:                      |            |          |            |
| Federal                       | \$ 454     | \$ 33    | \$ (23 )   |
| State                         | (16 )      | 35       | (237 )     |
| Foreign                       | (1,555)    | (1,812)  | (2,465)    |
|                               | (1,117)    | (1,744)  | (2,725)    |
| Deferred:                     |            |          |            |
| Federal                       | (1,859)    | 5,156    | (4,012)    |
| State                         | 4          | 300      | (196 )     |
| Foreign                       | 488        | (214 )   | 79         |
| Change in valuation allowance | -          | 316      | 116        |
|                               | (1,367)    | 5,558    | (4,013)    |
|                               | \$ (2,484) | \$ 3,814 | \$ (6,738) |

The allocation of total income tax benefit (provision) is as follows (in thousands):

| YEAR ENDED<br>AUGUST 31,                | 2010       | 2009     | 2008       |
|---|------------|----------|------------|
| Continuing operations                   | \$ (2,484) | \$ 3,814 | \$ (6,738) |
| Other comprehensive income              | 229        | 123      | 129        |
| Discontinued operations                 | (440 )     | (185 )   | (808 )     |
| Gain on sale of discontinued operations | (854 )     | -        | -          |
|   | \$ (3,549) | \$ 3,752 | \$ (7,417) |

Income from continuing operations before income taxes consisted of the following (in thousands):

| YEAR ENDED<br>AUGUST 31, | 2010     | 2009        | 2008      |
|--------------------------|----------|-------------|-----------|
| United States            | \$ 1,127 | \$ (15,229) | \$ 8,053  |
| Foreign                  | 53       | 367         | 3,225     |
|                          | \$ 1,180 | \$ (14,862) | \$ 11,278 |

The differences between income taxes at the statutory federal income tax rate and income taxes from continuing operations reported in our consolidated statements of operations were as follows:

| YEAR ENDED<br>AUGUST 31, | 2010 | 2009 | 2008 |
|--------------------------|------|------|------|
|--------------------------|------|------|------|

|   |         |        |        |
|---|---------|--------|--------|
| Federal statutory income tax rate                                 | 35.0 %  | 35.0 % | 35.0 % |
| State income taxes, net of federal effect                         | 1.2     | 2.3    | 3.8    |
| Foreign jurisdictions tax differential                            | (4.2 )  | (1.5 ) | 1.7    |
| Tax differential on income subject to both U.S. and foreign taxes | 140.6   | (5.4 ) | 9.3    |
| Uncertain tax positions   | (21.2 ) | -      | (1.8 ) |
| Tax on management stock loan interest                             | 25.9    | (2.7 ) | 6.1    |
| Non-deductible executive compensation                             | 26.8    | (0.5 ) | 2.6    |
| Non-deductible meals and entertainment                            | 7.4     | (0.6 ) | 1.3    |
| Other   | (0.9 )  | (0.9 ) | 1.7    |
|   | 210.6 % | 25.7 % | 59.7 % |

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We paid significant amounts of withholding tax on foreign royalties during fiscal years 2010, 2009, and 2008. We also recognized income tax expense on repatriated earnings from foreign income that are taxed in both foreign and domestic jurisdictions. However, no domestic foreign tax credits were available to offset the foreign withholding taxes and the taxes on dividends during those years.

The Company accrues taxable interest income on outstanding management common stock loans (Note 11). Consistent with the accounting treatment for these loans, the Company is not recognizing interest income for book purposes, thus resulting in a permanent book versus tax difference.

The significant components of our deferred tax assets and liabilities were comprised of the following (in thousands):

| YEAR ENDED   |           |           |
|--|-----------|-----------|
| AUGUST 31,   | 2010      | 2009      |
| Deferred income tax assets:                              |           |           |
| Net operating loss carryforward                          | \$ 10,795 | \$ 12,094 |
| Sale and financing of corporate headquarters             | 11,439    | 11,729    |
| Foreign income tax credit carryforward                   | 2,159     | 2,159     |
| Investment in Franklin Covey Products                    | 1,747     | 2,934     |
| Impairment of Franklin Covey Products note receivable    | 1,504     | 1,395     |
| Bonus and other accruals                                 | 821       | 969       |
| Unearned revenue   | 783       | 210       |
| Inventory and bad debt reserves                          | 603       | 607       |
| Impairment of investment in Franklin Covey Coaching, LLC | 595       | 1,151     |
| Alternative minimum tax carryforward                     | 421       | 847       |
| Deferred compensation                                    | 293       | 334       |
| Sales returns and contingencies                          | 286       | 454       |
| Other  | 146       | 99        |
| Total deferred income tax assets                         | 31,592    | 34,982    |
| Less: valuation allowance                                | (2,159 )  | (2,159 )  |
| Net deferred income tax assets                           | 29,433    | 32,823    |
| Deferred income tax liabilities:                         |           |           |
| Intangibles step-ups – definite lived                    | (9,812 )  | (10,867)  |
| Intangibles step-ups – indefinite lived                  | (8,606 )  | (8,658 )  |
| Property and equipment depreciation                      | (6,098 )  | (6,728 )  |
| Intangible asset impairment and amortization             | (3,454 )  | (2,803 )  |
| Unremitted earnings of foreign subsidiaries              | (386 )    | (181 )    |
| Other  | (129 )    | (104 )    |
|  | (28,485)  | (29,341)  |

|                                       |        |          |
|---------------------------------------|--------|----------|
| Total deferred income tax liabilities |        |          |
| Net deferred income taxes             | \$ 948 | \$ 3,482 |

Deferred income tax amounts are recorded as follows in our consolidated balance sheets (in thousands):

| YEAR ENDED                    |          |          |
|-------------------------------|----------|----------|
| AUGUST 31,                    | 2010     | 2009     |
| Current assets                | \$ 2,543 | \$ 2,551 |
| Long-term assets              | 42       | 931      |
| Long-term liabilities         | (1,637)  | -        |
| Net deferred income tax asset | \$ 948   | \$ 3,482 |

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A federal net operating loss of \$33.3 million was generated in fiscal 2003. During fiscal years 2005 through 2010, a total of \$32.5 million of the fiscal 2003 loss carryforward was utilized, leaving a remaining loss carryforward from fiscal 2003 of \$0.8 million, which expires on August 31, 2023. The federal net operating loss carryforward generated in fiscal 2004 totaled \$21.2 million and expires on August 31, 2024. In fiscal 2009, a federal net operating loss of \$9.9 million was generated, which expires on August 31, 2029. The total loss carryforward of \$31.9 million includes \$1.8 million of deductions applicable to additional paid-in capital that will be credited once all loss carryforward amounts are utilized.

The state net operating loss carryforward of \$33.3 million generated in fiscal 2003 was reduced by the utilization of \$32.5 million during fiscal years 2005 through 2010 for a net carryforward amount of \$0.8 million, which primarily expires between August 31, 2010 and August 31, 2018. The state net operating loss carryforward of \$21.2 million generated in fiscal 2004 primarily expires between August 31, 2010 and August 31, 2019. The state net operating loss carryforward of \$9.9 million generated in fiscal 2009 expires primarily between August 31, 2012 and August 31, 2024.

Our foreign income tax credit carryforward of \$2.2 million that was generated during fiscal 2002 expires on August 31, 2012.

## Valuation Allowance on Deferred Tax Assets

We have determined that projected future taxable income is adequate to allow for realization of all domestic deferred tax assets, except for those related to foreign tax credits. We considered sources of taxable income, including future reversals of taxable temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards, and reasonable, practical tax-planning strategies to generate additional taxable income. Based on the factors described above, we concluded that realization of our domestic deferred tax assets, except for foreign tax credit carryforwards, is more likely than not at August 31, 2010.

The table below presents the pre-tax book income, significant book versus tax differences, and taxable income for the years ended August 31, 2010, 2009, and 2008 (in thousands).

| YEAR ENDED<br>AUGUST 31,                                   | 2010     | 2009        | 2008     |
|--|----------|-------------|----------|
| Domestic pre-tax book income (loss)                        | \$ 1,745 | \$ (14,593) | \$ 8,857 |
| Actual and deemed foreign dividends                        | 2,502    | 593         | 604      |
| Property and equipment depreciation and dispositions       | 1,482    | 1,599       | (10,420) |
| Unearned revenue   | 1,534    | 400         | (342 )   |
| Disallowed executive compensation                          | 755      | 198         | 824      |
| Share-based compensation                                   | 359      | 227         | (1,144 ) |
| Impairment of note receivable from Franklin Covey Products | 315      | 3,706       | -        |
| Interest on management common stock loans                  | 313      | 1,133       | 1,968    |
| Taxable earnings (losses) from Franklin Covey Products     | (3,073)  | 623         | -        |
| Deduction for foreign income taxes                         | (1,272)  | (1,410 )    | (1,260 ) |
| Changes in accrued liabilities                             | (724 )   | (931 )      | (2,588 ) |
| Amortization/write-off of intangible assets                | (617 )   | (1,022 )    | (2,039 ) |
| Sale of corporate headquarters campus                      | (585 )   | (530 )      | (491 )   |
|  | -        | -           | 4,431    |



Deferred taxable loss on sale of assets to  
Franklin Covey Products

|   |          |             |          |
|---|----------|-------------|----------|
| Negative basis difference for book purposes on<br>sale of assets to Franklin Covey Products | -        | -           | 2,755    |
| Other book versus tax differences   | 232      | (152 )      | 165      |
|   | \$ 2,966 | \$ (10,159) | \$ 1,320 |

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## Uncertain Tax Positions

We may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits is as follows (in thousands):

| YEAR ENDED  |          |          |          |
|---|----------|----------|----------|
| AUGUST 31,  | 2010     | 2009     | 2008     |
| Beginning balance   | \$ 4,225 | \$ 4,232 | \$ 4,349 |
| Additions based on tax positions related to the current year  | 46       | 434      | 267      |
| Additions for tax positions in prior years  | 173      | 51       | 31       |
| Reductions for tax positions of prior years resulting from the lapse of applicable statute of limitations | (425 )   | (271 )   | (292 )   |
| Other reductions for tax positions of prior years   | (79 )    | (221 )   | (123 )   |
| Ending balance  | \$ 3,940 | \$ 4,225 | \$ 4,232 |

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$2.8 million. Included in the ending balance of gross unrecognized tax benefits is \$3.1 million related to individual states' net operating loss carryforwards. Interest and penalties related to uncertain tax positions are recognized as components of income tax expense. The net accruals and reversals of interest and penalties decreased income tax expense by \$0.1 million in fiscal 2010, increased income tax expense by an insignificant amount in fiscal 2009, and reduced income tax expense by a total of \$0.1 million during fiscal 2008. The balance of interest and penalties included on our consolidated balance sheets at August 31, 2010 and 2009 was \$0.1 million and \$0.2 million, respectively. We do not expect significant changes in our unrecognized tax benefits over the next twelve months.

We file United States federal income tax returns as well as income tax returns in various states and foreign jurisdictions. The tax years that remain subject to examinations for our major tax jurisdictions are shown below. Additionally, any net operating losses that were generated in prior years and utilized in these years may be subject to examination.

2003-2010 Canada

2005-2010 Japan, United Kingdom

2006-2010 United States – state and local income tax

2007-2010 United States – federal income tax

Basic earnings per common share (EPS) is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding for the period. Diluted EPS is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding plus the assumed exercise of all dilutive securities using the treasury stock method or the “if converted” method, as appropriate. Due to modifications to our management stock loan program, we determined that the shares of management stock loan participants that were placed in the escrow account are participating securities 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

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excluded from the basic EPS calculation in periods of net loss. Our unvested share awards granted prior to fiscal 2010 also participate in common stock dividends on the same basis as outstanding shares of common stock. However, the impact of the unvested share awards was immaterial to our EPS calculations for the periods presented.

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

| YEAR ENDED<br>AUGUST 31,                            | 2010        | 2009        | 2008     |
|---|-------------|-------------|----------|
| Numerator for basic and diluted earnings per share: |             |             |          |
| Income (loss) from continuing operations            | \$ (1,304 ) | \$ (11,048) | \$ 4,540 |
| Income from discontinued operations, net of tax     | 548         | 216         | 987      |
| Gain on sale of discontinued operations, net of tax | 238         | -           | -        |
| Net income (loss)                                   | \$ (518 )   | \$ (10,832) | \$ 5,527 |

|   |        |        |        |
|---|--------|--------|--------|
| Denominator for basic and diluted earnings per share: |        |        |        |
| Basic weighted average shares outstanding             | 13,525 | 13,406 | 19,577 |
| Effect of dilutive securities(1):                     |        |        |        |
| Stock options and other share-based awards            | -      | -      | 223    |
| Common stock warrants(2)                              | -      | -      | 122    |
| Diluted weighted average shares outstanding           | 13,525 | 13,406 | 19,922 |

## EPS Calculations:

|   |           |           |        |
|---|-----------|-----------|--------|
| Income (loss) from continuing operations per share: |           |           |        |
| Basic and diluted                                   | \$ (.10 ) | \$ (.82 ) | \$ .23 |

|  |     |     |     |
|--|-----|-----|-----|
| Income from discontinued operations, net of tax per share: |     |     |     |
| Basic and diluted  | .04 | .01 | .05 |

|  |     |   |   |
|--|-----|---|---|
| Gain on sale of discontinued operations, net of tax per share: |     |   |   |
| Basic and diluted  | .02 | - | - |

|                              |        |        |     |
|------------------------------|--------|--------|-----|
| Net income (loss) per share: |        |        |     |
| Basic and diluted            | (.04 ) | (.81 ) | .28 |

- (1) Since we recognized net income for the fiscal year ended August 31, 2008, basic weighted average shares for that period includes 3.5 million shares of common stock held by management stock loan participants that were placed in escrow. These shares were excluded from basic weighted-average shares for the fiscal years ended August 31, 2010 and 2009.
- (2) For the fiscal years ended August 31, 2010 and 2009, the conversion of 6.2 million common stock warrants is not assumed because such conversion would be anti-dilutive.

At August 31, 2010, 2009, and 2008, we had 0.7 million, 1.7 million, and 1.8 million stock options outstanding (Note 13) that were not included in the calculation of diluted weighted average shares outstanding for those periods because the options' exercise prices were greater than the average market price of our common stock. We also have 6.2 million common stock warrants outstanding that have an

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exercise price of \$8.00 per share (Note 10). These warrants, which expire in March 2013, and the out-of-the-money stock options described above will have a more pronounced dilutive impact on our EPS calculation in future periods if the market price of our common stock increases.

18. SEGMENT INFORMATION

Operating Segment Information

Prior to the sale of the CSBU, we had two operating segments: the OSBU and the CSBU. Following the sale, our operations constitute one reportable segment. However, to improve comparability, the amounts presented in the table below reflect fiscal 2008 operating results based upon the previously defined segments and include the impact of the sale of the CSBU, which closed during the fourth quarter of fiscal 2008. The following is a description of the previously reported operating segments, their primary operating components, and their significant business activities:

**Organizational Solutions Business Unit** – The OSBU was primarily responsible for the development, marketing, sale, and delivery of strategic execution, productivity, leadership, sales force performance, and communication training and consulting solutions directly to organizational clients, including other companies, the government, and educational institutions. The OSBU included the financial results of our domestic sales force, public programs, and certain international operations. The domestic sales force remains responsible for the sale and delivery of our training and consulting services in the United States and Canada. Our international sales group includes the financial results of our directly owned foreign offices and royalty revenues from licensees.

**Consumer Solutions Business Unit** – This business unit was primarily focused on sales to individual customers and small business organizations and included the results of our domestic retail stores, consumer direct operations (primarily Internet sales and call center), wholesale operations, international product channels in certain countries, and other related distribution channels, including government product sales and domestic printing and publishing sales. The CSBU results of operations also included the financial results of our paper planner manufacturing operations. Although CSBU sales primarily consisted of products such as planners, binders, software, totes, and related accessories, virtually any component of our leadership, productivity, and strategy execution solutions may have been purchased through the CSBU channels.

The Company's chief operating decision maker is the Chief Executive Officer (CEO), and the primary measurement tool used in business unit performance analysis is earnings before interest, taxes, depreciation, and amortization (EBITDA), which may not be calculated as similarly titled amounts calculated by other companies. For segment reporting purposes, our consolidated EBITDA can be calculated as income or loss from operations excluding depreciation, amortization, and the gain from the sale of CSBU in fiscal 2008.

The fiscal 2009 restructuring charge totaled \$2.0 million, of which \$1.9 million was allocated to the domestic division and \$0.1 million was allocated to the international division. The fiscal 2009 asset impairment charge of \$3.6 million was expensed through our corporate operations. The fiscal 2008 restructuring charge, which totaled \$2.1 million, was allocated \$1.1 million to domestic and \$1.0 million to international. The \$1.5 million asset impairment was attributed to domestic financial results in the following segment information.

In the normal course of business, we may make structural and cost allocation revisions to our segment information to reflect new reporting responsibilities within the organization. During the fourth quarter of fiscal 2010, we sold the products division of our wholly owned subsidiary in Japan (Note 2). We determined that the operating results of the Japan products division should be presented as discontinued operations and we have excluded the operating results of this discontinued operation from the following



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table. All prior period segment information has also been revised to conform to the most recent classifications and organizational changes. We account for our segment information on the same basis as the accompanying consolidated financial statements.

## ENTERPRISE INFORMATION

(in thousands)

| Fiscal Year Ended                          | Sales to<br>External<br>Customers | Gross<br>Profit | EBITDA   | Depreciation | Amortization | Segment<br>Assets | Capital<br>Expenditures |
|--|-----------------------------------|-----------------|----------|--------------|--------------|-------------------|-------------------------|
| August 31, 2010                            |                                   |                 |          |              |              |                   |                         |
| Organizational Solutions<br>Business Unit: |                                   |                 |          |              |              |                   |                         |
| Domestic                                   | \$ 98,344                         | \$ 60,367       | \$ 7,956 | \$ 1,825     | \$ 3,746     | \$ 70,765         | \$ 1,966                |
| International                              | 35,309                            | 27,148          | 10,456   | 352          | 14           | 13,205            | 86                      |
| Total OSBU                                 | 133,653                           | 87,515          | 18,412   | 2,177        | 3,760        | 83,970            | 2,052                   |

|                                      |            |           |           |          |          |            |          |
|--------------------------------------|------------|-----------|-----------|----------|----------|------------|----------|
| Consumer Solutions<br>Business Unit: |            |           |           |          |          |            |          |
| Total operating units                | -          | -         | -         | -        | -        | -          | -        |
| Corporate and<br>eliminations        | 3,221      | 1,556     | (6,945 )  | 1,492    | -        | 63,373     | 60       |
| Consolidated                         | \$ 136,874 | \$ 89,071 | \$ 11,467 | \$ 3,669 | \$ 3,760 | \$ 147,343 | \$ 2,112 |

Fiscal Year Ended

August 31, 2009

|  |           |           |             |          |          |           |          |
|--|-----------|-----------|-------------|----------|----------|-----------|----------|
| Organizational Solutions<br>Business Unit: |           |           |             |          |          |           |          |
| Domestic                                   | \$ 83,193 | \$ 48,808 | \$ (5,212 ) | \$ 2,304 | \$ 3,748 | \$ 75,743 | \$ 3,397 |
| International                              | 36,385    | 27,352    | 11,040      | 377      | 13       | 13,766    | 343      |
| Total OSBU                                 | 119,578   | 76,160    | 5,828       | 2,681    | 3,761    | 89,509    | 3,740    |

|                                      |            |           |             |          |          |            |          |
|--------------------------------------|------------|-----------|-------------|----------|----------|------------|----------|
| Consumer Solutions<br>Business Unit: |            |           |             |          |          |            |          |
| Total operating units                | -          | -         | -           | -        | -        | -          | -        |
| Corporate and<br>eliminations        | 3,556      | 1,722     | (9,375 )    | 1,851    | -        | 54,369     | 94       |
| Consolidated                         | \$ 123,134 | \$ 77,882 | \$ (3,547 ) | \$ 4,532 | \$ 3,761 | \$ 143,878 | \$ 3,834 |

Fiscal Year Ended

August 31, 2008

|  |           |           |        |          |          |           |          |
|--|-----------|-----------|--------|----------|----------|-----------|----------|
| Organizational Solutions<br>Business Unit: |           |           |        |          |          |           |          |
| Domestic                                   | \$ 99,308 | \$ 62,237 | \$ 374 | \$ 1,407 | \$ 3,596 | \$ 85,016 | \$ 4,796 |
| International                              | 43,060    | 32,704    | 13,573 | 778      | 7        | 16,190    | 521      |
| Total OSBU                                 | 142,368   | 94,941    | 13,947 | 2,185    | 3,603    | 101,206   | 5,317    |

|                                      |         |        |          |       |   |        |       |
|--------------------------------------|---------|--------|----------|-------|---|--------|-------|
| Consumer Solutions<br>Business Unit: |         |        |          |       |   |        |       |
| Total operating units                | 107,235 | 61,509 | 8,207    | 1,361 | - | -      | 1,285 |
| Corporate and<br>eliminations        | 2,471   | 1,081  | (7,786 ) | 2,146 | - | 76,471 | 401   |



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Consolidated                    \$ 252,074   \$ 157,531   \$ 14,368   \$ 5,692   \$ 3,603   \$ 177,677   \$ 7,003

Capital expenditures in the OSBU domestic segment include \$0.7 million, \$1.8 million, and \$4.0 million of spending on capitalized curriculum during the fiscal years ended August 31, 2010, 2009 and 2008, respectively.

A reconciliation of enterprise EBITDA to consolidated income (loss) before taxes is provided below (in thousands):

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| YEAR ENDED   |           |             |           |
|--|-----------|-------------|-----------|
| AUGUST 31,   | 2010      | 2009        | 2008      |
| Enterprise EBITDA  | \$ 18,412 | \$ 5,828    | \$ 22,154 |
| Corporate expenses   | (6,945 )  | (9,375 )    | (7,786 )  |
| Consolidated EBITDA  | 11,467    | (3,547 )    | 14,368    |
| Gain on sale of CSBU assets                                  | -         | -           | 9,131     |
| Depreciation   | (3,669 )  | (4,532 )    | (5,692 )  |
| Amortization   | (3,760 )  | (3,761 )    | (3,603 )  |
| Consolidated income (loss) from operations                   | 4,038     | (11,840)    | 14,204    |
| Interest income  | 34        | 27          | 157       |
| Interest expense   | (2,892 )  | (3,049 )    | (3,083 )  |
| Income (loss) from continuing operations before income taxes | \$ 1,180  | \$ (14,862) | \$ 11,278 |

Interest expense and interest income are primarily generated at the corporate level and are not allocated. Income taxes are likewise calculated and paid on a corporate level (except for entities that operate in foreign jurisdictions) and are not allocated for analysis purposes.

Corporate assets, such as cash, accounts receivable, and other assets are not generally allocated for business analysis purposes. However, inventories, intangible assets, goodwill, identifiable fixed assets, and certain other assets are allocated for analysis purposes. A reconciliation of enterprise assets to consolidated assets is as follows (in thousands):

| AUGUST 31,                       | 2010       | 2009       | 2008       |
|----------------------------------|------------|------------|------------|
| Reportable unit assets           | \$ 83,970  | \$ 89,509  | \$ 101,206 |
| Corporate assets                 | 63,423     | 54,513     | 78,010     |
| Intercompany accounts receivable | (50 )      | (144 )     | (1,539 )   |
|                                  | \$ 147,343 | \$ 143,878 | \$ 177,677 |

## Enterprise-Wide Information

Our revenues are derived primarily from the United States. However, we also operate wholly-owned offices or contract with licensees to provide products and services in various countries throughout the world. Our consolidated revenues from continuing operations were derived from the following countries (in thousands):

| YEAR ENDED     |           |           |            |
|----------------|-----------|-----------|------------|
| AUGUST 31,     | 2010      | 2009      | 2008       |
| Net sales:     |           |           |            |
| United States  | \$ 97,286 | \$ 82,437 | \$ 197,181 |
| Japan          | 13,935    | 16,955    | 18,492     |
| Canada         | 6,157     | 6,555     | 10,389     |
| United Kingdom | 5,751     | 5,235     | 10,174     |
| Australia      | 4,545     | 3,314     | 4,313      |
| Singapore      | 1,900     | 1,652     | 1,443      |
|                | 1,229     | 1,039     | 1,283      |

|                         |            |            |            |
|-------------------------|------------|------------|------------|
| Brazil/South<br>America |            |            |            |
| Korea                   | 1,028      | 917        | 1,234      |
| Indonesia/Malaysia      | 822        | 706        | 794        |
| Mexico                  | 261        | 138        | 1,905      |
| Others                  | 3,960      | 4,186      | 4,866      |
|                         | \$ 136,874 | \$ 123,134 | \$ 252,074 |

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At August 31, 2010, we had wholly-owned offices in Australia, Japan, and the United Kingdom. Our long-lived assets were held in the following locations for the periods indicated (in thousands):

| AUGUST 31,         | 2010      | 2009       | 2008       |
|--------------------|-----------|------------|------------|
| Long-lived assets: |           |            |            |
| United States      | \$ 96,512 | \$ 101,335 | \$ 106,878 |
| Americas           | -         | -          | 2,230      |
| Japan              | 1,962     | 1,835      | 1,509      |
| United Kingdom     | 145       | 410        | 258        |
| Australia          | 108       | 156        | 141        |
|                    | \$ 98,727 | \$ 103,736 | \$ 111,016 |

Inter-segment sales were immaterial and are eliminated in consolidation.

## 19. RELATED PARTY TRANSACTIONS

The Company pays the Vice-Chairman of the Board of Directors a percentage of the proceeds received for seminars that he presents. During the fiscal years ended August 31, 2010, 2009, and 2008, we expensed charges totaling \$1.4 million, \$1.3 million, and \$2.8 million to the Vice-Chairman for his seminar presentations. We also pay the Vice-Chairman a percentage of the royalty proceeds received from the sale of certain books that were authored by him. During fiscal 2010, 2009, and 2008, we expensed approximately \$50,000, \$0.2 million, and \$0.3 million for royalties to the Vice-Chairman under these agreements. At August 31, 2010 and 2009, we had accrued \$1.2 million and \$0.8 million payable to the Vice-Chairman under the forgoing agreements. These amounts were included as a component of accrued liabilities in our consolidated balance sheets.

We pay a son of the Vice-Chairman of the Board of Directors, who is also an employee of the Company, a percentage of the royalty proceeds received from the sales of certain books authored by him. During the fiscal years ended August 31, 2010, 2009, and 2008, we expensed \$0.2 million, \$0.1 million, and \$0.7 million to the son of the Vice-Chairman for these royalties and had \$0.1 million accrued at August 31, 2010 and 2009 as payable under the terms of this arrangement. These amounts are included in accrued liabilities in our consolidated balance sheets.

During fiscal 2006, we signed a non-exclusive license agreement for certain intellectual property with a son of the Vice-Chairman of the Board of Directors, who was previously an officer of the Company and a member of our Board of Directors. We are required to pay the son of the Vice-Chairman royalties for the use of certain intellectual property developed by the son of the Vice-Chairman. The amount expensed for these royalties due to the son of the Vice-Chairman totaled \$1.1 million, \$0.5 million, and \$0.3 million during the fiscal years ended August 31, 2010, 2009, and 2008, respectively. During fiscal 2009, we acquired CoveyLink (Note 14), which was owned by this son of the Vice-Chairman, and signed an amended license agreement as well as a speaker services agreement. Based on the provisions of the speakers' services agreement, we pay the son of the Vice-Chairman a portion of the speaking revenues received for his presentations. We expensed \$0.8 million for payment from these presentations during each fiscal 2010 and fiscal 2009, which are based upon the concepts found in *The Speed of Trust*, which was authored by this son of the Vice-Chairman. We had \$0.1 million and \$0.4 million accrued for these fees at August 31, 2010 and 2009. These amounts are included in accrued liabilities in our consolidated balance sheets.

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Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

An evaluation was conducted under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act, as of the end of the period covered by this report.

Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective.

Management's Report on Internal Control Over Financial Reporting

The management of Franklin Covey Co. is responsible for establishing and maintaining adequate internal control over financial reporting for the Company (including its consolidated subsidiaries) and all related information appearing in the Company's annual report on Form 10-K. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes those policies and procedures that:

1. pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
2. provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with the authorization of management and/or of our Board of Directors; and
3. provide reasonable assurance regarding the prevention or timely detection of any unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness in future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting using the criteria set forth in

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Internal Control—Integrated Framework as issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based upon this evaluation, our management concluded that our internal control over financial reporting was effective as of the end of the period covered by this annual report on Form 10-K.

Our independent registered public accounting firm, KPMG LLP, has audited the consolidated financial statements included in this annual report on Form 10-K and, as part of their audit, has issued an audit report, included herein, on the effectiveness of our internal control over financial reporting. Their report is included in Item 8 of this Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f)) during the fourth quarter ended August 31, 2010 that materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Item 9B. Other Information

There was no information to be disclosed in a current Report on Form 8-K during fourth quarter of fiscal 2010 that was not previously reported.

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## PART III

## Item 10. Directors, Executive Officers and Corporate Governance

Certain information required by this Item is incorporated by reference to the sections entitled “Nominees for Election to the Board of Directors,” “Directors Whose Terms of Office Continue,” “Executive Officers,” “Section 16(a) Beneficial Ownership Compliance,” “Corporate Governance,” and “Board of Director Meetings and Committees” in our definitive Proxy Statement for the annual meeting of shareholders, which is scheduled to be held on January 14, 2011. The definitive Proxy Statement will be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended.

The Board of Directors has determined that one of the Audit Committee members, Robert Daines, is a “financial expert” as defined in Regulation S-K 407(d)(5) adopted under the Securities Exchange Act of 1934, as amended. Our Board of Directors has determined that Mr. Daines is an “independent director” as defined by the New York Stock Exchange (NYSE).

We have adopted a code of ethics for our senior financial officers that include the Chief Executive Officer, the Chief Financial Officer, and other members of our financial leadership team. This code of ethics is available on our website at [www.franklincovey.com](http://www.franklincovey.com). We intend to satisfy the disclosure requirement regarding any amendment to, or a waiver of, any provision of our code of ethics through filing a current report on Form 8-K for such events if they occur.

## Item 11. Executive Compensation

The information required by this Item is incorporated by reference to the sections entitled “Compensation Discussion and Analysis,” “Compensation Committee Interlocks and Insider Participation,” and “Compensation Committee Report” in our definitive Proxy Statement for the annual meeting of shareholders, which is scheduled to be held on January 14, 2011.

## Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

| Plan Category   | [a]   | [b]  | [c]  |
|---|---|--|--|
|   | Number of securities to be issued upon exercise of outstanding options, warrants, and rights (in thousands) | Weighted-average exercise price of outstanding options, warrants, and rights | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column [a]) (in thousands) |
| Equity compensation plans approved by security holders(1)(2)(4) | 949   | \$ 10.99   | 2,122 (3)  |

- (1) Excludes 97,064 shares of unvested (restricted) stock awards that are subject to forfeiture.
- (2) Amount includes 217,424 performance share awards that are expected to be awarded under the terms of a Board of Director approved long-term incentive plan (LTIP). The number of shares eventually awarded to LTIP participants is variable and based upon the achievement of specified financial performance goals related to cumulative



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operating income. The weighted average exercise price of outstanding options, warrants, and rights does not take the LTIP awards into account. For further information on our share-based compensation plans, refer to the notes to our financial statements as presented in Item 8 of this report.

(3) Amount is based upon the number of LTIP shares expected to be awarded at August 31, 2010 and may change in future periods based upon the achievement of specified goals and revisions to estimates.

(4) At August 31, 2010, we had approximately 720,000 shares authorized for purchase by participants in our Employee Stock Purchase Plan.

The remaining information required by this Item is incorporated by reference to the section entitled “Principal Holders of Voting Securities” in our definitive Proxy Statement for the annual meeting of shareholders, which is scheduled to be held on January 14, 2011.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is incorporated by reference to the section entitled “Certain Relationships and Related Transactions” and “Corporate Governance” in our definitive Proxy Statement for the annual meeting of shareholders, which is scheduled to be held on January 14, 2011.

Item 14. Principal Accountant Fees and Services

The information required by this Item is incorporated by reference to the section entitled “Principal Accountant Fees” in our definitive Proxy Statement for the annual meeting of shareholders, which is scheduled to be held on January 14, 2011.

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PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) List of documents filed as part of this report:

1. Financial Statements. The consolidated financial statements of the Company and Report of Independent Registered Public Accounting Firm thereon included in the Annual Report to Shareholders on Form 10-K for the year ended August 31, 2010, are as follows:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets at August 31, 2010 and 2009

Consolidated Statements of Operations and Statements of Comprehensive Income (Loss) for the years ended August 31, 2010, 2009, and 2008

Consolidated Statements of Shareholders' Equity for the years ended August 31, 2010, 2009, and 2008

Consolidated Statements of Cash Flows for the years ended August 31, 2010, 2009, and 2008

Notes to Consolidated Financial Statements

2. Financial Statement Schedules.

Schedule II – Valuation and Qualifying Accounts and Reserves (Filed as Exhibit 99.2 to this Report on Form 10-K).

Other financial statement schedules are omitted because they are not required or applicable, or the required information is shown in the financial statements or notes thereto, or contained in this report.

3. Exhibit List.

| Exhibit No. | Exhibit   | Incorporated |                |
|-------------|---|--------------|----------------|
|             |   | By Reference | Filed Herewith |
| 2.1         | Master Asset Purchase Agreement between Franklin Covey Products, LLC and Franklin Covey Co. dated May 22, 2008              | (19)         |                |
| 2.2         | Amendment to Master Asset Purchase Agreement between Franklin Covey Products, LLC and Franklin Covey Co. dated May 22, 2008 | (20)         |                |
| 3.1         | Articles of Restatement dated March 4, 2005 amending and restating the Company's Articles of Incorporation                  | (8)          |                |
| 3.2         | Amendment to Amended and Restated Articles of Incorporation of Franklin Covey (Appendix C)                                  | (12)         |                |

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|        |   |      |
|--------|---|------|
| 3.3    | Amended and Restated Bylaws of the Registrant   | (1)  |
| 4.1    | Specimen Certificate of the Registrant's Common Stock, par value \$.05 per share  | (2)  |
| 4.2    | Stockholder Agreements, dated May 11, 1999 and June 2, 1999   | (5)  |
| 4.3    | Registration Rights Agreement, dated June 2, 1999   | (5)  |
| 4.4    | Restated Shareholders Agreement, dated as of March 8, 2005, between the Company and Knowledge Capital Investment Group  | (8)  |
| 4.5    | Restated Registration Rights Agreement, dated as of March 8, 2005, between the Company and Knowledge Capital Investment Group                                       | (8)  |
| 10.1*  | Amended and Restated 1992 Employee Stock Purchase Plan  | (3)  |
| 10.2*  | Amended and Restated 2000 Employee Stock Purchase Plan  | (6)  |
| 10.3*  | Amended and Restated 2004 Employee Stock Purchase Plan  | (15) |
| 10.4*  | Amended and Restated 1992 Stock Incentive Plan  | (4)  |
| 10.5*  | First Amendment to Amended and Restated 1992 Stock Incentive Plan   | (16) |
| 10.6*  | Third Amendment to Amended and Restated 1992 Stock Incentive Plan   | (17) |
| 10.7*  | Fifth Amendment to the Franklin Covey Co. Amended and Restated 1992 Stock Incentive Plan (Appendix A)   | (12) |
| 10.8*  | Forms of Nonstatutory Stock Options   | (1)  |
| 10.9*  | Amended and Restated Option Agreement, dated December 8, 2004, by and between the Company and Robert A. Whitman   | (7)  |
| 10.10  | Warrant, dated March 8, 2005, to purchase 5,913,402 shares of Common Stock issued by the Company to Knowledge Capital Investment Group                              | (8)  |
| 10.11  | Form of Warrant to purchase shares of Common Stock to be issued by the Company to holders of Series A Preferred Stock other than Knowledge Capital Investment Group | (8)  |
| 10.12* | Franklin Covey Co. 2004 Non-Employee Directors' Stock Incentive Plan  | (9)  |
| 10.13* | The first amendment to the Franklin Covey Co. 2004 Non-Employee Director Stock Incentive Plan, (Appendix B)   | (12) |
| 10.14* | Form of Option Agreement for the 2004 Non-Employee Directors Stock Incentive Plan   | (9)  |
| 10.15* | Form of Restricted Stock Agreement for the 2004 Non-Employees Directors Stock Incentive Plan  | (9)  |
| 10.16  | Master Lease Agreement between Franklin SaltLake LLC (Landlord) and Franklin Development Corporation (Tenant)   | (10) |
| 10.17  | Purchase and Sale Agreement and Escrow Instructions between Levy Affiliated Holdings, LLC (Buyer) and Franklin Development Corporation (Seller) and Amendments      | (10) |



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|  |      |
|--|------|
| 10.18 Redemption Extension Voting Agreement between Franklin Covey Co. and Knowledge Capital Investment Group, dated October 20, 2005  | (11) |
| 10.19 Agreement for Information Technology Services between each of Franklin Covey Co., Electronic Data Systems Corporation, and EDS Information Services LLC, dated April 1, 2001   | (13) |
| 10.20 Additional Services Addendum No. 1 to Agreement for Information Technology Services between each of Franklin Covey Co., Electronic Data Systems Corporation, and EDS Information Services LLC, dated June 30, 2001   | (13) |
| 10.21 Amendment No. 2 to Agreement for Information Technology Services between each of Franklin Covey Co., Electronic Data Systems Corporation, and EDS Information Services LLC, dated June 30, 2001  | (13) |
| 10.22 Amendment No. 6 to the Agreement for Information Technology Services between each of Franklin Covey Co., Electronic Data Systems Corporation, and EDS Information Services L.L.C. dated April 1, 2006  | (14) |
| 10.23 Revolving Line of Credit Agreement (\$18,000,000) by and between JPMorgan Chase Bank, N.A. and Franklin Covey Co. dated March 14, 2007   | (18) |
| 10.24 Secured Promissory Note between JPMorgan Chase Bank, N.A. and Franklin Covey Co. dated March 14, 2007  | (18) |
| 10.25 Security Agreement between Franklin Covey Co., Franklin Covey Printing, Inc., Franklin Development Corporation, Franklin Covey Travel, Inc., Franklin Covey Catalog Sales, Inc., Franklin Covey Client Sales, Inc., Franklin Covey Product Sales, Inc., Franklin Covey Services LLC, Franklin Covey Marketing, LTD., and JPMorgan Chase Bank, N.A. and Zions First National Bank, dated March 14, 2007 | (18) |
| 10.26 Repayment Guaranty between Franklin Covey Co., Franklin Covey Printing, Inc., Franklin Development Corporation, Franklin Covey Travel, Inc., Franklin Covey Catalog Sales, Inc., Franklin Covey Client Sales, Inc., Franklin Covey Product Sales, Inc., Franklin Covey Services LLC, Franklin Covey Marketing, LTD., and JPMorgan Chase Bank N.A., dated March 14, 2007                                | (18) |
| 10.27 Pledge and Security Agreement between Franklin Covey Co. and JPMorgan Chase Bank, N.A. and Zions First National Bank, dated March 14, 2007   | (18) |
| 10.28 Revolving Line of Credit Agreement (\$7,000,000) by and between Zions First National Bank and Franklin Covey Co. dated March 14, 2007  | (18) |
| 10.29 Secured Promissory Note between Zions First National Bank and Franklin Covey Co. dated March 14, 2007  | (18) |
| 10.30 Repayment Guaranty between Franklin Covey Co., Franklin Covey Printing, Inc., Franklin Development Corporation,  | (18) |

Franklin Covey Travel, Inc., Franklin Covey Catalog Sales, Inc., Franklin Covey Client Sales, Inc., Franklin Covey Product Sales, Inc., Franklin Covey Services LLC, Franklin Covey Marketing, LTD., and Zions First National Bank, dated March 14, 2007

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|  |      |    |
|--|------|----|
| 10.31 Master License Agreement between Franklin Covey Co. and Franklin Covey Products, LLC   | (21) |    |
| 10.32 Supply Agreement between Franklin Covey Products, LLC and Franklin Covey Product Sales, Inc.   | (21) |    |
| 10.33 Master Shared Services Agreement between The Franklin Covey Products Companies and the Shared Services Companies   | (21) |    |
| 10.34 Amended and Restated Operating Agreement of Franklin Covey Products, LLC   | (21) |    |
| 10.35 Sublease Agreement between Franklin Development Corporation and Franklin Covey Products, LLC   | (21) |    |
| 10.36 Sub-Sublease Agreement between Franklin Covey Co. and Franklin Covey Products, LLC   | (21) |    |
| 10.37 Loan Modification Agreement between Franklin Covey Co. and JPMorgan Chase Bank, N.A. dated July 8, 2008  | (21) |    |
| 10.38 General Services Agreement between Franklin Covey Co. and Electronic Data Systems (EDS) dated October 27, 2008   | (22) |    |
| 10.39* Second Amendment to the Franklin Covey Co. Non-Employee Directors Stock Incentive Plan  | (23) |    |
| 10.40 Asset Purchase Agreement by and Among Covey/Link LLC, CoveyLink Worldwide LLC, Franklin Covey Co., and Franklin Covey Client Sales, Inc. dated December 31, 2008   | (24) |    |
| 10.41 Amended and Restated License of Intellectual Property by and Among Franklin Covey Co. and Covey/Link LLC, dated December 31, 2008                                  | (24) |    |
| 10.42 Loan Modification Agreement between Franklin Covey Co. and JPMorgan Chase Bank, N.A. dated November 11, 2009   | (25) |    |
| 10.43 Fourth Modification Agreement by and among Franklin Covey Co. and JPMorgan Chase Bank, N.A., dated February 25, 2010   | (26) |    |
| 21 Subsidiaries of the Registrant  |      | éé |
| 23 Consent of Independent Registered Public Accounting Firm  |      | éé |
| 31.1 Rule 13a-14(a) Certification of the Chief Executive Officer   |      | éé |
| 31.2 Rule 13a-14(a) Certification of the Chief Financial Officer   |      | éé |
| 32 Section 1350 Certifications   |      | éé |
| 99.1 Report of KPMG LLP, Independent Registered Public Accounting Firm, on Consolidated Financial Statement Schedule for the years ended August 31, 2010, 2009, and 2008 |      | éé |
| 99.2 Financial Statement Schedule II – Valuation and Qualifying Accounts and Reserves.   |      | éé |

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- (1) Incorporated by reference to Registration Statement on Form S-1 filed with the Commission on April 17, 1992, Registration No. 33-47283.
  - (2) Incorporated by reference to Amendment No. 1 to Registration Statement on Form S-1 filed with the Commission on May 26, 1992, Registration No. 33-47283.
  - (3) Incorporated by reference to Report on Form 10-K filed November 27, 1992, for the year ended August 31, 1992.\*\*
  - (4) Incorporated by reference to Registration Statement on Form S-1 filed with the Commission on January 3, 1994, Registration No. 33-73728.
  - (5) Incorporated by reference to Schedule 13D (CUSIP No. 534691090 as filed with the Commission on June 14, 1999). Registration No. 005-43123.
  - (6) Incorporated by reference to Report on Form S-8 filed with the Commission on May 31, 2000, Registration No. 333-38172.
    - (7) Incorporated by reference to Report on Form 8-K filed with the Commission on December 14, 2004.\*\*
    - (8) Incorporated by reference to Report on Form 8-K filed with the Commission on March 10, 2005.\*\*
    - (9) Incorporated by reference to Report on Form 8-K filed with the Commission on March 25, 2005.\*\*
    - (10) Incorporated by reference to Report on Form 8-K filed with the Commission on June 27, 2005.\*\*
    - (11) Incorporated by reference to Report on Form 8-K filed with the Commission on October 24, 2005.\*\*
  - (12) Incorporated by reference to Definitive Proxy Statement on Form DEF 14A filed with the Commission on December 12, 2005.\*\*
  - (13) Incorporated by reference to Report on Form 10-Q filed July 10, 2001, for the quarter ended May 26, 2001.\*\*
    - (14) Incorporated by reference to Report on Form 8-K filed with the Commission on April 5, 2006.\*\*
  - (15) Incorporated by reference to Definitive Proxy Statement on Form DEF 14A filed with the Commission on February 1, 2005.\*\*
  - (16) Incorporated by reference to Definitive Proxy Statement on Form DEF 14A dated November 5, 1993.\*\*
  - (17) Incorporated by reference to Definitive Proxy Statement on Form DEF 14A filed with the Commission on December 3, 1999.\*\*
    - (18) Incorporated by reference to Report on Form 8-K filed with the Commission on March 19, 2007.\*\*
    - (19) Incorporated by reference to Report on Form 8-K/A filed with the Commission on May 29, 2008.\*\*
  - (20) Incorporated by reference to Report on Form 10-Q filed July 10, 2008, for the Quarter ended May 31, 2008.\*\*
    - (21) Incorporated by reference to Report on Form 8-K filed with the Commission on July 11, 2008.\*\*
    - (22) Incorporated by reference to Report on Form 10-K filed with the Commission on November 14, 2008.\*\*
    - (23) Incorporated by reference to Report on Form 10-Q filed with the Commission on January 13, 2009.\*\*
    - (24) Incorporated by reference to Report on Form 10-Q filed with the Commission on April 9, 2009.\*\*
    - (25) Incorporated by reference to Report on Form 8-K filed with the Commission on November 16, 2009.\*\*
    - (26) Incorporated by reference to Report on Form 8-K filed with the Commission on March 2, 2010.\*\*
- ée Filed herewith and attached to this report.
- \* Indicates a management contract or compensatory plan or agreement.
- \*\* Registration No. 001-11107.



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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on November 12, 2010.

FRANKLIN COVEY CO.

By: /s/ Robert A.  
Whitman  
Robert A. Whitman  
Chairman and  
Chief Executive  
Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature  | Title   | Date                 |
|--|---|----------------------|
| /s/ Robert A.<br>Whitman<br>Robert A.<br>Whitman           | Chairman of the<br>Board and Chief<br>Executive Officer | November<br>12, 2010 |
| /s/ Stephen R.<br>Covey<br>Stephen R. Covey                | Vice-Chairman of<br>the Board                           | November<br>12, 2010 |
| /s/ Clayton M.<br>Christensen<br>Clayton M.<br>Christensen | Director  | November<br>12, 2010 |
| /s/ Robert H.<br>Daines<br>Robert H. Daines                | Director  | November<br>12, 2010 |
| /s/ E.J. "Jake" Garn<br>E.J. "Jake" Garn                   | Director  | November<br>12, 2010 |

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/s/ Dennis G. Heiner      Director      November  
12, 2010  
Dennis G. Heiner

/s/ Donald J. McNamara      Director      November  
12, 2010  
Donald J.  
McNamara

/s/ Joel C. Peterson      Director      November  
12, 2010  
Joel C. Peterson

/s/ E. Kay Stepp      Director      November  
12, 2010  
E. Kay Stepp