

This article by Matthew Sweeney is excerpted from a letter of [Laughing Water Capital](#).

I have been following Franklin Covey (FC) off and on since 2014 when I first met the management team, and it recently entered our portfolio as a smaller position. FC is in the business of performance improvement, with a strategy based on the ideas first laid out in the best-selling book, "The 7 Habits of Highly Effective People."

Insiders own 33% of the company, and check Charlie Munger's "cannibal" box, having repurchased almost 20% of outstanding shares since I first met with them.

The crux of the thesis is based on stepping over what should be a very low hurdle: customers like getting more value for the same price.

In short, historically customers have been able to order FC's training materials a la carte, paying one price (~\$200 per employee) for training materials on a specific topic. The materials are considered best in breed, and renewal rates are high. However, recently the company has shifted gears and began offering access to training materials across all topics for one price via their "All Access Pass." While this should represent incredible value to existing customers and has already opened doors to new customers, there are a few wrinkles that have impaired recent results and caused the stock to trade down.

First, under the old model FC was selling to HR managers who could make purchase decisions out of their existing budget, leading to a short sales cycle. Under the All Access Pass, customers must sign a 1 year contract, which typically requires legal review, and thus a longer sales cycle.

Second, under the new model, GAAP accounting requires that revenue be recognized ratably over the course of the contract, while expenses are recognized during the period that they are incurred. In other words, if FC sells a one year subscription, in the first quarter they must recognize all of the expenses associated with that subscription, but they can only recognize one quarter worth of revenue.

These two items combined have been a drag on recent results, but over time they should lead to higher revenues and lower expenses: a potent combination. In the near term, as the launch of All Access Pass is lapped, deferred revenue will be recognized, which should catalyze shares by mid 2018.

Longer term, the company's addressable market is enormous, the combination of secular growth and a management team with a proven affinity for rewarding shareholders through repurchasing shares is attractive, and there is potential to separate the company's education business from its corporate business, which the market would likely reward.