FRANKLIN COVEY CO
Form 10-Q
July 10, 2008

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended May 31, 2008

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

For the transition period from __________ to __________

Commission file no. 1-11107

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

| | |
|---|---|
| Utah<br>(State of incorporation) | 87-0401551<br>(I.R.S. employer identification number) |
| 2200 West Parkway Boulevard<br>Salt Lake City, Utah<br>(Address of principal executive | 84119-2099<br>(Zip Code) |

offices)

| | |
|---|---|
| Registrant's telephone number, Including area code | (801) 817-1776 |

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

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 filer | £ | Accelerated filer | T |

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

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

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

19,615,444 shares of Common Stock as of July 1, 2008

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

FRANKLIN COVEY CO.

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

| | May 31, 2008 | August 31, 2007 |
|---|---|---|
| | (unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 4,815 | $ 6,126 |
| Accounts receivable, less allowance for doubtful accounts of $777 and $821 | 24,597 | 27,239 |
| Inventories | 7,034 | 24,033 |
| Deferred income taxes | 3,697 | 3,635 |
| Prepaid expenses and other assets | 4,837 | 9,070 |
| Assets of operations held for sale (Note 2) | 30,754 | - |
| Total current assets | 75,734 | 70,103 |
| | | |
| Property and equipment, net | 25,807 | 36,063 |
| Intangible assets, net | 73,223 | 75,923 |
| Deferred income taxes | 105 | 101 |
| Other assets | 16,934 | 14,441 |
| | $ 191,803 | $ 196,631 |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt and financing obligation | $ 667 | $ 629 |
| Line of credit | 8,223 | 15,999 |
| Accounts payable | 8,341 | 12,190 |
| Income taxes payable | 57 | 2,244 |
| Accrued liabilities | 21,145 | 30,101 |
| Liabilities of operations held for sale (Note 2) | 10,415 | - |
| Total current liabilities | 48,848 | 61,163 |
| | | |
| Long-term debt and financing obligation, less current portion | 32,504 | 32,965 |
| Deferred income tax liabilities | 4,455 | 565 |
| Other liabilities | 1,652 | 1,019 |
| Total liabilities | 87,459 | 95,712 |
| | | |
| Shareholders' equity: | | |
| Common stock – $0.05 par value; 40,000 shares authorized, 27,056 shares issued and outstanding | 1,353 | 1,353 |
| Additional paid-in capital | 183,836 | 185,890 |
| Common stock warrants | 7,602 | 7,602 |

| | | |
|---|---|---|
| Retained earnings | 23,119 | 19,489 |
| Accumulated other comprehensive income | 2,039 | 970 |
| Treasury stock at cost, 7,249 and 7,296 shares | (112,956) | (114,385) |
| Other comprehensive loss held for sale | (649) | - |
| Total shareholders’ equity | 104,344 | 100,919 |
| | $ 191,803 | $ 196,631 |

See notes to condensed consolidated financial statements.

FRANKLIN COVEY CO.

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

| | Quarter Ended | | Three Quarters Ended | |
|---|---|---|---|---|
| | May 31, 2008 | June 2, 2007 | May 31, 2008 | June 2, 2007 |
| | (unaudited) | | (unaudited) | |
| Net sales: | | | | |
| Products | $ 25,197 | $ 30,857 | $ 105,872 | $ 118,248 |
| Training and consulting services | 33,864 | 33,652 | 101,891 | 98,666 |
| | 59,061 | 64,509 | 207,763 | 216,914 |
| Cost of sales: | | | | |
| Products | 11,883 | 14,619 | 46,565 | 52,528 |
| Training and consulting services | 11,421 | 10,254 | 32,807 | 31,163 |
| | 23,304 | 24,873 | 79,372 | 83,691 |
| Gross profit | 35,757 | 39,636 | 128,391 | 133,223 |
| | | | | |
| Selling, general, and administrative | 34,210 | 35,287 | 110,634 | 112,803 |
| Gain on sale of manufacturing facility | - | - | - | (1,227) |
| Depreciation | 1,497 | 1,060 | 4,044 | 3,463 |
| Amortization | 902 | 906 | 2,702 | 2,708 |
| Income (loss) from operations | (852) | 2,383 | 11,011 | 15,476 |
| | | | | |
| Interest income | 55 | 124 | 78 | 682 |
| Interest expense | (725) | (867) | (2,396) | (2,203) |
| Income (loss) before provision for income taxes | (1,522) | 1,640 | 8,693 | 13,955 |
| Benefit (provision) for income taxes | 11 | (753) | (5,063) | (6,939) |
| Net income (loss) | (1,511) | 887 | 3,630 | 7,016 |
| Preferred stock dividends | - | (348) | - | (2,215) |
| Net income (loss) available to common shareholders | $ (1,511) | $ 539 | $ 3,630 | $ 4,801 |
| | | | | |
| Net income (loss) available to common shareholders per share: | | | | |
| Basic | $ (.09) | $ .03 | $ .19 | $ .24 |
| Diluted | $ (.09) | $ .03 | $ .18 | $ .24 |
| | | | | |
| Weighted average number of common shares: | | | | |
| Basic | 16,132 | 19,412 | 19,542 | 19,637 |
| Diluted | 16,132 | 19,738 | 19,815 | 19,933 |

See notes to condensed consolidated financial statements.

FRANKLIN COVEY CO.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

| | Three Quarters Ended | |
|---|---|---|
| | May 31, 2008 | June 2, 2007 |
| | (unaudited) | |
| Cash flows from operating activities: | | |
| Net income | $ 3,630 | $ 7,016 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 7,699 | 7,503 |
| Deferred income taxes | 3,130 | 4,824 |
| Loss (gain) on disposals of property and equipment | 274 | (1,283) |
| Share-based compensation expense (benefit) | (936) | 894 |
| Changes in assets and liabilities: | | |
| Increase in accounts receivable, net | (2,031) | (4,408) |
| Decrease (increase) in inventories | 3,033 | (2,951) |
| Decrease in other assets | 747 | 1,236 |
| Decrease in accounts payable and accrued liabilities | (2,884) | (4,357) |
| Decrease in other long-term liabilities | (81) | (188) |
| Increase (decrease) in income taxes payable | (775) | 411 |
| Net cash provided by operating activities | 11,806 | 8,697 |
| | | |
| Cash flows from investing activities: | | |
| Proceeds on notes receivable from disposals of subsidiaries | 1,110 | - |
| Purchases of property and equipment | (2,784) | (7,855) |
| Curriculum development costs | (2,860) | (4,234) |
| Proceeds from sales of property and equipment | 60 | 2,596 |
| Net cash used for investing activities | (4,474) | (9,493) |
| | | |
| Cash flows from financing activities: | | |
| Proceeds from line-of-credit borrowing | 61,689 | 30,429 |
| Payments on line-of-credit borrowing | (69,465) | (12,585) |
| Redemption of preferred stock | - | (37,345) |
| Principal payments on long-term debt and financing obligation | (478) | (402) |
| Proceeds from sales of common stock from treasury | 311 | 206 |
| Proceeds from management stock loan payments | - | 27 |
| Purchases of treasury shares | - | (2,561) |
| Payment of preferred stock dividends | - | (2,215) |
| Net cash used for financing activities | (7,943) | (24,446) |
| | | |
| Effect of foreign exchange rates on cash and cash equivalents | (662) | (175) |
| Net decrease in cash and cash equivalents | (1,273) | (25,417) |
| Cash and cash equivalents at beginning of the period | 6,126 | 30,587 |
| Cash and cash equivalents at end of the period | $ 4,853 | $ 5,170 |

| | | | | |
|---|---|---|---|---|
| Supplemental disclosure of cash flow information: | | | | |
| Cash paid for interest | $ | 2,475 | $ | 2,048 |
| Cash paid for income taxes | $ | 3,117 | $ | 1,804 |
| | | | | |
| Non-cash investing and financing activities: | | | | |
| Acquisition of property and equipment through accounts payable | $ | 1,060 | | - |

See notes to condensed consolidated financial statements.

FRANKLIN COVEY CO.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1 – BASIS OF PRESENTATION

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

The accompanying unaudited condensed consolidated financial statements reflect, in the opinion of management, all adjustments (which include only normal recurring adjustments, except as discussed in Note 2) necessary to present fairly the financial position and results of operations of the Company as of the dates and for the periods indicated. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to Securities and Exchange Commission (SEC) rules and regulations. The information included in this quarterly report on Form 10-Q should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended August 31, 2007.

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

The Company utilizes a modified 52/53-week fiscal year that ends on August 31 of each year. Corresponding quarterly periods generally consist of 13-week periods that ended on December 1, 2007, March 1, 2008, and May 31, 2008 during fiscal 2008. Under the modified 52/53-week fiscal year, the quarter ended May 31, 2008 had the same number of business days as the quarter ended June 2, 2007 and the three quarters ended May 31, 2008 had one less business day than the three quarters ended June 2, 2007.

The results of operations for the quarter and three quarters ended May 31, 2008 are not necessarily indicative of results expected for the entire fiscal year ending August 31, 2008.

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NOTE 2 – SALE OF CONSUMER SOLUTIONS BUSINESS UNIT ASSETS

On May 22, 2008, we signed a definitive agreement with Peterson Partners to create a new company, Franklin Covey Products, LLC (Franklin Covey Products). This new company will purchase substantially all of the assets of our Consumer Solutions Business Unit (CSBU) and will focus on expanding sales of Franklin Covey products pursuant to a comprehensive license agreement. The CSBU is primarily responsible for sales of our products to both domestic and international consumers through a variety of channels (Note 8). Subsequent to May 31, 2008, we completed the sale of substantially all of the CSBU assets to Franklin Covey Products, which becomes effective during the quarter ended August 31, 2008. Franklin Covey Products, which is controlled by Peterson Partners, purchased the CSBU assets for $32.0 million in cash, subject to adjustments for working capital on the closing date of the sale. 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 preferred capital contribution with a 10 percent priority return, and will have the opportunity to earn contingent license fees if Franklin Covey Products achieves specified performance objectives.

Based upon the guidance found in Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we determined that the assets and liabilities of the CSBU, which constitutes an entire operating segment of the Company, should be classified as held for sale at May 31, 2008. The sale transaction was completed during our fourth fiscal quarter ended August 31, 2008 and we expect to recognize a gain on the sale of the CSBU assets. The carrying amounts of the assets and liabilities of our CSBU, which were classified as held for sale in our May 31, 2008 condensed consolidated balance sheet were as follows (in thousands):

| Description | | |
|---|---|---|
| Cash and cash equivalents | $ | 38 |
| Accounts receivable, net | | 5,266 |
| Inventories | | 14,340 |
| Other current assets | | 2,852 |
| Property and equipment, net | | 8,100 |
| Other assets | | 158 |
| Total assets held for sale | $ | 30,754 |
| | | |
| Accounts payable | $ | 4,284 |
| Accrued liabilities | | 6,131 |
| Total liabilities held for sale | $ | 10,415 |

As a result of Franklin Covey Products' structure as a limited liability company with separate owner capital accounts and the guidance found in Emerging Issues Task Force (EITF) Issue No. 03-16, Accounting for Investments in Limited Liability Companies, we determined that the Company's investment in Franklin Covey Products is more than minor and the Company will therefore be able to exercise significant influence over the operations of Franklin Covey Products. Combined with the possibility of receiving future cash distributions from Franklin Covey Products for returns of capital and dividends, plus possible participation in Franklin Covey Products' cash flows through the license agreement, we determined that the financial results of the CSBU should not be reported as discontinued operations in the accompanying condensed consolidated income statements or in future periods.

NOTE 3 – INVENTORIES

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

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| | May 31, 2008 | August 31, 2007 |
|---|---|---|
| Finished goods | $ 6,670 | $ 20,268 |
| Work in process | - | 743 |
| Raw materials | 364 | 3,022 |
| | $ 7,034 | $ 24,033 |

NOTE 4 – SHARE-BASED COMPENSATION

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 share 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.  The compensation cost of our share-based compensation plans was included in selling, general, and administrative expenses in the accompanying condensed consolidated income statements and no share-based compensation was capitalized during the three quarters ended May 31, 2008.  The Company generally issues shares of common stock for its share-based compensation plans from shares held in treasury.  The following is a description of recent developments in our share-based compensation plans.

Performance Awards

The Company has 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 Compensation Committee of the Board of Directors.  The LTIP performance awards cliff vest at the completion of a three-year performance period that begins on September 1 in the fiscal year of the grant.  The number of common shares that are finally awarded to LTIP participants is variable and is based entirely upon the achievement of a combination of performance objectives related to sales growth and cumulative operating income during the three-year 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 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 revised estimate of common shares that are expected to be awarded.

The Company granted performance awards under provisions of the LTIP in fiscal 2006, which vest on August 31, 2008, and in fiscal 2007, which vest on August 31, 2009.  The following is a description of the accounting for the fiscal 2006 and fiscal 2007 LTIP awards as of May 31, 2008.

Fiscal 2006 LTIP Award – Based upon actual financial performance through December 1, 2007 and estimated performance through the remaining service period of the fiscal 2006 LTIP grant, the Company determined that no shares of common stock would be awarded to participants under the terms of the fiscal 2006 LTIP grant.  Although we expect sufficient levels of cumulative operating income to be recognized for the fiscal 2006 award, anticipated sales growth is below the minimum threshold for shares to be awarded under the plan.  Our anticipated sales growth in

training and consulting sales is expected to be insufficient to offset forecasted product sales declines, which were revised using actual product sales levels late in our first fiscal quarter and early second fiscal quarter, and the impact of eliminated sales resulting from the sales of our subsidiary in Brazil and our training operations in Mexico, which occurred during the fourth quarter of fiscal 2007. As a result of this determination, we recorded a cumulative adjustment in the quarter ended December 1, 2007 that reduced our selling, general, and administrative expenses by $0.7 million and we did not record any compensation expense for the fiscal 2006 LTIP award during the quarters ended March 1, 2008 or May 31, 2008.

Fiscal 2007 LTIP Award – Consistent with our policy as stated above, we reevaluated the fiscal 2007 LTIP award at May 31, 2008 based upon revised estimates for sales growth and cumulative operating income. As a result of this reevaluation, we determined that no shares of common stock would be awarded to participants under the terms of the fiscal 2007 LTIP grant. Consistent with the analysis of the fiscal 2006 LTIP grant, we expect sufficient levels of operating income to be recognized for the fiscal 2007 award, but sales growth is expected to be insufficient for any shares to be awarded under this plan. The revised sales projections included actual performance through May 31, 2008 and estimated sales performance through fiscal 2009 based upon revised assumptions, which were adversely affected by slowing economic conditions in the United States and other countries in which the Company has operations. Although training and consulting sales are expected to increase in fiscal 2009, the growth rate was insufficient to offset expected declines in product sales and the impact of transitioning our Mexico and Brazil offices to licensees. As a result of this determination, we recorded cumulative adjustments totaling $1.0 million to reduce selling, general, and administrative expenses during the three quarters ended May 31, 2008.

Unvested Stock Awards

The fair value of our unvested stock awards is calculated based on the number of shares issued and 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 awards, which generally range from three to five years. The following information applies to our unvested stock awards granted to members of the Board of Directors under the Directors' Plan and to employees through the three quarters ended May 31, 2008:

| | Number of Shares | Weighted-Average Grant-Date Fair Value Per Share |
|---|---|---|
| Unvested stock awards at August 31, 2007 | 410,670 | $ 3.80 |
| Granted(1) | 36,000 | 7.50 |
| Vested(2) | (87,590) | 3.01 |
| Forfeited | - | - |
| Unvested stock awards at May 31, 2008 | 359,080 | $ 4.62 |

(1) Shares granted during the three quarters ended May 31, 2008 consisted of shares awarded to our Board of Directors under the provisions of the Directors' Plan.

(2) Share awards that vested during the three quarters ended May 31, 2008 consisted of 76,090 shares that were awarded to members of our Board of Directors in fiscal 2005 under the Directors' Plan and 11,500 shares that were granted to certain employees and were vested on an accelerated basis because the employees' area of responsibility met specified financial performance criteria. The compensation expense from the accelerated vesting of these shares totaled approximately $37,000.

Employee Stock Purchase Plan

We have an employee stock purchase plan 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. During the quarter and three quarters ended May 31, 2008, a total of 18,089 and 52,116 shares were issued to participants in the ESPP and the corresponding share-based compensation expense from the discount totaled approximately $22,000 and $61,000, respectively.

Stock Options

The Company has an incentive stock option plan whereby options to purchase shares of our common stock are issued to key employees at an exercise price not less than the market price 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 of our Board of Directors.

Information related to stock option activity during the three quarters ended May 31, 2008 is presented below:

| | Number of Stock Options | Weighted Avg. Exercise Price Per Share |
|---|---|---|
| Outstanding at August 31, 2007 | 2,058,300 | $ 12.72 |
| Granted | - | - |
| Exercised | (12,500) | 1.70 |
| Forfeited | (18,000) | 9.69 |
| Outstanding at May 31, 2008 | 2,027,800 | $ 12.82 |
| | | |
| Options vested and exercisable at May 31, 2008 | 2,027,800 | $ 12.82 |

NOTE 5 – INCOME TAXES

Income Tax Provision

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

Our effective tax rate for the three quarters ended May 31, 2008 of approximately 58 percent was higher than statutory combined rates primarily due to the accrual of taxable interest income on the management stock loan program and withholding taxes on royalty income from foreign licensees.

Adoption of FIN 48

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109 (FIN 48). This interpretation addresses

the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, 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. Interpretation No. 48 also provides guidance on de-recognition, classification, interest and penalties on income taxes, accounting for income taxes in interim periods, and requires increased disclosure of various income tax items.

We adopted the provisions of FIN 48 on September 1, 2007. The amount of gross unrecognized tax benefits at September 1, 2007 totaled $4.3 million, of which $3.1 million would affect our

effective tax rate, if recognized. The gross unrecognized tax benefit includes $2.9 million related to individual states' net operating loss carryforwards. The Company has determined that all material temporary differences, except for certain states' net operating loss carryforwards, can be fully recognized for FIN 48 purposes. At the date of adoption, we had approximately $0.2 million of accrued interest and penalties related to uncertain tax positions. Based upon guidance in FIN 48, interest and penalties related to uncertain tax positions are now recognized as components of income tax expense. The amount of our unrecognized tax benefits did not change significantly during the three quarters ended May 31, 2008.

Prior to the adoption of FIN 48, the reserve for uncertain tax positions was classified as a component of income taxes payable in our consolidated balance sheets. Consistent with the guidance found in FIN 48, our unrecognized income tax benefits related to net operating loss carryforwards now reduce the related deferred income tax asset and have the effect of increasing our net deferred income tax liability. All other unrecognized income tax benefits, which totaled $0.7 million, were reclassified as other long-term liabilities in our consolidated balance sheets.

The Company anticipates that it is reasonably possible that unrecognized tax benefits, including interest and penalties, of up to $0.3 million could be recognized within the next twelve months due to the lapse of applicable statutes of limitation, of which $0.2 million would affect our effective tax rate in those periods.

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 the Company's 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.

| | |
|---|---|
| 2000-2007 | Canada |
| 2002-2007 | Japan, Mexico, United Kingdom |
| 2003-2007 | United States – state and local income taxes |
| 2004-2007 | United States – federal income tax |

NOTE 6 – COMPREHENSIVE INCOME

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

| | Quarter Ended | | Three Quarters Ended | |
|---|---|---|---|---|
| | May 31, | June 2, | May 31, | June 2, |

| | 2008 | 2007 | 2008 | 2007 |
|---|---|---|---|---|
| Net income (loss) | $ (1,511) | $ 887 | $ 3,630 | $ 7,016 |
| Other comprehensive income (loss) items, net of tax: | | | | |
| Foreign currency translation adjustments | (121) | (30) | 420 | (14) |
| Comprehensive income (loss) | $ (1,632) | $ 857 | $ 4,050 | $ 7,002 |

NOTE 7 – EARNINGS PER SHARE

Basic earnings per common share (EPS) is calculated by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is calculated by dividing net income available to common shareholders by the weighted-average number of common shares outstanding plus the assumed exercise of all dilutive securities using the treasury stock method or the “as converted” method, as appropriate. Due to 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 as defined by EITF Issue No. 03-6, Participating Securities and the Two-Class Method

under FASB Statement No. 128, because they continue to have equivalent common stock dividend rights. Accordingly, these management stock loan shares are included in our basic EPS calculation during periods of net income and excluded from the basic EPS calculation in periods of net loss.

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

| | Quarter Ended | | Three Quarters Ended | |
|---|---|---|---|---|
| | May 31, 2008 | June 2, 2007 | May 31, 2008 | June 2, 2007 |
| Numerator for basic and diluted earnings per share: | | | | |
| Net income | $ (1,511) | $ 887 | $ 3,630 | $ 7,016 |
| Preferred stock dividends | - | (348) | - | (2,215) |
| Net income (loss) available to common shareholders | $ (1,511) | $ 539 | $ 3,630 | $ 4,801 |
| | | | | |
| Denominator for basic and diluted earnings per share: | | | | |
| Basic weighted average shares outstanding(1) | 16,132 | 19,412 | 19,542 | 19,637 |
| Effect of dilutive securities: | | | | |
| Stock options(2) | - | 34 | 7 | 31 |
| Unvested stock awards(2) | - | 292 | 266 | 265 |
| Common stock warrants(3) | - | - | - | - |
| Diluted weighted average shares outstanding | 16,132 | 19,738 | 19,815 | 19,933 |
| | | | | |
| Basic and diluted EPS: | | | | |
| Basic EPS | $ (.09) | $ .03 | $ .19 | $ .24 |
| Diluted EPS | $ (.09) | $ .03 | $ .18 | $ .24 |

(1) Since the Company recognized a net loss for the quarter ended May 31, 2008, basic weighted-average shares for that period excludes 3.5 million shares of common stock held by management stock loan participants that were placed in escrow. Basic weighted-average shares include the 3.5 million management stock loan shares for all other periods presented.

(2) Due to the net loss reported for the quarter ended May 31, 2008, the dilutive effects of in-the-money stock options and unvested stock awards were excluded from the Company's EPS calculation for the quarter because these items were anti-dilutive.

(3) The conversion of 6.2 million common stock warrants is not assumed because the average share price of our common stock was less than the exercise price of the warrants and such conversion would be anti-dilutive for the periods presented.

At both May 31, 2008 and June 2, 2007, we had approximately 1.9 million stock options outstanding, which were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the Company's common shares for the respective periods. Although these shares were not included in our calculation of diluted EPS, these stock options, and other dilutive securities, may have a dilutive effect on the

Company's EPS calculation in future periods if the price of our common stock increases.

NOTE 8 – SEGMENT INFORMATION

The Company currently has two segments: the Consumer Solutions Business Unit (CSBU) and the Organizational Solutions Business Unit (OSBU). The following is a description of our segments, their primary operating components, and their significant business activities:

Consumer Solutions Business Unit – This business unit is primarily focused on product sales to individual customers and small business organizations and includes the results of our domestic retail stores, consumer direct operations (primarily eCommerce 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 include the financial results of our paper planner manufacturing operations. Although CSBU sales primarily consist of products such as planners, binders, software, totes, books, and various accessories, virtually any component of our leadership, productivity, and strategy execution solutions may be purchased through our CSBU channels. As described in Note 2, during the quarter ended May 31, 2008 the Company entered into an agreement to sell substantially all of the assets of the CSBU to a newly formed company. Refer to Note 2 for further information regarding the sale of CSBU assets.

Organizational Solutions Business Unit – The OSBU is 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 includes the financial results of our domestic sales force, public programs, and certain international operations. The domestic sales force is responsible for the sale and delivery of our training and consulting services in the United States. Our international sales group includes the financial results of our directly owned foreign offices and royalty revenues from licensees.

The Company's chief operating decision maker is the Chief Executive Officer (CEO), and each of the segments has a president who reports directly to the CEO. 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 our income or loss from operations excluding depreciation and amortization charges.

In the normal course of business, the Company may make structural and cost allocation revisions to its segment information to reflect new reporting responsibilities within the organization. During fiscal 2008, we transferred our public programs operations from CSBU to OSBU and made other less significant organizational changes. All prior period segment information has been revised to conform to the most recent classifications and organizational changes. The Company accounts for its segment information on the same basis as the accompanying condensed consolidated financial statements.

SEGMENT INFORMATION
(in thousands)

| Quarter Ended May 31, 2008 | Sales to External Customers | Gross Profit | EBITDA | Depreciation | Amortization |
|---|---|---|---|---|---|
| Consumer Solutions Business Unit: | | | | | |
| Retail | $ 7,896 | $ 4,626 | $ (1,737) | $ 218 | $ - |
| Consumer direct | 6,949 | 4,127 | 2,107 | 85 | - |
| Wholesale | 5,046 | 2,698 | 2,569 | - | - |
| CSBU International | 1,119 | 471 | (62) | 6 | - |

| | | | | | |
|---|---|---|---|---|---|
| Other CSBU | 1,280 | 3 | (5,314) | 99 | - |
| Total CSBU | 22,290 | 11,925 | (2,437) | 408 | - |
| | | | | | |
| Organizational Solutions Business Unit: | | | | | |
| Domestic | 23,111 | 14,058 | 482 | 257 | 899 |

| | | | | | |
|---|---|---|---|---|---|
| International | 13,660 | 9,774 | 4,014 | 187 | 3 |
| Total OSBU | 36,771 | 23,832 | 4,496 | 444 | 902 |
| Total operating segments | 59,061 | 35,757 | 2,059 | 852 | 902 |
| Corporate and eliminations | - | - | (512) | 645 | - |
| Consolidated | $ 59,061 | $ 35,757 | $ 1,547 | $ 1,497 | $ 902 |
| | | | | | |
| Quarter Ended June 2, 2007 | | | | | |
| Consumer Solutions Business Unit: | | | | | |
| Retail | $ 10,010 | $ 5,706 | $ (715) | $ 169 | $ - |
| Consumer direct | 7,890 | 4,561 | 2,522 | 66 | - |
| Wholesale | 6,901 | 3,851 | 3,704 | - | - |
| CSBU International | 1,125 | 628 | (176) | - | - |
| Other CSBU | 1,523 | 281 | (4,765) | 190 | - |
| Total CSBU | 27,449 | 15,027 | 570 | 425 | - |
| | | | | | |
| Organizational Solutions Business Unit: | | | | | |
| Domestic | 23,143 | 15,078 | 2,706 | 185 | 899 |
| International | 13,917 | 9,531 | 3,375 | 215 | 7 |
| Total OSBU | 37,060 | 24,609 | 6,081 | 400 | 906 |
| Total operating segments | 64,509 | 39,636 | 6,651 | 825 | 906 |
| Corporate and eliminations | - | - | (2,302) | 235 | - |
| Consolidated | $ 64,509 | $ 39,636 | $ 4,349 | $ 1,060 | $ 906 |

| Three Quarters Ended May 31, 2008 | Sales to External Customers | Gross Profit | EBITDA | Depreciation | Amortization |
|---|---|---|---|---|---|
| Consumer Solutions Business Unit: | | | | | |
| Retail | $ 38,659 | $ 23,416 | $ 2,930 | $ 697 | $ - |
| Consumer direct | 35,335 | 20,836 | 13,588 | 233 | - |
| Wholesale | 12,227 | 6,707 | 6,282 | - | - |
| CSBU International | 6,692 | 3,543 | 1,223 | 39 | - |
| Other CSBU | 3,721 | 432 | (17,626) | 464 | - |
| Total CSBU | 96,634 | 54,934 | 6,397 | 1,433 | - |
| | | | | | |
| Organizational Solutions Business Unit: | | | | | |
| Domestic | 66,436 | 41,511 | 1,844 | 1,076 | 2,697 |
| International | 44,693 | 31,946 | 13,385 | 414 | 5 |
| Total OSBU | 111,129 | 73,457 | 15,229 | 1,490 | 2,702 |
| Total operating segments | 207,763 | 128,391 | 21,626 | 2,923 | 2,702 |
| Corporate and eliminations | - | - | (3,869) | 1,121 | - |
| Consolidated | $ 207,763 | $ 128,391 | $ 17,757 | $ 4,044 | $ 2,702 |
| | | | | | |
| Three Quarters Ended | | | | | |

| June 2, 2007 | | | | | |
|---|---|---|---|---|---|
| Consumer Solutions Business Unit: | | | | | |
| Retail | $ 43,402 | $ 25,966 | $ 5,195 | $ 546 | $ - |
| Consumer direct | 38,674 | 22,792 | 15,630 | 154 | - |
| Wholesale | 15,059 | 8,561 | 8,114 | - | - |
| CSBU International | 6,153 | 3,721 | 1,020 | - | - |
| Other CSBU | 4,360 | 394 | (17,425) | 963 | - |
| Total CSBU | 107,648 | 61,434 | 12,534 | 1,663 | - |
| | | | | | |
| Organizational Solutions Business Unit: | | | | | |
| Domestic | 66,432 | 42,848 | 5,999 | 453 | 2,701 |
| International | 42,834 | 28,941 | 9,592 | 625 | 7 |
| Total OSBU | 109,266 | 71,789 | 15,591 | 1,078 | 2,708 |
| Total operating segments | 216,914 | 133,223 | 28,125 | 2,741 | 2,708 |
| Corporate and eliminations | - | - | (7,705) | 722 | - |
| Consolidated | $ 216,914 | $ 133,223 | $ 20,420 | $ 3,463 | $ 2,708 |

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

| | Quarter Ended | | Three Quarters Ended | |
|---|---|---|---|---|
| | May 31, 2008 | June 2, 2007 | May 31, 2008 | June 2, 2007 |
| Reportable segment EBITDA | $ 2,059 | $ 6,651 | $ 21,626 | $ 28,125 |
| Corporate expenses | (512) | (2,302) | (3,869) | (7,705) |
| Consolidated EBITDA | 1,547 | 4,349 | 17,757 | 20,420 |
| Gain on sale of manufacturing facility | - | - | - | 1,227 |
| Depreciation | (1,497) | (1,060) | (4,044) | (3,463) |
| Amortization | (902) | (906) | (2,702) | (2,708) |
| Income (loss) from operations | (852) | 2,383 | 11,011 | 15,476 |
| Interest income | 55 | 124 | 78 | 682 |
| Interest expense | (725) | (867) | (2,396) | (2,203) |
| Income (loss) before provision for income taxes | $ (1,522) | $ 1,640 | $ 8,693 | $ 13,955 |

The cumulative adjustments resulting from revisions to share-based compensation awards described in Note 4 are included in corporate expenses in the above tables.

NOTE 9 – LICENSE AGREEMENT SETTLEMENT

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 alleges 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 has denied liability in the patent infringement and has filed certain counter-claims related to the case since the filing of the action in District Court. However, during the quarter ended May 31, 2008, the Company 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 are released from further action regarding these patents.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIALCONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based upon management's current expectations and are subject to various uncertainties and changes in circumstances. Important factors that could cause actual results to differ materially from those described in forward-looking statements are set forth below under the heading "Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995."

The Company suggests that the following discussion and analysis be read in conjunction with the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended August 31, 2007.

RESULTS OF OPERATIONS

Overview

During the quarter ended May 31, 2008, we announced that we had entered into a definitive agreement 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 (CSBU) and will focus on expanding sales of Franklin Covey products pursuant to a comprehensive license agreement. The CSBU is primarily responsible for sales of our products to both domestic and international consumers through a variety of channels. Subsequent to May 31, 2008, we completed the sale of the CSBU assets to Franklin Covey Products, which becomes effective during our fiscal quarter ended August 31, 2008. Franklin Covey Products, which is controlled by Peterson Partners, purchased the CSBU assets for $32.0 million in cash, subject to adjustments for working capital on the closing date of the sale. On the closing date of the sale, we invested $1.8 million to purchase a 19.5 percent voting interest in Franklin Covey Products, made a $1.0 million preferred capital contribution with a 10 percent priority return, and have the opportunity to earn contingent license fees if Franklin Covey Products achieves specified performance objectives. As a result of the sale of the CSBU assets, certain forward-looking statements made in this management's discussion and analysis will be materially affected by the completion of the sale, the elimination of CSBU operating results in future periods, and the accounting for our investment in Franklin Covey Products.

Our third fiscal quarter, which includes the months of March, April, and May, has historically reflected stronger training and consulting sales, but seasonally weaker product sales when compared to our first two fiscal quarters. For the quarter ended May 31, 2008, our income from operations decreased to a $0.9 million operating loss compared to $2.4 million in operating income in the prior year. Our income (loss) before taxes also declined compared to the prior year and was a loss of $1.5 million compared to $1.6 million of income for the same period of fiscal 2007 and our net income (loss) available to common shareholders decreased to a $1.5 million loss compared to $0.5 million of income in the corresponding quarter of the prior year.

The primary factors that influenced our operating results during the quarter ended May 31, 2008 were as follows:

- Sales – Our consolidated sales declined $5.4 million, which was the result of a $5.7 million decrease in product sales that was partially offset by a slight increase in training and consulting services sales. Product sales declined primarily due to reduced retail sales, consumer direct sales, and wholesale sales compared to the prior year. We

believe that declining product sales were also impacted by weakening economic conditions, especially in the United States. Training and consulting services sales increased despite the unfavorable impact of the sales and conversions of our Brazil and Mexico offices to licensee operations.

- Gross Profit – Our consolidated gross profit totaled $35.8 million for the quarter ended May 31, 2008 compared to $39.6 million for the same quarter in fiscal 2007. The decrease was primarily due to decreased product sales during fiscal 2008 compared to the prior year. Our consolidated gross margin, which is gross profit stated in terms of a percentage of sales, decreased to 60.5 percent of sales compared to 61.4 percent in fiscal 2007. The decrease in gross margin percentage was primarily attributable to lower gross margins on our training and consulting sales. However, the impact of decreased training and consulting gross margins was partially offset by the continued shift toward increased training and consulting sales as a percent of total sales since training and consulting sales generally have higher gross margins than our product sales. Training and consulting service sales increased to 57 percent of total sales in the quarter ended May 31, 2008 compared to 52 percent in the same quarter of the prior year.

- Operating Costs – Our operating costs decreased by $0.6 million compared to the prior year, which was the result of a $1.1 million decrease in selling, general, and administrative expenses and a $0.4 million increase in depreciation expense. Amortization expense from our definite-lived intangible assets did not differ appreciably from the prior year.

Further details regarding these factors and their impact on our operating results and liquidity are provided throughout the following management's discussion and analysis.

Quarter Ended May 31, 2008 Compared to the Quarter Ended June 2, 2007

Sales

The following table sets forth sales data by category and for our operating segments (in thousands):

| | Quarter Ended | | | Three Quarters Ended | | |
|---|---|---|---|---|---|---|
| | May 31, 2008 | June 2, 2007 | Percent Change | May 31, 2008 | June 2, 2007 | Percent Change |
| Sales by Category: | | | | | | |
| Products | $ 25,197 | $ 30,857 | (18) | $ 105,872 | $ 118,248 | (10) |
| Training and consulting services | 33,864 | 33,652 | 1 | 101,891 | 98,666 | 3 |
| | $ 59,061 | $ 64,509 | (8) | $ 207,763 | $ 216,914 | (4) |
| | | | | | | |
| Consumer Solutions Business Unit: | | | | | | |
| Retail Stores | $ 7,896 | $ 10,010 | (21) | $ 38,659 | $ 43,402 | (11) |
| Consumer Direct | 6,949 | 7,890 | (12) | 35,335 | 38,674 | (9) |
| Wholesale | 5,046 | 6,901 | (27) | 12,227 | 15,059 | (19) |
| CSBU International | 1,119 | 1,125 | (1) | 6,692 | 6,153 | 9 |
| Other CSBU | 1,280 | 1,523 | (16) | 3,721 | 4,360 | (15) |
| | 22,290 | 27,449 | (19) | 96,634 | 107,648 | (10) |
| Organizational Solutions Business Unit: | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Domestic | 23,111 | 23,143 | - | 66,436 | 66,432 | - |
| International | 13,660 | 13,917 | (2) | 44,693 | 42,834 | 4 |
| | 36,771 | 37,060 | (1) | 111,129 | 109,266 | 2 |
| Total Sales | $ 59,061 | $ 64,509 | (8) | $ 207,763 | $ 216,914 | (4) |

Product Sales – Consolidated product sales, which primarily consist of planners, binders, totes, software and related accessories that are primarily sold through our CSBU channels, declined $5.7 million compared to the prior year. The decline in overall product sales during the quarter ended May 31, 2008 was primarily due to the following performance in our CSBU delivery channels:

- Retail Stores – The decline in retail sales was primarily due to reduced traffic in our retail locations, which was partially due to a significant increase in the number of wholesale outlets that sell our products and compete directly against Company-owned retail stores, reduced demand for technology and related products, and fewer store locations, which had a $0.9 million impact on retail sales. Our retail store traffic, or the number of consumers entering our retail locations, declined by approximately 19 percent on a comparable basis (for stores which were open during the comparable periods) compared to the third quarter of fiscal 2007 and resulted in decreased sales of "core" products (e.g. planners, binders, totes, and accessories). Due to declining demand for electronic handheld planning products, during late fiscal 2007 we decided to exit the low-margin handheld device and related electronics accessories business, which reduced retail sales by $0.3 million compared to the prior year. These factors combined to produce a 10 percent decline in year-over-year comparable store sales versus the prior year. We closed 4 retail locations during the quarter ended May 31, 2008 and were operating 73 domestic retail locations at May 31, 2008 compared to 87 locations at June 2, 2007.

- Consumer Direct – Sales through our consumer direct channels (primarily eCommerce and call center) decreased $0.9 million, primarily due to a decline in the number of customers visiting our website and a decline in the number of orders that are being processed through the call center. Visits to our website decreased from the prior year by approximately 15 percent. Declining consumer orders through the call center continues a long-term trend and decreased by approximately 18 percent compared to the prior year, which we believe is partially the result of a transition of customers to our other product channels.

- Wholesale – Sales through our wholesale channel, which includes sales to office superstores and other retail chains, decreased $1.9 million primarily due to the transition of a portion of our wholesale business to a new distributor and the timing of sales as the new distributor builds inventories.

- CSBU International – This channel includes the product sales of our directly owned international offices in Canada, the United Kingdom, Mexico, and Australia. Product sales remained flat through these channels compared to the prior year.

- Other CSBU – Other CSBU sales consist primarily of domestic printing and publishing sales and building sublease revenues. The decrease in other CSBU sales was primarily due to a $0.2 million decrease in external printing sales compared to the prior year. The decrease in printing sales was primarily due to reduced demand for these products.

Following completion of the sale of our CSBU assets to Franklin Covey Products, we expect that our product sales will decline sharply as the majority of sales reported through the above channels are transitioned to Franklin Covey Products beginning in the quarter ended August 31, 2008.

Training and Consulting Services – We offer a variety of training courses, training related products, and consulting services focused on leadership, productivity, strategy execution, sales force performance, and effective communications that are provided both domestically and internationally through the Organizational Solutions Business Unit (OSBU). Our consolidated training and consulting service sales increased by $0.2 million compared to the prior year, and were significantly impacted by the sales and transitions of our offices in Brazil and Mexico to licensees, which decreased sales by $1.3 million compared to the prior year. On a comparable basis, which excludes the impact of Brazil and Mexico direct office sales in fiscal 2007, our training and consulting sales increased by 5 percent when compared to fiscal 2007. Training and consulting service sales performance during the quarter ended May 31, 2008 was primarily influenced by the following factors in our OSBU divisions:

- Domestic – Our domestic division includes sales from our five geographic and two vertical direct sales offices, public programs, the sales performance group, book and audio channels, and various other sources. Our domestic division sales were flat compared to the prior year. Increased sales from 5 of our 7 direct sales offices and certain specialized events were offset by decreased sales in 2 of our direct offices, lower sales from our sales performance group, and our public program and media channels. The relatively flat domestic sales performance during the quarter was reflective of the successful launch of the Company's new leadership offering during the second quarter of fiscal 2007, which also had a favorable impact on domestic training and consulting sales during the third quarter of fiscal 2007.

Sales in our 5 geographical regions and 2 vertical market direct offices are comprised of sales from our core product offerings, which includes The Seven Habits of Highly Effective People, Leadership: Great Leaders, Great Teams, Great Results, and The 4 Disciplines of Execution programs. Our client-led facilitator training sales increased 7 percent compared to the prior year even though the prior year facilitator sales were favorably impacted by the release of our new leadership offerings. However, increased facilitator sales were offset by decreased consultant-led programs. During mid-April, the Company experienced a softening in our booking pace that has lasted through the remainder of the quarter ended May 31, 2008. As a result, the number of domestic onsite program days delivered in the quarter decreased by 11 percent compared to fiscal 2007.

- International – International sales decreased $0.3 million compared to the same quarter of fiscal 2007 primarily as a result of the elimination of sales from our wholly owned offices in Brazil and Mexico. We sold these operations to external licensees during fiscal 2007 and we now receive royalty revenue from their operations based upon gross sales. The conversion of these operations to licensees had a $1.3 million unfavorable impact on our international sales, but the conversion of these entities improved our income from their operations during the quarter. Sales increased 11 percent over the prior year at our directly owned offices and from foreign licensee royalty revenues. The translation of foreign sales to United States dollars resulted in a $1.1 million favorable impact to our consolidated sales as foreign currencies strengthened against the United States dollar during the quarter ended May 31, 2008.

We do not expect the sale of CSBU assets to Franklin Covey Products to have a material impact on our OSBU sales in future periods.

Gross Profit

Gross profit consists of net sales less the cost of goods sold or the cost of services provided. Our consolidated gross profit totaled $35.8 million for the quarter ended May 31, 2008 compared to $39.6 million in fiscal 2007. The decrease in gross profit was primarily due to decreased product sales during fiscal 2008 compared to the same quarter of the prior year. Our consolidated gross margin, which is gross profit stated in terms of a percentage of sales, decreased slightly to 60.5 percent of sales compared to 61.4 percent in fiscal 2007. The decrease in gross margin percentage was primarily attributable to lower margins on our training and consulting sales, which was partially offset by the continuing shift toward increased training and consulting sales, which generally have higher margins than our product sales. Training and consulting service sales increased to 57 percent of total sales in the quarter ended May 31, 2008 compared to 52 percent in the same quarter of fiscal 2007.

Our gross margin on product sales remained relatively consistent at 52.8 percent of sales compared to 52.6 percent in fiscal 2007.

For the quarter ended May 31, 2008, our training and consulting services gross margin decreased to 66.3 percent compared to 69.5 percent in the prior year. The decline in gross margin was primarily attributable to increased amortization of capitalized development costs and increased sales of low-margin specialized seminar events.

Following the sale of the CSBU assets, we anticipate that our consolidated gross profit will decline as the majority of our product sales are transitioned to Franklin Covey products. However, we anticipate that our overall gross margin will improve to a percentage closer to the current OSBU gross margin.

Operating Expenses

Selling, General and Administrative – Our selling, general, and administrative (SG&A) expenses decreased by $1.1 million, or 3 percent, compared to the prior year. The decrease in our consolidated SG&A expenses was primarily due to 1) the sales and conversions of our Brazil and Mexico offices to licensee operations, which reduced SG&A expenses by $1.0 million; 2) a $0.7 million decrease in share-based compensation expense that was primarily due to the determination that no shares will be awarded under our fiscal 2007 long-term incentive plan and the corresponding reversal of accumulated share-based compensation expense related to that plan; and 3) decreased rent and utility expe