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BLKB.OQ - Q3 2022 Blackbaud Inc Earnings Call

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PRESENTATION

Operator

Good day, and welcome to Blackbaud's Q3 2022 Earnings Call. Today's conference is being recorded. I'll now turn the conference over to Steve Hufford. Please go ahead, sir.

Steve Hufford - *Blackbaud, Inc. - Director of IR*

Good morning, everyone. Thank you for joining us on Blackbaud's Third Quarter 2022 Earnings Call. Joining me on the call today are Mike Gianoni, Blackbaud's President and CEO; and Tony Boor, Blackbaud's Executive Vice President and CFO. Mike and Tony will make prepared comments, and then we will open up the line for your questions.

Please note that our comments today contain forward-looking statements subject to risks and uncertainties that could cause actual results to differ materially from those projected. Please refer to our most recent Form 10-K and other SEC filings for more information on those risks.

We believe that a combination of both GAAP and non-GAAP measures are more representative of how we internally measure our business. Unless otherwise specified, we will refer only to non-GAAP measures on this call.

Please note that non-GAAP financial measures should not be considered in isolation from or as a substitution for GAAP measures. A reconciliation of GAAP and non-GAAP results is available in the press release we issued last night, and a more detailed supplemental schedule is available in our presentation on our Investor Relations website. With that, I'll turn the call over to you, Mike.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Thanks, Steve. Good morning, everyone, and thank you for joining us on the call today. I'll open the call by saying we had a very strong quarter. We now expect to meet or exceed our financial guidance for the year which increases our 28% Rule of 40 performance expectation to roughly 29% on a constant currency basis. And next year, we anticipate a step-level acceleration in Rule of 40 performance into the mid-30s based on actions we've already taken and initiatives in place to drive both growth and profitability.

Turning to the quarter. We had total revenue growth of 13%, and our organic recurring revenue at constant currency continues to trend consistently in the mid-single digits, growing 5% in the quarter. Year-to-date, our organic revenue growth at constant currency also stands at roughly 5%, and our adjusted EBITDA margin was roughly 25% at constant currency. Combined, we've achieved 30% on Rule of 40 through the first three quarters

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of the year, which leaves us very well positioned with only one quarter to go in the year. We remain confident in the resilience of our end markets, underpinned by some recent wins, continued strength in customer renewals and several pricing initiatives underway, which I will touch on shortly. And we're expecting to meet or exceed our financial guidance for the year and carry that momentum into 2023, which Tony will cover in more detail.

Next year, we're targeting the mid-30s on Rule of 40 at constant currency through a combination of mid-single-digit organic revenue growth and an adjusted EBITDA margin approaching 29%. On the top line, the underlying trends in the business suggest mid-single-digit organic revenue growth as a solid baseline. We're also layering in several multi-year pricing initiatives, which are already underway and should provide additional revenue durability. And the continued advancements in our product innovation, sales productivity and customer success programs provide further upside into the high single digits as we approach 2025. I'll note, pricing has a double benefit on Rule 40 as much of the revenue upside follows through to profit as well.

Turning to profitability. We have very high visibility into step-level margin expansion in 2023, including a more intensified focus on pricing initiatives, the continued scaling of our infrastructure costs as well as actions to rebalance our workforce and reduce overhead. We've taken several prudent steps this year to better align our workforce to strategic priorities, including the elimination of open positions as well as the difficult decision to reduce our workforce last week. And given these actions have already been executed in 2022, we've significantly reduced the run rate of our operating structure entering 2023, which we expect to add several points of margin improvement on a go-forward basis. So while we intend to provide our full year 2023 financial guidance on our Q4 call in February, as is our normal practice, the key point here is that we have high visibility towards accelerated Rule of 40 performance next year based on a combination of actions taken and initiatives in place that are well within our control to manage. And, the multi-year nature of these initiatives provides future upside towards achieving Rule of 40 by the end of 2025.

To provide some further context on pricing, it wasn't until recently that we institutionalized price management at Blackbaud. We now have a dedicated team and steering committee with executive sponsorship, and we are seeing the impact of early pricing initiatives taking effect. Most recently, we announced the general availability of Complete Cover and donor cover for Raiser's Edge NXT and eTapestry customers in the U.S. and Canada. As a reminder, donor cover is widely available in the market and give supporters a simple yes or no option to cover costs for their specific online transaction. And, Complete Cover is the new pricing model that is unique to Blackbaud in that we cover the organization's cost of processing and supporters can choose at checkout to contribute toward enabling and processing the transaction.

This pricing model is very successful in our Just Giving business and something we have been testing here in the U.S. for a while now. These new offerings drive both increased revenue growth for us and reduce costs for our customers. Also, our customers are already seeing the benefit. One customer, Manchester University in Indiana, has raised thousands in additional fundraising dollars after adopting Complete Cover, which means more financial assistance for their students. It's a fantastic model change for our customers. What's important to take away from our price management efforts is that it's new to our model, multi-year in nature, benefits both growth and profit, and we have several initiatives at play. Some simply catch us up to competitive pricing and practices, while others are model changes that drive greater revenue for both Blackbaud and for our customers, which is a win-win, and we expect to see a high level of adoption.

Now shifting to a few recent operational highlights. We continue to make strides in delighting our customers with innovative cloud solutions. Two weeks ago, we hosted our annual conference, bbcon, that was again offered virtually and free to thousands of customers and prospective customers that attended. We also held our product update briefings that covered recent product updates and future road maps.

During the conference, we shared how our purpose-built solutions bring together the capabilities essential to our customers in managing their data, making their teams more productive, motivating their audience to act and ultimately driving outcomes. For example, the National Parks Foundation is connecting data across the organization to create insights and visualizations that are available at a moment's notice without manual intervention. Or the University of North Carolina at Chapel Hill, where the implementation of Blackbaud CRM provided new levels of transparency and allow them to focus in on key metrics and establish growth plans, resulting in annual fundraising going from less than $300 million a year to nearly $800 million in their last fiscal year, a 2.5-fold increase. I'm excited about the outcomes we're driving for our customers and their supporters.

We also continue helping our corporate customers create impact to our EVERFI platform. In September, we announced our partnership with the Center for Audit Quality on a new accounting education initiative for high school students to attract greater diversity and representation in the

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profession. We also renewed our partnership with the NFL on their national school sponsorship of the Character Playbook course powered by EVERFI. To date, over 12,000 schools have activated the course and we reached over 1.5 million students. And HCA Healthcare expanded their partnership with EVERFI to extend their sponsorship of the EVERFI Understanding Mental Wellness course across California, North Carolina, and Virginia high schools. These are all substantial enterprise-size ARR deals for us.

Shifting to recent acquisitions and divestitures, we acquired Kilter in August, which was not material to our near-term financials, but is a big deal for many of our customers. Kilter is an intuitive, gamified activity-based engagement app, and we will initially leverage filter with Blackbaud Team Raiser to serve nonprofits by expanding the way they can engage with their supporters to prepare for their existing fundraising walks, runs and rides and it creates totally new types of engagement opportunities that aren't tied to a specific date or place. Kilter will also provide a unique solution with YourCause CSRconnect platform for companies as employers take a more active role in supporting their employees' health and wellness pursuits across remote and distributed workforces. We also divested our FIMS and DonorCentral NXT products to our channel partner, NPact in the quarter, which are fairly immaterial products for us and simply the result of our continued efforts around portfolio optimization.

Lastly, before I turn the call to Tony, I'd like to briefly remind you of our view on Blackbaud's positioning against a few macro factors. First, we continue to stay focused on our people and culture and we clearly remain a sought-out destination for employment, having recently been named the Quartz's ranking of the Best Companies for Remote Workers in 2022. We limited some of our exposure to rising interest rates while we refinanced our debt in 2020 and took advantage of the low interest rate environment. On the topic of inflation and the potential recession, our company and our market have proven to be resilient in past downturns, including the pandemic. This was the ultimate test for us and our customers. From a currency perspective, our exposure is limited given the size of our international footprint, and we have some hedging in place. Our strong year-to-date results and outlook clearly demonstrate the durability of our revenue and scalability in our operating model in the current macro environment.

In summary, we had a very solid third quarter and expect to meet or modestly exceed our guidance for the full year. We're positioned to achieve a Rule of 40 in the mid-30s at constant currency next year, which is a step-level improvement over our 2022 expectation of roughly 29%. And we remain confident in our outlook with plans in place to deliver significant, enhanced shareholder value. With that, I'll turn the call over to Tony before we open it up for Q&A. Tony?

Anthony W. Boor - *Blackbaud, Inc. - Executive VP of Finance & Administration and CFO*

Thanks, Mike. Good morning, everyone. Today, I'll cover our results for the third quarter and review our outlook for the remainder of the year before opening up the line for questions. Please refer to yesterday's press release and the investor materials posted to our website for the full details of our Q3 2022 financial performance.

We had another strong quarter, leaving us well positioned as we head into the final quarter of the year. Third quarter total revenue was $261 million, representing total revenue growth of 13% versus prior year. Organic revenue growth for the quarter at constant currency was roughly 4% after adjusting for foreign currency impacts of approximately $5 million. Organic recurring revenue at constant currency grew 5% in the quarter. Our customer renewal rates continue to improve and we're seeing a continued shift towards multi-year contract terms. Also, early pricing initiatives associated with our contractual revenue continued to gain traction, which is a very positive combination. Transactional revenue growth was positive despite the tough compare versus the third quarter of last year. This growth is supported by a continued shift in giving towards online donations, and we continue to make headway on our pricing initiatives like our two fee cover models that Mike shared earlier, that have the potential to be very positive tailwinds for our payments revenue going forward. One-time Services & Other revenue was a 110 basis point drag on our total revenue growth in the quarter, and as we anticipated, declined 6% year-over-year.

Moving to earnings, our third quarter gross margin was 60%. We generated adjusted EBITDA of $67 million, representing an adjusted EBITDA margin of 25.6% and diluted earnings per share of $0.69. Our year-to-date adjusted EBITDA margin of 24.9% is above our original expectation of 24% to 24.5%, which reflects the early benefits we are seeing from some of the cost actions taken in Q3, including slowing our pace of hiring and eliminating open roles. We continue to make progress on our margin initiatives like pricing, scaling infrastructure costs and better aligning our resources to key strategic priorities, resulting in an improved operating structure.

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That brings me to the cash flow statement and balance sheet. Our adjusted free cash flow was $94 million in the third quarter and represented an adjusted free cash flow margin of approximately 36%, largely driven by the timing of our cash collections pulling into Q3 from Q4, paired with the fact that we had our highest collection rate in company history. Year-to-date, we generated adjusted free cash flow of $146 million, which exceeds the midpoint of our full year guidance range. We ended the quarter with $823 million in net debt with an additional $327 million of borrowing capacity. Through Q3, we've reduced our debt-to-EBITDA ratio to 3.1x and we remain focused on rapidly deleveraging in the near term. Also in the quarter, we put hedges in place to minimize foreign exchange impact versus the Canadian dollar and the British pound. And we recorded approximately $5 million in aggregate liabilities for certain loss contingencies related to the security incident that we believe we can now reasonably estimate. Though there are other security incident-related items, for which we have not recorded a liability as we're unable to reasonably estimate the possible loss at this time. For more information, please refer to yesterday's press release and our upcoming 10-Q, which will be available in coming days.

Turning to our outlook for 2022 from a revenue perspective, we believe we will end the year at or slightly above the midpoint of our guidance range of $1.05 billion to $1.07 billion despite further unfavorable movements in foreign exchange rates, continued softness in EVERFI bookings as well as our recent divestitures. To date, we've recorded roughly $9 million in negative FX impacts to revenue with further declines in FX rates expected in the fourth quarter. I'll remind you, we could see some additional variability depending on Q4 transactional revenue performance as the fourth quarter tends to be our seasonal high for payments revenue with year-end giving. And while year-to-date EVERFI bookings have been lighter than expected, we've taken decisive action to bolster management and to fill sales account executive vacancies which are now fully staffed and ramping to drive future bookings and in turn, revenue growth going forward.

Shifting to profitability. We now expect to modestly exceed the top end of our full year guidance range for adjusted EBITDA margin of 23.7% to 24.2% or 24% to 24.5% when excluding roughly 30 basis points of currency impacts. This improved expectation is driven by the acceleration of our cost actions we are taking in the back half of this year. We also continue to make progress in our efforts to drive efficiencies in our go-to-market and to create additional scalability in our products and infrastructure.

Turning to the Rule of 40 and with high visibility for the remainder of the year, we now anticipate achieving roughly 29% for the full year at constant currency. And as we look ahead to 2023, our early views call for mid-single-digit revenue growth and an adjusted EBITDA margin approaching 29% on a constant currency basis. We have very good line of sight to step-level EBITDA margin improvement next year, given the recent reduction in our workforce and the elimination of open positions. We expect the cost actions we've already taken and those underway will reduce our planned future cost run rate by approximately $40 million to $50 million, with some offsets to fund investments in areas like cybersecurity and innovation. And we see further opportunity in 2023 and beyond to scale our infrastructure costs, reduce overhead and execute pricing initiatives with much of that upside falling through to margin.

Lastly, moving to cash flow. We anticipate coming in at the high end or modestly above our adjusted free cash flow range of $140 million to $150 million for the full year. As I mentioned earlier, we stand at $146 million year-to-date due to strong Q3 performance, which included a substantial pull forward of cash collections from Q4. Our full year expectations also include incurring between $6 million and $8 million in pre-tax employee severance costs that weren't previously contemplated in guidance as a result of our targeted workforce reduction. We also experienced a shift in cash tax payments from Q3 to Q4 and lighter than expected collections from EVERFI bookings.

And as a reminder, our guidance for adjusted free cash flow excludes cash to be spent net of insurance reimbursements related to ongoing litigation of our previously disclosed security incident. Our most recent expectation for the year is a net cash outlay of $15 million to $25 million for ongoing legal fees related to the security incident.

In summary, we had a solid third quarter achieving 30% on a Rule of 40 at constant currency. Our strong execution against our strategic initiatives, spanning across revenue, profitability and cash leaves us well positioned to meet or modestly exceed our full year 2022 guidance. And as we look ahead to 2023, we have high visibility to achieve the mid-30s on a Rule of 40, which is substantial year-over-year performance acceleration.

With that, I'd like to open up the line for your questions.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of (inaudible)

Jeffrey Parker Lane - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

Thinking about the workforce reduction that you talked about what roles were most impacted or what areas of the business you trimmed the most in response to that. And then two, looking at that 500 basis point step-up in adjusted EBITDA for next year, should we expect that the workforce rebalance and reduction is going to have the largest impact on you achieving that 500 basis point improvement.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. I didn't catch the first -- there's some feedback. I didn't catch the first part of your question. The second part -- this is Mike, by the way. The second part, the answer is yes, and we've already completed those cost reductions. We'll also see some impact, though, on things like improved sales productivity and several pricing initiatives underway. But the cost reductions will have a significant impact to the second part of your question. I'm sorry, I didn't hear the first part of your question. Can you repeat that?

Jeffrey Parker Lane - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

Yes. The first part was really just focused on what areas are being impacted the most by the workforce rebalance either sides of the business or particular types of roles.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. Not one area in particular, actually. We had both workforce reduction and elimination on some future open positions as well. So we're just remaining conservative on the cost side of the business, but no one particular area stood out on that list.

Jeffrey Parker Lane - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

Got it. And then maybe one quick follow-up on EVERFI, you talked about the resiliency of the business through COVID and through the financial crisis back in '08, '09. EVERFI, obviously a newer asset to the company. How much resiliency do you see in that business in particular? And when it comes to the lighter bookings, is some of that just the result of sales turnover or lower execution rates right now that will soon improve? Can you provide a little more context there?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes, sure. We see that the business is a recurring revenue model business like the rest Blackbaud. There's a lot of resiliency there with the customer base and the revenue line. The slow start to sales, there's a couple of things that we've mentioned previously. One is sales turnover, higher than expected in the beginning of the year. We're now fully staffed by the way. And secondly, we had a couple of enterprise deals coming into the year in the digital currency space that basically went away, given what's happened in that marketplace. So some of those larger deals didn't happen that we expected to happen in the beginning of the year. But we're fully staffed in closing some nice deals, as I mentioned in my prepared remarks.

Operator

Our next question comes from the line of Matt VanVliet with BTIG.

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Matthew David VanVliet - *BTIG, LLC, Research Division - VP & Application Software Analyst*

I wonder kind of if we could get an update in terms of the Church Management product, how that's progressing? And what other areas of that product do you expect to sort of expand on in the coming years, and where you'll have sort of the most success landing some of those new deals?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes, Matt, I'll take that. It's Mike again. So in that faith-based marketplace, we're still selling in there, we've got a product portfolio of things that we've been selling over the years. The Church Management, in particular, has not really gone that well. So that product line was a bit of a struggle. So we've looked to get a partner in that space. We're pretty strong in payments and fundraising and financials in that space. And we're also cross-selling our K-12 platform into the faith-based school systems, but the core Church product that we had brought to market and developed in its early stage a couple of years ago, we've really walked away from that core market and have looked to add partners and focus back on our core solutions there.

Matthew David VanVliet - *BTIG, LLC, Research Division - VP & Application Software Analyst*

Got it. And then looking at the K-12 market or maybe the education market in general, is that proving to be a little more countercyclical? Or are you having success there? Or are you running into some longer sales cycles, much like we're seeing in other areas of the business?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. No, the K-12 markets doing fine. We've got a big presence in that market, and we're doing well in the market. We've got a really strong portfolio that covers almost all of the IT spend in those schools. We continue to sell great products there. There's still a lot of cross-sell opportunity there as well. Given the product portfolio, we typically will sell a couple of products upfront and then we can come back and add modules, whether it's in the school platform or tuition management, or fundraising or the financials and in fact, tuition management has been really strong year-to-date this year.

Operator

Our next question comes from the line of Kirk Materne with Evercore ISI.

Peter John Burkly - *Evercore ISI Institutional Equities, Research Division - Research Analyst*

This is actually Peter Burkly on for Kirk. Mike, maybe if I can just start by asking one to you. You talked about the pricing a little bit. I'm just curious, are these pricing actions largely on the transactional side of the business? Or are there opportunities related to pricing on the subscription side as well?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes, Peter, it's both actually. And there's a whole slew of these that are underway. We've talked about these. And our investor get kind of laid some of these out. There's a whole bunch of tracks of work going on here related to pricing on the subscription side and transaction and new products, like I talked about in my prepared remarks, the two products I mentioned, donor cover and Complete Cover. So you could think of it in terms of opportunities on subscription, transactions and a couple of new products as well. And these will be rolling out going forward in '23 most significantly than we have in the past and over the next 2 - 3 years also. So some will happen in '24 and '25, but we'll really see it ramp up in '23.

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Peter John Burkly - *Evercore ISI Institutional Equities, Research Division - Research Analyst*

Okay. Tony, maybe just a quick one for you, and I appreciate the early look into '23 here. Just curious if there's any unique items that you'd call out from a cash flow growth perspective next year that we should be thinking about specifically just as it relates to EBITDA growth or if they should kind of flow together.

Anthony W. Boor - *Blackbaud, Inc. - Executive VP of Finance & Administration and CFO*

Yes. I think that the planned improvement in profitability should largely flow through to free cash flow. I wouldn't expect anything on the CapEx side to see any big surges there because we're moving more and more third-party cloud, so a lot less infrastructure investments we have to make CapEx wise. The one big wildcard probably outside of profitability on GAAP free cash flow versus our adjusted free cash flow that we're looking at now would just be where our security incident legal spend goes next year. It's very hard to predict what of those actions will get settled this year versus carry into next. That will probably be the one wild card on the regular free cash flow, than on the adjusted. I would say most all of that planned EBITDA improvement should fall through.

Operator

And our next question comes from the line of Brian Peterson with Raymond James.

Brian Christopher Peterson - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

So just first on the revenue outlook, we're getting that growth outlook maybe one quarter earlier than we typically get it. I'm just curious, what gives you the visibility to kind of guide to that at this point? And Mike, I'd love to hear what you're seeing on the macro. I know that this is a more resilient market than most people expect or anticipate, but I'd love to get any thoughts there.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes, sure. I'll take those. So, from a revenue growth standpoint, a couple of things. We're up nicely in sales productivity on the Blackbaud side EVERFI I have confidence it'll come back, but again, a slow start there. So sales productivity is going well on sort of core Blackbaud side. That's sort of one thing. Secondly, these pricing initiatives are under management control. Those will drive organic revenue growth and profitability. We kind of get a double on the Rule of 40, right, when you do that. And those are under management control. So we feel confident in executing those. So both of those are contributing to organic revenue growth. What was the other part of your question?

Brian Christopher Peterson - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Just on the macro environment and anything...

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. So we are a very resilient business. We went back and looked at our marketplace, our customers, donation trends, Blackbaud company performance back in kind of '07, '08. And the company grew through that, and we're a very different business now. First of all, we're much larger. And secondly, we're at 95% recurring revenue now. We were not back in '07 and '08.

So we're a more resilient business model now in times of tough macros than we were back then. The company did pretty well back then. So the customers are very resilient. The biggest test for our market was COVID. And, we did not see customers go out of business. We didn't see any of that. So we're quite well prepared for this inflationary period and any potential recessionary times that happen in front of us.

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And again, we look backwards and looking forward, I think we're in good shape related to that, really sticky customer base, our products are systems of record. They're not discretionary. So we feel pretty good about being a resilient business in this macro environment. We recapitalized the business and refinanced our debt in '20. So we have really good rates there. So we feel pretty good about that.

Brian Christopher Peterson - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Mike. And maybe just a follow-up, just if I think about the totality of all the pricing initiatives you have, in terms of the arc of those benefits, how big is 2023 in that evolution? I know you said it's a multi-year effort, but I would love to get your thoughts on how that will kind of fold into the model over time.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. We haven't broken those out specifically, but you'll see a step level change in '23 and then another one in '24 and somewhat more in '25. So -- but '23 will be a step-level change because of where we are and where we're going from a first initiation standpoint, if you will, on some of these. And a lot of these also are kind of market catch-ups, too. We're a little behind in a couple of areas. So it's not like we're going to be overextending ourselves, I think, from a pricing standpoint. But you'll see a step change in '23.

Operator

And our final question comes from the line of Patrick Schulz with Baird.

Patrick A. Schulz - *Robert W. Baird & Co. Incorporated, Research Division - Research Associate*

So really appreciate you guys providing additional color in 2023 for more organic revenue growth and operating margins. And you kind of alluded to that on the last question with the step-up function for margins. But should we be thinking about a step-up function for organic revenue growth, too? And what are your macro assumptions for '23 just regarding the macro environment? And I guess, in addition to that, too, as free cash flow improves, how should we be thinking about your top priorities of capital allocation, especially as your net leverage continues to come down?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. So for '23, we talked about getting to the mid-30s on a Rule of 40. We talked about EBITDA getting up to 29% or so, which is a pretty big change. So that kind of gives you a picture of what we're thinking around organic growth, frankly, confidence is high, as I mentioned, because of high renewals and customer retention, bookings performance and pricing initiatives. I also mentioned, too, those pricing initiatives have a multi-year effect. So they're compounding as well, just to mention that. So we feel pretty good about getting that earlier visibility into '23.

I think your second part was on CapEx. Tony mentioned that we're moving from our data centers to mostly Azure, but we have a pretty big footprint in AWS as well. So it's going to reduce our CapEx requirements going forward in the future. We're also -- we announced earlier this year, we closed one of our smaller data centers. We have plans to continue to do that, including next year as well. So that reduces requirements for CapEx, and it reduces our cost run rate as well.

Anthony W. Boor - *Blackbaud, Inc. - Executive VP of Finance & Administration and CFO*

And then Patrick, maybe I can just end this, Tony. From a capital allocation, obviously, that strong free cash flow would love to delever a bit more fully. So we're down to just over 3x. I think we're at 3.6 just post acquisition. We've taken nearly half a turn off the table. Our optimal debt level is somewhere around 1.8x to 2x leverage. So I'd like to deleverage. Obviously, we did the small acquisition with Kilter. So we're still in that acquisition market. We've done a couple of divestitures as well. And then obviously, the board reapproved or refilled the buyback pool. So we still have $250

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million. And obviously, that's something we'd look at lot more closely as we get debt paid down and have more liquidity available to us, especially at where today's kind of valuations are.

Patrick A. Schulz - *Robert W. Baird & Co. Incorporated, Research Division - Research Associate*

Very helpful. And then just one quick follow-up with the pricing initiatives. How have customers react to that? I know it's a multiyear product, but are you seeing any customer pushback against that?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

This is Mike. No, we have not. We've initiated some already in the past 18 months, nothing significant. But no, our retention and renewal rates are actually up nicely. So we're not seeing any negative effects of that.

Operator

And we have reached the end of the question-and-answer session. And I'll now turn the call back over to Mike Gianoni with closing remarks.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Thanks, everyone. I'll just close by saying that we had a really solid third quarter and expect to meet or modestly exceed our financial guidance for the full year this year, and we're positioned to achieve the Rule of 40 target in the mid-30s at constant currency next year which is a step-level improvement over our 2022 expectation of around 29%. We remain confident in our outlook with plans in place to deliver significant enhanced shareholder value. Tony and I look forward to updating you all on our next call. Thank you.

Operator

And this concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.

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