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PRESENTATION

Operator

Greetings, and welcome to the Blackbaud Second Quarter 2020 Earnings Call. (Operator Instructions) As a reminder, this conference is being recorded.

I'd now like to turn the conference over to your host, Mr. Mark Furlong, Senior Director, Corporate Finance and Investor Relations for Blackbaud. Thank you. You may begin.

Mark Furlong - *Blackbaud, Inc. - Director of IR*

Good morning, everyone. Thanks for joining us on Blackbaud's Second Quarter 2020 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'll 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 now available on our investor presentation on our Investor Relations website.

Before I turn the call over to Mike, I'll briefly cover our upcoming investor engagement activity, which is available on our Investor Relations website. During the third quarter, our team will be virtually attending the Oppenheimer 23rd Annual Technology, Internet & Communications Conference and Canaccord Genuity 40th Annual Growth Conference. We will also be participating in virtual meetings hosted by D.A. Davidson and Raymond James.

With that, I'll turn the call over to Mike.

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

Thanks, Mark. Good morning, everyone, and thanks for joining our call today. When the COVID-19 pandemic began, we moved quickly to respond and enacted plans to ensure business health, while prioritizing the welfare of our employees and continuing to be a strong partner for our customers. I'm incredibly proud of our employees and their dedication to serving our customers at a very high standard during these uncertain times.

Our second quarter results reflect strong execution against these plans with a heightened focus on driving profitability and cash flow given the duration and magnitude of the pandemic remains uncertain. Revenue for the quarter fell short of our original plan, though it exceeded our initial scenario planning from the start of the pandemic as our customers globally continued to demonstrate the often underappreciated resilience of this market during these challenging times. We are proud to support their efforts through reliable and highly effective technology, and we believe having cloud software in place to support the missions of social good organizations has never been more critical.

This morning, I will share a few updates related to our business and our market before turning it over to Tony to cover the financials in more detail. The transformational changes we've made in the business over the last several years allowed us to immediately switch to a virtual work environment in March and supported our global employees' ability to effectively work from home. With our physical offices across the world closed, we've experienced a new way of working. And I've been quite impressed by our ability to operate so effectively as a remote workforce.

As we think ahead, in anticipation of our offices reopening, we're reevaluating elements of our workforce strategy based on the lessons learned over the past few months. We are fairly committed to building on our strong culture by creating employee experiences and programs that further develop and attract the best talent and promote a diverse and inclusive environment. In fact, Blackbaud's workplace culture just received 2 national recognitions, being named to Forbes List of Best Employers for Women and Fast Company's Best Workplaces for Innovators list.

We continued to make progress in creating more inclusive diversity programs that are focused on education, awareness, recruitment, empowerment, community involvement and financial support. We also recognized that, now more than ever, the topic of equality needs a strong unified voice at Blackbaud. This is one of the reasons I'm excited we're in the process of hiring a Head of Diversity and Inclusion, reporting directly to our Chief People Officer, Maggie Driscoll, who you'll remember joined us earlier this year. This is the next step on our journey.

Turning to our customers. The impact of the virus continues to manifest itself in different ways across the vertical markets that we serve. During this difficult time, our solutions are supporting key nonprofits, higher education and health care institutions around the world with software technology needed to effectively fundraise and manage other core functions within their operations. We're proud to power fundraisers that directly fund critical research in essential equipment, including potential vaccine breakthroughs, low cost ventilator production and methods to treat the virus and slow its spread.

As the current environment continues to shape the landscape of education, we've been on the front line supporting private K-12 schools throughout the pandemic from quickly moving day-to-day activities online to planning for the future of the classroom. This was evident earlier this month at our Annual Tech Conference for K-12 private school leaders, which took place in a completely remote environment this year and was made free for all to attend. We welcomed over 5,000 registrants with thousands being first time attendees. That's a new record for us in both categories, as we typically have around 600 in attendance.

The timeliness of our competency-based education release was on display during the conference as the most attended sessions focused on Blackbaud Learning Management System and competency-based education best practices, as schools plan for distance learning and hybrid education models for the fall. I'll note registration is now open for our large event, bbcon 2020, which will also be virtual with no admission fee and will be held October 6th through the 8th with a reimagined global format.

In an effort to learn how the current environment has impacted churches, we partnered with an independent research group to conduct a survey of over 500 churches ranging in size from under 100 to more than 5,000 in pre-pandemic attendance. Of the churches surveyed, 2/3 of churches indicated that giving has increased or stayed the same during the pandemic, and more than 80% reported having adequate cash reserves set aside in preparation for a crisis.

Zoos, museums and other cultural organizations continue to be challenged with lost revenue from in-person attendance and events, although some of these organizations are beginning to open their doors, having made investments and updated policies and procedures to promote the health and safety of the visitors. Blackbaud plays a critical role in solving these challenges, often serving as a core system of record as these organizations rely even more on technology and cloud solutions to run their operations. The need for our systems to run core operations is a key driver of our 92% customer retention rate and renewal rates which continue to trend above our original plan for the year.

During the quarter, many in-person events shifted online, had to be postponed or even canceled, and social good organizations are being forced to employ new strategies to maintain momentum with current supporters, while capturing the attention of potential new donors. We've been there to help them make this shift. Our solutions are already equipped with features that are lending themselves to this current environment, and we have quickly acted upon customer feedback to add enhancements and new functionality to serve our customers so they can continue to focus on their missions during this time.

For example, we built new integration between peer-to-peer fundraising and donor management solutions, simplifying the process of raising donations and acquiring new supporters through pandemic friendly virtual events and peer-to-peer campaigns. We simplified donation forms to expedite fundraising by allowing organizations to quickly and easily create campaigns, which is critical to the current environment.

We also added new financial management capabilities, further easing the transition to working from home with solutions that support collaboration and efficient cash flow management and financial operations from the cloud. This ties back to our continued execution against our 4-point growth strategy and our focus on delighting our customers through innovative cloud solutions.

We are also increasing our focus on driving sales effectiveness in the current environment. The investments we've made to enhance our digital footprint are enabling us to be more prescriptive and cost-effective in our marketing efforts and to quickly adapt to changing market conditions. And over the longer term, we believe the impact of COVID-19 will accelerate the existing trends, driving adoption of modern cloud solutions in our market.

We also introduced new pricing and financing offers based on the changing needs of our customers. Despite our optimism over the long term, the uncertainty of today's environment is creating short-term challenge in our ability to build new pipeline. And bookings are falling short of budget expectations, which we expect to put pressure on near-term revenues. As a result, we began shifting investments toward digital marketing aimed at lead generation and put a greater emphasis on selling solutions with the highest lifetime value. Also, we've enabled our sales managers to backfill sales positions with a focus on 2021 bookings.

Overall, I'm pleased with our execution through the second quarter as we all adapt to the current environment. We continue to prioritize the well-being of our employees as we think about the future of work at Blackbaud, continuing to build on our strong customer-centric culture. Our customers are once more proving the resilience of our market and finding creative ways to ensure they can continue to deliver on their missions. This crisis will be a catalyst for the industry to move even faster towards modern, purpose-built cloud solutions, and we remain very well positioned as a leader in this market and the best long-term partner for social good organizations.

Our strategy, since I came to Blackbaud, has relied on a balanced approach to growth and profitability. The pandemic has created short-term uncertainty in our revenue outlook, and the early impact on pipeline of bookings will likely limit our ability to drive near-term revenue growth at our originally planned levels. Therefore, in line with our strategy, we made a pivot to greater emphasis on delivering shareholder value through increased profitability and cash flow, which are more controllable. The results of the quarter are a clear indicator of our ability to do this. We see long-term opportunity to drive similar results as in Q2 and drive up the underlying economics of the business.

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. I'll briefly cover our second quarter highlights and underlying trends before opening up the line for your questions. You can refer to yesterday's press release and the investor materials posted to our website for the full detail of our Q2 performance.

Turning to our results. Second quarter revenue increased 2.5% over Q2 of 2019, and recurring revenue grew 3.4% on an organic basis. Our contracted recurring revenue, which is roughly 2/3 of our total company revenue, remains healthy, although fell short of our original plan. As Mike mentioned, the current environment will likely put pressure on near-term revenue growth.

Renewal rates have trended ahead of our expectations through July, which is our seasonal high from a renewals perspective. Bookings performed slightly better than our initial scenario planning, though at this point, we are currently expecting a significant shortfall versus our original plan for the year, and we continue to see challenges building pipeline at historical rates.

While this will create some drag on second half revenue growth, our 2020 booking softness will have a much greater impact on next year's revenue. Therefore, we've rebalanced our go-to-market investments with a focus on 2021.

I'll also note that consistent with last quarter, we reclassified approximately $4 million that would have historically been presented in recurring revenue to onetime services and other revenue. This reclassification reduced our organic recurring revenue growth rate by approximately 200 basis points, or 120 basis points after normalizing 2019 for the change. For more detail, please refer to the supplemental schedule included in our investor presentation available on our Investor Relations website.

Moving to earnings. Our second quarter gross margin was 60.4%. We generated operating income of $54 million, representing an operating margin of 23.5% and diluted earnings per share of $0.85.

As you know, we took early actions to meaningfully reduce costs, bolster our liquidity and increase related borrowing capacity. The actions taken generated a significant cost reduction for the quarter, although some of these actions are temporary and will likely reverse heading into next year. However, we expect an elevated margin profile going forward.

For example, we expect to reinstate our 401(k) match program for our employees in 2021. Given the importance of the initiative, we also continued making investments related to our shift of cloud infrastructure to third-party cloud service providers. Our performance in the quarter clearly shows the resiliency we have and what is possible from a profitability perspective over the long term.

Now let's turn to the cash flow statement and balance sheet. Our Q2 free cash flow increased 27% over Q2 of 2019 to $48 million, representing a free cash flow margin of 20.8%. Again, we acted quickly to preserve our strong balance sheet, and we believe the actions taken ensure we have financial flexibility needed to manage a wide array of outcomes that may result from this pandemic.

We ended the quarter with $458 million in net debt. Our capital strategy calls for a debt-to-EBITDA ratio of less than 3.5x. And at the end of Q2, we stood at 2.2x with $191 million of borrowing capacity.

We continued making necessary innovation and infrastructure investments to support our cloud operations amounting to $3 million in CapEx and $11 million for capitalized software development for the quarter. Also in June, we entered into an agreement to purchase our Charleston headquarters building and the adjacent land, which we currently lease. The transaction will generate significant cost savings of the term of the lease and gives us additional flexibility as we think ahead to our planned Phase 2 building. We expect the transaction to close during the second half of 2020 with an upfront cash outlay of approximately $13 million.

In summary, we executed very well in the second quarter while remaining critically focused on the success of our customers and the health and economic stability of our employees. We continue to model a wide array of possible scenarios, refining our assumptions as more information becomes available. But the challenge is still predicting the duration and magnitude of the pandemic and the ultimate impact on our business.

The results in the quarter are a clear reflection of our -- of the stability of our customer base, the underappreciated resiliency of the market we serve and our ability to scale profitability and cash flow. As Mike and I have said all along, this is a balanced story and despite the uncertainties of the current environment, we are firmly committed to creating value for our shareholders while continuing to execute against our 4-point growth strategy.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Tom Roderick with Stifel.

Thomas Michael Roderick - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Mike, let me just throw the first one here at you. I think this is a really interesting and important pivot in the business model at a time where the end markets are challenged. I'd love to hear a little bit more about where you're finding extra ways to sort of take some costs out of the business. And then it's probably a good discussion for all of you on the line here. But how long can you take those costs out of the model? In other words, when growth starts to come back, obviously, T&E will come back, travel will come back. So there's some discretionary cost that stayed down for right now, but will come back at some point. Just take us through in a little bit more detail, if you don't mind, some of the structural changes as you think about the philosophical pivot to giving us some more margin, while revenue growth is impaired because of the end markets, where that comes from? And then what sort of growth initiatives have to be put on the back burner for that to happen?

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

Sure, Tom. Thanks. So a couple of things related to that. We're driving more productivity in many parts of the business. So in areas like sales, for example, we've actually increased investments in things like our digital capabilities. So driving leads and driving better productivity per sales rep and team through digital platforms is something we started about a year ago in a bigger way, and we've pretty significantly increased our spend there this year, which is to drive more sales productivity, i.e., more bookings per person, although this environment is a bit challenged, as you mentioned, right now, related to that. Our revenue came in, in the quarter lower than our original plan in the beginning of the year, but higher than our early plan in the beginning of the pandemic. Markets are pretty resilient.

Also from a cost standpoint, we have -- for the first time this year, we haven't had to have an organizational change. I've talked about this quite a bit where we've set up these scaled, what we call, centers of excellence. So one group for engineering, one for professional services, one call center, every function in the company and that's scalable. So we can actually grow the business without having to significantly scale the cost in those areas related to people.

We've also done a fantastic job in the last 5 years in our internal IT groups by automating the company and eliminating hundreds of little pockets of systems to common systems. It allowed us to go remote with a 2-day notice and not miss a beat operationally. But the key thing is it allows us to scale the business from a margin standpoint as well because we're all operating on common systems -- just a handful of common systems. So there's quite a few areas where we now can drive scalability. And some of our costs will come back. Tony mentioned in the prepared remarks, we shut off the 401(k) match, that will come back January 1. There's a few other things that will come back. But in the main, this result in Q2 is a representative example of the future.

Thomas Michael Roderick - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Great. That's really good. And then, Mike, could you take just a second to address some of the recent media reports regarding the ransomware attack that impacted the company back in the spring. It seems as though it was an issue that was sort of put to bed back in May. I understand the communications with customers are going out right now. So I guess the questions around it would just be, number one, are you confident that the issue is entirely in the rearview mirror? Number two, how are customers reacting to your communication and should we worry about any impact from lingering churn associated with that issue? And then number three, are there any down-the-road financial charges that we need to be aware for or has this all been sort of taken care of and buttoned up inside of the numbers that we can see?

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

Yes. Sure. Happy to do that, Tom. I just -- related to that, I just want to start off for any customers that might be listening on the call, because I know they do and they also listen to the -- when it's recorded. And I've been talking to a lot of customers. I'd like to just apologize on behalf of Blackbaud for the incident. Over the last 5 years, we've made significant investments to build a modern cybersecurity practice, significant. And we follow industry best practices. We conduct ongoing risk assessments and simulations. We aggressively test security of our solutions and our infrastructure, including with several third-party experts that come in, which is the best practice. And during the quarter, we discovered and stopped a sophisticated attempted ransomware attack.

Like a lot of companies, we get millions of intrusion attempts a month. And unfortunately, one got in to a subset of our customers and a subset of our backup environment. And based on the nature of the incident and our research, including with several third-party experts and investigation folks including law enforcement that we work with, we've no reason to believe that any data went beyond the cyber criminal or will be disseminated or made available publicly. So the incident did not reach a majority of our host environments, and it did impact a subset of our customers who were quickly notified a couple of weeks ago.

The goal of the -- this -- of any cyber criminal is to get control of a company's production environment, and we were able to detect and eradicate and stop that. So that never happened. So it's unfortunate, but we did not have a service disruption because of this. And we're working with all of our customers that were involved here to help them through this.

So my level of confidence here related to this one particular area is we did remediate this area, we tested it, we had outside firms test it, and we're pretty confident that this one area has been shored up, if you will. It's unfortunate that this happened because this obviously wasn't discovered by us or the outside firms we work with over the last several years. And I think we're in a good spot related to the amount of investment, the expertise we have, the folks we've hired from outside of the company that have significant backgrounds in the space and the outside companies that we work with are tops in their fields. So it's a big focus of ours and it's unfortunate it happened, but we remain quite diligent in driving this part of the business forward.

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

And Tom, just to follow up on your other 2. Thus far, our renewal rates, as we talked about in the prepared comments, are doing very well. So through July, which you know Q2 -- end of Q2 and first part of Q3, are our biggest seasonality for renewals. Renewal rates are running ahead of our original budget, which is great. And as we originally thought in some of the early scenarios that we might see increased churn because of potential business failures, et cetera, with the pandemic, but we've actually continued to run ahead of our original plan.

And to the cost, you'll see when the Q comes out, we currently don't anticipate any kind of material financial impact for the company. We do have insurance coverage that will come into play here as well. But currently, and in this Q, you'll see we did not record a charge because we currently do not anticipate anything material to hit our financials.

Operator

(Operator Instructions) Our next question comes from the line of Rob Oliver with Baird.

Robert Cooney Oliver - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

A follow-up, Tony, to your comments around the renewal environment. Obviously, really meaningful renewals in this quarter and in the second half. And just wanted to get, if I could, a little bit more color on what you're hearing from customers? And sort of what gives you confidence that, that renewal opportunity can continue to run ahead of plan as it has been through July, particularly in an environment that's lower touch for your sales force? And then I just had one quick follow-up.

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

Okay. Thanks, Rob. We're effectively 7 months through the year already. The biggest chunk of renewals for us, by far, due to seasonality is really June and July time frame. You see that a bit in accounts receivable balances, right, and deferred balances at the end of Q2 as well. Those are significantly higher than you normally see throughout the year because of that surge in the renewal timing. A lot of that fiscal year ends were nonprofits, schools, et cetera, just the buying patterns there. And so being through July and knowing that both gross and net dollar renewals are ahead of budget is a really good indication that our products are as stickier -- stickier than we originally thought, even inclusive of the impacts of the pandemic. I think -- when we talked about last call a bit, I think the market is appreciating more now the importance of cloud-based, modern technology stacks, and it's proving invaluable to private K-12 schools and then higher ed and other places.

So we feel really good about it. The rest of the year, it's hard to say. Will we have some incremental bad debt, yes, we increased. You'll see that in the financials. Increased our bad debt accrual slightly in the quarter in anticipation of some increased defaults, which is to be expected, I think, in these economic times, but nothing that's out of line with what we expected in original scenarios. We've not really seen a huge indication of folks wanting to take advantage of extended payment terms. We also developed some financing options with third parties we're offering. So we're doing a lot of stuff to try and help customers where we can to ensure their longevity. And thus far, I've been pretty pleased with what we've seen for volumes across all of those and feel really good about the trends on the renewal front.

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

Rob, it's Mike. Just to add a little to that. So one point to just reiterate is the renewals, the higher peak is Q2 in July, and the renewals are higher than our original budget in the beginning of the year, which is really good news. And the other thing I'll mention is our systems are predominantly systems of record or solutions, and they're not discretionary. And so that makes them quite important to the core operations of our customers. We're seeing some good results there.

Robert Cooney Oliver - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

That's helpful. And actually, my follow-up was touching on that. So as we've spoken with some of you -- to follow up on Tom Roderick's question on the malware attack. As we've spoken with some of your customers, particularly in the K through 12 area where you guys really dominate, what's been coming back to us is that these guys are absolutely sticking essential to our process and particularly with a time of remote learning and your interaction with google classroom and stuff, it keeps coming up, is very important. So I'm just wondering, it sounds as if -- and I can't recall if I read this in the press or in your posting on -- to your customers about the attack. But I believe it happened in one of your COLO facilities. And since what we're hearing from your customers is, hey, these guys are a SaaS platform that's essential to us. Should this -- a lot of -- obviously, you guys have been running this kind of dual cost structure around multi-tenant infrastructure as a service as well as COLO. Could this serve to accelerate your move off of COLO? And it would seem that at this time, your customers would likely be open to that.

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

Yes. Rob, we're going to put a higher emphasis on that. But we've been pushing that pretty hard anyway. And it's complex, right? It's not just pick up and move. It's changed some of the older infrastructure to new. So it's an engineering effort, not just an operations effort to migrate customers. But we'll continue on that. It's important, and we've got a good partnership with Microsoft on their Azure platform and with Amazon AWS in that regard. So still a big focus of ours, for sure.

Operator

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 I think in the prepared remarks, there was a comment on focusing on products and end markets that have the highest long-term value. I hope I'm not paraphrasing that incorrectly. But maybe help us on what some of those products or markets are? And if there was any effort to kind of consolidate some of the product portfolio as you think about the next several years here? And what Blackbaud looks like going forward?

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

Sure, Brian. It's the core products that you're familiar with. So we are just driving those as much as we can. They are quite resilient from a renewal standpoint. As I mentioned, there's system of record. What's happened with this entire pandemic situation for all of our vertical markets that we serve is the customers that are Blackbaud customers were up and operating. Many of the ones that weren't, if they had on-premise systems, had a hard time. And so the need for cloud solutions has been really highlighted, which is a positive, I think, for our markets we serve and for Blackbaud. So that's really positive. So what's the core products you're familiar with?

Your second part of your question. We have been pretty aggressively sunsetting solutions over the years, as you know. We've completed, I think, 24 in the last 5 years. We continue to do that. We announced we've got a product called everydayhero. Those customers can move over to JustGiving. That's underway. And so we do continue to do that in some of our smaller, older solutions to move customers to the more modern platforms. It's a small part of the business from a financial standpoint, but it helps focus our engineering teams, too, on all the go-forward platform. So I would think of that as just normal course of operations that we've been doing for years now.

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

Understood. And obviously, you guys gave a lot of color on the health of the business with renewals and bookings and things like that. I guess I'm just curious if you'd be able to parse out the bookings in terms of expansion with existing customers versus maybe net new logos. I guess, I could see how -- look, you have a lot of different offerings. You got people sell more into the base given the current pandemic. But maybe new logos are harder to get. Is that maybe what's playing out? I'm just kind of curious on what you're seeing from a bookings perspective.

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

Yes. Brian -- yes, we don't break those out separately, as you know. But yes, there's some pressure on pipeline building and bookings, as we talked about, which is no surprise. But also, the deals in the quarter, we closed both existing customers and new logos, and we closed some really nice deals in the quarter. So we're pretty happy about that. It's not at our current -- our originally planned numbers, which is a challenge. But some of our markets are in a different place than others, right? So it depends on the type of vertical market. Some are doing quite fine and surviving well. Some are struggling a little bit more based on the type of institution. So it's kind of a mixed story related to both recurring revenue and the bookings. But we're holding our own and closing some nice deals throughout the quarter, and continuing to build pipeline, not at the levels that originally planned, but continuing to build pipeline.

Operator

Our next question comes from the line of Rishi Jaluria from D.A. Davidson.

Rishi Nitya Jaluria - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Why don't I start maybe a little bit philosophically as we think about the cost-saving measures that you're implementing in the face of the pandemic. Makes a ton of sense. When it comes to kind of snapping back investments though, how do you think about that? In other words, how do you, I suppose, avoid the potential of not dialing back -- not increasing your investments and increasing your hiring at the right time and having that show up as kind of future drag on new bookings, let's say, next year, heading out of the pandemic? And I've got a follow-up.

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

Sure. This is Mike. So if you look at our second quarter results, it's a representative of what we're going to look like in the future. We're not going to have wild swings, if you will. We are hiring in sales, as we speak. So we are backfilling open positions where needed with an eye toward bookings in the last half of the year and mostly 2021 bookings in revenue. So we started in the beginning of the quarter and the beginning of the pandemic with a hiring freeze to kind of get a sense of where we're going to end up. We had a small workforce reduction, unfortunately, in the beginning of the quarter. But we're backfilling sales head counts right now.

So we're focused on the model that you've seen in Q2. It's sort of a representative example of what we're going to look like. And I'd caution you on -- we still have uncertainty in some of our markets, right, because they're uncertain. So it's a mix, but we're going to look a lot like Q2, I think, going forward with some uncertainty related to bookings and revenue given the markets are uncertain.

Rishi Nitya Jaluria - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

All right. Great. That's helpful. And then Tony, I wanted to ask about the recurring gross margin line. I know there's obviously a ton of moving components and whatnot. But it still looks like it was down about 130 basis points year-over-year. Can you maybe tell us what's going on there? Any mix shift or other factors we should be aware of? And then how should we, in general, think about that line going forward?

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

Yes, Rishi. I think to cap on Mike's comment, too, just as we look ahead, we feel pretty comfortable with the resiliency in the overall business and the margin structure. You've seen how quickly we pivoted our guide for the year and the investments we made had us running at -- more at about a 16% non-GAAP EBIT. We were very quickly through these fairly aggressive actions to drive 23.5%, and that's inclusive of some charges, increased bad debt. One of the things that you're seeing on the gross margin side that's inclusive in there is that we had a $4-plus million charge for end-of-support products back to the earlier discussion this morning on shrinking the portfolio and consolidating. We continue to do that. We've been doing that for years. And we took a little over a $4 million charge up in cost of goods related to end of support on some products. And so that's what was the biggest driver within there along with the normal other incremental costs we've got to try to move to the third party cloud, the increased amortization of capitalized software, some of those normal things that have put near-term pressure on gross margins that will continue for a bit.

And then I think to Mike's comments in the prior discussion, there's a lot of uncertainty of what giving will look like in Q3 and Q4 and when this pandemic will end. And so we're not, at this point, comfortable in what the top line will look at. And so we've taken these cost actions to focus a bit more on profitability and free cash flows. We feel really comfortable that we could do 20% plus kind of non-GAAP EBIT margins, even if we see some additional downturn on the revenue side. So I think the model is in good shape. We feel good about the actions we've taken on the longer term. But again, to make sure, on your question, all of that delta you're seeing on the gross margin decline could really be isolated largely to this -- that $4-plus million charge we took.

Operator

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

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

I just wanted to look at a couple of different verticals that you've made a lot of investments over in the past couple of years and they are sort of hot topics now. One being the CSR, corporate social responsibility, market where, obviously, companies are focused on the employee experience right now, and whether that means enabling work from home or anywhere, but also supporting the social movement and other elements in people's lives. Curious what you're seeing from a demand perspective from the large corporate customers that you've started to engage with. Has there been an uptick in both interest in sort of the YourCause platform and a lot of what you're offering, as well as supporting other peer-to-peer type investments with corporate matching and things of that nature?

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

Sure, Matt, it's Mike. Yes, the YourCause acquisition is 18 months old now and it's going super well. It's a great space to be in, and that's a fantastic platform. There's lots of interest. It's an expanding market. And companies of all sizes are interested in moving their workforce toward giving and volunteering and having a modern platform to help them do that, including matching gifts. So that acquisition has gone really well. There's a lot of interest. Business is growing nicely. And it's a great fit for us. So we're really excited 18 months in on the YourCause platform and the level of interest, and the bookings and win rates there. We're doing great.

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

Great. And then following up on higher education as well. Obviously, a lot of uncertainty in terms of will kids be back on campus? What's that going to look like? Some have gone fully virtual, some have talked about opening back up. How has that impacted that being a relatively new vertical for you with a more expansive product set beyond just fundraising? Are you seeing more interest in having a wraparound solution for both, sort of, in-class student management and overall fundraising? Maybe talk about what the bookings or pipeline development have been around that given that you've sort of been investing around there to build out a more vertical team, but certainly a lot of unknowns to be had there?

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

Sure. Yes, we've had a vertical team there for several years now. It's not a new market for us, right? There are some new products that we brought to market. But the -- what's interesting about that is our solutions support higher ed institutions whether they have students on-campus or virtual. So our platform support both environments. And for higher ed institutions, the foundation and fundraising, I think, is becoming even more important for them. So there's a big focus on the foundations and fundraising in higher education institutions. The new platform we brought to market just fairly recently last year -- last part of last year is focused on specific higher ed institution types and not all, and that's how it was designed, is to start in a specific smaller university market. And it's still early days on that. We have customers live. We keep selling that platform. And so it's still early days because it's fairly new, and we're continuing to add capabilities with input from our early adopter customers. So it's a big market for us on the foundation side. And I personally believe that the fundraising side of this is going to be even more important for higher ed institutions, and we're positioned really well there.

From a booking standpoint, it's a little bit mixed. The universities are quite busy, trying to wrap up or they did wrap up the spring semester and then thinking about if they're opening or not and how in the fall. And so a lot of them are making decisions that are kind of mixed, part to students show up a couple of days a week and the other days, they're going to be remote and sort of staggered. And we keep monitoring the marketplace related to that. But how they open doesn't impact our operations or our revenue, right, because they can -- again, they can have students on-campus or not, and they need cloud solutions. Same with our K-12 customers by the way.

Operator

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

Stewart Kirk Materne - *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

One maybe for Mike and then a follow-up for Tony. I guess, just, Mike, when you're talking to customers these days, is it a right reprioritization of the budget? Or is the budget in general under sort of scrutiny given the macroeconomic conditions? I'm just wondering, do you feel like you're getting pushed down the priority list because of schools have to spend more on remote learnings, technologies maybe outside of what you all do, security, things like that? I was just kind of curious how do you frame that and I assume it's maybe a little bit different on a vertical-by-vertical basis?

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

Yes. It's different by vertical, but everyone is talking about needing cloud solutions. For schools, specifically, we are the remote learning. For K-12 schools, for example, they all flipped to virtual and they're using the same Blackbaud solutions. The only difference is we're integrated to Google platforms or to Zoom because they needed the video component. And we were already integrated to those platforms. But the core solutions that run the school, all the mobile solutions the parents use, the solutions for classroom scheduling and attendance and learning management and tuition management that they use when the kids are in the building is the same platform they use when the kids are at home, which is our platform. So we are the cloud remote platform for schools.

And for Blackbaud customers, as I mentioned, they went virtual without missing a beat. And that is the story for all of our verticals. A really cool thing happened is a lot of our verticals came to us when they all went remote. And for some, like for nonprofits, we reacted quite quickly, and we had webinars with thousands and thousands of customers. We put together a 3-part webinar called The Resilient Nonprofit, and basically showed them how to run virtual events with the same Blackbaud solutions that they use all the time when the events were physical events because our solutions support both. And we had customers in the webinars talking about success stories of virtual events.

The other thing that happened is customers by vertical came to us quickly and asked for new capabilities. And in every case, in a week or 2, we discovered what they needed, we built it, we tested it and put into production. And these were things like membership changes for museums to faith-based institutions asking for capabilities for small group gatherings. And it goes on and on and on. So we've quickly, from an engineering standpoint, put new capabilities into our solutions to help them. But all of our solutions, because they're in the cloud and they can run the operations virtually, really facilitated all of our customers to go remote and go virtual. They didn't have to change or look at other vendors because our -- again, our solutions do both, whether the end folks, students or constituents are showing up or not.

Stewart Kirk Materne - *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

Okay. And then maybe just -- not to put, I guess, words in your mouth, but you feel like you're gaining share of the budget, even though the budget as a whole is coming under pressure. Is that a fair way of sort of thinking about it?

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

Yes. There's no -- I mean budget-wise -- the solutions we provide are system of record. So our end customers have to have a solution like ours or from someone that we compete with, right? It's not discretionary. So it's a core system that they run their institution on. And for fundraising, it's for driving revenue. For our solutions like church management, education and performing arts, it's the core solution that runs the operation and the revenue side.

Stewart Kirk Materne - *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

Okay. That's helpful. And then maybe just, Tony, when we think about the bottom line outperformance this quarter, I know some of these things are onetime in nature, how do you think about sort of some of the learnings you picked up over the last 6 months, being maybe a little bit more permanent in terms of driving your higher level of operating leverage over the long term? I know you guys are trying to create the right balance here between growth and leverage in the model, but is there opportunities on the real estate front on the -- just -- anything you could think of, I mean maybe on the sales and marketing front doing more virtually? How are you sort of thinking about that, I guess, at least anecdotally right now?

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

Yes. We still have a lot of opportunities across the business that some of those we've been working on for some period of time now, Mike spoke to, the efforts to really improve the productivity in sales and marketing. We're still not where we want to be on that front. We've spent a lot of time over the last 3 years reorganizing and changing comp plans, and all those things were very disruptive. And we really hope this year was going to be that year that we saw real productivity improvements start to show up within sales, but then the pandemic hit us. So that will continue to be a big focus. We think there's big opportunities on that front over the next few years. The facility optimization efforts that we started a couple of years ago will pay big dividends going forward. We think there's other opportunities.

We're going to be purchasing our headquarters building. We think that's a great opportunity to improve profitability and cash flow over the coming years versus the leasing option. Especially at today's very low interest rates, gives us a lot more flexibility as well. There's still a lot of opportunity within our workforce, which is a big piece of our cost structure, and then ultimately, to get to the third-party cloud and out of those redundant costs as amortization of cap software plateaus. There's several key drivers on the profitability front that gives us comfort. As I said a little earlier in the call that we think we can do 20% plus non-GAAP EBIT margins, which would be 24% plus EBITDA margins, even with the revenue difficulties that we may have to deal with in the middle of the pandemic, which would bode well, I think, as revenues start to rebound coming out of this, whenever that is, later next year or going into 2022. So I feel really good that we can sustain a heightened profitability level. We previously, just a couple of years ago, before we made some of these heightened investments in sales and marketing, we're running at 20% and 21% non-GAAP EBIT. So that's clear that we can do that, and we believe we have upside from there on the long term.

Operator

Our next question comes from the line of Mark Schappel with Benchmark.

Mark William Schappel - *The Benchmark Company, LLC, Research Division - Director of Research & Equity Research Analyst*

Just one question, Mike, for you. In your prepared remarks, you mentioned that you're offering some new pricing options to suit the changing needs of customers. I was wondering if you could just go into a little bit more detail on those pricing options?

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

Yes. We do that often when we look at customers of different sizes. It's nothing new for us. We just look at different bundles and what makes sense by vertical market. What's new for us, though, is we have more financing options. So we've partied with some -- we connected with some third-parties to create some financing options because of this pandemic to help our customers finance our solutions in new ways, which has been quite helpful and quite well received by our sales teams and our customers.

Operator

Our next question comes from the line of Ryan MacDonald with Needham & Company.

Ryan Michael MacDonald - *Needham & Company, LLC, Research Division - Senior Analyst*

Mike, you mentioned in the -- earlier in your prepared remarks, in regards to faith-based communities that had a survey that a number saw about the same or increased giving during this time and then an even greater amount were able to have sufficient funds to kind of go through this rough period. I'd love to know how that's translating into sort of bookings and ability to start projects, particularly for the faith-based community solution and undergo that digital transformation at this time?

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

Yes, sure. We continue to do well in that space. And we've had a footprint in there on the fundraising side for a while. And we now have a church management platform that we brought to market last fall, and we continue to sign customers and go live with customers. The value prop doesn't really change during the pandemic for these faith-based institutions. When they go live with us, they're consolidating a dozen or so systems in the one. And so there's a really good ROI. There's a simplification of their operations. There's better reporting for them. We continue to drive more and more capabilities in that platform because it's a high-velocity platform, meaning we can put new capabilities into production and a very high frequency. And so we're live with customers, many customers. We keep getting feedback from the user groups, and the system is just ever improving. And so we remain very bullish and excited about this market and our ability to drive success for the customers and for Blackbaud in this space.

Ryan Michael MacDonald - *Needham & Company, LLC, Research Division - Senior Analyst*

Excellent. And just a quick follow-up for you, Tony. Can you give us an update on what RPO was during the quarter and perhaps percent of that which was current?

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

Yes. It's not something that I have handy with me. I'll have to -- we can circle back with you on that one, I'm sorry, Ryan.

Operator

Ladies and gentlemen, this concludes our question-and-answer session. I'll turn the floor back to Mr. Gianoni for any final comments.

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

Thank you, operator. I'll just close by saying I'm incredibly proud of our employees and their dedication for serving our customers at a very high standard during these pretty uncertain times. We continue to showcase ourselves as the best long-term partner for our customers. And I believe this is further elevating our status as a leader in the market and positioning us for long-term success. The pandemic has created some interesting challenges for all of us. And through our balanced strategy, we're committed to driving value for our shareholders.

Tony and I look forward to updating you on our progress on the next earnings call. Thanks, everyone.

Operator

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