REFINITIV STREETEVENTS

EDITED TRANSCRIPT

BLKB.OQ - Q3 2021 Blackbaud Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 04, 2021 / 12:00PM GMT

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

Rachel Lena Freeman *BTIG, LLC, Research Division - Research Analyst*

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

PRESENTATION

Operator

Good day, and welcome to Blackbaud's Third Quarter 2021 Earnings Call. Today's conference is being recorded. I'll now turn the conference over to Steve Hufford, Director of Investor Relations at Blackbaud. Please go ahead, sir.

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

Good morning, everyone. Thanks for joining us on Blackbaud's Third Quarter 2021 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 financial 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.

Before I turn the call over to Mike, I'll briefly cover our investor engagement activities for the quarter. During the fourth quarter, our team will be participating in the Credit Suisse 25th Annual Technology Conference, Raymond James Technology Investors Conference and Barclays Global Technology, Media and Telecommunications Conference. We will also be holding virtual investor meetings hosted by Stifel on November 10 and Baird on December 14. With that, I'll turn the call over to you, Mike.

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

Thank you, Steve. Good morning, everyone. Thank you for joining our call today. Third quarter results reflected a fantastic quarter of execution for Blackbaud, exceeding even our own expectations on a much improved market backdrop. We achieved near double-digit recurring revenue growth, which represents a roughly 95% of our total revenue. Top line growth drove a roughly 10-point improvement on the rule of 40 over the year, and we're on pace to potentially have our best free cash flow year in the company's history.

I firmly believe we're at an inflection point for our market and our company as the shift to a digital-first world continues to accelerate. We've seen this shift as we have successfully transitioned to remote first company where we are building a connected engaged culture regardless of where people are located. And we've seen this in our customers as they are meeting and exceeding new expectations with online grant applications cloud-based fundraising tools, virtual walks, runs and rides, time to entry capabilities for admissions and even virtual prayer walls for faith-based organizations, just to name a few.

As I've mentioned before, the percentage of giving done online grew by 40% in 2020, with roughly a quarter of that giving taking place on mobile devices. We believe these trends are here to stay. And we are transforming and accelerating how people and organizations connect by combining our end-to-end commitment to driving outcomes for our customers with the technology platform and services with increased velocity, performance and scale, and we're just getting started as the vision we set for the SKY platform is becoming a reality.

Also, last month, tens of thousands of customers and prospects joined us virtually at our annual conference, bbcon, to witness how the latest innovations from Blackbaud can help them drive more impact while maximizing their time and resources.

Turning to the remainder of the year, we are again raising our outlook for full year 2021. We have high confidence we will exceed the $920 million high end of our upside revenue scenario for 2021 laid out on our Q4 2020 call earlier this year. And we expect to see further acceleration in our full year recurring revenue growth rate in 2022. We're also raising our best estimate for profitability and free cash flow, and we continue to believe Blackbaud is undervalued. Thus, we executed on our share buyback program again in the third quarter. We continue to execute on our four-point strategy and each are progressing well. Today, I'm going to provide an update primarily on our recent innovation efforts. As usual, following my comments, I'll turn the call over to Tony to cover the financials in more detail.

A big part of our strategy is to delight customers with innovative cloud solutions to drive more impact. Over the past year, I've seen the innovation and determination of both our experienced experts and incredible new leaders who have joined our engineering, product and customer success teams. I'm especially excited that over 50% of our newest team members come from backgrounds that are historically underrepresented in tech. We believe that by building a diverse team that reflects our customers and communities, we'll have deeper and more representative insight that drives impact throughout everything we do. We're not just helping our customers digitally transform the old ways of working. We're creating tools that offer breakthrough improvements and reinvent the way they accomplish outcomes and track results.

For instance, we recently released an entirely new experience for Blackbaud Grantmaking and we've since converted every existing grant customer to the new platform, a great example of the vision we have for our entire portfolio. Another example is a major recent release on Financial Edge NXT, where we're transforming the entire accounts receivable experience. This provides a modern experience and a new streamlined workflows and controls in areas such as invoice creation, billing and receiving payments as well as holistic relationship management across vendors, customers and sponsors. And in 2022, we plan to release a new wave of data intelligence capabilities, extending our success in this area by bringing together the industry's most robust database of philanthropic giving with artificial intelligence to drive unmatched insights for our customers.

We're also committed to giving customers the flexibility to benefit not just from Blackbaud's innovation, but the innovation happening outside of our walls as well. Our developer community is growing rapidly with more tools than ever to create new capabilities that extend Blackbaud solutions. We now have over 5,500 non-Blackbaud developers registered in our ecosystem. And we've seen substantial growth in the Blackbaud marketplace, where over 6,400 organizations have found a curated app to help them work smarter.

And I'm excited about the use cases we're seeing in the market, such as an app that integrates Shopify with Raiser's Edge NXT or a new API integrating YourCause with Workday, enabling our customers to easily connect employee data into the YourCause platform for more effective employee engagement. We're also enabling non developers with low-code or no-code tools such as our Microsoft Power Platform connector, to build automated workflows with our APIs without having to be a seasoned developer. We also continue to innovate as online gifts become a greater share of our customers' total donations.

At bbcon, the team announced that Giving checkout with our Complete Cover model is now available in the U.S. with additional markets to follow after seeing strong success in the U.K. You can think of giving checkout is an easy-to-add simple-to-use donation button that can be used by any nonprofit organization. Giving Checkout differentiates itself from others with a Complete Cover model, where there are no processing fees for the organization. Instead, donors choose that checkout if they want to cover the processing fees. We've tested this extensively with great success in the U.K. with our JustGiving platform and it's a real win-win for Blackbaud and our customers.

I'll summarize by reiterating that I believe we are at an inflection point for our market and our company with significant growth opportunities ahead. We're raising our estimates across the board for full year 2021, and we expect recurring revenue growth to accelerate in full year 2022. Our investments in the SKY platform continued to deliver results. We're focused on fueling future growth through additional investments in innovation, customer success, security and cloud infrastructure and a higher velocity go-to-market motion.

Our market has once again proven to be resilient and innovative in the face of a challenging pandemic environment, and we continue to strengthen our leadership position as the best long-term partner for our customers. Blackbaud is well positioned to capture the organic and inorganic growth opportunities in front of us, while driving meaningful acceleration in financial performance.

Overall, we had a very strong quarter, and we're well positioned to carry this momentum through the end of the year and into 2022. 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 Q3 and our latest outlook for the full year before we open up the line for questions. You can refer to yesterday's press release and the investor materials posted to our website for the full details of our Q3 2021 financial performance. You've heard us say on previous calls that we expected an acceleration of revenue performance in the second half of '21. Q3 not only delivered but exceeded those expectations.

Recurring revenue grew 9.2% on an organic basis, and this should serve as a proof point for what's achievable as we execute against the 10 growth drivers laid out in our investor session earlier this year. Strong transactional revenue performance was a key driver of overall revenue growth and benefited from larger in-person events returning and a higher percentage of online giving compared to historical levels, a trend we believe has staying power. As an example of the success we're seeing here, JustGiving had one of their best revenue months ever. Our contractual recurring revenue, which is the core of our business, grew $3 million in Q3.

We've seen year-over-year improvement in sales productivity per rep and overall ARR bookings with some of our early pricing initiatives starting to take hold. Also, we continue to see strong trends in renewals with our customer retention rate increasing in the quarter to 93%. One-time services and other revenue declined $2 million, which was approximately a 200 basis point drag on total revenue growth. Again, we expect this drag to bottom as soon as 2022, which should result in a lift on total revenue growth.

For the second quarter in a row, the trends we're seeing in the business are leading us to raise our best estimates for the full year and we now expect to exceed the top end of our upside scenario laid out at the beginning of the year, which was $920 million.

Moving to earnings, our third quarter gross margin was 59%. We generated adjusted EBITDA of $62 million, representing an adjusted EBITDA margin of 27% and a diluted earnings per share of $0.78. We laid the foundation for considerable margin expansion going forward. And through three quarters of '21, we had an adjusted EBITDA margin of 27.3%, inclusive of our investments in areas like innovation, customer success, security and cloud infrastructure and a higher velocity sales motion. Our best estimate for full year adjusted EBITDA margin of roughly 25% included certain investments being back-half loaded. While we're making good progress here, some of these investments are likely to push into early '22, particularly in areas where we're increasing headcount.

We continue to do a great job attracting top talent in a competitive labor market, but the rate at which we're adding headcount is less than we had planned. Our prior investments in the people and tools needed to create a best-in-class candidate experience are paying off, and we've increased our recruiting capacity as we look to accelerate hiring. Given our revenue overperformance in Q3 and anticipated timing of investments, we now expect to achieve an adjusted EBITDA margin of at least 26% for the full year '21. That brings me to the cash flow statement and balance sheet.

Our free cash flow was $58 million for the third quarter, a year-on-year increase of $16 million, representing a free cash flow margin of 25%. Through three quarters, we've generated approximately $132 million of free cash flow, and our current plan has us on pace for one of the best years ever in terms of free cash flow generation. Our latest modeling suggests we're likely to generate at least $150 million of free cash flow, inclusive of the heightened investments planned for Q4. I'll also note that we completed $40 million of opportunistic share repurchases during the quarter. We still feel that the valuation today does not fully reflect where we're heading as a company.

As of September 30, we had approximately $111 million remaining and available under our current share repurchase authorization. We ended the quarter with $500 million in net debt. Our capital strategy calls for a debt-to-EBITDA ratio of less than 3.5x. And at the end of Q3, we stood at 1.7x and we had $425 million of borrowing capacity.

As we look forward, we're actively evaluating acquisition opportunities and we plan to continue opportunistically executing on share repurchases when our internal estimates determine the company's shares are undervalued by the market.

To summarize our outlook for '21, from a revenue perspective with three quarters behind us, we have high confidence that we will exceed the high end of previous modeling of $920 million for the full year 2021 revenue. And , that may prove to be conservative depending on our fourth quarter transactional revenue performance. Our full year recurring revenue growth is on pace to accelerate year-over-year. And looking ahead to '22, our plans call for further acceleration in our recurring revenue growth rate.

Shifting to profitability, we expect to achieve an adjusted EBITDA margin of at least 26% for full year '21 inclusive of the ramped investments I spoke to earlier, some of which will carry into 2022. And our strong performance year-to-date, combined with our outlook for the fourth quarter suggests we should generate at least $150 million of free cash flow. I'll remind you, we could see some variability here depending on Q4 transactional revenue performance as fourth quarter tends to be our seasonal high for payments revenue.

We will also continue executing against our capital deployment strategy which calls for ensuring access to adequate levels of capital to grow the business through balance sheet management, rigorous oversight of investments in the business, including acquisitions, and identifying and efficiently returning excess capital to shareholders including the option for additional share repurchases.

In summary, during the third quarter, we saw a nearly double-digit recurring revenue growth, representing roughly 95% of total revenue. We achieved a roughly 10-point improvement on the rule of 40 year-over-year and we're on pace to potentially have the best free cash flow year in the company's history. We've raised our outlook for the full year '21 and have increased confidence in our ability to accelerate financial performance in '22 and the years to come. We have greater visibility to our near-term performance and while nobody truly knows how long the pandemic will last, we are increasingly confident in the resilience of our business, our market and our ability to accelerate our financial performance.

We're aiming to achieve the rule of 40 as a company and accelerating growth, combined with our margin expansion initiatives has us well positioned to accomplish that goal. And our proven capital strategy inclusive of M&A and our share repurchase program provides us with ample optionality to allocate capital in a way that maximizes value for our shareholders over the long term. With that, I'd like to open up the line for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Parker Lane with Stifel.

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

Mike, I was hoping you could talk a little bit about the pickup in sales productivity across the business, are there any particular areas that you'd point to that you'd say have been incrementally positive relative to your commentary last quarter? Or is it mostly a balanced performance you're seeing productivity improve across the board?

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

Yes. Thanks, Parker, for your question. We're seeing it across the board. We've gotten better at sort of more prescribed products for our kind of SMB marketplace. We've seen improved productivity there. And in all of our verticals, I look at the deals that we closed in the quarter and year-to-date, and we're seeing good performance across the different broker markets and internationally. Canada is really cruising well and we're doing well in Pacific and out in the U.K. So we've seen productivity improvements across the board on a year-over-year basis.

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

Got it. And then in terms of hiring, you mentioned that you're increasing your recruiting capacity. You're a little bit behind in the plan. Where are we seeing those investments? Is that mostly sales and marketing focus? Or again, is that an area where you're looking to accelerate R&D investments, maybe hiring there as well? How should we think about the mix of employees you're looking to bring on here as you enter 2022?

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

Yes, it's a couple of areas. So you can see in the R&D line, we're investing more there. Big focus there on infrastructure, security and innovation. We're adding more in sales and in customer success. So those are the kind of the 3 big areas that we've been adding headcount this year and the last 18 months.

Operator

Your next question comes from the line of Rob Oliver with Baird.

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

Mike, a question for you, just calling out the inflection in the market, that's pretty exciting. I just wanted to dive into that a little bit more in terms of what you're seeing, in particular, that's driving that inflection? Is it kind of a post-COVID normalization or return to in-person events?

And then following up on that, are we back do you think to levels that we saw pre-COVID in terms of the potential for fundraising and fundraising events and some capital budgets coming back to your customers? And then I just had a quick follow-up.

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

Yes. Sure, Rob. Yes. So we're seeing -- we've been saying for a long time that the back half of this year, we thought we'd see our return to growth and the third quarter proves that. So yes, we're seeing return to events. We're seeing all of our markets basically got sort of an MBA in digital. And so they're actually mixing in-person events and digital as opposed to just digital as last year. We're seeing some of our markets open now that were closed before.

We're also seeing a significant shift to digital first and digital only from a fundraising standpoint, grew a lot last year. Online fundraising grew, what, 40% or so year-over-year last year, and that's here to stay. So we're seeing all that mix. And the pandemic showed folks they need a solid cloud partner to help them when they're in the facility or not. So it's a mix of a lot of things. It's transactions, we're seeing coming back. It's bookings, in general, great year-over-year growth and productivity. So we're seeing that across the board.

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

And Rob, this is Tony. I'll just add. I think capacity-wise, at least what I've seen from the nonprofits I'm involved with and just some of the events I've gone to, capacity is not all the way back yet. So there's still some constraints from the pandemic of how many folks are able to participate in a gala or folks in the museums and zoos and all those other things. And then the secondary piece of that is we missed a lot of the seasonal high for events earlier this year where things were still a bit tighter from the pandemic. And so I think we have some upside next year as we kind of come out of this. And in that spring and summer event schedule, we should see better participation than what we saw in the first 2 quarters of this year.

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

Yes. Another add there, too, is we talked about this quite a bit when we had our Investor Day earlier in the year. We're implementing several initiatives around pricing that we've kind of outlined in that presentation. And those take a little while to come to fruition. So some are implemented, some are coming. So there's good upside there going forward as well.

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

That's really helpful color, guys. My follow-up is brief, but I guess potentially open ended. But Mike, you guys -- I mean, you talked about the pace of R&D spending or Tony, you talked about it. Definitely an impressive list of products coming out of the user conference last month giving search, AI. Just Mike briefly, I would be curious kind of what you're most excited about when you look at that pace of innovation, which you guys have clearly dialed up the knob a little bit here, and I'll be curious to hear which ones you're most excited about.

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

Yes. There's quite a few, to your point, we're really getting some awesome leverage out of multi-use engineering platform that we've built, which we call SKY. And it's an engineering system that's touching a lot of products, and we're using it across all of our verticals in one way or another. And so it's driving accelerated innovation. I'd say the biggest thing that we just completed was our Blackbaud grants management platform that has been completely transformed in the new engineering system, and we literally have moved 100% of our grants customers to this platform in this last quarter, and now it's a great modern go-forward platform as well. So that's sort of one of the things I'd highlight is the latest completed innovation.

Operator

The 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 Mike, I mean it's pretty clear in your commentary that the environment and the backdrop and the execution is getting better. I'm just curious, could you parse that out a little bit in terms of what's happening with net new opportunities versus the customer base? Just curious to get any color on how that split is looking.

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

Yes. We're signing a lot of new logos in community colleges and nonprofits around the world. Our YourCause corporate platform is really growing well, becoming much more global in its footprint. So we're seeing that new logos kind of across the board, closing big deals in health care recently. And like I said, the year-over-year growth in bookings and productivity in sales is quite strong. And we've got our sales team separated between our hunters and farmers. So we're pleased with where we're at so far this year. Again, we've talked about increasing performance throughout the year, and Q3 was a good example of that, not just in revenue growth but bookings as well.

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

Great. And Tony, maybe just a follow-up on the hiring. I mean I did see the press release that you guys are transitioning to a fully remote workforce. Would you expect that to kind of help those efforts? And how do you feel about getting where your hiring was to be in 2021 or the fourth quarter here? Or do you think that bleeds into 2022?

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

I'll start. This is Mike. I'll start. Appreciate the question. Yes, we actually sent a press release on the fact that we're remote first. And it really just sort of demonstrates the position we took over a year ago now in that -- when the pandemic started, we sort of hunkered down for a while, but kept recruiting and have been recruiting folks not close to a Blackbaud office. You recall a year ago, we got out of some of our real estate around the world. It's just been a fantastic transition for us and it's been going well for over a year. Our access to talent in diversity is like it's never been.

We're not a big company, but we hire a few hundred folks a year and we now get over 100,000 applicants for those jobs. And people are excited about looking at Blackbaud from a career standpoint because we are sort of the perfect combination of a public cloud software company that serves the market and set of customers that people care a lot about. And so we've been really doing well from a talent and diversity hiring standpoint for well over a year now.

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

Yes. And Brian, I'll just follow up. I think the difficult side on the personnel piece of the business is actually attrition just in this crazy market dynamic we have right now. We've seen attrition tick up as I think every company has. And so it's not been the hiring that's been a problem, but the attrition has been a bit higher than what we've historically seen. And then obviously, inflation is hitting us, and there's certainly some inflation on the cost of personnel as well that we're all having to deal with.

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

Congrats on a great quarter.

Operator

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

Unidentified Analyst

This is (inaudible) asking on behalf of Kirk Materne. Two questions. First, I know you guys kind of talked about this before, but you mentioned sales productivity getting better on the contractual recurring side of the business. Is there more room for productivity to improve there? And how do you think about the balance of adding capacity versus further adding further productivity improvements when looking ahead to calendar year '22?

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

We are doing both. So yes, there's room for improved productivity in sales. We've seen a really nice year-over-year growth, but there's plenty of room for more productivity. There's no doubt about that. And secondly, we are adding to capacity in a couple of sales areas as well. So that continues.

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

I think the other area we're spending some additional dollars is on the digital marketing side to drive more lead gen work and take some of that up salespeople so that we can increase their kind of sales velocity as well, which will increase their productivity.

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

Yes. We've also built a really efficient centralized sales hiring model that it literally takes us a couple of weeks to hire and onboard or hire new sales executives, which is great. It's a really high velocity model.

Unidentified Analyst

I appreciate that. And then just a quick follow-up. On the payment side, was there anything unusual from a seasonality standpoint in 3Q around like one-time events? And how should we think about the payments growth heading into the holiday season?

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

I think Mike mentioned earlier, we saw a sharp increase, like we've never seen last year in online donation volume. We historically have run at of total donation somewhere sub-10% was donated online. That jumped up to 13% last year. We think that's here to stay. So that's one benefit. And then frankly, just year-over-year because of the impact of the pandemic in '20 and the lack of events, et cetera, last year, Q3 was an easier compare from an online donation perspective. And so part of Q3 this year's impact is really just starting to get back somewhere closer to normal.

And then I think as we were answering one of Rob's earlier questions, I think there's still upside next year as events come back more fully. And as capacity continues to increase back up to more normal levels coming out of this pandemic, hopefully, we'll see some increased volumes. And I think that's part of what we expect -- we said in our prepared comments, we expect to see continued acceleration in overall revenue growth in '22 versus this year.

Operator

Our next question is coming from the line of Rachel Freeman with BTIG.

Rachel Lena Freeman - *BTIG, LLC, Research Division - Research Analyst*

This is Rachel on for Matt VanVliet. You touched on the capacity constraints that you expect to see coming off in 2022. So for next year, do you foresee seeing some more revenues per customer with a more hybrid approach of in-person and hybrid events plus more incremental digital events through the year? Or are you expecting to see a return of in-person events being the main events for customers?

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

Yes, I'll take that start, Rachel, thanks. We are seeing an increase in revenue per customer because of events coming back and events happening that didn't happen. We're also seeing higher ARR bookings as well in our sales performance. So we're seeing that -- both of that. Also, again, the industry is shifting more online which drives transaction growth for us as well. If you recall, last year, online fundraising went from 9% to 13% of total in one year, and it took a decade and a half or more to get to 9%. It's a big jump, and that's not going backwards. So there's that shift in the dynamics of online and mobile and then also more revenue per customer and then higher ARR in bookings.

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

Yes. And Rachel, this is Tony. I'll jump in there. We don't monetize all dollars that run through one of our customers' systems necessarily the things, to Mike's point, that are transactional in nature, typically have a variable pricing model. And so we will get some benefit from increased online transaction volumes, certainly. I think the other thing to keep in mind for next year, and we've just started implementing some of these. We still have some that have not yet begun and some of the pricing initiatives as well. I think by bringing the U.K. success model with JustGiving and complete cover to the U.S. will increase revenue per customer as well. So we've got several pricing opportunities that we went through in the investor session earlier this year that will also help drive increased volume per customer. We're hopeful going forward.

Rachel Lena Freeman - *BTIG, LLC, Research Division - Research Analyst*

That's great. And then just on the return to in-person schooling in the fall, how did that impact transaction revenues during the quarter? And can you just speak to how the K-12 market is performing overall?

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

Yes. So the K-12 market is performing well. Bookings are pretty good. Our systems were so vital in the last 18 months because all of our customers were able to operate regardless of if the students were in class or not. So the administrators in the schools had the advantage of having mobile access to our platform to run their schools regardless of student locations, so super positive. We've seen a return in our tuition management platform.

In the last 6 months, our schools haven't had an issue in class or not. So they've all had a good start to the quarter. A lot of good innovation happening on our platforms there. In fact, we've got a user group here at headquarters this week in the K-12 schools that we run these user groups a lot. We get their feedback and talk about innovative things that we're doing and things that they'd like to see, so a very good close relationship that we have with those schools. So yes, the K-12 market is solid for us.

Operator

At this time, I will turn the floor back to management for closing remarks.

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

All right. Great. Thank you, everyone. I'll just close by saying that third quarter was an excellent example of what we're after as a company. We achieved near double-digit recurring revenue growth, driving roughly a 10-point improvement on rule of 40 year-over-year. We're on pace to potentially have our best free cash flow year in the company's history.

As we said over the course of this year, we have multiple levers with which to accelerate revenue growth and margin are starting to take hold. First, the pandemic recovery with event-driven transactional revenue and bookings returning; second, a few pricing model and price catch-up opportunities; and third, we're actively looking at M&A opportunities. We've yet again raised our outlook for the business. We believe the steady execution against the rule of 40 financial framework and our continued commitment to disciplined capital deployment will generate substantial shareholder value. Thank you, everyone.

Operator

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