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PRESENTATION

Operator

Good day, and welcome to Blackbaud's First Quarter 2023 Earnings Call. Today's conference is being recorded.

I'll now turn the call over to Kevin Mooney. Please go ahead, sir.

Kevin W. Mooney - *Blackbaud, Inc. - Executive VP of Strategy & Business Development*

Good morning, everyone. Thank you for joining us on Blackbaud's First Quarter 2023 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 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 form or as a substitution for GAAP measures. A reconciliation of GAAP and non-GAAP results is available in the press release we issued this morning 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 mention that on today's call, we'll be sharing incremental commentary to provide more detail behind the key initiatives of our operating plan. I encourage you to review our presentation on our IR website that contains these additional details as well.

Also, notice of our 2023 Annual Meeting of Stockholders and proxy statement were filed on April 25th and our annual meeting materials were posted to our Investor Relations website that same day. And during the second quarter, our team will be virtually attending the Needham 18th Annual Technology and Media Conference on May 18th, the Evercore Diamonds in the Rough Conference on May 31st, the Stifel Cross Sector Insight Conference on June 6th, the Baird Global Consumer Technology and Services Conference on June 7th and the Bank of America Technology Conference on June 7th. Additionally, we'll be participating in investor meetings with Raymond James on June 1st.

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

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

Thanks, Kevin. Good morning, everyone. Thank you for joining us on the call today.

We're pleased to report strong first quarter results and improved outlook that underscore the strength and potential of our operating plan. Results of our plan are just beginning to bear fruit with performance expected to further accelerate with each successive quarter of 2023 and beyond. I'd like to spend time today reflecting on the actions we've taken, the momentum in our business and the continued upside we see over the near, mid and long term.

Our improved outlook from the beginning of the year stems from better-than-expected performance on a few key factors. I'll touch on these in more detail momentarily, but our increased level of confidence in our operating plan is driven by strong Q1 bookings that were ahead of expectations, continued strength in transactional revenue despite a challenged micro, renewal rates remaining strong as we started implementing our new contractual pricing approach, and meaningful margin improvement beginning to flow through as cost actions take full effect. Taken together, our performance on these factors supports raising guidance across all metrics, which we will discuss further in a bit.

Let's now review our first quarter results. We reported revenues of $262 million, which is up 3.4% year-over-year on an organic constant currency basis and double our fourth quarter 2022 organic revenue growth demonstrating strong sequential progress. Non-GAAP adjusted EBITDA was $71 million and represented an adjusted EBITDA margin of 27.5% at constant currency, which is up 5 points from Q1 2022.

Taken together, Rule of 40 at constant currency was 31% for the quarter, a 3-point increase year-over-year. Importantly, the quarter reflects only a modest impact from the initiatives we have underway to drive revenue growth and cost savings with significant upside still to come.

I'd like to spend a few minutes discussing those initiatives, how we arrived at them and why they give us confidence in our trajectory. As we saw a return to normalcy following the pandemic, we took a comprehensive look at the business, examining every revenue stream and cost center to determine how best to improve both the top and bottom line.

Following this review last summer, we developed and began to execute a 5-point plan that focuses on: first, product innovation; second, bookings growth and acceleration; third, transactional revenue optimization and expansion; fourth, modernized approach to pricing and multi-year customer contracts; and fifth, keen attention on cost management.

Q1 results show early indications of the planned success. I'd like to touch on each of these 5 key drivers, the metrics that we are monitoring and the impact we expect each to have. I'll then discuss why the trends we saw in Q1 give us confidence to raise our 2023 guidance as well as what we are anticipating in 2024 and beyond.

Starting with product innovation and delivery. We support our customers by replacing their aging mission-critical systems of record and adding advanced digital services. We continuously seek ways to add substantial value for our customers and their constituents by investing in both organic innovation and ecosystem enablement through partnerships and acquisitions. These new capabilities and partnerships strengthen our offers and create new opportunities for our customers to deliver on their missions.

For example, with the availability of SKY API endpoints for Blackbaud CRM and Blackbaud Altru, we're enabling customers to leverage applications in the Blackbaud marketplace to seamlessly integrate complementary point solutions with our partners. CRM customers can now easily activate the double the donation solution, a Blackbaud partner, to drive matching gift funding automation from donors without extra operational lift.

We've also focused on expanding strategic partnerships to unlock even more value for our customers with partners like Almabase and SwipeTrack's XTruLink. We recently announced an expanded partnership with Almabase to provide a modern solution for advancement teams to unlock higher education and K-12 school alumni engagement and better fundraising by creating integrations that enable secure movement of constituent gift and event data between systems without friction.

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Additionally, we have partnered with SwipeTrack Solutions to create a seamless and secure integration between Blackbaud Altru and Blackbaud Merchant Services to modernize the patron digital experience and back-office operations at arts and cultural organizations.

With most organizations getting back to pre-pandemic levels of visitors, we are able to provide our customers with critical technology to keep lines moving and provide guests and members with a fast and easy way to enter their locations.

We also recently announced a new feature for general availability with Blackbaud TeamRaiser, Good Move. Good Move leverages Kilter, which we acquired last year and helps charitable organizations raise more with mobile-first, gamified activity tracking and peer-to-peer fundraising.

For example, Good Move will help the nonprofit carry the load, expand the reach and impact of hundreds of thousands of volunteers who have walked millions of miles to honor and remember military service members and first responders. These innovations and partnerships will strengthen our customer value proposition and drive product stickiness and bookings growth.

Turning to our second point, sales bookings. We drove strong bookings performance in the first quarter, up significantly versus last year, led by our team in the corporate sector, who more than doubled their bookings over Q1 2022. As a reminder, our corporate sector consists of our YourCause and EVERFI solutions. We had a strong pipeline heading into the year and our sales teams delivered.

We signed several notable large enterprise contracts in the period including Microsoft, Guardian, Accenture, Asia Wild and University of the Pacific to name a few. This speaks to the resilience of our end markets we serve and the focus we have placed on driving further improvements in sales productivity and productivity per sales rep has improved over 30% year-over-year. Needless to say, there can be volatility quarter-to-quarter in bookings. However, the strong start to the year with the most in-year revenue impact, positions us well.

Third, transactional revenue, which is about 1/3 of our total revenue. That's proven to be resilient so far in 2023, following the softness in average donation size we experienced in Q4. The rate changes that we announced on Blackbaud Merchant Services in the U.S. in late 2022 began to take effect this quarter and added durability, contributing to the 7% growth rate despite a tough compare. Blackbaud Tuition Management and JustGiving continued to perform well against plan. As we look ahead, our teams are hard at work to drive innovation across our payment solutions that are a win-win for both our customers and Blackbaud.

We have recently introduced our two fee cover models, and we are also looking at ways to optimize our payment solutions to drive a better donor experience. We're excited to share more on what the team is working on in the coming months.

The fourth area I'd like to discuss is our modernized approach to pricing on renewals of our contractual software subscriptions. We've been talking about this a lot lately, and I want to ensure that the powerful compounding effect of our pricing changes is fully appreciated.

Let me start by saying that we deeply value the relationships we have with our customers. Many of whom have been with us for decades. Our solutions add considerable value for our customers and raised billions of dollars annually to fuel social impact, and we continue to innovate on our suite of products to generate incremental value.

Following the implementation of our 5-Point plan last summer, we put in place an updated pricing policy that directly reflects the value we provide to customers is in line with the broader market and reflects the inflationary pressures that all businesses are facing.

In November of last year, we started notifying customers with a March 2023 contract renewal that we'd be making two important contract changes. First, we'd be offering 3-year contract renewal terms as our standard, replacing 1-year renewal terms. This process was already being implemented outside of the pricing changes.

Second, we'd be implementing a more material rate increase on the 1-year option versus the 3-year option. And third, the 3-year option includes annual rate increases that will compound.

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For context, our 3-year options did not historically include annual compounding rate increases. You can think of the rate increase for year 1 of both the 1-year and 3-year renewals as catch-up in nature with the subsequent annual rate increases in years 2 and 3 as above inflation. Through April, we have already renewed over 25% of the customers that are up for renewal in our 2023 cohort.

In terms of our process, we notify customers about 5 months in advance of their renewal expiration date, and we require contract changes 45 days ahead of that renewal date. So we have very good visibility into the coming months. In fact, we have largely completed the contract renewals through mid-June and have notified customers of their rate increase through the end of September and are now working into October.

The close day-to-day management of renewals, the mix of 3-year and 1-year contracts and the impact of pricing is progressing very well. What's even more impactful is the compounding effect of these rate increases over time as we layer in future contract renewals and annual rate increases.

Let me explain. Over 50% of our expected 2023 revenue at the midpoint will renew in a little over 3 years. And approximately 35% of that renewable base will renew in this year. These contracts are renewing every day and create revenue growth that we expect to accelerate with each successive quarter this year.

So in 2023, we'll receive only a portion of the rate increase. That sets up an even more impactful situation in 2024, 2025 and beyond as we begin to see the full year impact of the rate increases compound annually. A little over 30% of the renewal base is up for renewal in 2024 and more than 20% in 2025. The adoption of 3-year renewals as a standard will have an added benefit of higher retention, which provides greater revenue assurance and predictability.

Looking even further ahead, the cycle starts fresh in 2026 as the 2023 signed contracts will begin to renew. This is a sustainable and meaningful revenue growth stream for us, and it comes with minimal cost increases, so it's margin rich. We have included an illustrative example of this in our updated investor presentation that was posted earlier this morning to our IR website for everyone to fully appreciate this compounding effect.

The last driver I'd like to discuss today is our keen attention to costs. As we have already reported, we closed four data centers last year, and we plan on closing more this year. This effort was a few years in the making. We renegotiated key vendor contracts, including Microsoft Azure and AWS and made a difficult decision to further reduce our staff in the first quarter.

Because we have organized to achieve much better scale efficiencies, we now have reduced our headcount by 14% since Q3 2022. Our goal is to run the business at about this head count for the foreseeable future, such that our revenue growth will have much greater fall-through to drive margin acceleration.

Also, the competitive dynamics are shifting a bit in our favor. Just this past quarter, 2 very large enterprise companies, in an effort to reduce costs and focus on their core markets, discontinued their point solutions that were targeted to nonprofits.

In the first quarter, we began to see the impacts of our initiatives targeting these priority areas, which strengthened our overall confidence for the year and underscore the strength and potential of our operating plan.

To recap quickly, Sales bookings are going very well. Our transaction revenue is growing nicely. Our contractual renewal rate increase program is really exciting for retention and growth. And lastly, our focus on significant cost reductions already completed is driving much higher margin opportunity. Seeing these initiatives progress even faster than anticipated across these areas supports raising guidance across all metrics.

For the full year at midpoint, we now anticipate organic revenue growth at constant currency of approximately 5.5%, adjusted EBITDA margin at constant currency of 31% and a Rule of 40 at constant currency of approximately 36.5%, up nearly 7.5 points versus 2022. And with the acceleration plan for each sequential quarter, we expect to exit this year at organic revenue growth rate in the high single digits and Rule of 40 performance to cross the 40% line in the fourth quarter this year, which is well ahead of our prior target of 2025. And looking ahead to 2024, we expect to continue growing revenue and expanding margin to achieve Rule of 40 for the full year.

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

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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 first quarter of 2023 as well as our updated outlook and guidance for 2023, before opening up the line for questions. Please refer to today's press release and the investor materials posted to our website for the full details of our Q1 financial performance.

In the first quarter, we reported total revenue of $262 million, adjusted EBITDA of $71 million, adjusted EBITDA margin of 27.2% and Rule of 40 of 29.5%. Revenue of $262 million represented organic growth of 2.3% and when adjusted for $3 million of negative foreign exchange impacts, organic growth at constant currency was 3.4%.

As I mentioned last quarter, we had a strong pipeline heading into Q1, and our sales teams delivered. Bookings in the quarter were well ahead of plan and increased significantly year-over-year. This speaks to the resiliency of the end markets we serve and proves our focus on driving further improvements in sales productivity is paying off.

On last quarter's call, we introduced our contractual renewal price increase. In Q1, our effective rate increase on renewal contracts was in the low double digits, which is a blended rate, reflecting 2 months of our old pricing with 1 month of our new renewal pricing model since our rate increases began with March renewals. We've seen higher adoption of the 3-year option versus the 1-year option relative to our plan. I'll share more on what that looks like for the full year shortly.

Lastly, transactional revenue grew 7% year-over-year supported by the rate change that took effect at the beginning of this year as well as elevated volumes associated with a few events. And as a reminder, this is 7% growth over a tough compare. If you'll recall, we experienced elevated volumes in Q1 of 2022 related to the Ukraine crisis. The decline in onetime services and other revenue persisted in the quarter and accounted for a point and a half of drag on total revenue growth with organic recurring revenue growth of 4.9% at constant currency.

Adjusted EBITDA of $71 million grew 25% with an adjusted EBITDA margin of 27.5% at constant currency. In the quarter, we aggressively managed the business towards profit and cash flow optimization through a series of cost actions. And while many of these actions have been completed as of early March, we've only realized a portion of the year-over-year improvement and expect to realize more in each subsequent quarter this year.

Additionally, we're going to continue to manage our cost structure to get more scale from our expenses. Taken together, Rule of 40 at constant currency in the quarter was 30.9%.

Turning to our cash and balance sheet. Our adjusted free cash flow was $16 million in the first quarter and benefited from a decrease in payroll, strong performance in transactions and better-than-expected cash collections. We ended the quarter with $854 million in net debt with an additional $298 million of borrowing capacity. The debt-to-EBITDA ratio was 3.0x and we remain focused on rapidly deleveraging in the near term.

Now let's turn to 2023. We remain focused on operational execution across our business that will generate significant improvements to growth, profitability, and the Rule of 40. As Mike walked us through our strategic activities earlier, it's evident that we are well underway on the plan that we embarked on last summer. We are getting even more out of the five key drivers outlined than we initially expected, and we are raising our guidance across the board to reflect those early successes and increased confidence in our operating plan.

Starting with revenue, we see revenue in the range of $1.095 billion to $1.125 billion, representing approximately 5.5% organic growth at constant currency at the midpoint up, approximately 150 basis points versus our prior guidance. We now anticipate the negative FX impact to be a little less than $5 million for the full year, with the drag occurring in the first half and a benefit in the second half.

Our overperformance versus the following key metrics support the revenue guidance raise versus our February outlook. First, on the bookings front, our sales teams outperformed internal plans in the quarter and versus last year. Our corporate sector more than doubled their bookings versus last year, and total company pipeline remains solid as we look into Q2 and the remainder of the year.

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Second, transactional revenue grew nicely in the quarter at 7% supported by a number of puts and takes, including the rate change on BBMS in the U.S. that we implemented at the beginning of the year, increased volume on our JustGiving and Tuition Management platforms and elevated volumes across our payment solutions related to relief for those impacted by several extraordinary events.

Third, renewal rates remained strong as we started implementing our new renewal rate increases on our contractual software subscriptions, primarily in the social sector.

Let me provide some additional context. As Mike mentioned earlier, over 50% of our expected 2023 revenue at the midpoint will renew in a little over 3 years. And approximately 35% of that renewable base will renew in this year.

So far, more than 25% of the customers in the 2023 cohort have renewed, and here's what we're seeing, a rate increase of low double digits in Q1 that reflects a blended rate of 2 months with old pricing and March renewals with new rate increase. We expect the effective rate increase to step up to the high teens in Q2 and hold steady there.

We've also seen a meaningful shift in term mix from 1-year renewals to 3-year renewals. Just to ensure this is fully appreciated, in 2022, 3-year renewal terms comprised the minority of the total mix and that has jumped to the vast majority of total mix in 2023, which is outpacing our initial expectations. And renewal rates are performing well against our plan and above last year.

For the remainder of 2023, we expect successive quarters of improvement to total company organic revenue growth with a growth rate in the high single digits as we exit the year.

Shifting to profitability. We remain intently focused on managing costs at our new run rate and driving significant improvement to margins throughout the year, while we increase organic revenue growth. We now anticipate adjusted EBITDA margin in the range of 30.5% to 31.5%, a 6-point improvement year-over-year at the midpoint and a 1-point increase versus our prior guidance.

As we previously shared, we further reduced our head count in February to achieve our original plan with the November action and when combined, represents a 14% reduction to staff from Q3 of 2022.

We also continued scaling our infrastructure by renegotiating some of our largest vendor contracts with both AWS and Microsoft Azure and reducing our private cloud footprint by closing 4 data centers last year and expect to close another 2 this coming year. Collectively, these actions are, by and large, complete and reduced our annualized expenses. We will continue to have a sharp focus on cost management and expect to further optimize and scale in '23 and beyond.

Also, many of our pricing initiatives have a double benefit to the Rule of 40 as much of the revenue upside falls through to margin. Our cost management initiatives, combined with ramping pricing initiatives in the second quarter should generate a step-level improvement to margin from Q1 to Q2 with more modest sequential improvement through Q4.

Taken together, we are targeting Rule of 40 at constant currency of approximately 36.5% for the full year, a nearly 7.5 point improvement year-over-year at the midpoint. As we progress through the year, we anticipate exiting 2023 at a Rule of 40 run rate above 40%, when considering the ramp in organic revenue growth to the high single digits and an adjusted EBITDA margin north of 31% in the fourth quarter.

Before I turn to the cash flow in the quarter, we settled all claims with the SEC related to our previously disclosed security incident. We continue to make improvements to our cybersecurity program to minimize future risk of cyber attacks in the ever-changing threat landscape. We're pleased to have resolved this matter and have shifted our focus to resolving the remaining regulatory investigation matters as well as ongoing litigation related to the incident.

At the end of the first quarter, we had $30.2 million in aggregate liabilities for certain probable loss contingencies related to the security incident that we believe we can now reasonably estimate. There are other security incident-related matters for which we have not recorded a liability as

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we are unable to reasonably estimate the possible loss at this time. We will continue to update the investment community and regulatory bodies through disclosures in our SEC filings.

Lastly, moving to cash flow. We now anticipate adjusted free cash flow in the range of $190 million to $210 million, approximately 30% growth year-over-year at the midpoint. The increase in guidance is supported by our cost management initiatives, which are driving a decrease in payroll and outside services.

We are also benefiting from strength in our transactional revenue versus initial expectations. And as a reminder, we still anticipate higher cash taxes, which will partially offset some of the additional benefit we are seeing.

Our adjusted figure excludes cash to be spent related to the security incident. Our expectation for the full year is a net cash outlay of $25 million to $35 million for ongoing legal fees related to the security incident. In the near term, we remain focused on reducing our net leverage with our cash generation and adjusted EBITDA growth as we gain clearer visibility into the timing and magnitude of any probable security incident costs, we will consider other alternatives to deploy our cash as well as continue to lower our net leverage to our targeted range.

In summary, our primary focus is to continue to run our business well. Early overperformance relative to our budget has given management a higher degree of confidence to support raising our 2023 guidance across the board. We've started the year better than expected and will drive strong execution on our plan to generate an acceleration in financial performance as we progress throughout the year. And with that, we anticipate heading into 2024 with a high single-digit revenue growth and 40% plus on the Rule of 40.

With that, I'll open up the line for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question today is coming from Brian Peterson of Raymond James.

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

Gentlemen, congrats on the really strong start to the year. So Mike or Tony, I don't know who wants to take this. But it's great to see the success that you've had in the bookings and the pricing initiatives. You guys don't typically raise the outlook in the first quarter of the year, and you're pointing to an acceleration. So if we think about what's driving that acceleration from a stack rank perspective? I'd love for you guys to unpack that a bit.

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

Yes. Sure, Brian. Thanks. There are some new things here that we're seeing that we haven't seen before predominantly in the contract renewing process, which I mentioned in my prepared remarks.

So for example, we're pretty much through with Q2 as of today, almost through with June, we've already notified customers out to early October of this year. So we notify customers about 5 months ahead and they have 45 days to talk to us about any changes. So -- and we haven't had this before. So we can see many months in the future closed renewed contracts.

And with most customers signing up for a 3-year renewals, which we haven't had before and very different pricing in those contracts, much higher in year 1 and then price uplifts in year 2 and 3, which we have not had before. We have a very good view to the future of that new and substantial

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revenue line, which predominantly falls to the bottom line as well. So that is the biggest thing that we have, I'd say that's new, that has a very good future look many months ahead into growth.

So that's why we raised guidance, and that's why we said we're crossing Rule of 40 in Q4 this year with high single-digit organic growth. Now combine that with really strong bookings year-to-date and a really strong pipeline as well. And we had a price increase in our payments platform at the end of the year last year, which came into effect in January of this year. So when you combine all of those, a very good view to the future on this quarter-by-quarter sequential growth and for 2024 as well.

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

Great. That sounds like a lot of visibility there, Mike. And maybe just following up. I know you guys mentioned the really strong corporate bookings this quarter. I know it's a choppy environment overall if you look at software broadly. But any more color on what's driving the strength there.

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

Yes. A good start to the year in our Corporate Impact group. I think that's your question. That's EVERFI and YourCause. We had a slow year last year with EVERFI, they came out of the gate really strong this year, doubled their bookings in the first quarter year-over-year. I mentioned some of the customers closed in my prepared remarks, like Microsoft, Guardian and Accenture, really great pipeline there as well. Tom and team are really driving that. It's come back really strong. Really good marketplace there, a lot of enterprise customers that were upselling and new logos as well.

Operator

The next question is coming from Rob Oliver of Baird.

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

Mike, first question is for you. So you mentioned some of the initial positive impact to your vendor consolidation, which is a theme clearly running through our sector with a lot of our platform companies. Can you talk a little bit and maybe give us some examples? It sounds like you guys have kind of a double benefit here because on the one hand, people are looking to cut costs and maybe look towards platform vendors like you. On the other, as you guys have pointed out, you also have a lot of business up for renewal over the next year.

So can you talk a little bit about sort of plan of attack around, maybe taking advantage of getting more products into people's hands as you guys renew these contracts? And then I just had a quick follow-up for Tony.

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

Yes, sure. So we do have a lot of cross-sell efforts to existing customers underway in addition to new logos, right? But a lot of cross-sell efforts. In the corporate sector, last July, we put the YourCause and EVERFI business together under Tom Davidson, not a lot of shared customers there, so good open cross-sell opportunities in our corporate impact sector. We remain focused on that in the rest of the company as well under Dave Benjamin's leadership. So there is a lot of opportunity there.

There are some of the -- I mentioned in my prepared remarks, Rob, that some of the very large enterprise players in our space have walked away from some of their solutions. So that creates new enterprise opportunities for us as well, given this pace is our sole focus. So lots of opportunity there.

And then back to what I just said earlier on the contract renewal program that we put in place about a year ago planning and started to notify customers last November is something brand new for us that we'll continue to repeat every single year because we -- I'll give you a quick example.

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This year, we're going to renew about 35% of those customers, next year 30%, the year after 25%. And in 2026, the remaining 10%, but also in 2026, renew the 2023 customer.

So this compounding effect. We tried to make this apparent in our several new slides in our IR deck. So there's some graphs in there that show the compounding nature of this new initiative. So super powerful for us from a top line and bottom line growth standpoint and it's increased retention. So customer retention is up as well.

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

Okay. Great. That's really helpful, Mike. I appreciate that. And then, Tony, my follow-up is for you. Obviously, very strong start to the year on the commercial side of the business, really great to see EVERFI straightened out and YourCause doing well because we haven't had a normal kind of year yet really in that business because we had the pandemic and then you guys bought EVERFI, and then there was the hiccup there. Can you just remind us what the normal linearity would be for that business? And Mike, in his prepared remarks said, hey, it was a great quarter, but uncertain. Could you just help us with that linearity?

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

Yes. From a seasonality perspective, Rob, is that what you're getting at on that?

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

Yes, exactly like is it more typically back-end loaded? Is the Q1 strength a sign of -- a good sign, but somewhat anomalous from a timing perspective. That's what I'm trying to understand.

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

Yes. Last year, if you recall, right after we completed that transaction at the end of the prior year, we had quite a bit of turnover and attrition in the ranks for the go-to-market. So our big effort last year was getting those sales and go-to-market teams restaffed and trained and ramped. We're seeing the benefits of that. We saw some of that to finish the year. So they finished the very end of last year strong and as you've seen here, a very good start to the year and good pipeline.

I think the testing on the -- especially on the EVERFI side and a bit on YourCause is those are lumpier enterprise size deals. And so I think from a seasonality perspective, I don't expect there to be a lot of seasonality necessarily from quarter-to-quarter. There will be a little bit more because a lot of that training is done into the school systems. So maybe a little bit more of that in advance of a new school year.

But I think what we're going to see on that one is because they can be such large deals, just a bit of that typical lumpiness that you used to see maybe in a license kind of business. Now most of these are also subs, so they'll spread over time. But that bookings will come in a bit chunky compared to what we'd see on the regular side of the business and maybe a little more seasonality midyear versus end of year.

Operator

The next question is coming from Parker Lane of Stifel.

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

Congrats on the good quarter. Mike, somewhat of a timing question here. When you're talking about getting in front of some of these renewals towards the back end of the year, I think you referenced October. In the event that some of these customers decide to go with the 3-year renewal, will the effect of that come into the model at that point in October? Or are you actually pulling forward these renewals on sort of a coterminous basis?

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

No. So let me just explain how this is working. And again, there's some slides in the IR deck that kind of have some graphics that explain this. So we notify customers 5 months ahead. So for example, our Q1 results, we just announced only March has the new price increases in it because we started to notify customers last November.

And so every month go forward now, March forward, every month, we'll have the new price increases. Most of our customers are opting for the 3-year contract renewal. And in years past, most were on 1-year contracts. So we're really flipping the whole subscription business on the entire company to 3-year contracts. So that's number one.

Number two, because we notify 5 months ahead and we asked for 45 days notice if they want to have any discussions related to the contract, we have very good visibility into the future.

So as of today, our entire Q2 is almost complete signed contracts. We have 2 weeks left of June to complete as of today. So that means we have a pretty high percentage of July complete, some August complete, and we're speaking with customers that are September and October renewals.

So this is very different than what you might think of where typically, you have a backward view to your previous quarter and things like this. We have a forward view that's almost a quarter ahead to know how many contracts are already closed and at what rate.

And Tony talked about the rates in these contracts. And so the 3-year contract, Tony mentioned, year 1, the rate increase is in the high teens. And then subsequently, years 2 and 3 have rate increases. We've never had rate increases in years 2 and 3 before, so it has been zero. We have very good visibility into this program many months ahead.

Does that make sense?

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

Yes, definitely does.

Operator

The next question is coming from Kirk Materne of Evercore ISI.

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

I'll add my congrats on a really good start to the year. Mike, can you just talk about the transactional business, obviously, that there's -- the volume side of it and the pricing side of it, I guess how are you thinking about that? Or what's embedded in the outlook for that side of the business that perhaps has a little bit more seasonality? Can you just talk about what you're sort of thinking about for that business over the next few quarters?

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

Sure, Kirk. So, I'll remind you, the transactional business is about 1/3 of our revenue, and there's 3 main platforms in there. So one platform is Blackbaud Merchant Services, that is our donation processing platform. So very volume-driven based on donations, number of donations and dollars per donation drives that platform, which is 1 of the 3 platforms.

We implemented a price increase on that platform at the end of the year last year. So that just started in January. So we only have a first quarter financial benefit of that one platform. That platform does grow over the years -- over the quarters, and we usually see higher seasonality in the fourth quarter because of holiday giving and so that platform in the first quarter did well, new price increase and the volume did well.

The second part of our transactions is a Tuition Management System and that's growing very, very well also. We do tuition processing for our private school customers, and that volume has been really strong and growing quite well.

The third part of our transaction is our JustGiving platform, which is doing extremely well. It's a global platform. In some large campaigns, we have individuals from over 100 countries that donate on that platform for particular campaigns, that's going really, really well also.

So those are the 3 components and we feel really good about the first quarter and the trajectory of those for the rest of the year and going forward. So when you combine that with these subscription renewals that I just spent a lot of time on and with bookings, that's why we raised guide, and that's why we're saying high single digits Q4 going forward into '24 and crossing the Rule of 40 this year Q4 as opposed to our previous guide, which is the year 2025. So big changes.

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

Yes. Thanks for the additional slides I am looking at them as we speak on the renewals. Tony, if I could just ask one sort of wonky accounting question for you around the renewals. Are there termination -- do these have termination for convenience in them? I guess the reason I ask that is I believe if you're doing 3-year deals, you sort of recognize year 2 and year 3, you average it out if it's not terminated -- if there is not a termination for convenience clause. Can you just walk through that a little bit? Just -- it doesn't matter as much until you get to the end of the cycle, but I was just kind of curious how that plays into the numbers.

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

Yes, Kirk, the vast majority of our contracts do not have termination for convenience clauses. We did inherit a handful of those over the years with some of the acquisitions and our typical processes as those come up for renewal, the legal team will try and renegotiate them to our standard Blackbaud terms and conditions, which historically have never included a termination for convenience. We do have a handful, like I said, I think that we inherited like on EVERFI, YourCause, et cetera.

Operator

The next question is coming from Matt VanVliet of BTIG.

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

I guess when we look towards the end of the year and talking about high single-digit organic revenue growth rate, can you maybe just help us think about maybe the 3 or 4 key drivers there between the price increases being a big part of that, upsell / cross-sell kind of as you continue to make progress there and focus on that? And then maybe what net new bookings are looking like or at least baked into that where we could see maybe a little more volatility in what high single digits ultimately looks like?

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

Sure. I can take that, Matt. It's Mike. So it's all the components that we've been talking about. So first of all, strong bookings across the board, Blackbaud products and the Corporate Impact two platforms there. And that's cross-sell and new logo. So our end markets are quite resilient. They're fully open post pandemic. And so we're seeing a really healthy buying environment. I mentioned a couple of big enterprise companies have taken their focus off the space, which is helpful for us in the long run.

Second, I just talked about the transaction business doing really well. All 3 components of that doing well. One of the components, Blackbaud Merchant Services with a price increase and volumes doing well, including the Tuition platform and JustGiving.

And then lastly, the contract renewal process, which I spent a lot of time on now, which is new for us, which is pretty significant. And Tony walked you through kind of what that looked like. If you think of most of the customers signing up for 3-year contracts. Our retention is higher. Year 1 price increases in the high teens, year 2 high single digits, year 3 high single digits, and that renews after that. And so we're going to do about 1/3 of those this year. So this all rolls forward in all of those categories.

The last thing I'll mention, too, is we've spent a lot of time getting scale and efficiencies out of the business. In the last year, we had a 14% reduction in headcount, closed 4 data centers, optimized all of our real estate, renegotiated our contracts with Microsoft Azure and Amazon AWS, which are big contracts. So we have lower annual cost there. And we're going to about maintain our current headcount. So these initiatives are going to fall through to the bottom line.

If you look at the new guide we just gave, for example, we moved up revenue $15 million. We also moved up adjusted EBITDA at $15 million also. So a nice fall through there in the new guide, and we're just getting started on the fall through with these contract renewals and of course, we've moved up adjusted free cash flow by $20 million at the midpoint as well. So it's all of those things that bring us to the new guide and talking about crossing Rule of 40 a couple of years ahead of the original plan in Q4 this year and high single-digit organic growth Q4 and go forward.

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

All right. Great. And then, Tony, you mentioned a nice big step-up in sales productivity. Wondering if you could just help with a few of the mechanics there. How much of the reduction in head count maybe impacted sales reps or the broader go-to-market team? And then what sort of mechanically or strategically from an operational standpoint has gone into place to help the remaining sales team drive that productivity that you talked about?

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

Absolutely, Matt. The go-to-market team was affected very minimally in the reductions. That team, as you know, we've done a lot of work with that group over the past several years, largely coming into the pandemic outside of EVERFI. We were in really good shape and starting to see nice improvement in productivity then pandemic hit us.

And so I think really what you're seeing now is just the fruits of our labor over several years. Mr. Mooney here did a lot of that work. But it's just paying dividends. And so all the things that we've done in our hiring or changes in organizational structure, we put in a lot of new technologies and approaches, et cetera, and this is not the end. This is just the beginning.

And so we still expect to see significant additional improvement in sales productivity over the next couple of years. We're not anywhere near where we'd like to be on CAC payback and return on CAC perspective overall, although we've made tremendous progress over the last few years.

So I'd say most of that is really just everything coming to fruition on all the hard work we did for several years leading into the pandemic, and we're seeing the benefit of that now that the economy is going to rebound a bit coming out.

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The other side of it would be on the corporate side. EVERFI, YourCause, Tom and team are doing a great job on that front. We just had a lot of disruption last year in that team, and then you had the economy impact the corporate sector as well. And we've rebounded. We've got the team restaffed and ramped and just think things are looking very positive on the corporate sector also.

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

Yes. Matt, I'll just add that last summer, we also reorganized sales. So we had about a half a dozen groups running sales, and they were rolling up into several different areas. So we combined the Blackbaud global sales teams under Dave Benjamin. So David runs all of global sales.

In addition to Tom Davidson, and Tom, as you know, is the CEO and Founder of EVERFI, Tom runs the global business for the combination of EVERFI and YourCause, which we're selling to corporations. And so we have a much more streamlined single leadership, global selling organization as of last summer that we haven't had before, too. So it's driving a lot more efficiency, common practices and better go-to-market, and we're seeing all those changes from the last summer really come to fruition this year.

Operator

Thank you. This brings us to the end of the question-and-answer session. I would like to turn the floor back over to Mr. Gianoni for closing comments.

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

Thanks, everyone who joined our call today.

In summary, we're laser-focused on operating the business to drive strong results for our company, our customers and our shareholders. We're committed to providing our customers with innovative, mission-critical solutions to advance their causes and fuel social impact.

Coming out of the pandemic last summer, we thoughtfully began implementing a 5-point operating plan as creating durable, significant and long-lasting improvements. This plan strengthens product innovation and delivery, drives bookings growth, optimizes and expands transactional revenue, modernizes our contractual pricing and strengthens cost management.

We're just now starting to see the benefits of this plan in our financials as evidenced by strong first quarter performance and increased guidance. We expect to see further improvement each sequential quarter and by the fourth quarter of this year to achieve organic revenue growth in the high single digits as well as Rule of 40. That's well ahead of our prior target of the year 2025.

And looking ahead to 2024, we expect to continue growing revenue and expanding margin to achieve Rule of 40 for the full year. I'm incredibly proud of our employees, the progress our team has made, and I'm confident that we'll build on our progress and drive strong, sustainable growth that will create value for our shareholders.

Thank you, everyone.

Operator

Ladies and gentlemen, this concludes today's event. You may disconnect your lines or walk off the webcast at this time, and enjoy the rest of your day.

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