

FRANKLIN COVEY CO  
Form DEF 14A  
February 01, 2005

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

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934 (Amendment No. 1)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

**FRANKLIN COVEY CO.**

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
  - (1) Title of each class of securities to which transaction applies:  

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(4) Proposed maximum aggregate value of transaction:

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(1) Amount Previously Paid:

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(4) Date Filed:

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**Franklin Covey Co.**  
**2200 West Parkway Boulevard**  
**Salt Lake City, Utah 84119-2331**

January 26, 2005

Dear Shareholder:

You are cordially invited to attend the Annual Meeting of Shareholders of Franklin Covey Co. (the "Company"), which will be held on March 4, 2005 at 8:30 a.m., at the Hyrum W. Smith Auditorium, 2200 West Parkway Boulevard, Salt Lake City, Utah 84119-2331 (the "Annual Meeting"), for the following purposes:

- (1) To elect four directors of the Company, each to serve a term of three years expiring at the annual meeting of shareholders of the Company to be held following the end of fiscal year 2007 and until their respective successors shall be duly elected and shall qualify;
- (2) To consider and vote on a proposal to approve the adoption of the Franklin Covey Co. 2004 Employee Stock Purchase Plan;
- (3) To consider and vote on a proposal to approve the adoption of the Franklin Covey Co. 2004 Non-Employee Directors' Stock Incentive Plan;
- (4) To consider and vote on a proposal to ratify the appointment of KPMG LLP as independent auditors of the Company for the fiscal year ending August 31, 2005;
- (5) To consider and vote on the following proposals necessary to implement the Recapitalization (as defined below) which all must be approved for any to become effective:
  - a) Amend and restate the Articles of Incorporation of the Company to modify the rights, preferences and limitations of the Series A Preferred Stock and the Series B Preferred Stock;
  - b) Issue warrants to purchase Common Stock, \$0.05 par value per share, to all holders of Series A Preferred Stock;
  - c) Amend and restate the Articles of Incorporation of the Company to effect a one-to-four forward split of each outstanding share of Series A Preferred Stock;
  - d) Amend and restate the Articles of Incorporation of the Company to increase the Company's authorized Preferred Stock, no par value per share, from 4,000,000 to 14,000,000 shares;
  - e) Amend and restate the Articles of Incorporation of the Company to increase the number of shares of Preferred Stock of the Company designated as Series A Preferred Stock, no par value per share, from 1,500,000 to 4,000,000 shares; and
  - f) Amend and restate the Articles of Incorporation of the Company to increase the number of shares of Preferred Stock of the Company designated as Series B Preferred Stock, no par value per share, from 400,000 to 4,000,000 shares;
- (6) To consider and vote on a proposal to eliminate from or modify in the Articles of Incorporation of the Company certain miscellaneous provisions such as simplifying the provision providing for a detailed list of the purposes of the Company,

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eliminating the provision designating the Company's registered office and agent, eliminating the provision authorizing the Board of Directors to make partial liquidating distributions or to encumber the Company's assets and eliminating the provision addressing interested director transactions, which is substantially similar to a provision of the Utah Revised Business Corporation Act concerning interested director transactions;

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(7)

To consider and vote on the following proposals:

a)

to adjourn the Annual Meeting, if needed, to solicit additional votes in favor of Proposal 5(a), the proposal to amend and restate the Articles of Incorporation of the Company to modify the rights, preferences and limitations of the Series A Preferred Stock and the Series B Preferred Stock; and

b)

to adjourn the Annual Meeting, if needed, to solicit additional votes in favor of Proposal 5(b), the proposal to issue warrants to all holders of Series A Preferred Stock to purchase Common Stock of the Company; and

(8)

To transact such other business as may properly come before the Annual Meeting or at any adjournment or postponement thereof.

The Recapitalization proposals, collectively referred to as the "Recapitalization," are being proposed in accordance with a Preferred Stock and Warrant Issuance Agreement dated as of November 29, 2004 between the Company and Knowledge Capital Investment Group ("Knowledge Capital"). Knowledge Capital is the Company's largest shareholder in terms of voting power. Knowledge Capital is the beneficial owner of 827,859.67 shares of Series A Preferred Stock, or 94.8 percent of the Series A Preferred Stock outstanding, which shares provide Knowledge Capital with 6,622,877 votes with the holders of Common Stock, or 24.0 percent of the total voting power of the Common Stock and the Common Stock voting power of the Series A Preferred Stock. Knowledge Capital additionally holds 1,015,002 shares of Common Stock, or 4.9 percent of the Common Stock voting power excluding the Common Stock voting power of the Series A Preferred Stock. The common and preferred shares owned by Knowledge Capital represent approximately 27.6 percent of the total voting power of the Company.

A special committee of independent directors (the "Special Committee") unanimously determined that the Recapitalization is fair to and in the best interests of the common shareholders of the Company and recommended that the Board of Directors approve the Recapitalization. The Board of Directors, taking into account the findings and recommendation of the Special Committee, determined that the Recapitalization is fair to and in the best interests of the common shareholders of the Company, approved the Recapitalization and recommends that shareholders vote for approval of the Recapitalization proposals.

The accompanying Proxy Statement provides a detailed description of the Recapitalization and the other proposals of the Company. Please read the entire Proxy Statement and its appendices carefully.

**I urge you to vote in favor of the Recapitalization and all other proposals, and I look forward to the opportunity to share our outlook and plans with you at the Annual Meeting.**

Sincerely,

/s/ Robert A. Whitman

Robert A. Whitman

*President, Chief Executive Officer and  
Chairman of the Board*

**This Proxy Statement is dated January 26, 2005 and is first being mailed to shareholders on or about February 1, 2005.**

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**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

**To Be Held  
March 4, 2005**

**FRANKLIN COVEY CO.**

You are cordially invited to attend the Annual Meeting of Shareholders of Franklin Covey Co. (the "Company"), which will be held on Friday, March 4, 2005 at 8:30 a.m., at the Hyrum W. Smith Auditorium, 2200 West Parkway Boulevard, Salt Lake City, Utah 84119-2331 (the "Annual Meeting"), for the following purposes:

- (1) To elect four directors of the Company, each to serve a term of three years expiring at the annual meeting of shareholders of the Company to be held following the end of fiscal year 2007 and until their respective successors shall be duly elected and shall qualify;
- (2) To consider and vote on a proposal to approve the adoption of the Franklin Covey Co. 2004 Employee Stock Purchase Plan;
- (3) To consider and vote on a proposal to approve the adoption of the Franklin Covey Co. 2004 Non-Employee Directors' Stock Incentive Plan;
- (4) To consider and vote on a proposal to ratify the appointment of KPMG LLP as independent auditors of the Company for the fiscal year ending August 31, 2005;
- (5) To consider and vote on the following proposals necessary to implement the Recapitalization (as defined in this Proxy Statement) which all must be approved for any to become effective:
  - a) Amend and restate the Articles of Incorporation of the Company to modify the rights, preferences and limitations of the Series A Preferred Stock and the Series B Preferred Stock;
  - b) Issue warrants to purchase Common Stock, \$0.05 par value per share, to all holders of Series A Preferred Stock;
  - c) Amend and restate the Articles of Incorporation of the Company to effect a one-to-four forward split of each outstanding share of Series A Preferred Stock;
  - d) Amend and restate the Articles of Incorporation of the Company to increase the Company's authorized Preferred Stock, no par value per share, from 4,000,000 to 14,000,000 shares;
  - e) Amend and restate the Articles of Incorporation of the Company to increase the number of shares of Preferred Stock of the Company designated as Series A Preferred Stock, no par value per share, from 1,500,000 to 4,000,000 shares; and
  - f) Amend and restate the Articles of Incorporation of the Company to increase the number of shares of Preferred Stock of the Company designated as Series B Preferred Stock, no par value per share, from 400,000 to 4,000,000 shares;
- (6) To consider and vote on a proposal to eliminate from or modify in the Articles of Incorporation of the Company certain miscellaneous provisions such as simplifying the provision providing for a detailed list of the purposes of the Company, eliminating the provision designating the Company's registered office and agent, eliminating the provision authorizing the

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Board of Directors to make partial liquidating distributions or to encumber the Company's assets and eliminating the provision addressing interested director transactions, which is substantially similar to a provision of the Utah Revised Business Corporation Act concerning interested director transactions;

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(7)

To consider and vote on the following proposals:

a)

to adjourn the Annual Meeting, if needed, to solicit additional votes in favor of Proposal 5(a), the proposal to amend and restate the Articles of Incorporation of the Company to modify the rights, preferences and limitations of the Series A Preferred Stock and the Series B Preferred Stock; and

b)

to adjourn the Annual Meeting, if needed, to solicit additional votes in favor of Proposal 5(b), the proposal to issue warrants to all holders of Series A Preferred Stock to purchase Common Stock of the Company; and

(8)

To transact such other business as may properly come before the Annual Meeting or at any adjournment or postponement thereof.

The Board of Directors has fixed the close of business on January 7, 2005, as the record date for the determination of shareholders entitled to receive notice of and to vote at the Annual Meeting and at any adjournment or postponement thereof.

All shareholders are urged to attend the meeting.

By Order of the Board of Directors

/s/ Robert A. Whitman

Robert A. Whitman

*Chairman of the Board of Directors*

January 26, 2005



**IMPORTANT**

**Whether or not you expect to attend the Annual Meeting in person, to assure that your shares will be represented, please promptly complete, date, sign and return the enclosed proxy without delay in the enclosed envelope, which requires no additional postage if mailed in the United States. Your proxy will not be used if you are present at the Annual Meeting and desire to vote your shares personally.**

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**Franklin Covey Co.**

**2200 West Parkway Boulevard  
Salt Lake City, Utah 84119-2331**

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**PROXY STATEMENT**

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**Annual Meeting of Shareholders  
March 4, 2005**

**SOLICITATION OF PROXIES**

This Proxy Statement is being furnished to the shareholders of Franklin Covey Co., a Utah corporation ("Franklin Covey" or the "Company"), in connection with the solicitation by the board of directors (the "Board" or "Board of Directors") of the Company of proxies from holders of outstanding shares of the Company's Common Stock, \$0.05 par value per share (the "Common Stock"), and outstanding shares of the Company's Series A Preferred Stock, no par value per share (the "Series A Preferred Stock"), for use at the Annual Meeting of Shareholders of the Company to be held on Friday, March 4, 2005, and at any adjournment or postponement thereof (the "Annual Meeting"). This Proxy Statement, the Notice of Annual Meeting of Shareholders and the accompanying form of proxy are first being mailed to shareholders of the Company on or about February 1, 2005.

**PURPOSE OF THE ANNUAL MEETING**

At the Annual Meeting, shareholders will consider and vote upon, among other matters, the set of proposals identified as Proposals 5(a) through 5(f) (collectively, the "Recapitalization Proposals") related to the proposed recapitalization of the Series A Preferred Stock and related amendment and restatement of the Company's Articles of Incorporation and the issuance of warrants to purchase Common Stock (individually, a "Warrant" and collectively, the "Warrants") to all holders of Series A Preferred Stock. The Recapitalization Proposals contemplate proposals to (i) (Proposal 5(a)) amend and restate the Company's Articles of Incorporation to modify the rights, preferences and limitations of the Series A Preferred Stock and the Company's Series B Preferred Stock, no par value per share and of which no shares are outstanding (the "Series B Preferred Stock"), (ii) (Proposal 5(b)) issue the Warrants to all holders of Series A Preferred Stock, (iii) (Proposal 5(c)) effect a one-to-four forward split of the outstanding Series A Preferred Stock and (iv) (Proposals 5(d), 5(e) and 5(f), respectively) to increase the number of authorized shares of the Company's Preferred Stock, no par value per share (the "Preferred Stock"), the Series A Preferred Stock and the Series B Preferred Stock.

The actions described in the Recapitalization Proposals that relate to the amendment and restatement of the Company's Articles of Incorporation, which specifically include Proposals 5(a), 5(c), 5(d), 5(e) and 5(f), as well as the actions described in Proposal 6, are collectively referred to herein as the "Articles Amendment." The actions described in all the Recapitalization Proposals, including, without limitation, the approval of the Articles Amendment and the issuance of the Warrants as described in Proposal 5(b), are referred to in this Proxy Statement as the "Recapitalization." All of the Recapitalization Proposals must be approved by the Company's shareholders as specified in this Proxy Statement or none of them will be effective. Shareholders will also consider and vote upon Proposals 7(a) and 7(b) to adjourn the Annual Meeting, if needed, to solicit additional votes in favor of Proposals 5(a) and 5(b), respectively.

In addition to the Recapitalization Proposals, shareholders of the Company will consider and vote on proposals to (i) (Proposal 1) elect four directors to serve for a term of three years, (ii) (Proposal 2) approve the adoption of the Franklin Covey Co. 2004 Employee Stock Purchase Plan, (iii) (Proposal 3) approve the adoption of the Franklin Covey Co. 2004 Non-Employee Directors' Stock Incentive Plan,

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(iv) (Proposal 4) ratify the appointment of KPMG LLP ("KPMG") as independent auditors of the Company for the fiscal year ending August 31, 2005 and (v) (Proposal 6) eliminate or modify certain miscellaneous provisions in the Company's Articles of Incorporation.

### COSTS OF SOLICITATION

The Company will bear all costs and expenses relating to the solicitation of proxies, including the costs of preparing, printing and mailing to shareholders this Proxy Statement and accompanying materials. In addition to the solicitation of proxies by use of the mails, the directors, officers and employees of the Company, without receiving additional compensation therefore, may solicit proxies personally or by telephone, facsimile or electronic mail. Arrangements will be made with brokerage firms and other custodians, nominees and fiduciaries for the forwarding of solicitation materials to the beneficial owners of the shares of Common Stock and Series A Preferred Stock held by such persons, and the Company will reimburse such brokerage firms, custodians, nominees and fiduciaries for reasonable out-of-pocket expenses incurred by them in connection therewith.

### VOTING

The Board of Directors has fixed the close of business on January 7, 2005 as the record date for determination of shareholders entitled to notice of and to vote at the Annual Meeting (the "Record Date"). As of the Record Date, there were issued and outstanding 20,654,403 shares of Common Stock and 873,457.404 shares of Series A Preferred Stock. The holders of record of the shares of Common Stock on the Record Date are entitled to cast one vote per share on each matter submitted to a vote at the Annual Meeting. The holders of record of Series A Preferred Stock on the Record Date are entitled to cast eight votes for each whole share of Series A Preferred Stock they hold and, for any fractional shares of Series A Preferred Stock they hold, a fewer number of shares depending upon the number of shares of Common Stock into which such fractional shares may convert. In the aggregate, the holders of outstanding shares of Series A Preferred Stock are entitled to 6,987,665 votes for all of the outstanding Series A Preferred Stock. Unless otherwise indicated, the shares of Common Stock and Series A Preferred Stock vote together as a single class on all matters to be presented at the Annual Meeting. There are no shares of Series B Preferred Stock outstanding.

### Proxies

Shares of Common Stock and Series A Preferred Stock which are entitled to be voted at the Annual Meeting and which are represented by properly executed proxies will be voted in accordance with the instructions indicated on such proxies. If no instructions are indicated, such shares will be voted (i) **FOR** the election of each of the four director nominees, (ii) **FOR** the proposal to approve the adoption of the Franklin Covey Co. 2004 Employee Stock Purchase Plan, (iii) **FOR** the proposal to approve the adoption of the Franklin Covey Co. 2004 Non-Employee Directors' Stock Incentive Plan, (iv) **FOR** the ratification of the appointment of KPMG as independent auditors of the Company for the fiscal year ending August 31, 2005, (v) **FOR** the Recapitalization Proposals, (vi) **FOR** the proposal to eliminate or modify certain miscellaneous provisions in the Company's Articles of Incorporation and (vii) **FOR** the proposals to adjourn the Annual Meeting, if needed, to solicit additional votes in favor of the proposal to modify the rights, preferences and limitations of the Series A Preferred Stock and the Series B Preferred Stock, and the proposal to adjourn the annual meeting, if needed, to solicit additional votes in favor of the proposal to issue Warrants to purchase Common Stock to all holders of Series A Preferred Stock. It is not anticipated that any other matters will be presented at the Annual Meeting. If other matters are presented, proxies will be voted in accordance with the discretion of the proxy holders.

A shareholder who has executed and returned a proxy may revoke it at any time prior to its exercise at the Annual Meeting by executing and returning a proxy bearing a later date, by filing with

the Secretary of the Company, at the address set forth above, a written notice of revocation bearing a later date than the proxy being revoked, or by voting the Common Stock or Series A Preferred Stock covered thereby in person at the Annual Meeting.

### Vote Required

A majority of the votes entitled to be cast at the Annual Meeting is required for a quorum at the Annual Meeting. Abstentions and broker non-votes are counted for purposes of determining the presence or absence of a quorum for the transaction of business. Holders of Common Stock and Series A Preferred Stock will vote together as a single class, unless otherwise indicated.

*Proposal 1.* In the election of the directors, the four nominees receiving the highest number of votes will be elected. Accordingly, abstentions and broker non-votes will not affect the outcome of the election for directors.

*Proposals 2, 3 and 4.* The ratification of the adoption of the Franklin Covey Co. 2004 Employee Stock Purchase Plan, the adoption of the Franklin Covey Co. 2004 Non-Employee Directors' Stock Incentive Plan, and the ratification of the appointment of KPMG as independent auditors for the Company requires that the number of votes cast in favor of each such proposal exceed the number of votes cast in opposition. Abstentions and broker non-votes will not affect the outcome of these proposals.

*Proposal 5(a).* Approval of the proposal to amend and restate the Articles of Incorporation of the Company to modify the rights, preferences and limitations of the Series A Preferred Stock and the Series B Preferred Stock requires the following affirmative votes:

a majority of the votes cast by the holders of Common Stock and Series A Preferred Stock, voting together as a single class;

a majority of the votes cast by the holders of Common Stock, voting as a single class; and

the votes of the holders of two-thirds of the outstanding shares of Series A Preferred Stock, voting as a single class.

Abstentions and broker non-votes will not affect the outcome of Proposal 5(a), except that abstentions and broker non-votes of Series A Preferred Stock will have the effect of a no vote for purposes of calculating whether the holders of two-thirds of the outstanding shares of Series A Preferred Stock, voting as a single class, approve this proposal.

*Proposal 5(b).* The approval of Proposal 5(b) regarding the issuance of the Warrants requires the affirmative vote of a majority of the votes cast by the holders of Common Stock and Series A Preferred Stock, voting together as a single class, provided that the total vote cast on the proposal represents over 50 percent in interest of all securities entitled to vote on the proposal. Abstentions and broker non-votes will not affect the outcome of Proposal 5(b), except that abstentions and broker non-votes will not be counted in calculating the total vote cast on the proposal for purposes of determining if the total vote cast on the proposal exceeds 50 percent of all securities entitled to vote on this proposal.

*Proposal 5(c).* The approval of Proposal 5(c) regarding amendment and restatement of the Articles of Incorporation of the Company to effect a one-to-four forward split of each outstanding share of Series A Preferred Stock requires the following affirmative votes:

a majority of the votes cast by the holders of Common Stock and Series A Preferred Stock, voting together as a single class;  
and

the holders of a majority of the outstanding shares of Series A Preferred Stock, voting as a single class.



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Abstentions and broker non-votes will not affect the outcome of Proposal 5(c), except abstentions and broker non-votes will have the effect of a no vote for purposes of calculating whether the holders of a majority of the outstanding shares of Series A Preferred Stock, voting as a single class, approve this proposal.

*Proposal 5(d).* The approval of Proposal 5(d) regarding the amendment and restatement of the Articles of Incorporation of the Company to increase the Company's authorized Preferred Stock, no par value per share, from 4,000,000 to 14,000,000 shares requires the following affirmative votes:

a majority of the votes cast by the holders of Common Stock and Series A Preferred Stock, voting together as a single class;

a majority of the votes cast by the holders of Common Stock, voting as a single class; and

the holders of a majority of the outstanding shares of Series A Preferred Stock, voting as a single class.

Abstentions and broker non-votes will not affect the outcome of Proposal 5(d), except that abstentions and broker non-votes will have the effect of a no vote for purposes of calculating whether the holders of a majority of the outstanding shares of Series A Preferred Stock, voting as a single class, approve this proposal.

*Proposal 5(e).* The approval of Proposal 5(e) regarding the amendment and restatement of the Articles of Incorporation of the Company to increase the number of shares of Preferred Stock of the Company designated as Series A Preferred Stock from 1,500,000 to 4,000,000 shares requires the affirmative vote of the holders of a majority of the outstanding shares of Series A Preferred Stock, voting as a single class. Although no other shareholder approval is required, the Company also seeks the approval of a majority of the votes cast by the holders of Common Stock and Series A Preferred Stock, voting together as a single class. Abstentions and broker non-votes will not affect the outcome of Proposal 5(e), except that abstentions and broker non-votes will have the effect of a no vote for purposes of calculating whether the holders of a majority of the outstanding shares of Series A Preferred Stock, voting as a single class, approve this proposal.

*Proposal 5(f).* The approval of Proposal 5(f) regarding the amendment and restatement of the Articles of Incorporation of the Company to increase the number of shares of Preferred Stock of the Company designated as Series B Preferred Stock from 400,000 to 4,000,000 shares requires the affirmative vote of the holders of a majority of the outstanding shares of Series A Preferred Stock, voting as a single class. Although no other shareholder approval is required, the Company also seeks the approval of a majority of the votes cast by the holders of Common Stock and Series A Preferred Stock, voting together as a single class. Abstentions and broker non-votes will not affect the outcome of Proposal 5(f), except that abstentions and broker non-votes will have the effect of a no vote for purposes of calculating whether the holders of a majority of the outstanding shares of Series A Preferred Stock, voting as a single class, approve this proposal.

*Proposal 6.* The approval of Proposal 6 regarding the elimination from or modification in the Articles of Incorporation of the Company of certain miscellaneous provisions such as simplifying the provision providing for a detailed list of the purposes of the Company, eliminating the provision designating the Company's registered office and agent, eliminating the provision authorizing the Board of Directors to make partial liquidating distributions or to encumber the Company's assets and eliminating the provision addressing interested director transactions, which is substantially similar to a provision of the Utah Revised Business Corporation Act (the "URBCA") concerning interested director transactions, requires the affirmative vote of (i) a majority of the votes cast by the holders of Common Stock and Series A Preferred Stock, voting together as a single class, and (ii) the holders of a majority of the outstanding shares of Series A Preferred Stock, voting as a single class. Abstentions and broker

non-votes will not affect the outcome of Proposal 6 except abstentions and broker non-votes will have the effect of a no vote for purposes of calculating whether the holders of a majority of the outstanding shares of Series A Preferred Stock, voting as a single class, approve this proposal.

*Proposal 7(a).* The proposal to adjourn the Annual Meeting, if needed, to solicit additional votes in favor of Proposal 5(a) requires that the number of votes cast in favor of the proposal exceed the number of votes cast in opposition. Abstentions and broker non-votes will not affect the outcome of this proposal.

*Proposal 7(b).* The proposal to adjourn the Annual Meeting, if needed, to solicit additional votes in favor of Proposal 5(b) requires that the number of votes cast in favor of the proposal exceed the number of votes cast in opposition. Abstentions and broker non-votes will not affect the outcome of this proposal.

Pursuant to a Voting Agreement dated as of November 29, 2004 (the "Voting Agreement") between the Company and Knowledge Capital Investment Group, the largest shareholder in terms of voting power and the largest holder of Series A Preferred Stock ("Knowledge Capital"), Knowledge Capital has agreed to vote all shares of the Company's capital stock it owns, including shares of Common Stock and Series A Preferred Stock, in favor of each of Proposals 5(a) through 5(f), as well as Proposal 6. Knowledge Capital controls approximately (i) 94.8 percent of the Series A Preferred Stock, (ii) 27.6 percent of the total voting power of the Common Stock including the Common Stock voting power of all shares of Series A Preferred Stock and (iii) 4.9 percent of the Common Stock voting power excluding the Common Stock voting power of any shares of Series A Preferred Stock. As a result of Knowledge Capital's ownership, the approval of Proposals 5(a) through 5(f), as well as Proposal 6, required by the holders of the Series A Preferred Stock, voting as a single class, is assured.

## **PROPOSAL 1**

### **TO APPROVE THE ELECTION OF THE FOUR NOMINEES AS DIRECTORS**

At the Annual Meeting, four directors are to be elected to serve three-year terms expiring at the annual meeting of shareholders to be held following the end of fiscal year 2007 and until their successors shall be duly elected and qualified. Unless the shareholder indicates otherwise, the accompanying proxy will be voted in favor of the following persons: Clayton Christensen, Robert H. Daines, E. J. "Jake" Garn and Donald J. McNamara. If any of the nominees should be unavailable to serve, which is not now anticipated, the proxies solicited hereby will be voted for such other persons as shall be designated by the present Board of Directors. The four nominees receiving the highest number of votes at the Annual Meeting will be elected.

Based upon the recommendation of Robert A. Whitman, the President, Chief Executive Officer and Chairman of the Board, in March 2004, the Board of Directors considered upon and voted to add Clayton Christensen to the Company's Board of Directors.

### **THE BOARD OF DIRECTORS RECOMMENDS THAT SHAREHOLDERS VOTE FOR EACH OF THE FOUR NOMINEES TO THE BOARD OF DIRECTORS.**

#### **Nominees for Election to the Board of Directors**

Certain information with respect to the nominees is set forth below.

*Clayton Christensen, 52*, was appointed as a director of the Company in March 2004 and began his service in July 2004. Dr. Christensen is the Robert and Jane Cizik Professor of Business Administration at the Harvard Business School where he has been a faculty member since 1992. His research and teaching interests center on the management issues related to the development and commercialization of business model innovation and technology. His specific area of focus is in developing organizational

capabilities. Dr. Christensen was a Rhodes Scholar and received his Masters of Philosophy degree from Oxford and his MBA and DBA from the Harvard Business School. He also served as President and Chairman of Ceramics Process Systems from 1984 to 1989. From 1979 to 1984 he worked as a consultant and project manager for the Boston Consulting Group.

*Robert H. Daines*, 70, has been a director of the Company since April 1990. Dr. Daines is an Emeritus Driggs Professor of Strategic Management at Brigham Young University, where he was employed for 44 years. Dr. Daines also currently serves on the board of directors for Volvo Commercial Credit Corporation. Dr. Daines received his MBA from Stanford and his DBA from Indiana University.

*E. J. "Jake" Garn*, 72, was elected to serve as a director of the Company in January 1993. Mr. Garn is a self-employed consultant. From December 1974 to January 1993, Mr. Garn was a United States Senator from the State of Utah. During his term in the Senate, Mr. Garn served six years as Chairman of the Senate Banking, Housing and Urban Affairs Committee and served on the Appropriations, Energy and Natural Resources, and Senate Rules Committees. Prior to his election to the Senate, Mr. Garn served as Mayor of Salt Lake City, Utah, from January 1972 to December 1974. Mr. Garn also currently serves as a director of Morgan Stanley Funds (NYSE), Nu Skin Enterprises, Inc. (NYSE) and BMW Bank, NA (NASDAQ), and is a member of the Board of Trustees of Intermountain Health Care.

*Donald J. McNamara*, 51, was appointed to serve as a director of the Company in June 1999. Mr. McNamara is the founder of The Hampstead Group, L.L.C. ("The Hampstead Group"), a privately held equity investment firm based in Dallas, Texas, and has served as its Chairman since its inception in 1989. He currently serves as Chairman of the Board of Directors of FelCor Lodging Trust, a NYSE listed hotel REIT. He received his undergraduate degree from Virginia Tech and his MBA in 1978 from Harvard University. The Hampstead Group is the sponsor of Knowledge Capital, and Mr. McNamara serves as a director as a designee of Knowledge Capital pursuant to contractual rights granted to it by the Company.

#### **Directors Whose Terms of Office Continues**

In addition to the directors to be elected at the Annual Meeting, the directors named below will continue to serve their respective terms of office as indicated. Stephen R. Covey, Dennis G. Heiner, and Brian A. Krisak are currently serving terms which expire at the annual meeting of the Company's shareholders to be held following the end of fiscal year 2005. Joel C. Peterson, E. Kay Stepp and Robert A. Whitman are currently serving terms which expire at the annual meeting of the Company's shareholders to be held following the end of fiscal year 2006.

*Stephen R. Covey*, 72, has been Vice Chairman of the Board of Directors since June 1999. Dr. Covey served as Co-Chairman of the Board of Directors from May 1997 to June 1999. Dr. Covey founded Covey Leadership Center ("Covey") and served as its Chief Executive Officer and Chairman of the Board from 1980 to 1997. Dr. Covey received his MBA degree from Harvard Business School and his doctorate from Brigham Young University, where he was a professor of organizational behavior and business management from 1957 to 1983, except for periods in which he was on leave from teaching, and served as Assistant to the President and Director of University Relations. Dr. Covey is the author of several acclaimed books, including *The 7 Habits of Highly Effective People*, *Principle-Centered Leadership*, *The 7 Habits of Highly Effective Families*, and *Living the 7 Habits: Stories of Courage and Inspiration*, and is the co-author of *First Things First*. His latest book, *The 8<sup>th</sup> Habit: From Effectiveness to Greatness*, was released in November 2004. He is also a director of Points of Light foundation and a fellow of the Center for Organizational and Technological Advancement at Virginia Tech.

*Dennis G. Heiner*, 61, was appointed as a director of the Company in January 1997. Mr. Heiner served as President and Chief Executive Officer of Werner Co., a leading manufacturer of climbing products and aluminum extrusions, from 1999 until his retirement in October 2004. Prior to joining Werner, he was employed by Black & Decker Corporation from 1985 to 1999 where he served as Executive Vice President and President of the Security Hardware Group, a world leader in residential door hardware.

*Brian A. Krisak*, 53, was appointed a director in June 1999, while a principal of The Hampstead Group. Mr. Krisak was with The Hampstead Group from January 1999 to September 2002. Currently, Mr. Krisak is President of Krisak and Company, a management consulting firm specializing in strategy founded in 1987. He also serves as Chairman of Apangea Learning, Inc., an educational services firm, and as a board member of Hyperactive Technologies, Inc., a robotics firm serving the fast food industry. Previously Mr. Krisak has held several executive and board positions in the technology and consumer products and services industries. He received his degree in Government and Law from Lafayette College and his MBA from Harvard University. Mr. Krisak serves as a director as a designee of Knowledge Capital.

*Joel C. Peterson*, 57, has been a director of the Company since May 1997. Mr. Peterson served as a director of Covey from 1993 to 1997 and as Vice Chairman of Covey from 1994 to 1997. Mr. Peterson founded Peterson Partners LP, and its predecessor Private Equity Investment Enterprises, a privately-held equity investment firm in 1996 and has served as its Founding Partner from its inception. Mr. Peterson also has taught MBA courses at Stanford Business School since 1992. Mr. Peterson also serves on the boards of directors of Asurion and JetBlue Airways Corporation (NASDAQ). Mr. Peterson earned his MBA from Harvard Business School.

*E. Kay Stepp*, 59, has been a director of the Company since May 1997. Ms. Stepp served as a director of Covey from 1992 to 1997. Ms. Stepp is the Chairperson of the Board of Directors of Providence Health System and is the former President and Chief Operating Officer of Portland General Electric, an electric utility. Ms. Stepp is also currently a director of StanCorp Financial Group (NYSE) and Planar Systems, Inc. (NASDAQ). She formerly was principal of Executive Solutions, an executive coaching firm, and was a director of the Federal Reserve Bank of San Francisco. She received her Bachelor of Arts degree from Stanford University and a Master of Arts in Management from the University of Portland and attended the Stanford Executive Program and the University of Michigan Executive Program.

*Robert A. Whitman*, 51, has been a director of the Company since May 1997 and has served as Chairman of the Board of Directors since June 1999 and President and Chief Executive Officer of the Company since January 2000. Mr. Whitman served as a director of Covey from 1994 to 1997. Prior to joining the Company, Mr. Whitman served as President and Co-Chief Executive Officer of The Hampstead Group from 1992 to 2000. Mr. Whitman received his Bachelor of Arts degree in Finance from the University of Utah and his MBA from Harvard Business School.

#### **Director Who Will Conclude His Term of Office Upon the Occurrence of the Annual Meeting**

Certain information with respect to the director who will conclude his service as of the date of the Annual Meeting is set forth below.

*Hyrum W. Smith*, 61, a co-founder of the Company, has served as a director of the Company since December 1983 and has served as Vice Chairman of the Board of Directors since June 1999. Mr. Smith served as Chairman of the Board of Directors from December 1986 to June 1999. Mr. Smith served as the Chief Executive Officer of the Company from February 1997 to March 1998, a position he also held from April 1991 to September 1996. He was Senior Vice President of the Company from December 1984 to April 1991. Mr. Smith is author of *The Ten Natural Laws of Successful Time and Life Management* and *What Matters Most*. He is also a director of SkyWest, Inc. (NASDAQ), Greater Salt

Lake Area Red Cross, and a member on the Advisory Board for the University of Utah School of Business.

#### **AFFIRMATIVE DETERMINATION REGARDING BOARD INDEPENDENCE**

The Board of Directors has determined each of the following directors to be an "independent director" under the listing standards of the New York Stock Exchange (the "NYSE"): Clayton Christensen, Robert H. Daines, Jake Garn, Dennis G. Heiner, Joel C. Peterson and E. Kay Stepp.

In assessing the independence of the directors, the Board of Directors determines whether or not any director has a material relationship with the Company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the Company). The Board of Directors considers all relevant facts and circumstances in making independence determinations, including the director independence standards adopted by the Board of Directors.

The director independence standards adopted by the Board of Directors state that the Board must determine that the director being reviewed has no material relationship with the Company other than as a director, either directly or indirectly (such as a partner, shareholder or executive officer of another entity that has a relationship with the Company). In each case, the Board shall broadly construe all relevant facts and circumstances in making its determination. The director independence standards also provide standards, similar to the NYSE independence standards, that a director must meet in order to be considered independent.

#### **BOARD OF DIRECTOR MEETINGS AND COMMITTEES**

During the 2004 fiscal year, there were five meetings held by the Board of Directors of the Company. All directors attended more than 75 percent of the Board meetings. No director attended fewer than 75 percent of the total number of meetings of the committees on which he or she served. Although the Company encourages Board members to attend its annual meetings of shareholders, it does not have a formal policy regarding director attendance at annual shareholder meetings.

The non-management directors meet regularly in executive sessions, as needed, without the management directors or other members of management. Joel C. Peterson, chairperson of the Nominating and Corporate Governance Committee and the Lead Independent Director, generally presides over these meetings.

The Board of Directors has a standing Audit Committee, Nominating and Corporate Governance Committee (the "Nominating Committee"), and an Organization and Compensation Committee (the "Compensation Committee"). The members of the Audit Committee are Messrs. Jake Garn, Chairperson, Robert H. Daines and Joel C. Peterson. The Nominating Committee consists of Messrs. Joel C. Peterson, Chairperson, Robert H. Daines and Ms. E. Kay Stepp. The Compensation Committee consists of Ms. E. Kay Stepp, Chairperson, and Messrs. Dennis G. Heiner and Robert H. Daines. Brian A. Krisak served as a member of the Compensation Committee during fiscal 2004 but no longer serves as a member of the Compensation Committee. The Board of Directors has adopted a written charter for each of the committees.

These charters, along with the Company's Corporate Governance Guidelines and Code of Business Conduct and Ethics, are available at the Company's website at [www.franklincovey.com](http://www.franklincovey.com). In addition, shareholders may obtain a printed copy of any of these documents by making a written request to Investor Relations, Franklin Covey Co., 2200 West Parkway Boulevard, Salt Lake City, Utah 84119-2331.

The Audit Committee functions on behalf of the Board of Directors in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and met five times during the 2004 fiscal year. Its functions are: (i) to review and approve the selection of,

and all services performed by, the Company's independent auditors; (ii) to review the Company's internal controls and audit functions; and (iii) to review and report to the Board of Directors with respect to the scope of internal and external audit procedures, accounting practices and internal accounting, and financial and risk controls of the Company. Each of the members of the Audit Committee is independent as described under NYSE rules. The Board of Directors has determined that one of the Audit Committee members, Robert Daines, is a "financial expert" as defined in Item 401(h) of Regulation S-K.

The Nominating Committee met five times during the 2004 fiscal year. The Nominating Committee assists the Board of Directors by: (i) identifying individuals who are qualified and willing to become Board members; (ii) recommending that the Board nominate as many identified individuals as needed for appointment as a director for each annual Company shareholder meeting; (iii) ensuring that the Audit Committee, the Compensation Committee, and the Nominating Committees of the Board are comprised of qualified and experienced "independent" directors; (iv) developing and recommending succession plans for the Chief Executive Officer; and (v) developing corporate governance policies and procedures applicable to the Company and recommending that the Board adopt said policies and procedures. All of the members of the Nominating Committee are "independent" as described under NYSE rules.

The Compensation Committee met six times during the 2004 fiscal year. Its functions are: (i) to review, and make recommendations to the Board of Directors regarding the salaries, bonuses and other compensation of the Company's Chairman of the Board; and (ii) to review and administer any stock option plan, stock purchase plan, stock award plan and employee benefit plan or arrangement established by the Board of Directors for the benefit of the executive officers, employees and the independent directors of the Company. All of the Compensation Committee members are "independent" as described under NYSE rules.

#### **OUR DIRECTOR NOMINATION PROCESS**

As indicated above, the Nominating Committee of the Board of Directors oversees the director nomination process. This committee is responsible for identifying and evaluating candidates for membership on the Board of Directors and recommending to the Board of Directors nominees to stand for election. Each candidate to serve on the Board of Directors must meet the expectations for directors set out in the Corporate Governance Guidelines approved by the Board of Directors and available on our website at [www.franklincovey.com](http://www.franklincovey.com). In addition to the qualifications set forth in the Corporate Governance Guidelines, nominees for Director will be selected on the basis of such attributes as their integrity, experience, achievements, judgment, intelligence, personal character, ability to make independent analytical inquiries, willingness to devote adequate time to Board duties, and the likelihood that he or she will be able to serve on the Board for a sustained period. In connection with the selection of nominees for director, consideration will be given to the Board's overall balance of diversity of perspectives, backgrounds and experiences. Accordingly, the Board will consider factors such as global experience, experience as a director of a large public company and knowledge of particular industries.

Although not an automatically disqualifying factor, the inability of a candidate to meet independence standards of the NYSE will weigh negatively in any assessment of a candidate's suitability, as will a candidate's service on a number of boards exceeding the standards contained in the Company's Corporate Governance Guidelines.

The Committee intends to use a variety of means of identifying nominees for director, including outside search firms and recommendations from current Board members and from shareholders. In determining whether to nominate a candidate, the Committee will consider the current composition and capabilities of serving Board members, as well as additional capabilities considered necessary or

desirable in light of existing Company needs and then assess the need for new or additional members to provide those capabilities.

Unless well known to one or more members of the Committee, normally at least one member of the Committee will interview a prospective candidate who is identified as having high potential to satisfy the expectations, requirements, qualities and capabilities for Board membership.

### **Shareholder Nominations**

The Nominating Committee, which is responsible for the nomination of candidates for appointment or election of the Board of Directors, will consider, but shall not be required to nominate, candidates recommended by the Company's shareholders who beneficially own at the time of the recommendation not less than one percent of the Company's outstanding stock ("Qualifying Shareholders").

Generally speaking, the manner in which the Nominating Committee evaluates nominees for director recommended by a Qualifying Shareholder will be the same as that for nominees from other sources. However, the Nominating Committee will seek and consider information concerning the relationship between a Qualifying Shareholder's nominee and that Qualifying Shareholder to determine whether the nominee can effectively represent the interests of all shareholders.

Qualifying Shareholders wishing to make such recommendations to the Nominating Committee for its consideration may do so by submitting a written recommendation, including detailed information on the proposed candidate, including education, professional experience and expertise, via mail addressed as follows:

c/o Val J. Christensen, Corporate Secretary, Franklin Covey Co., 2200 West Parkway  
Boulevard, Salt Lake City, Utah 84119-2331

### **Contractual Rights of Knowledge Capital to Designate Nominees**

Currently, under the Stockholders Agreement dated June 2, 1999 between the Company and Knowledge Capital (the "Stockholders Agreement"), the Company is obligated to nominate three designees of Knowledge Capital for election to the Board of Directors, including the Chairman of the Board of Directors, and all such designees must be nominated to be elected in different classes. Currently, only two designees of Knowledge Capital are members of the Board of Directors, including Donald J. McNamara and Brian A. Krisak. Upon the mutual agreement of the Company and Knowledge Capital, Robert A. Whitman, the Chairman of the Board of Directors, does not currently serve as a designee of Knowledge Capital. The Company is obligated at each meeting of the shareholders of the Company at which directors are elected to cause the Knowledge Capital designees to be nominated for election and will solicit proxies in favor of such nominees and vote all management proxies in favor of such nominees except for proxies that specifically indicate to the contrary.

The Stockholders Agreement also provides that the Company is obligated to ensure that at least one designee of Knowledge Capital is a member of all committees of the Board other than the Nominating Committee. No designee of Knowledge Capital currently serves on any committee of the Board.

## COMMUNICATIONS WITH DIRECTORS

Shareholders or other interested parties wishing to communicate with the Board of Directors, the non-management directors as a group, or any individual director may do so in writing by addressing the correspondence to that individual or group, c/o Val J. Christensen, Corporate Secretary, Franklin Covey Co., 2200 West Parkway Boulevard, Salt Lake City, Utah 84119-2331 or by using the Company's website at [www.franklincovey.com](http://www.franklincovey.com). All such communications will initially be received and processed by the office of the Corporate Secretary. The Secretary or Assistant Secretary will initially review such correspondence and either (i) immediately forward the correspondence to the indicated director and to the Chair of the Nominating Committee, or (ii) hold for review for before or after the next regular meeting of the Board of Directors.

## DIRECTOR COMPENSATION

Messrs. Robert A. Whitman, Brian A. Krisak, Donald J. McNamara, Hyrum W. Smith and Stephen R. Covey do not currently receive compensation for Board or committee meetings. The remaining directors are paid as follows:

Each Board member is paid an annual retainer of \$30,000 paid quarterly for service on the Board and attending Board meetings;

Each Board member is paid an additional annual retainer of \$7,000 for service on each committee they serve in lieu of committee meeting fees;

Committee chairpersons are paid an additional annual retainer of \$5,000 for the Audit and Compensation committees and \$3,000 for all other committees;

Each Board member will be annually granted a restricted stock award equivalent to \$27,500 which vests over a three-year term if Proposal 3 is approved by the shareholders;

Directors are reimbursed by the Company for their out-of-pocket travel and related expenses incurred in attending all Board and committee meetings.

## EXECUTIVE OFFICERS

In addition to Mr. Whitman, certain information is furnished with respect to the following executive officers of the Company:

*Val J. Christensen*, 51, has been Secretary and General Counsel of the Company since January 1990 and an Executive Vice President since March 1996. Mr. Christensen served as a director of the Company from July 1991 to June 1997. From January 1990 to March 1996, Mr. Christensen served as a Senior Vice President of the Company. From March 1987 to November 1989, Mr. Christensen was engaged in the private practice of law with the law firm of LeBoeuf, Lamb, Lieby & MacRae (now LeBoeuf, Lamb, Greene & MacRae, LLP), specializing in general business and business litigation matters. From 1983 until he joined the Company, Mr. Christensen acted as outside counsel to the Company. Mr. Christensen earned his Bachelor of Arts in Economics from Brigham Young University and his J.D. from Brigham Young University.

*Robert W. Bennett, Jr.*, 48, has been President of the Organizational Solutions Business Unit of the Company since July 2002. Mr. Bennett joined the Company in February 2000 as Vice President of Sales and later served as Senior Vice President of Global Sales and Delivery. Prior to joining the Company, Mr. Bennett served as President of PowerQuest from 1998 to 2000 and as General Manager and President of Folio from 1993 to 1998. Mr. Bennett has 24 years of sales and sales management experience with Fortune 500 companies including IBM. Mr. Bennett earned his Bachelor of Arts in Government and Law from Lafayette College in Pennsylvania.



*Sarah Merz*, 40, has been President and General Manager of the Consumer Business Unit since October 2003. Ms. Merz joined the Company in May 2000 as Vice President of Marketing. Prior to joining the Company, Ms. Merz was a Partner and co-owner of Kannon Consulting, Inc. and an associate for Booz, Allen & Hamilton, where she created marketing strategies for Fortune 100 businesses throughout the U.S. as well as major corporations overseas. Ms. Merz also served as Vice President of International Sales and Business Development for Revell-Monogram, Inc. Ms. Merz received an MBA with honors from Northwestern's Kellogg Graduate School of Management and earned her Bachelor of Arts with honors in Economics from the University of Chicago.

*Stephen D. Young*, 51, joined the Company as Senior Vice President of Finance, Chief Accounting Officer and Controller in January 2001 and was appointed Chief Financial Officer in November 2002. Prior to joining the Company, he served as Senior Vice President of Finance, Chief Financial Officer and director of international operations for Weider Nutrition International, Inc. for seven years. Mr. Young has 25 years of accounting and management experience. Mr. Young is a CPA and holds a Bachelor of Science in Accounting degree from Brigham Young University.

## EXECUTIVE COMPENSATION

The compensation of Robert A. Whitman, the Company's Chairman, President and Chief Executive Officer, and the other named executive officers listed below (collectively, the "Named Executive Officers") at August 31, 2004, the most recent fiscal year end, is shown below.

## Summary Compensation Table

| Name and Position  | Fiscal Year          | Annual Compensation           |                               |                                | Long Term Compensation Awards |                                       |                             |
|--|----------------------|-------------------------------|-------------------------------|--------------------------------|-------------------------------|---------------------------------------|-----------------------------|
|  |                      | Salary (\$)                   | Bonus (\$)                    | Other Annual Compensation\$(1) | Restricted Stock Awards(2)    | Securities Underlying Options/SARs(3) | All Other Compensation\$(4) |
| Robert A. Whitman(5)<br>Chairman, President<br>and Chief Executive<br>Officer    | 2004<br>2003<br>2002 | 500,004                       | 281,250                       | 5,041                          |                               |                                       |                             |
| Val J. Christensen<br>Executive Vice<br>President and Secretary                  | 2004<br>2003<br>2002 | 300,000<br>300,000<br>300,000 | 150,000<br>150,000<br>150,000 | 1,590<br>1,456<br>543          | 143,325                       |                                       | 6,150<br>7,500<br>9,754     |
| Robert W. Bennett, Jr.<br>President<br>Organizational<br>Solutions Business Unit | 2004<br>2003<br>2002 | 250,000<br>250,000<br>250,000 | 126,875<br>110,962<br>54,315  | 1,957<br>1,644                 | 143,325                       |                                       | 7,987<br>6,798<br>6,427     |
| Sarah Merz<br>President Consumer<br>Business Unit                                | 2004<br>2003<br>2002 | 226,154<br>130,000<br>130,000 | 98,438<br>11,070<br>13,295    | 58,691                         | 143,325                       | 50,000                                | 8,569<br>3,705<br>5,640     |
| Stephen D. Young<br>Senior Vice President<br>Chief Financial Officer             | 2004<br>2003<br>2002 | 221,154<br>200,000<br>200,000 | 86,875<br>36,250<br>30,531    | 53,280                         | 128,993                       |                                       | 8,352<br>5,921<br>4,872     |

- (1) Other amounts relate to miscellaneous benefits paid during the year and reimbursement of taxes that were paid during the year.
- (2) Restricted stock awards vest in full five years from the date of grant. Vesting may occur partially or in full prior to five years from grant if certain financial targets are met. Holders of restricted shares are entitled to vote the shares.
- (3) Amounts shown reflect options granted to the Named Executive Officers pursuant to the Franklin Covey 1992 Stock Incentive Plan (the "Incentive Plan"). As of August 31, 2004, the Company had not granted any stock appreciation rights.
- (4) Amounts shown reflect contributions made by the Company for the benefit of the Named Executive Officers under the Franklin Covey 401(k) Profit Sharing Plan.
- (5) Mr. Whitman did not accept a base salary or bonus compensation from May 2001 through August 2003.



**Option/SAR Grants in Last Fiscal Year**

The following table sets forth individual grants of stock options made by the Company during the fiscal year ended August 31, 2004 to the Named Executive Officers. As of August 31, 2004, the Company had not granted any stock appreciation rights to the Named Executive Officers.

| Name                   | Options<br>Granted | Percent of<br>Total Options<br>Granted to<br>Employees in<br>Fiscal Year | Exercise or<br>Base Price | Expiration<br>Date | Potential Realizable Value at<br>Assumed Annual Rate of Stock<br>Price Appreciation for the<br>Option Term<br>(in dollars) |            |
|------------------------|--------------------|--|---------------------------|--------------------|--|------------|
|                        |                    |  |                           |                    | 5%   | 10%        |
| Robert A. Whitman      |                    |  |                           |                    |  |            |
| Val J. Christensen     |                    |  |                           |                    |  |            |
| Robert W. Bennett, Jr. |                    |  |                           |                    |  |            |
| Sarah Merz             | 50,000             | 71.4%  | \$ 1.70                   | 11/14/13           | \$ 53,456  | \$ 135,468 |
| Stephen D. Young       |                    |  |                           |                    |  |            |

**Aggregated Option/SAR Exercises in Last Fiscal Year and Fiscal Year Option/SAR Values**

The following table sets forth the number of shares of Common Stock acquired during the fiscal year ended August 31, 2004 upon the exercise of stock options, the value realized upon such exercise, the number of unexercised stock options held on August 31, 2004, and the aggregate value of such options held by the Named Executive Officers. This table reflects options to acquire shares of Common Stock granted to the Named Executive Officers by the Company and by certain affiliates of the Company. As of August 31, 2004, the Company had not granted any stock appreciation rights to any of the Named Executive Officers.

| Name                   | Number of<br>Shares<br>Acquired on<br>Exercise | Value<br>Realized on<br>Exercise | Number of Unexercised<br>Options at<br>August 31, 2004 |               | Value of Unexercised<br>In-the-Money Options at<br>August 31, 2004 |               |
|------------------------|--|----------------------------------|--|---------------|--|---------------|
|                        |  |                                  | Exercisable  | Unexercisable | Exercisable  | Unexercisable |
| Robert A. Whitman      |  |                                  |  | 1,602,000(1)  |  |               |
| Val J. Christensen     |  |                                  | 90,300   |               |  |               |
| Robert W. Bennett, Jr. |  |                                  | 50,000   |               |  |               |
| Sarah Merz             |  |                                  |  | 50,000        | \$   | 2,500         |
| Stephen D. Young       |  |                                  | 26,250   | 8,750         |  |               |

(1) These options became exercisable on December 8, 2004. For more information regarding the acceleration of these options, see "Employment Agreements."

The Company also maintains a deferred compensation plan in which participants may elect to defer a portion of their income and select one of the specified investments, including the stock of the Company, on which a return on the deferred amount will be calculated. None of the Named Executive Officers deferred any compensation under this plan in fiscal 2004.

**Equity Compensation Plan Information**

Shares in the equity compensation plans not approved by security holders consist of non-qualified options issued to employees from principal shareholders of the Company. There have been no non-qualified options issued since 1992. The following table sets forth information as of August 31, 2004.

| Plan Category  | [a]<br>Number of securities to be issued upon exercise of outstanding options, warrants, and rights<br>(in thousands) | [b]<br>Weighted-average exercise price of outstanding options, warrants, and rights<br>(in thousands) | [c]<br>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column [a])<br>(in thousands) |
|--|---|---|--|
| Equity compensation plans approved by security holders     | 2,487   | \$ 12.44  | 1,040  |
| Equity compensation plans not approved by security holders | 18  | \$ 2.78   | None   |

**Employment Agreements**

The Company does not have an employment agreement with any of its Named Executive Officers, including Robert A. Whitman, the President, Chief Executive Officer and Chairman of the Board. As described in detail in the Organization and Compensation Committee Report, Mr. Whitman's employment agreement with the Company was cancelled, at his request, effective December 8, 2004.

**Organization and Compensation Committee Report**

The following report was prepared by the Organization and Compensation Committee (as previously defined, the "Compensation Committee"), which administers all elements of the Company's executive compensation program, including the Incentive Plan. The Compensation Committee has responsibility for all compensation-related matters, including equity awards, for Robert A. Whitman, the Company's Chairman, President and Chief Executive Officer. It also determines any equity awards under the Incentive Plan for all other executive officers; Mr. Whitman determines the amount of cash compensation for the other executive officers. The Compensation Committee reports at least annually to the full Board on the Company's executive compensation program. The Compensation Committee's charter can be found at [www.franklincovey.com](http://www.franklincovey.com).

*Compensation Committee Membership and Process.* For fiscal year 2004, the members of the Compensation Committee were E. Kay Stepp, who serves as Chairperson, Robert H. Daines, Brian A. Krisak and Dennis G. Heiner. Mr. Krisak no longer serves as a member of the Compensation Committee. Consistent with the listing requirements of the NYSE, the Company's Compensation Committee is composed entirely of independent non-employee directors. None of the Compensation Committee members has any material business relationships with the Company.

The Compensation Committee held six meetings during fiscal year 2004. The Compensation Committee regularly meets without any employees present to discuss executive compensation matters, including Mr. Whitman's compensation package. The Compensation Committee has retained the services of an independent compensation consulting firm to assist with executive compensation program design, calibrating the program to Company performance and the competitive market, and monitoring program effectiveness. The Compensation Committee has the authority to determine the scope of the consulting firm's services and retains the right to terminate the consultant's contract at any time.

The Compensation Committee's report on executive compensation matters includes a description of the program for fiscal year 2004, as well as material actions taken early in fiscal 2005.

*Annual Chief Executive Officer Performance Review.* Mr. Whitman has served as Chairman of the Board of Directors since June 1999 and President and Chief Executive Officer of the Company since January 2000. The Compensation Committee has identified specific criteria for evaluating Mr. Whitman's performance to be considered in addition to the Company's financial results. The criteria include specific leadership competencies, specific competencies related to the role of the Chief Executive Officer, and specific non-financial business objectives. The Chair of the Compensation Committee annually surveys board members and executive management and reports her findings on each objective to Mr. Whitman, the Compensation Committee and the Board of Directors.

*Executive Compensation Philosophy.* The Compensation Committee established an executive compensation strategy and structure based on the following principles:

**Compensation should reward successful execution of the business strategy.** Therefore, the executive compensation program should be both aligned with achieving the Company's strategic business plan and directly related to Company performance;

**Company success depends on teamwork from the executive level down through the organization.** Therefore, the compensation program should be designed to promote shared destiny and reward entity/team success, not just individual effort;

**A critical objective must be to attract and retain qualified executive talent.** Successful execution of the business strategy necessitates keeping the Company's management team in place and focused on business goals. Therefore, the Company's programs must be competitive and equity awards are granted with vesting schedules designed to promote retention.

**Franklin Covey pays for performance.** Executives who have the greatest direct influence on organizational performance should have the greatest portion of their compensation at risk. Therefore, executives are held accountable through the compensation program for organizational performance.

**Executive pay should be aligned with the interests of shareholders.** Equity is used to reward the executives for creating shareholder value over a several year time horizon.

*Fiscal 2004 Compensation Program.* In fiscal 2004, the Compensation Committee worked with its independent consultant and outside legal counsel to realign the compensation program with the executive compensation philosophy and the changing competitive marketplace. Taking into account emerging financial accounting changes, the evolving expectations of shareholders, market trends and improved Company performance, the Compensation Committee determined in fiscal 2004 to adopt a new long-term incentive strategy using performance-contingent restricted shares combined with a cash incentive. The Compensation Committee noted that no long-term incentive awards had been granted to the executive team (with the exception of Ms. Merz) since January 2001. Ms. Merz was awarded 50,000 stock options in fiscal 2004 in connection with her assuming the role of President of the Consumer Business Unit. In January 2004, restricted share awards were issued to Named Executive Officers as follows: Robert W. Bennett, Jr., 52,500 shares; Val J. Christensen, 52,500 shares; Sarah Merz, 52,500 shares; and Stephen D. Young, 47,250 shares.

The restricted shares issued to executive officers, pursuant to the Incentive Plan, vest over a five-year period if the executive remains employed by the Company. Vesting is accelerated 50 percent in 2006 if the Company achieves specific financial performance objectives. If specific financial goals are met for 2007, all remaining unvested shares, if any, shall vest. If an executive officer's employment terminates prior to vesting, the officer generally forfeits all restricted shares that have not yet vested.

As shown in the Summary Compensation Table, a supplemental cash incentive was paid to those executives who chose to be taxed immediately on the restricted share grant.

In addition to assessing the long-term component, the Compensation Committee also reviewed the salary and annual incentive program for the executive officers. The Compensation Committee found the program to be generally well-aligned with market practice. Consequently, base salary adjustments were made by the Chief Executive Officer with respect to only two executive officers: Ms. Merz, who moved into her new role early in the fiscal year, and Mr. Young.

The Company's financial performance was substantially improved for fiscal 2004. Annual cash incentives were paid to the management team at approximately 50 percent of their incentive targets, reflecting performance against pre-determined goals.

*Mr. Whitman's Compensation.* On September 1, 2000, the Company entered into an employment agreement with Mr. Whitman (the "Employment Agreement"). Although the Employment Agreement's term extended through August 31, 2007, Mr. Whitman requested that the Employment Agreement be cancelled in order to create parity between himself and other executive officers and to enhance his working partnership with the Board. The Board agreed to Mr. Whitman's request and the Employment Agreement was cancelled effective December 8, 2004. Mr. Whitman continues to serve as Chairman of the Board, President and Chief Executive Officer of the Company at the will and pleasure of the Board, on such terms and conditions as the Board and Mr. Whitman from time-to-time agree, consistent with the Company's Bylaws.

As previously reported by the Compensation Committee, Mr. Whitman had elected to forgo receipt of any cash compensation from the Company from May 1, 2001 through August 31, 2003 (the "Forgone Compensation") despite having performed all of his duties and responsibilities contemplated for such period under the terms of the Employment Agreement. In connection with his cancellation of the Employment Agreement, Mr. Whitman has confirmed in writing that he unconditionally forever waives, and releases the Company from, any and all claims, rights or demands he has or may have to the Forgone Compensation.

The Compensation Committee noted that Mr. Whitman gave up valuable rights under the Employment Agreement, including severance, compensation in the event of a change in control, and life insurance and disability benefits. Having evaluated the significant cost of these benefits to the Company, the Compensation Committee believed that it was in the shareholders' interest to accept Mr. Whitman's voluntary cancellation of the Employment Agreement. In consideration of the Company's substantially improved financial performance under Mr. Whitman's leadership, Mr. Whitman's Forgone Compensation, and the cancellation of the Employment Agreement, the Compensation Committee determined the following compensation program for Mr. Whitman:

**Cash Compensation.** For fiscal year 2005, the Compensation Committee agreed to continue Mr. Whitman's base salary at \$500,000. His target annual incentive for achieving predetermined Company financial and operational goals will also remain at \$500,000.

**Stock Awards.** Pursuant to the Incentive Plan, the Compensation Committee awarded Mr. Whitman 187,000 shares of Company stock that are immediately vested. In addition, the Compensation Committee granted Mr. Whitman 225,000 shares of restricted stock that vest over five years, subject to earlier vesting on the same terms and conditions as described above for the restricted shares granted to the other executive officers in fiscal year 2004, including the supplemental cash incentive.

**Option Acceleration.** On September 1, 2000, the Company granted Mr. Whitman the option to purchase 1,602,000 shares of Company stock at an exercise price of \$14.00 per share. The option was structured to vest over seven years unless specified stock price hurdles were achieved that accelerated

the vesting. In connection with the cancellation of Mr. Whitman's Employment Agreement, the Compensation Committee determined to fully accelerate the vesting of the option. At the time of the option grant, there was no compensation expense recorded in the income statement. However, the Company disclosed in its footnotes to the financial statements pro forma compensation expense of approximately \$700,000 per year with three years of pro forma expense (fiscal 2005 through 2007) still to be recognized. Accelerating the vesting of the option will accelerate the recognition of the remaining pro forma expense that will be disclosed in the footnotes. In December 2004, the FASB issued statement No. 123R, which changes the accounting for stock-based awards to require that compensation expense be recorded in the income statement beginning in interim or annual periods commencing after June 15, 2005. In addition to accelerating the option, it will remain exercisable for its full ten-year term regardless of Mr. Whitman's earlier termination of employment, death or disability.

**Life Insurance and Long Term Disability Benefits.** Mr. Whitman's Employment Agreement provided for the Company to pay \$2,500,000 in the event of his death or disability. The Compensation Committee determined that it would be more cost effective for the Company and tax-effective for Mr. Whitman to restructure the Company's obligation. Therefore, the Compensation Committee agreed that the Company would procure, at its expense, a portable 20-year level term life insurance policy on Mr. Whitman's life with a death benefit of \$2,500,000. The Company will also provide Mr. Whitman with sufficient funds to enable him to procure long term disability insurance which, combined with the Company's current group policy, provides, in the aggregate, monthly long term disability benefits equal to 75 percent of his fiscal 2005 target cash compensation.

**Severance and Change in Control Benefits.** The Compensation Committee decided to evaluate severance and change in control benefits for all executive officers, including Mr. Whitman, as part of its agenda for fiscal year 2005.

**Mr. Whitman's Fiscal 2004 Compensation.** The Company resumed Mr. Whitman's salary payments effective as of the beginning of the fiscal year at the previous annual rate of \$500,000. His annual incentive opportunity was reinstated to be 100 percent of his salary. The Compensation Committee determined Mr. Whitman's annual cash incentive for fiscal 2004 based upon the success of the desired business model, growth of core top lines, and achievement of certain financial results. As shown in the Summary Compensation Table, Mr. Whitman received a payment equal to 56.25 percent of his targeted annual incentive. No equity awards were made to Mr. Whitman during fiscal year 2004 and as of the end of the fiscal year, none of his options were exercisable. (See the discussion above regarding the subsequent acceleration in early fiscal 2005 of vesting of Mr. Whitman's outstanding stock options.)

**Stock Program.** As of August 31, 2004, executive officers held incentive stock options to purchase an aggregate of 1,827,300 shares of Common Stock granted under the direction of the Compensation Committee pursuant to the Incentive Plan since its inception in 1992 and the Non-Qualified Executive Stock Option Plan of 2000. Of those options, 166,550 were exercisable as of the end of fiscal 2004. The Incentive Plan provides multiple vehicles for making equity awards to executive officers, including incentive stock options, non-qualified stock options, stock appreciation rights and restricted share awards.

**Other Compensation Plans.** The Company has a number of other broad-based employee benefit plans in which executive officers participate on the same terms as other employees meeting the eligibility requirements, subject to any legal limitations on amounts that may be contributed to or benefits payable under the plans. These include (i) the Company's cafeteria plan administered pursuant to Section 125 of the Internal Revenue Code of 1986, as amended (the "Code"); (ii) the Company's



401(k) Plan, pursuant to which the Company makes matching contributions; and (iii) the Company's Employee Stock Purchase Plan implemented and administered pursuant to Section 423 of the Code.

Respectfully submitted,

E. Kay Stepp  
Robert H. Daines  
Dennis G. Heiner

**Compensation Committee Interlocks and Insider Participation**

No member of the Compensation Committee was or is an officer or employee of the Company or any of its subsidiaries. The Company is not aware of any Compensation Committee interlocks.

**PERFORMANCE GRAPH**

The following graph shows a comparison of cumulative total shareholder return, calculated on a dividend reinvested basis, for the five fiscal years ended August 31, 2004, for the Common Stock, the S&P 600 SmallCap Index and the S&P Diversified Commercial Services Index. The Company was previously included in the S&P 600 SmallCap Index and was assigned to the S&P Diversified Commercial Services Index within the S&P 600 SmallCap Index. The Company believes that if it were included in an index it would be included in the indices where it was previously listed. The Diversified Commercial Services Index consists of 18 companies similar in size and nature to the Company. The Company is no longer a part of the S&P 600 SmallCap Index but believes that the S&P 600 SmallCap Index and the Diversified Commercial Services Index continues to provide appropriate benchmarks with which to compare the Company's stock performance.

**INDEXED RETURNS**

|                                 | Years Ending |        |        |        |        |        |
|---------------------------------|--------------|--------|--------|--------|--------|--------|
|                                 | Aug-99       | Aug-00 | Aug-01 | Aug-02 | Aug-03 | Aug-04 |
| FRANKLIN COVEY CO               | 100.00       | 85.48  | 57.07  | 26.95  | 17.80  | 22.25  |
| S&P SMALLCAP 600 INDEX          | 100.00       | 128.19 | 128.88 | 116.60 | 143.07 | 164.33 |
| Diversified Commercial Services | 100.00       | 89.61  | 99.97  | 104.46 | 125.61 | 140.63 |

**PRINCIPAL HOLDERS OF VOTING SECURITIES**

The following table sets forth information as of January 7, 2005, with respect to the beneficial ownership of shares of Common Stock and Series A Preferred Stock by each person known by the Company to be the beneficial owner of more than five percent of Common Stock or Series A Preferred Stock, by each director, by the Named Executive Officers and by all directors and officers as a group. Unless noted otherwise, each person named has sole voting and investment power with respect to the shares indicated. The percentages set forth below have been computed without taking into account treasury shares held by the Company and are based on 20,654,403 shares of Common Stock and 873,457.404 shares of Series A Preferred Stock outstanding as of January 7, 2005. There are no shares of Series B Preferred Stock outstanding. The shares of Series A Preferred Stock on an "as-converted basis" are equal to approximately 7.14 shares of Common Stock issuable on conversion of each share of Series A Preferred Stock. Until converted into Common Stock, each whole share of Series A

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Preferred Stock is entitled to eight votes, and any fractional shares are entitled to fewer votes depending upon the number of shares of Common Stock into which they may convert.

Beneficial Ownership as of January 7, 2005

|  | Number of Preferred Shares | Percentage of Class | Number of Common Shares | Percentage of Class |
|--|----------------------------|---------------------|-------------------------|---------------------|
| <b>Preferred Stock and Common Stock:</b>   |                            |                     |                         |                     |
| Knowledge Capital Investment Group(1)(2)<br>3232 McKinney Ave<br>Dallas, Texas 75204                                   | 827,859.67                 | 94.8%               | 1,015,002               | 4.9%                |
| Financial and Investment Management Group(1)<br>417 St. Joseph St.<br>Suttons Bay, Michigan 49682                      | 39,494                     | 4.5%                | 2,446,993               | 11.8%               |
| Robert A. Whitman(6)(8)(9)<br>c/o Franklin Covey Co.<br>2200 West Parkway Boulevard<br>Salt Lake City, Utah 84119-2331 |                            |                     | 2,329,210               | 10.5%               |
| Dennis R. Webb(3)(4)(8)<br>2626 Hillsden Drive<br>Holladay, Utah 84117   |                            |                     | 1,209,812               | 5.9%                |
| Dimensional Fund Advisors, Inc.(5)<br>1299 Ocean Avenue<br>Santa Monica, California 90401                              |                            |                     | 1,165,050               | 5.6%                |
| Donald J. McNamara(2)<br>c/o Franklin Covey Co.<br>2200 West Parkway Boulevard<br>Salt Lake City, Utah 84119-2331      | 827,859.67                 | 94.8%               | 1,097,212               | 5.3%                |
| Stephen R. Covey(3)<br>c/o Franklin Covey Co.<br>2200 West Parkway Boulevard<br>Salt Lake City, Utah 84119-2331        |                            |                     | 1,052,384               | 5.1%                |
| Hyrum W. Smith(3)  |                            |                     | 467,815                 | 2.3%                |
| Val J. Christensen(6)(9)   |                            |                     | 395,806                 | 1.9%                |
| Joel C. Peterson   |                            |                     | 186,592                 | *%                  |
| Robert W. Bennett, Jr.(6)(9)   |                            |                     | 118,587                 | *%                  |
| Stephen D. Young(6)(9)   |                            |                     | 95,562                  | *%                  |
| Sarah Merz(6)(9)   |                            |                     | 91,873                  | *%                  |
| Robert H. Daines(7)  |                            |                     | 20,002                  | *%                  |
| E. Kay Stepp   |                            |                     | 17,452                  | *%                  |
| Dennis G. Heiner   |                            |                     | 13,000                  | *%                  |
| Brian A. Krisak  |                            |                     | 10,000                  | *%                  |
| E. J. "Jake" Garn  |                            |                     | 4,000                   | *%                  |
| Clayton Christensen  |                            |                     | 0                       | *%                  |
| All directors and executive officers as a group<br>(15 persons)  | 827,859.67                 | 94.8%               | 5,899,495               | 26.3%               |

\*  
Less than 1%.

(1) Each share of Series A Preferred Stock is convertible into approximately 7.14 shares of Common Stock. As a result, in addition to the shares of Common Stock listed in the beneficial ownership table, Knowledge Capital's ownership of its Series A Preferred Stock would allow it to convert its Series A Preferred Stock into 5,913,283 shares of Common Stock. Knowledge Capital's total



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Common Stock ownership, assuming conversion of its Series A Preferred Stock, would be 6,928,285 shares of Common Stock, or 25.8 percent of the outstanding Common Stock calculated on an as-converted basis. Additionally, Knowledge Capital's Series A Preferred Stock holdings entitle it to 6,622,877 votes on matters brought generally before the holders of Common Stock. As a result, together with its shares of Common Stock listed on the beneficial ownership table, Knowledge Capital has 7,637,879 total Common Stock votes with the holders of Common Stock, representing 27.6 percent of the total Common Stock voting power of the Company.

In addition to the shares of Common Stock listed on the beneficial ownership table, Financial and Investment Management Group's ownership of its Series A Preferred Stock would allow it to convert its Series A Preferred Stock into 282,100 shares of Common Stock. Financial and Investment Management Group's total Common Stock ownership, assuming conversion of its Series A Preferred Stock, would be 2,729,093 shares, or 10.1 percent of the outstanding common stock calculated on an as-converted basis. Additionally, Financial and Investment Management Group's Series A Preferred Stock holdings entitle it to 315,952 votes on matters generally brought before the holders of Common Stock. As a result, together with its shares of Common Stock listed on the beneficial ownership table, Financial and Investment Management Group has 2,762,945 total Common Stock votes with the holders of Common Stock, representing 10.0 percent of the total Common Stock voting power of the Company.

- (2) The Common Stock share amounts indicated include 82,210 shares held by Mr. McNamara and 1,015,002 shares held by Knowledge Capital. Mr. McNamara, who is a director of the Company, is a principal of The Hampstead Group, the private investment firm that sponsors Knowledge Capital, and therefore may be deemed the beneficial owner of the Common Stock and the Series A Preferred Stock held by Knowledge Capital and the Common Stock into which Knowledge Capital's Series A Preferred Stock may be converted. Mr. McNamara disclaims beneficial ownership of Knowledge Capital's Common Stock, Series A Preferred Stock and the Common Stock into which Knowledge Capital's Series A Preferred Stock may be converted.
- (3) The share amounts indicated for Hyrum W. Smith are owned of record by Hyrum W. Smith as trustee of The Hyrum W. Smith Trust with respect to 329,700 shares; those indicated for Dennis R. Webb, by Dennis R. Webb as trustee of The Lighthouse Foundation with respect to 82,500 shares; those indicated for Stephen R. Covey, by SRS MC Properties LLC with respect to 40,000 shares and by SANSTEP Properties, L.C. with respect to 1,012,384 shares. Messrs. Smith and Webb are the respective trustees of their trusts and foundations, having sole power to vote and dispose of all shares held by the respective trusts and foundations, and may be deemed to have beneficial ownership of such shares. Mr. Covey, as co-manager of SRS MC Properties LLC and SANSTEP Properties, L.C., has shared voting and dispositive control over the shares held by those entities and may be deemed to have beneficial ownership of such shares.
- (4) Of the share amount indicated as beneficially owned by Dennis R. Webb, 18,000 shares are subject to options granted to other key employees of the Company.
- (5) Dimensional Fund Advisors' information is provided as of September 30, 2004, the filing of its last 13F report.
- (6) The share amounts indicated include shares subject to options currently exercisable held by the following persons in the following amounts: Val J. Christensen, 90,300 shares; Robert W. Bennett, Jr., 50,000 shares; Stephen D. Young, 26,250 shares; Sarah Merz, 12,500 shares; Robert A. Whitman, 1,602,000 shares; and all executive officers and directors as a group, 1,781,050 shares.
- (7) The share amounts indicated for Robert H. Daines include 5,000 shares owned by Tahoe Investments, L.L.C., of which Mr. Daines is a member.

- (8) Mr. Whitman acquired 200,000 shares from Dennis R. Webb, at the request of Mr. Webb, on October 2, 2001, at a price of \$2.50 per share. Mr. Whitman agreed to permit Mr. Webb to rescind the transaction by delivering to him the purchase price paid in the original transaction within certain limitations. The 200,000 shares are counted in Mr. Whitman's number of shares listed above. The shares are not included in Mr. Webb's shares listed above, though he may be deemed to be a beneficial owner of those shares.
- (9) The share amounts indicated include Restricted Stock Awards currently not vested held by the following persons in the following amounts: Val J. Christensen, 52,500 shares; Robert W. Bennett, Jr., 52,500 shares; Stephen D. Young, 47,250 shares; Sarah Merz, 52,500 shares; Robert A. Whitman, 225,000 shares; and all officers and directors as a group, 429,750 shares.

#### **SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Exchange Act requires the Company's directors and executive officers, and persons who own more than 10 percent of the Common Stock, to file with the Securities and Exchange Commission (the "Commission") initial reports of ownership and reports of changes in ownership of the Common Stock and other securities which are derivative of the Common Stock. Executive officers, directors and holders of more than 10 percent of the Common Stock are required by Commission regulations to furnish the Company with copies of all such reports they file. Based upon a review of the copies of such forms received by the Company and information furnished by the persons named above, the Company believes that all reports were filed on a timely basis except for a Form 4 report for Joel C. Peterson, a director, reporting the acquisition of 881 shares that was due on May 10, 2003, but not filed until October 22, 2004; and Form 4 reports in conjunction with a restricted share award to Robert W. Bennett, Jr. of 52,500 shares, Val J. Christensen of 52,500 shares, Sarah Merz of 52,500 shares and Stephen D. Young of 47,250 shares that were due on January 28, 2004, but not filed until February 20, 2004.

#### **CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

In connection with the merger between the Company and Covey completed in June 1997, Stephen R. Covey, who is Vice Chairman of the Board of Directors, entered into a Speaker Services Agreement with the Company pursuant to which Dr. Covey receives 80 percent of the proceeds from personal speaking engagements, which resulted in a payment of \$1.5 million to Dr. Covey for the fiscal year ended August 31, 2004.

Also in connection with the above referenced transaction, the Company succeeded to a 12-year lease agreement originally entered into by Covey expiring in 2009 on two office buildings (the "Property") located in Provo, Utah. The buildings are leased from entities (collectively, the "Landlord") in which Dr. Covey has a 35 percent interest. Lease rentals paid in fiscal 2004 were \$2.4 million. Subsequent to August 31, 2004, the Company exercised its option under the terms of the lease agreements assumed by it in the merger with Covey to purchase the Property. The exercise of the option was part of a three-way transaction in which the buildings and land were purchased directly from the landlords, and simultaneously sold to the current tenant, an unrelated party. Subsequent to the merger with Covey, the Company consolidated the operations that were previously located in buildings with its existing operations located in Salt Lake City, but remained obligated on the leases through December 2009. The Company was subsequently able to obtain a sublease for the buildings, but at rates less than its obligation to the landlords. Based on the continuing negative cash flow associated with these buildings, and other factors, the Company determined that it was in its best interest to exercise the option and sell the property to the current tenant. The negotiated purchase price with the landlord was \$14.0 million and the tenant agreed to purchase the property for \$12.5 million. These prices were within the range of estimated fair values of the buildings as determined by an independent appraisal obtained by the Company.

In fiscal 2002, Hyrum W. Smith, who is a member of the Board of Directors, entered into a Speaker Services Agreement with the Company pursuant to which Mr. Smith receives 80 percent of the proceeds from personal speaking engagements, which resulted in a payment of \$0.1 million for the fiscal year ended August 31, 2004. The Company has also licensed certain intellectual property to a company in which Mr. Smith is a principal shareholder. No license payments were required to be paid to the Company during fiscal 2004.

In fiscal 2002, Brian A. Krisak, a director of the Company as a designee of Knowledge Capital pursuant to its contractual rights described in more detail under "Contractual Rights of Knowledge Capital to Designate Nominees," entered into a consulting agreement with the Company to assist it with various projects and transactions, such as the sale of Premier and new product offerings. The consulting agreement expired in December 2002. Mr. Krisak did receive \$22,000 in fiscal 2004 for consulting fees received apart from the consulting agreement.

Donald J. McNamara, a director of the Company serving as a designee of Knowledge Capital pursuant to its contractual rights, is a principal of The Hampstead Group, the private investment firm that sponsors Knowledge Capital, the holder of 94.8 percent of the Company's outstanding Series A Preferred Stock, and of Hampstead Interests, LP, a Texas limited partnership. On June 2, 1999, the Company and Hampstead Interests, LP entered into a Monitoring Agreement (the "Monitoring Agreement") that provides for payment of a monitoring fee of \$0.1 million per quarter to Hampstead Interests, LP for assisting the Company in strategic planning, including acquisitions, divestitures, new development and financing matters. The agreement continues so long as Knowledge Capital owns more than 50 percent of the 750,000 shares of Series A Preferred Stock (or Common Stock equivalents) originally purchased. The Company paid \$0.4 million to Hampstead Interests, LP during the fiscal year ended August 31, 2004, pursuant to the Monitoring Agreement.

Robert A. Whitman, Chairman of the Board, President and Chief Executive Officer of the Company, beneficially owns a partnership interest of Knowledge Capital, and Brian A. Krisak worked for The Hampstead Group from January 1999 to September 2002.

Each transaction described above was entered into pursuant to arm's length negotiations with the party involved and was approved by disinterested majorities of the Board of Directors or the Compensation Committee of the Board.

## **PROPOSAL 2**

### **TO APPROVE THE ADOPTION OF THE FRANKLIN COVEY CO. 2004 EMPLOYEE STOCK PURCHASE PLAN**

#### **Background**

In March 1992, the Company adopted The Franklin Quest Co. Amended and Restated 1992 Employee Stock Purchase Plan (the "Prior ESPP"). The Prior ESPP was subsequently amended in June 1992, March 1996 and May 2000 to make various changes, including a change to the name of the Prior ESPP (renamed the Franklin Covey Co. Amended and Restated 2000 Employee Stock Purchase Plan), an increase in the number of shares of the Company's Common Stock reserved for issuance under the Prior ESPP, and an extension of the Prior ESPP through August 31, 2004. The Prior ESPP expired on August 31, 2004, with 292,312 shares of Common Stock remaining un-issued under the Prior ESPP. No further shares of Common Stock will be issued under the Prior ESPP.

To replace the Prior ESPP, on November 12, 2004, the Company's Board of Directors adopted the Franklin Covey Co. 2004 Employee Stock Purchase Plan (the "2004 ESPP") effective September 1, 2004, subject to the approval of the Company's shareholders. A copy of the 2004 ESPP is attached as Appendix A to this Proxy Statement, and is incorporated by reference into this Proxy Statement. The

following description of the 2004 ESPP does not purport to be complete and is qualified in its entirety by reference to the full text thereof.

#### **Description of the 2004 ESPP**

*Purpose.* The purpose of the 2004 ESPP is to provide a method whereby employees of the Company and certain of its subsidiaries will have an opportunity to acquire a proprietary interest in the Company through the purchase of shares of Common Stock. The Board of Directors believes that the 2004 ESPP is important because it provides incentives to present and future employees of the Company by allowing them to share in the growth of the Company. The 2004 ESPP is intended to qualify as an "employee stock purchase plan" under Section 423 of the Code.

*Administration.* The 2004 ESPP will be administered by the full Board of Directors unless the Board of Directors elects to delegate administrative authority to a board committee (the "ESPP Committee"). The Board of Directors and any such ESPP Committee have the authority to interpret and construe all provisions of the 2004 ESPP and to make decisions and determinations relating to the operation of the 2004 ESPP.

*Duration.* The 2004 ESPP became effective September 1, 2004, subject to the requirement that the shareholders of the Company approve the 2004 ESPP by March 31, 2005. In the event the shareholders of the Company do not approve the 2004 ESPP by March 31, 2005, no shares of Common Stock will be issued under the 2004 ESPP, all employee contributions under the 2004 ESPP will be refunded, and the plan will terminate. Assuming shareholder approval is obtained, the 2004 ESPP will remain in effect until August 31, 2014, unless terminated earlier or extended by the Board of Directors.

*Dilution/Shares Subject to 2004 ESPP.* The maximum number of shares of Common Stock that may be issued under the 2004 ESPP is 1,000,000 shares. Shares issued under the 2004 ESPP may be either newly issued shares or treasury shares. In the event the outstanding shares of Common Stock are increased, decreased, changed into, or exchanged for a different number or kind of shares or securities of the Company through reorganization, merger, recapitalization, reclassification, stock split, reverse stock split or a similar transaction, the maximum number of shares available for issuance under the 2004 ESPP shall be proportionately adjusted. The total number of shares of Common Stock potentially issuable under the 2004 ESPP, added together with shares issuable under the Incentive Plan and the proposed 2004 Non-Employee Directors' Incentive Stock Plan described below, represent approximately 9.9 percent of the Company's outstanding shares of Common Stock on January 7, 2005.

*Eligibility.* Participation in the 2004 ESPP is limited to employees of the Company and its subsidiaries who hold positions customarily requiring them to work at least 20 hours per week. Employees who own five percent or more of the voting stock of the Company, however, may not participate in the 2004 ESPP. As of January 7, 2005, approximately 1,300 employees are eligible to participate in the 2004 ESPP.

*Offerings Under the 2004 ESPP.* The 2004 ESPP provides for a series of annual offerings commencing on September 1, December 1, March 1 and June 1 of each calendar year during the term of the 2004 ESPP. An eligible employee may elect on or before the start of an offering to participate in the offering under the 2004 ESPP by authorizing the Company to make deductions from his or her pay on each payday during the time the employee is a participant in an offering at any rate between one percent and 15 percent of his or her cash salary. On the date of commencement of each offering, the Company will grant to each eligible employee who elects to participate in the offering an option to purchase a number of shares of Common Stock equal to the number of whole shares that can be purchased with the employee's salary reduction contributions during the offering period at a price equal to 85 percent of the fair market value of those shares at the close of the offering period. No employee



will be granted an option that permits him or her to purchase in excess of \$25,000 of Common Stock per calendar year.

An employee's share purchase option under the 2004 ESPP will be deemed to be exercised automatically at the close of each three-month offering period for the purchase of the number of full shares of Common Stock which the accumulated payroll deductions in his or her account will purchase, but not in excess of the maximum number of shares for which an option has been granted to an employee. Notwithstanding the foregoing, with respect to the offering period that commenced September 1, 2004 and ended November 30, 2004 and for the offering period that commenced December 1, 2004 and ended February 28, 2005, no shares of Common Stock will be issued unless and until the shareholders of the Company approve the adoption of the 2004 ESPP on or before March 31, 2005.

*Purchase Price of Shares.* The price per share to be paid by participants under the 2004 ESPP is 85 percent of the fair market value of the Common Stock on the applicable offering termination date. The fair market value of the Common Stock shall be the average of the high and low trading price of the Common Stock on the NYSE on the offering closing date or the nearest prior trading day, if such date is not a trading day. The exercise price shall be payable only through payroll deductions from an employee's compensation.

*Termination of Employment and Withdrawal.* Upon the termination of a participant's employment for any reason during an offering period and prior to the close of the offering period, including retirement, the payroll deductions credited to the participant's account shall be returned to the participant and shall not be used to purchase shares of Common Stock under the 2004 ESPP. In the event of the participant's death, his or her designated beneficiary shall have the right to receive all cash and shares credited to the participant's account under the 2004 ESPP. A participant may also withdraw voluntarily from any offering under the 2004 ESPP prior to the conclusion of that offering and thereby receive a refund of his or her contributions during the offering period.

*Amendment and Termination.* The Board of Directors may amend, suspend or terminate the 2004 ESPP or any portion thereof at any time; provided, however, that no amendment may be made without shareholder approval to the extent such amendment would increase the number of shares that may be issued under the 2004 ESPP or modify the requirements as to eligibility for participation in the plan.

*General Provisions.* No participant or his legal representatives, legatees or distributees will be deemed to be the holder of any shares of Common Stock subject to an offering under the 2004 ESPP until the option has been exercised, the purchase price for the shares has been paid, and the shares have been issued. No payroll deductions credited to a participant's stock purchase account nor any rights to receive shares of Common Stock under the 2004 ESPP may be assigned, transferred, pledged or otherwise disposed of in any way by a participant other than by will or the laws of descent and distribution. Purchase rights under the 2004 ESPP will be exercisable during a participant's lifetime only by the participant, his guardian or legal representative.

*Benefits Not Determinable.* Because the purchase of shares under the 2004 ESPP is discretionary with all eligible employees, the amount of shares that will be distributable, or which would have been distributable during fiscal 2004 had the 2004 ESPP been in effect, to all employees, or to groups of employees, or to any particular employee of the Company are not determinable.

#### **Certain Federal Income Tax Consequences**

The following tax discussion is a brief summary of the United States federal income tax law applicable to the 2004 ESPP. The discussion is intended solely for general information and omits certain information that does not apply generally to all participants in the 2004 ESPP.

*Grant of Purchase Options.* Assuming shareholder approval of the 2004 ESPP is obtained by March 31, 2005, the 2004 ESPP will qualify as an "employee stock purchase plan" within the meaning of Section 423 of the Code. As such, a participant under the 2004 ESPP will incur no income tax liability, and the Company will obtain no deduction, from the grant of the purchase rights at the beginning of each offering. Participant payroll deductions, however, are made on an after-tax basis. Participants will not be entitled to deduct or exclude from income or social security taxes any part of their payroll deductions.

*Exercise of Options.* An employee will not be subject to United States federal income tax upon the exercise of purchase rights granted under the 2004 ESPP, nor will the Company be entitled to a tax deduction by reason of such exercise, provided that the holder is still employed by the Company. The employee will have a cost basis in the shares of Common Stock acquired upon such exercise equal to the share price paid at the close of the offering.

*Disposition of Shares Acquired Under the 2004 ESPP.* In order to defer taxation on the difference between the fair market value and purchase price of shares acquired upon exercise of purchase rights, the employee must hold the shares more than one year after their issuance date and more than two years after the date the offering commenced. The only exceptions are for dispositions of shares upon death, as part of a tax-free exchange of shares in a corporate reorganization, into joint tenancy with right of survivorship with one other person, or the mere pledge or hypothecation of shares.

If an employee disposes of stock acquired under the 2004 ESPP before expiration of the holding periods described above, such as by gift or ordinary sale of such shares, the employee must recognize as ordinary compensation income in the year of disposition the difference between the purchase price paid and the stock's fair market value as of the date of purchase. This amount must be recognized as income even if it exceeds the fair market value of the shares as of the date of disposition or the amount of the sales proceeds received. The Company will be entitled to a corresponding compensation expense deduction.

Disposition of shares after expiration of the required holding period will result in the recognition of gain or loss in the amount of the difference between the amount realized on the sale of the shares and the exercise price for such shares. Any loss on such a sale will be a long-term capital loss. Any gain on such a sale will be taxed as ordinary income up to the amount of the difference between the purchase price and the stock's fair market value as of the date of acquisition, with any additional gain taxed as a long-term capital gain.

*Other Equity Compensation Plan Information.* (See Equity Compensation Plan Information under "Executive Compensation").

**THE BOARD OF DIRECTORS RECOMMENDS THAT SHAREHOLDERS VOTE FOR THE ADOPTION OF THE 2004 ESPP.**

**PROPOSAL 3**

**TO APPROVE THE ADOPTION OF THE FRANKLIN COVEY CO.  
2004 NON-EMPLOYEE DIRECTORS' STOCK INCENTIVE PLAN**

**Background**

On November 12, 2004, the Company's Board of Directors adopted the Franklin Covey Co. 2004 Non-Employee Directors' Stock Incentive Plan (the "Directors' Plan") effective March 31, 2005, subject to the approval of the Company's shareholders. A copy of the Directors' Plan is attached as Appendix B to this Proxy Statement, and incorporated by reference into this Proxy Statement. The following description of the Directors' Plan does not purport to be complete and is qualified in its entirety by reference to the full text thereof.

**Description of the Directors' Plan**

*Purpose.* The purpose of the Directors' Plan is to provide a method whereby non-employee directors of the Company who are ineligible to participate in the Company's Incentive Plan will have an opportunity to acquire a proprietary interest in the Company through the acquisition of shares of Common Stock. The Board of Directors believes that the Directors' Plan is important because it provides incentives to present and future non-employee directors of the Company by allowing them to share in the growth of the Company and aligns their interests with the interests of common shareholders.

*Administration.* The Compensation Committee of the Board of Directors will administer the Directors' Plan. Except for actions specifically reserved to the full Board of Directors, the Compensation Committee has the authority to interpret and construe all provisions of the Directors' Plan and to make decisions and determinations relating to the operation of the Directors' Plan.

*Duration.* The Board of Directors adopted the Directors' Plan on November 12, 2004, subject to approval by the shareholders of the Company. The Directors' Plan will become effective on March 31, 2005, if approved by the shareholders on or before that date. In the event the shareholders of the Company do not approve the Directors' Plan by March 31, 2005, however, no options or shares of Common Stock will be issued under the Directors' Plan and the plan will terminate. Assuming shareholder approval is obtained, the Directors' Plan will remain in effect until March 31, 2015 unless terminated earlier by the Board of Directors.

*Dilution/Shares Subject to Directors' Plan.* The maximum number of shares of Common Stock that may be issued under the Directors' Plan is 300,000 shares. Awards under the Directors' Plan that are forfeited or expire, or are settled in cash, do not count against the plan limits. Shares issued under the Directors' Plan may either be newly issued shares or treasury shares. In the event the outstanding shares of Common Stock are increased, decreased, changed into, or exchanged for a different number or kind of shares or securities of the Company through reorganization, merger, recapitalization, reclassification, stock split, reverse stock split or a similar transaction, the maximum number of shares available for issuance under the Directors' Plan shall be proportionately adjusted. The total number of shares potentially issuable under the Directors' Plan, added together with shares issuable under the Incentive Plan and the proposed 2004 ESPP described above, represent approximately 9.9 percent of the Company's outstanding shares of Common Stock on January 7, 2005.

*Eligibility.* Participation in the Directors' Plan is limited to directors of the Company who are not employees of the Company or any of its subsidiaries. Such non-employee directors are ineligible to participate in the Company's Incentive Plan. As of January 7, 2005, the Company had eight non-employee directors who would be eligible to participate in the Directors' Plan.

*Types of Awards Under the Directors' Plan.* Like the Company's Incentive Plan, the Directors' Plan permits the grant of different kinds of stock-based awards. The Directors' Plan provides for certain fixed annual awards to non-employee directors ("Basic Annual Awards") and discretionary additional awards as determined by the full Board of Directors ("Supplemental Grants"). The Company believes this flexibility is important because it allows the Company to adapt its equity compensation practices to changing business conditions. Subject to the specific limitations contained in the Directors' Plan and the powers reserved to the full Board of Directors, the Compensation Committee generally has broad discretion to set the particular terms and conditions of individual awards.

The specific types of awards permitted by the Directors' Plan, and some of the key limitations on those awards, are described below.

*Restricted Stock.* Restricted stock is an award of shares of Common Stock subject to vesting over a restricted period specified in the award agreement evidencing the restricted stock. During the restricted period, the shares may not be transferred and are subject to forfeiture. Potential events of forfeiture include termination of service as a director prior to a stated vesting date or detrimental activity on the part of the holder. Regardless of the vesting schedule otherwise specified in the applicable award agreement evidencing a grant of restricted stock, the holder of restricted stock will automatically vest in such shares if he ceases to be a director as a result of death or voluntary retirement from the Board of Directors at or after age 59 ("Retirement"), or upon a "Change in Control" as described below. The holder of restricted stock is treated as a registered shareholder with the right to receive dividends and vote the shares during the restricted period.

Restricted stock has a minimum restricted period of three years, except in case of death, Retirement or a Change in Control.

*Stock Options.* Stock options give the holder the right to purchase shares of Common Stock at a specified exercise price during specified periods. Stock options are subject to the following limitations:

The exercise price per share may not be less than the fair market value per share of Common Stock on the date of grant. For this purpose, fair market value is the average of the reported high and low selling prices per share of Common Stock on the NYSE on the date of grant (or on the last trading day preceding the date of grant if the date of grant is not a trading day).

Options may not be exercised for a period of at least one year after the date of grant, except in the case of death, Retirement or a Change in Control.

The maximum term of an option is ten years.

The exercise price may not be reduced after grant.

Except in the case of cessation of director status as a result of death or Retirement, to the extent vested, a stock option may only be exercised prior to the date that is six months after the holder ceases to be a director of the Company. Stock options held by holders whose status as a director ceases as a result of death or Retirement may be exercised up to five years after the date of death or Retirement, but in no event later than expiration of the initial ten-year term of such options.

*Deferred Stock.* Deferred stock is an award of shares of Common Stock to be delivered in one or more installments after expiration of specified vesting and deferral periods. During the deferral period prior to vesting, a holder of deferred stock may be paid cash amounts corresponding to dividends ("Dividend Equivalents") that would have been paid had the shares been outstanding, but does not have voting or other shareholder rights.

*Formula Grants.* As of March 31 of each year, commencing March 31, 2005, the Company will automatically grant to each eligible non-employee director under the Directors' Plan a formula grant

consisting of Restricted Shares having a fair market value on the date of grant equal to \$27,500, rounded up to the nearest whole share.

*Supplemental Grants.* The Company may award Supplemental Grants of restricted stock, options and/or deferred stock to eligible non-employee directors at such times, and on such other terms and conditions as the Board of Directors determines.

*Accelerated Vesting on Changes in Control.* All outstanding awards of restricted stock, options and deferred stock under the Directors' Plan will vest and become non-forfeitable upon a Change in Control with respect to the Company. A Change in Control includes a transaction or integrated series of transactions in which any person acquires beneficial ownership of 20 percent or more of the voting power of the Company's outstanding securities. It also includes certain changes over a two-year period in the composition of the majority of Company's Board of Directors made without the approval of three quarters of the incumbent Board.

*Amendment and Termination.* The Board of Directors may amend, suspend or terminate the Directors' Plan or any portion thereof at any time; provided, however, that no amendment may be made without shareholder approval to the extent such amendment would increase the number of shares that may be issued under the plan or otherwise materially modify or extend the plan.

*General Provisions.* No stock options under the Directors' Plan may be assigned, transferred, pledged or otherwise disposed of in any way by a participant other than by will or the laws of descent and distribution. Stock options under the Directors' Plan will be exercisable during a participant's lifetime only by the participant, his guardian or legal representative. Until vested and non-forfeitable, no restricted stock or rights with respect to deferred stock may be assigned, transferred, pledged or otherwise disposed of in any way by a participant other than by will or the laws of descent and distribution.

*Determinable Benefits.* Only non-executive directors are eligible to participate and will benefit from the Directors' Plan. On each March 31, commencing March 31, 2005, each participant will receive a Basic Annual Award of restricted stock having a fair market value of approximately \$27,500. Based on current Board composition, the Company anticipates that average Basic Annual Awards each calendar year will be approximately \$220,000. Supplemental Grants may be given above and beyond any Basic Annual Award, and are determined by the Board of Directors on a case-by-case basis. The amount and value of any Supplemental Grant is not determinable.

#### **Certain Federal Income Tax Consequences**

The following tax discussion is a brief summary of the United States federal income tax law applicable to the Directors' Plan. The discussion is intended solely for general information and omits certain information that does not apply generally to all participants in the Directors' Plan.

*Restricted Stock.* Directors generally recognize as taxable income the fair market value of restricted stock on the date the restricted period ends; provided, however, that directors may instead elect under Section 83(b) of the Code to be taxed on the value of such restricted stock at the time granted. The Company is entitled to a corresponding tax deduction at the same time the value of the restricted stock is taxable compensation to the Director. Absent an election by a director to accelerate taxation of his restricted stock to the date of grant, dividends or dividend equivalents paid during the restricted period are taxable compensation to the director when paid and are deductible by the Company.

*Stock Options.* Stock options will be granted in the form of non-qualified stock options ("NQSOs") only. Directors will not realize compensation income upon the grant of an NQSO. At the time of exercise of an NQSO, the holder will realize compensation income in the amount of the spread

between the exercise price of the option and the fair market value of the underlying shares of Common Stock on the date of exercise. The Company will generally be entitled to a corresponding deduction at the time and equal to the amount of compensation income realized upon option exercise.

*Deferred Stock.* Directors generally recognize as taxable income the fair market value of deferred stock on the date the restricted period ends. The Company is entitled to a corresponding tax deduction at the same time the value of the deferred stock is taxable to the director. Dividend Equivalents paid during the restricted period are taxable compensation to the director when paid and are deductible by the Company.

*Other Equity Compensation Plan Information.* (See Equity Compensation Plan Information under "Executive Compensation").

**THE BOARD OF DIRECTORS RECOMMENDS THAT SHAREHOLDERS VOTE FOR THE ADOPTION OF THE DIRECTORS' PLAN.**

**PROPOSAL 4**

**TO APPROVE THE RATIFICATION OF THE INDEPENDENT AUDITORS**

The Audit Committee of the Board of Directors has recommended, and the Board of Directors has selected, the firm of KPMG to audit the financial statements of the Company for the fiscal year ending August 31, 2005, subject to ratification by the shareholders of the Company. The Board of Directors anticipates that one or more representatives of KPMG will be present at the Annual Meeting and will have an opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

**Audit Fees**

The following table shows the fees paid or accrued by the Company for audit and other services provided by KPMG for fiscal years 2004 and 2003:

|                       | <b>Fiscal 2004</b> | <b>Fiscal 2003</b> |
|-----------------------|--------------------|--------------------|
| Audit Fees(1)         | \$ 447,106         | \$ 323,693         |
| Audit-Related Fees(2) | 16,600             | 34,542             |
| Tax Fees(3)           | 45,832             | 61,053             |
| All Other Fees        |                    |                    |
|                       | <b>\$ 509,538</b>  | <b>\$ 419,288</b>  |

- (1) Audit Fees represent fees and expenses for professional services provided in connection with the audit of the Company's financial statements found in the Annual Report on Form 10-K and reviews of the Company's Quarterly Reports on Form 10-Q.
- (2) Audit-Related Fees primarily consisted of fees and expenses for the Company's employee benefit plan audits and accounting consultation on proposed transactions.
- (3) Tax Fees consisted primarily of fees and expenses for services related to tax compliance, tax planning, and tax consulting.

The Audit Committee pre-approves all audit-related and non-audit services to be performed by the Company's independent auditors and subsequently reviews the actual fees and expenses paid to KPMG. The Audit Committee has determined that the fees paid to KPMG for non-audit services are compatible with maintaining KPMG's independence as the Company's auditors.



**Audit Committee Report**

In accordance with its written charter adopted by the Board of Directors, the Audit Committee assists the Board in fulfilling its responsibility for oversight of the quality and integrity of the accounting, auditing and financial reporting practices of the Company.

In discharging its oversight responsibility as to the audit process, the Audit Committee obtained from the independent auditors a formal written statement describing all relationships between the auditors and the Company that might bear on the auditors' independence consistent with Independence Standards Board Standard No. 1, "Independence Discussions with Audit Committees," discussed with the auditors any relationships that may impact their objectivity and independence and satisfied itself as to the auditors' independence.

The Audit Committee discussed and reviewed with the independent auditors all communications required by auditing standards generally accepted in the United States of America, including those described in Statement on Auditing Standards No. 61, as amended, "Communication with Audit Committees" and, with and without management present, discussed and reviewed the results of the independent auditors' work.

The Audit Committee reviewed the audited financial statements of the Company as of and for the fiscal year ended August 31, 2004, and met with and discussed such financial statements with management and the independent auditors.

Based on the above-mentioned review and discussions with management and the independent auditors, the Audit Committee recommended to the Board that the Company's audited financial statements be included in its Annual Report on Form 10-K for the fiscal year ended August 31, 2004, for filing with the Securities and Exchange Commission. The Audit Committee also recommended the reappointment, subject to shareholder approval, of KPMG and the Board concurred in such recommendation.

Date: November 12, 2004

E. J. "Jake" Garn, Chairperson  
Robert H. Daines  
Joel C. Peterson

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE IN FAVOR OF THE PROPOSAL TO RATIFY THE SELECTION OF KPMG AS INDEPENDENT AUDITORS FOR THE COMPANY FOR THE FISCAL YEAR ENDING AUGUST 31, 2005.**

**PROPOSALS 5(a), 5(b), 5(c), 5(d), 5(e) AND 5(f)**

**THE RECAPITALIZATION PROPOSALS**

In connection with the Recapitalization described below, the Company is asking shareholders:

To approve the amendment and restatement of the Articles of Incorporation of the Company to modify the rights, preferences and limitations of the Series A Preferred Stock and the Series B Preferred Stock (Proposal 5(a));

To approve the issuance of warrants to all holders of Series A Preferred Stock to purchase Common Stock of the Company (Proposal 5(b));

To approve the amendment and restatement of the Articles of Incorporation of the Company to effect a one-to-four forward split of each outstanding shares of Series A Preferred Stock (Proposal 5(c));



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To approve the amendment and restatement of the Articles of Incorporation of the Company to increase the Company's authorized Preferred Stock from 4,000,000 to 14,000,000 shares (Proposal 5(d));

To approve the amendment and restatement of the Articles of Incorporation of the Company to increase the number of shares of Preferred Stock of the Company designated as Series A Preferred Stock from 1,500,000 to 4,000,000 shares (Proposal 5(e)); and

To approve the amendment and restatement of the Articles of Incorporation of the Company to increase the number of shares of Preferred Stock of the Company designated as Series B Preferred Stock from 400,000 to 4,000,000 shares (Proposal 5(f)).

As previously defined, Proposals 5(a) through 5(f) are collectively referred to in this Proxy Statement as the "Recapitalization Proposals," and the actions described in the Recapitalization Proposals are collectively referred to in this Proxy Statement as the "Recapitalization." Additionally, as previously defined, the actions described in Proposals 5(a), 5(c), 5(d), 5(e) and 5(f), as well as Proposal 6, relating to the amendment and restatement of the Company's Articles of Incorporation are collectively referred to in this Proxy Statement as the "Articles Amendment."

### **Effectiveness of each of the Recapitalization Proposals**

None of the Recapitalization Proposals will be effective unless all of the Recapitalization Proposals are approved by the Company's shareholders.

### **General**

On November 29, 2004, the Company entered into the Preferred Stock Amendment and Warrant Issuance Agreement (the "Amendment Agreement") attached hereto as Appendix F with Knowledge Capital relating to the Recapitalization. Knowledge Capital is the Company's largest shareholder in terms of voting power, and holds 94.8 percent of the outstanding shares of Series A Preferred Stock. Under the terms of the Amendment Agreement, the Company and Knowledge Capital agreed, subject to the satisfaction or waiver of certain conditions, including receiving the required shareholder approvals, to recapitalize the outstanding shares of Series A Preferred Stock by bifurcating each share of Series A Preferred Stock into two separate securities, a share of Series A Preferred Stock that is no longer convertible into shares of Common Stock and a Warrant to purchase shares of Common Stock.

Upon the completion of the Recapitalization, the holders of Series A Preferred Stock would retain substantially the same voting rights with the holders of Common Stock they currently have, but each share of Series A Preferred Stock would, upon transfer to any transferee other than a limited group of permitted transferees, convert automatically into one share of Series B Preferred Stock that would be substantively identical to the Series A Preferred Stock except that it would not have Common Stock voting rights. As provided in the Articles Amendment, the Common Stock voting rights of the holders of Series A Preferred Stock would be reduced if the Warrants issued in the Recapitalization are exercised or if they are transferred or sold to another person so that the aggregate voting rights attributable to the outstanding shares of Series A Preferred Stock and the shares of Common Stock issuable upon exercise of the Warrants remains constant. The effects of the Recapitalization on relative voting rights are described in more detail under "Effect of the Recapitalization on Relative Voting Power and Economic Interest." Additionally, the terms of the Series A Preferred Stock and the Series B Preferred Stock are described in more detail under Proposal 5(a).

As one of the conditions in the Amendment Agreement to the obligations of the parties to complete the Recapitalization, the Company must, subject to receiving the required shareholder

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approvals, amend the Company's existing Articles of Incorporation (the "Existing Articles") in the Articles Amendment to:

modify the rights, preferences and limitations of the Series A Preferred Stock and the Series B Preferred Stock (Proposal 5(a));

effect a one-to-four forward split of each outstanding share of Series A Preferred Stock (Proposal 5(c));

increase the Company's authorized Preferred Stock from 4,000,000 to 14,000,000 shares (Proposal 5(d));

increase the number of shares of Preferred Stock designated as Series A Preferred Stock from 1,500,000 to 4,000,000 shares (Proposal 5(e));

increase the number of shares of Preferred Stock designated as Series B Preferred Stock from 400,000 to 4,000,000 shares (Proposal 5(f)); and

eliminate from or modify in the Existing Articles certain miscellaneous provisions such as simplifying the provision providing for a detailed list of the purposes of the Company, eliminating the provision designating the Company's registered office and agent, eliminating the provision authorizing the Board of Directors to make partial liquidating distributions or to encumber the Company's assets and eliminating the provision addressing interested director transactions, which is substantially similar to a provision of the URBCA concerning interested director transactions (Proposal 6).

Shareholder approval of the Recapitalization Proposals and the Articles Amendment requires the following affirmative votes:

for Proposals 5(a), 5(b), 5(c), 5(d) and 6, a majority of the votes cast by holders of Common Stock and Series A Preferred Stock, voting together as a single class;

for Proposals 5(a) and 5(d), a majority of the votes cast by holders of Common Stock, excluding holders of Series A Preferred Stock, voting as a single class;

for Proposal 5(a), two-thirds of the votes entitled to be cast by holders of Series A Preferred Stock, voting as a single class; and

for Proposals 5(c), 5(d), 5(e), 5(f) and 6, the approval of the holders of a majority of the outstanding shares of Series A Preferred Stock, voting as a single class.

The votes under the first and second bullet points above are required under the URBCA (except the approval of Proposal 5(b), which is required under applicable rules of the NYSE). The two-thirds vote under the third bullet point above is required under applicable rules of the NYSE. The majority vote under the fourth bullet point above is required by the Existing Articles. Additionally, with respect to Proposals 5(e) and 5(f), although not required, the Company also seeks the approval of a majority of the votes cast by the holders of the Common Stock and Series A Preferred Stock, voting together as a single class. The Recapitalization Proposals will not become effective unless the shareholders vote to approve all of them as described in this Proxy Statement.

In the Voting Agreement, Knowledge Capital has agreed to vote in favor of the Recapitalization Proposals and the Articles Amendment. Knowledge Capital owns 1,015,002 shares of Common Stock and 827,859.67 shares of Series A Preferred Stock. Under the Existing Articles, the holders of Series A Preferred Stock are entitled to eight votes for each whole share of Series A Preferred Stock they hold, and any fractional shares of Series A Preferred Stock they hold are entitled to fewer votes per share depending upon the number of shares of Common Stock into

which they convert.

As a result of its Common Stock and Series A Preferred Stock share ownership as of the Record Date:

Knowledge Capital is entitled to cast 7,637,879 votes for its shares of Series A Preferred Stock and Common Stock, which collectively are approximately 27.6 percent of the votes entitled to be cast by the holders of Common Stock and Series A Preferred Stock voting together as a single class;

Knowledge Capital is entitled to cast 1,015,002 votes for the shares of Common Stock it owns, excluding its shares of Series A Preferred Stock, which are approximately 4.9 percent of the votes entitled to be cast by the holders of Common Stock as a single class excluding all holders of Series A Preferred Stock; and

Knowledge Capital is entitled to cast 827,859.67 votes for the shares of Series A Preferred Stock it owns, which are approximately 94.8 percent of the votes entitled to be cast by holders of Series A Preferred Stock voting as a single class, and, consequently, the approval of the Recapitalization Proposals and the Articles Amendment by holders of Series A Preferred Stock voting as a single class is assured.

If the shareholders approve the Recapitalization Proposals and the Articles Amendment, the Board of Directors presently intends to effect the Articles Amendment by filing articles of restatement amending and restating its Articles of Incorporation with the Utah Department of Commerce, Division of Corporations and Commercial Code (the "Division of Corporations"). The articles of restatement are in the form attached hereto as Appendix C and are incorporated by reference into this Proxy Statement (the "Restated Articles"). The Restated Articles will be effective upon the acceptance of their filing by the Division of Corporations.

A Special Committee of independent members of the Board of Directors consisting of Joel C. Peterson, Robert H. Daines and Dennis G. Heiner (the "Special Committee") unanimously determined that the Amendment Agreement, the Recapitalization and the Articles Amendment are in the best interests of the Company's common shareholders and recommended that the Board of Directors approve the Recapitalization and the Articles Amendment. The Board of Directors, taking into account the findings and recommendation of the Special Committee and with members Robert A. Whitman, Donald J. McNamara and Brian A. Krisak abstaining because each has or has had a financial interest in Knowledge Capital as described in more detail under "Interests of Certain Persons in the Recapitalization," unanimously determined that the Recapitalization and the Articles Amendment are in the best interests of the Company's common shareholders, approved the Recapitalization and the Articles Amendment and recommended that shareholders vote FOR approval of the Recapitalization Proposals and the Articles Amendment.

#### **Effect of the Recapitalization on Relative Voting Power and Economic Interest**

##### *Relative Effect on Voting Power.*

If the Articles Amendment is approved and becomes effective and the Recapitalization is completed, the relative Common Stock voting power of the Company's shareholders will not immediately change, and neither will the relative Common Stock voting power of Knowledge Capital. However, as a result of the Recapitalization, the relative Common Stock voting power of the holders of shares of Series A Preferred Stock may be reduced in the future as described below, particularly upon any conversion of shares of Series A Preferred Stock upon transfer into shares of nonvoting Series B Preferred Stock. More detailed information concerning the voting rights of the Series A Preferred Stock and the Series B Preferred Stock is set forth under Proposal 5(a).

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Immediately following the Recapitalization, although the Series A Preferred Stock will no longer be convertible into shares of Common Stock, holders of Series A Preferred Stock, including Knowledge Capital, will be entitled to a number of votes with holders of Common Stock substantially equal to the number of votes they currently have prior to the Recapitalization. Holders of Series A Preferred Stock are currently entitled to eight votes for each whole share of Series A Preferred Stock that they hold. Immediately following the Recapitalization and the completion of the one-to-four forward split of the Series A Preferred Stock that is proposed to occur in connection with the Recapitalization, each whole share of Series A Preferred Stock will be entitled to two votes, which is the equivalent of eight votes prior to the forward split.

The following table summarizes the effects the Recapitalization will have on the relative voting power of the holders of shares of Series A Preferred Stock and Common Stock, as well as the relative voting power of Knowledge Capital and all other stockholders:

### Common Stock Voting Power

| Description                         | Pre-Recapitalization |                             | Post-Recapitalization(1) |                             |
|-------------------------------------|----------------------|-----------------------------|--------------------------|-----------------------------|
|                                     | # of Common<br>Votes | % of All<br>Common<br>Votes | # of Common<br>Votes     | % of All<br>Common<br>Votes |
| All Series A Preferred Stockholders | 6,987,665(2)         | 25.3                        | 6,987,566(3)             | 25.3                        |
| All Common Stockholders             | 20,654,403           | 74.7                        | 20,654,403               | 74.7                        |
| <b>Total:</b>                       | <b>27,642,068</b>    | <b>100.0</b>                | <b>27,641,969</b>        | <b>100.0</b>                |
| Knowledge Capital:                  |                      |                             |                          |                             |
| Series A Preferred Stock            | 6,622,877(4)         | 24.0                        | 6,622,876(5)             | 24.0                        |
| Common Stock                        | 1,015,002            | 3.7                         | 1,015,002                | 3.7                         |
| <b>Total:</b>                       | <b>7,637,879</b>     | <b>27.6</b>                 | <b>7,637,878</b>         | <b>27.6</b>                 |
| All Other Holders                   |                      |                             |                          |                             |
| Series A Preferred                  | 364,788              | 1.3                         | 364,690                  | 1.3                         |
| Common Stock                        | 19,639,401           | 71.0                        | 19,639,401               | 71.0                        |
| <b>Total:</b>                       | <b>20,004,189</b>    | <b>72.4</b>                 | <b>20,004,091</b>        | <b>72.4</b>                 |

(1) Assumes the Recapitalization has been completed including, without limitation, the effectiveness of the Articles Amendment, the issuance of the Warrants in accordance with the Amendment Agreement (assuming no Warrant exercises or transfers) and the occurrence of the proposed one-to-four forward split of the Series A Preferred Stock.

(2) Prior to the forward split of the Series A Preferred Stock and the effectiveness of the Articles Amendment, there were 873,457.404 shares of Series A Preferred Stock outstanding as of the Record Date. Each whole share of Series A Preferred Stock is entitled to eight whole common stock votes.

(3) Following the effectiveness of the Articles Amendment and the forward split of the Series A Preferred Stock, and after adjustments for eliminating fractional shares as contemplated in the Articles Amendment, there would be 3,493,783 shares of Series A Preferred Stock outstanding based upon the number of shares of Series A Preferred Stock outstanding as of the Record Date. Each whole share of Series A Preferred would be entitled to two whole Common Stock votes. Additionally, the total number of Common Stock votes attributable to all outstanding shares of Series A Preferred Stock would be reduced by 99 votes as a result of the elimination of outstanding fractional shares of Series A Preferred Stock that would occur in connection with the forward split of the Series A Preferred Stock.

(4) Prior to the forward split of the Series A Preferred Stock and the effectiveness of the Articles Amendment, Knowledge Capital held 827,859.67 shares of Series A Preferred Stock as of the Record Date and was entitled to 6,622,877 Common Stock votes with respect to such shares.

(5) Following the forward split of the Series A Preferred Stock and upon the effectiveness of the Articles Amendment, and after adjustments for eliminating fractional shares, Knowledge Capital would hold 3,311,438 shares of Series A Preferred Stock and would be entitled to 6,622,876 Common Stock votes with respect to such shares based upon the number of shares of Series A Preferred Stock held by Knowledge Capital as of the Record Date. The number of Knowledge Capital's Common Stock votes would be reduced by one vote as a result of the elimination of outstanding fractional shares of Series A Preferred Stock that would occur in connection with the forward split of the Series A Preferred Stock.

*Offsets Against Voting Power for Warrant Exercises and Transfers.* The Warrants that may be issued to holders of Series A Preferred Stock if the Recapitalization occurs potentially could be exercised by such holders or their transferees resulting in the issuance of additional shares of Common Stock with voting power. If such holders retained the Common Stock voting power attributable to their shares of Series A Preferred Stock and they or their transferees exercised Warrants for additional shares of Common Stock, then the aggregate Common Stock voting power attributable to such shares and the Warrants issued to the holders of such shares in the Recapitalization could exceed the aggregate Common Stock voting power attributable to such shares prior to the Recapitalization.

To avoid this result, the Articles Amendment provides that the Common Stock voting power of any holder of Series A Preferred Stock will be offset and reduced by:

- (x) the number of shares of Common Stock acquired by such holder upon the exercise of any Warrant issued to such holder under the Amendment Agreement; and
- (y) the number of shares of Common Stock purchasable upon exercise of a Warrant that has been sold or transferred to another person.

The net effect of such offsets is to ensure that, so long as shares of Series A Preferred Stock remain outstanding, the aggregate Common Stock voting power attributable to such shares does not increase beyond its pre-Recapitalization level as a result of the exercise of Warrants issued to the holders of such shares in connection with the Recapitalization.

*Elimination of Voting Power of Holders of Series A Preferred Stock upon Conversion to Series B Preferred Stock.* The aggregate Common Stock voting rights of the holders of Series A Preferred Stock, including, without limitation, Knowledge Capital, could permanently decrease following the Recapitalization. Upon any transfer of shares of Series A Preferred Stock to any transferee other than an affiliate, five percent equity holder, immediate family member or trust for the benefit of such transferring holder of Series A Preferred Stock, such shares will automatically convert into shares of Series B Preferred Stock without Common Stock voting rights. As a result, the Common Stock voting rights associated with the transferred shares of Series A Preferred Stock will be automatically extinguished and the aggregate Common Stock voting power of the holders of the Series A Preferred Stock will be reduced.

Notwithstanding the potential reduction of aggregate Series A Preferred Stock voting power from conversions to nonvoting Series B Preferred Stock, Warrant exercises may, as described above, result in the issuance of shares of voting Common Stock to exercising Warrant holders. However, there is no assurance that all or any of the Warrants will be exercised prior to their expiration. Additionally, according to the terms of the Warrants, Warrant holders may choose, or the Company may elect to require, any Warrant exercise to be a net exercise in which the exercising holder would receive fewer shares of Common Stock, depending on the fair market value of the Common Stock at the time of exercise, than otherwise could be received upon an exercise for cash. Such net exercises would reduce

the potential Common Stock voting power attributable to the Warrants upon exercise. Further, the Company, at its election, could choose to pay to any Warrant holder completing a net exercise a cash amount equal to the fair market value of the shares of Common Stock that otherwise would be issuable to such holder in connection with such net exercise as opposed to issuing shares of Common Stock to the exercising holder. Any payment to an exercising Warrant holder of this cash amount in lieu of shares would further reduce the potential Common Stock voting power attributable to the Warrants.

*Preferred Stock Voting Rights.* In addition to Common Stock voting rights, the holders of shares of Series A Preferred Stock and otherwise non-voting Series B Preferred Stock would have, following the Recapitalization, customary protective class voting rights, requiring the approval of the holders of a majority of the then-outstanding Series A Preferred Stock and Series B Preferred Stock, voting together as a single class (together, the "Senior Preferred Stock"), with respect to:

adverse amendments to the Company's Articles of Incorporation or its Bylaws;

issuances of shares of Preferred Stock that are senior or equal in rank to the Senior Preferred Stock or other stock that is junior in rank to the Senior Preferred Stock other than Common Stock;

any subdivision, combination or other recapitalization or restructuring of the Senior Preferred Stock; or

any dividends on stock that is junior in rank to the Senior Preferred Stock unless all dividends required to be paid to the holders of Senior Preferred Stock are current and provision has been made for the payment of any dividend payable to the holders of Senior Preferred Stock for the then-current quarter.

*Relative Effect on Economic Interest.*

Following the Recapitalization, if it occurs, the holders of shares of Senior Preferred Stock would retain similar economic interests in the Company as those they held prior to the Recapitalization except for the differences described below and otherwise described in more detail under Proposal 5(a).

*Dividends.* The holders of shares of Senior Preferred Stock would retain substantially the same right to receive quarterly dividends they have under the Existing Articles based upon an annual dividend rate of ten percent. However, they no longer would be entitled to participate in Common Stock dividends (apart from their fixed quarterly dividends) on an as-converted basis as they currently do prior to the Recapitalization.

*Liquidation.* The holders of shares of Senior Preferred Stock would retain substantially the same right to receive a preferential return of capital plus accrued and unpaid dividends they have under the Existing Articles. As a result of the proposed one-to-four forward split of the Senior Preferred Stock, such holders would receive \$25 per share in place of \$100 per share plus accrued and unpaid dividends.

*Conversion.* All shares of Senior Preferred Stock would no longer be convertible into shares of Common Stock. However, such holders would retain the right to acquire substantially the same number of shares of Common Stock upon exercise of the Warrants that would be issued to them in connection with the Recapitalization. In contrast to the current conversion price of \$14 per share for the shares of Series A Preferred Stock (resulting in one share being convertible into approximately 7.14 shares of Common Stock, which number of shares equals the quotient of \$100, the face amount of the Series A Preferred Stock, divided by the \$14 conversion price per share), the exercise price of the Warrants would be \$8 per share. Additionally, each Warrant would expire after eight years, when, in contrast, each share of Series A Preferred Stock

currently may remain outstanding perpetually unless a limited Company redemption right is triggered.

*Redemption.* The holders of shares of Senior Preferred Stock would become subject to an expanded Company right to repurchase such shares at any time during the first year following the closing of the Recapitalization at a price per share equal to the liquidation value of the Senior Preferred Stock plus accrued and unpaid dividends and then again after the sixth anniversary of the closing at 101 percent of the liquidation value plus accrued and unpaid dividends. Additionally, under the Amended and Restated Shareholders Agreement proposed to be entered into between the Company and Knowledge Capital in connection with the Recapitalization attached hereto as Appendix E (the "Shareholders Agreement"), the Company would have the right to repurchase from Knowledge Capital and its transferees shares of Senior Preferred Stock having a liquidation value of up to \$30 million during the first four years following the Recapitalization. Currently, such shares are not redeemable unless the volume weighted sales price of the Common Stock has exceeded at least \$18.20 per share (or \$16.80 if there are less than 100,000 shares of Series A Preferred Stock outstanding) for a specified time period.

### **Background of the Articles Amendment**

In 1999, the Company raised \$75 million in equity capital from Knowledge Capital and issued Series A Preferred Stock to Knowledge Capital. In 1999, the Company issued additional Series A Preferred Stock to shareholders in a rights offering. This capital was critical to the restructuring of the Company and was raised on market terms. However, from time to time since 2002, holders of the Common Stock have asked management whether the Company could take any action to modify the terms of the Series A Preferred Stock or redeem the Series A Preferred Stock to eliminate its perceived potential adverse effects on the value of the Common Stock. Some holders of Common Stock have indicated concerns that the Company's Series A Preferred Stock, with its rights, preferences and contractual rights and the contractual limitations it imposes on the Company, has kept the Common Stock from appreciating in value. In response to these inquiries from shareholders, management and the Board of Directors have, from time to time, evaluated ways of addressing these concerns as well as strategies for creating value for the Company's common shareholders.

At its November 14, 2003 meeting, the Board of Directors discussed the foregoing issues and determined that it would be prudent for the Board of Directors to begin considering whether, in light of the then-current market and the Company's turnaround efforts, it would make sense to explore potential capital transactions that would benefit common shareholders. Because any recapitalization transaction would likely include a transaction with holders of the Company's Series A Preferred Stock, Robert A. Whitman, Chairman of the Board of Directors and President and Chief Executive Officer of the Company, reminded the Board of Directors of his interest as a partner of Knowledge Capital, the majority holder of the Company's Series A Preferred Stock, and the conflict of interest he would have in any recapitalization transaction involving the Company's Series A Preferred Stock. Directors Donald J. McNamara, who is a principal of The Hampstead Group, the private investment firm that sponsors Knowledge Capital, and Brian A. Krisak, who formerly worked for The Hampstead Group, also informed the Board of Directors that they would be subject to a conflict of interest in any such transaction.

The Board of Directors established, by resolution, a special committee of the Board of Directors consisting of independent directors Robert H. Daines, Joel C. Peterson, and Dennis G. Heiner (previously defined as the "Special Committee") to evaluate a range of potential transactions the Company's management or Board of Directors might consider to be in the best interests of the Company's common shareholders. The Board of Directors designated Mr. Peterson as Chairman of the Special Committee and granted the Special Committee the right, at the Company's expense, to retain



its own legal counsel, investment bankers and other advisors to advise the committee. The Special Committee directed management to explore the range of capital transactions that would be beneficial to shareholders and submit them to the Special Committee for review and evaluation. Mr. Whitman was directed by the Special Committee to visit with Donald J. McNamara, a director of the Company and the principal of Knowledge Capital, about a possible recapitalization transaction with holders of shares of Series A Preferred Stock.

Following the November 14, 2003 meeting of the Board of Directors, management began analyzing various recapitalization transaction structures that would (i) give the Company greater flexibility to use available cash to repurchase Common Stock and pay common share dividends, (ii) eliminate the rights of holders of Series A Preferred Stock to receive dividends on their shares of Series A Preferred Stock and participate in dividends on Common Stock dividends on an as-converted basis, (iii) enable the Company to redeem shares of Series A Preferred Stock and (iv) reduce the potential time that the current outstanding shares of Series A Preferred Stock may remain outstanding. Management analyzed the Company's operations and the terms of the Series A Preferred Stock and refined management's thinking regarding the terms of a potential recapitalization involving the Company's Series A Preferred Stock. In late November 2003, Mr. Whitman met with Mr. McNamara of Knowledge Capital to discuss a possible structure for recapitalizing the Series A Preferred Stock. In January 2004, in connection with management's evaluation of a potential recapitalization, the Company engaged ThinkEquity Partners, LLC ("ThinkEquity") to act as the Company's investment banker and provide analysis and input on the proposed recapitalization and other strategic alternatives for creating value for the Company's common shareholders.

On January 16, 2004, the Special Committee engaged Dorsey & Whitney LLP ("Dorsey & Whitney") as legal counsel for the Special Committee and consulted with Dorsey & Whitney regarding the scope of the Special Committee's work and the fiduciary duties of the members of the Special Committee. The Special Committee directed management to prepare a detailed analysis regarding the proposed recapitalization and presented such analysis and management's recommendations to the Special Committee. The Special Committee also determined to hire its own investment banker. Management presented its preliminary analysis as well as the preliminary analysis prepared by ThinkEquity. This preliminary analysis indicated that common shareholders would benefit from (i) a recapitalization that bifurcated the Series A Preferred Stock into a straight dividend bearing preferred instrument and a warrant, (ii) modifications to the terms of the existing Series A Preferred Stock allowing the Company to repurchase Series A Preferred Stock, make repurchases of Common Stock using excess cash and pay dividends on Common Stock and (iii) establishing a definite warrant exercise period. Members of the Special Committee continued to confer periodically with one another and with Dorsey & Whitney and management until the Special Committee met again on January 22, 2004.

On January 22, 2004, at the request of the Special Committee, management made another presentation regarding the proposed recapitalization. Since the last meeting of the Special Committee, management and ThinkEquity had further refined and confirmed their preliminary analysis of the proposed recapitalization. Management presented its analysis as well as a possible structure for the proposed recapitalization. The Special Committee provided input and directed management to continue developing its analysis of the proposed recapitalization and report back to the Special Committee.

On February 2, 2004, the Special Committee met again with management and a representative of Dorsey & Whitney. Management made further presentations regarding the Company's operations, present and future cash positions and the proposed structure for the recapitalization and the Special Committee provided input and direction to management. The Special Committee further considered management's analysis in light of the Board of Directors' objective of creating value for common shareholders. The Special Committee determined that it would be prudent to continue consideration of the proposed recapitalization but defer a decision until more was known about the Company's fiscal

2004 operating results. Following this meeting, informal discussions continued among members of the Special Committee, management and Dorsey & Whitney.

The Special Committee met again on February 23, 2004 and determined to engage D.A. Davidson & Co. ("Davidson") as its investment banker. Management made an additional presentation to the Special Committee regarding its refined analysis of the proposed recapitalization. Management also relayed the additional input of ThinkEquity. The Special Committee decided to direct Davidson to critically analyze and independently review and test the analysis prepared by management and ThinkEquity in light of the Special Committee's objective of creating value for common shareholders. The Special Committee further determined to direct Davidson to compile its own analysis, assumptions and financial models regarding the proposed recapitalization and make an independent evaluation and recommendation thereof to the Special Committee. Discussion and analysis of the proposed recapitalization, both internally and with Knowledge Capital, continued over the next several months.

On June 4, 2004, Mr. Peterson and a representative of Dorsey & Whitney met with representatives of Davidson. At that meeting, Davidson presented its analysis and conclusions with respect to the proposed recapitalization.

The Special Committee then directed Dorsey & Whitney to prepare a draft term sheet for the proposed recapitalization. Dorsey & Whitney prepared the term sheet in consultation with the Special Committee and Davidson and presented the draft term sheet to the Special Committee and then management for their consideration. Following further refinement of the term sheet, Dorsey & Whitney was directed to forward the term sheet to Knowledge Capital for its review and comment. In the course of the negotiations that followed, Knowledge Capital responded to the draft term sheet and provided comments to the Special Committee. On June 9, 2004, Mr. Whitman and Mr. Peterson, together with a representative of Dorsey & Whitney, held a telephone call with representatives of Knowledge Capital to further negotiate the term sheet. These negotiations were directed by Mr. Peterson.

Following this telephone negotiation, periodic negotiations continued under Mr. Peterson's direction until the Special Committee met again on June 10, 2004. At that time the Special Committee further considered the proposed recapitalization and the negotiations to date with Knowledge Capital. Davidson also presented its analysis with respect to the proposed recapitalization and the Special Committee considered the open issues in the negotiations with Knowledge Capital and provided further directions for such negotiations. The analysis that Davidson prepared and presented on June 4 and June 10 concluded that the proposed Recapitalization would provide the Company with additional flexibility with respect to its capital structure and corporate initiatives. Davidson's analysis also concluded that if the Company meets its performance expectations and redeems the Series A Preferred Stock, additional value should accrue to common shareholders.

Negotiations between the Special Committee and Knowledge Capital continued until the Special Committee met again on June 24, 2004. At that meeting, members of the Special Committee reviewed and discussed the current status of negotiations with Knowledge Capital. The Special Committee also reviewed and discussed the current draft of the proposed term sheet for the recapitalization. In addition, the Special Committee reviewed and further assessed the perceived benefits of the proposed recapitalization for common shareholders and the Company.

On July 16, 2004, the Special Committee made its report to the Board of Directors and recommended that the Board of Directors approve the recapitalization as outlined in the term sheet, as it had been negotiated to date. The term sheet as presented to the Board of Directors contained terms that are substantially the terms of the Recapitalization described in this Proxy Statement. The Board approved the Recapitalization and directed the Special Committee to continue to pursue negotiations with Knowledge Capital and to work with the Special Committee's advisors and management to consummate the Recapitalization. The Special Committee and Mr. Whitman reported that, at Mr. Whitman's suggestion, the Company and Mr. Whitman would enter into an agreement providing

that Mr. Whitman would receive no personal benefit from the recapitalization as proposed over and above what he would have received from Knowledge Capital, absent the recapitalization.

From July 2004 until November 2004, the Special Committee, with assistance from Dorsey & Whitney and Davidson, continued negotiations with Knowledge Capital and its counsel, Munsch Hardt Kopf & Harr, PC, relating to the terms and structure of and the definitive documents for the proposed recapitalization.

On November 8, 2004, Davidson issued a fairness opinion to the Special Committee indicating that the Recapitalization was fair, from a financial point of view, to all holders of Common Stock.

On November 11, 2004, the Special Committee further considered the terms and benefits of the Recapitalization and approved, subject to obtaining all required shareholder approvals, the definitive documents for the proposed Recapitalization and recommended that the Board of Directors approve, subject to obtaining all required shareholder approvals, the Recapitalization as reflected in the definitive documents.

On November 12, 2004, the Board of Directors approved the execution and delivery of the definitive documents pertaining to the Recapitalization and further approved the filing of the proposed Articles Amendment.

On November 29, 2004, the Company and Knowledge Capital executed and delivered the definitive documents pertaining to the proposed recapitalization, and an agreement with Mr. Whitman as described elsewhere in this Proxy Statement. The closing of the proposed recapitalization is subject to the satisfaction of closing conditions, including, without limitation, the approvals required from the Company's shareholders.

#### **Reasons for and Against the Articles Amendment**

*Reasons for the Articles Amendment.* The Special Committee's primary purpose in proposing to enter into the Recapitalization is to benefit the Company's current common shareholders. In concluding that the Recapitalization, the Amendment Agreement and the Articles Amendment are in the best interests of the Company's common shareholders and recommending that the Board of Directors approve the Recapitalization and the Articles Amendment, the Special Committee consulted with its financial and legal advisors and carefully considered a number of factors, including the following material factors considered to be in favor of the Recapitalization and the Articles Amendment:

the Articles Amendment and other agreements related to the Recapitalization would give the Company greater flexibility to repurchase, if it so desires, its Common Stock to increase shareholder value because the terms of the Senior Preferred Stock and the contractual obligations to Knowledge Capital following the Recapitalization will be more liberal than the terms of the Series A Preferred Stock set forth in the Existing Articles that currently restrict the Company's ability to repurchase Common Stock;

the Articles Amendment would eliminate the Company's current obligation to pay Common Stock dividends to holders of Series A Preferred Stock on an as-converted basis because the Senior Preferred Stock will no longer be convertible into Common Stock;

the Articles Amendment and other agreements related to the Recapitalization would significantly increase the Company's ability to redeem outstanding shares of Senior Preferred Stock. Under the Existing Articles, the Series A Preferred Stock is not redeemable except in the limited circumstances described under Proposal 5(a). Upon the effectiveness of the Articles Amendment and the closing of the Recapitalization, the terms of the Senior Preferred Stock and contractual rights with respect to Knowledge Capital would be much more liberal than the current terms and contractual rights related to the Series A Preferred Stock. Senior Preferred

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Stock redemptions would be allowed in the first year following the Recapitalization and again after its sixth anniversary and also, pursuant to a contractual right, the Company would be able to repurchase from Knowledge Capital and its transferees shares of Senior Preferred Stock having an aggregate liquidation value of \$30 million during the four-year period following the Recapitalization;

the terms of the Warrants proposed to be issued in connection with the Recapitalization would minimize the potential dilutive effect of issuing shares of Common Stock upon exercise of Warrants by allowing the Company to elect to require Warrant holders to exercise using a net exercise mechanism reducing the number of shares of Common Stock ultimately issuable upon exercise of the Warrants and additionally to elect to pay to exercising Warrant holders a cash amount equal to the then-fair market value of the common shares that otherwise would be issuable to such holders upon exercise;

the terms of the Warrants proposed to be issued in connection with the Recapitalization would shorten the indefinite period during which the currently outstanding shares of Series A Preferred Stock may remain convertible into shares of Common Stock because following the Recapitalization the Warrants will only be exercisable for an eight-year period when, in comparison, the shares of Series A Preferred Stock currently may be converted by holders at any time such shares are outstanding, which period may be perpetual unless the fair market value of the Common Stock has exceeded \$18.20 per share (or \$16.80 if there are less than 100,000 shares of Series A Preferred Stock outstanding) for a specified period, at which time, under the Existing Articles, the Company would have the right to redeem all outstanding shares of Series A Preferred Stock; and

create the possibility that the Company will receive cash that may be used as working capital upon issuing shares of the Common Stock if Warrant holders pay the exercise price of \$8.00 per share (unless the Company or the applicable Warrant holder exercises using a net exercise mechanism), when in comparison the conversion of Series A shares would not generate any cash for the Company.

*Reasons Against the Articles Amendment.* Although the Special Committee determined the factors described above favoring the Articles Amendment and the Recapitalization to outweigh all factors that may be considered to be against the Articles Amendment and the Recapitalization, the Special Committee did examine factors that may be considered to be against the Articles Amendment and the Recapitalization, including the following material factors:

The Warrants proposed to be issued in connection with the Recapitalization would have an exercise price of \$8 per share, and the Existing Articles currently provide that outstanding shares of Series A Preferred Stock are convertible into shares of Common Stock at a conversion price of \$14 per share. The difference between the Warrant exercise price and the Series A Preferred Stock conversion price would cause the exercise of the Warrants to be "in the money" sooner than the conversion of the Series A Preferred Stock if the sale price of the Company's Common Stock increases enough to reach \$8 per share, which cannot be predicted. The Special Committee determined that the negative effects of the Warrant exercise price being less than the Series A Preferred Stock conversion price were fully mitigated by the benefits associated with the terms of the Warrants described above as well as the other factors beneficial to the Company described above.

Upon the effectiveness of the Articles Amendment and the completion of the Recapitalization, Knowledge Capital would receive some beneficial contractual rights to the detriment of the Company, including the following material rights:

Pursuant to the Amended and Restated Registration Rights Agreement proposed to be entered into between the Company and Knowledge Capital in connection with the Recapitalization (the "Restated Registration Rights Agreement"), among other registration obligations, the Company would be required to use its best efforts to register the resale of all shares of Common Stock and shares of Series B Preferred Stock issuable upon the transfer and conversion of the Series A Preferred Stock held by Knowledge Capital and certain permitted transferees of Knowledge Capital within 240 days following the initial filing of the registration statement covering such shares. Any failure by the Company to cause such registration statement to be declared effective within the specified time period would require the Company to pay to Knowledge Capital and such permitted transferees a penalty amount for each share equal to two percent per annum of the \$25 face value of the Series A Preferred Stock calculated based upon the number of days that such registration statement has not been declared effective.

Additionally, pursuant to the Restated Registration Rights Agreement, the Company would have the obligation to use its best efforts to register the resale of the shares of Common Stock Knowledge Capital and certain permitted transferees could receive pursuant to the exercise of the Warrant issuable to Knowledge Capital at the closing of the Recapitalization, provided the obligation to register the resale of such shares would be conditioned upon the weighted average sales price of the Common Stock over the previous ten trading days being at least 80 percent of the Warrant exercise price.

In addition, the Special Committee and the Board considered the interests of certain directors that are different from, or in addition to, the interests of the Company's shareholders generally, as described under "Interests of Certain Persons in the Recapitalization."

In reaching its decision to recommend that shareholders approve the Articles Amendment, the Board of Directors consulted with management and its legal and financial advisors and considered the conclusions and recommendation of the Special Committee and its financial and legal advisors and the factors referred to above as having been taken into account by the Special Committee.

*Other Considerations.* In view of the wide variety of factors considered in connection with its evaluation of the Amendment Agreement, the Recapitalization and the Articles Amendment, the Special Committee and the Board of Directors did not find it useful to and did not attempt to quantify, rank or otherwise assign relative weights to the factors considered in connection with its determination. The Special Committee relied on the experience and expertise of Davidson, its financial advisor, for quantitative analysis of the financial terms of the Recapitalization, as described under "Opinion of Financial Advisor to the Special Committee." In addition, the Special Committee and the Board of Directors did not undertake to make any specific determination as to whether any particular factor was essential to its ultimate determination, but rather the Special Committee and the Board of Directors conducted an overall analysis of the factors described above, including thorough discussions with management and the Special Committee's legal and financial advisors. In considering the factors described above, individual members of the Special Committee and the Board of Directors may have given different weight to different factors or reached different conclusions as to whether a specific factor weighed in favor of or against approving the Amendment Agreement, the Recapitalization and the Articles Amendment.

**Recommendation of the Special Committee and the Board of Directors**

At a meeting on November 11, 2004, the Special Committee unanimously (i) determined that the Amendment Agreement, the Recapitalization and the Articles Amendment are in the best interests of the Company and its common shareholders and (ii) recommended that the Board of Directors approve the Recapitalization and the Articles Amendment.

At a separate meeting held on November 12, 2004, the Board of Directors, taking into account the findings and recommendation of the Special Committee and with members Robert A. Whitman, Donald J. McNamara and Brian A. Krisak abstaining because each has or has had a financial interest in Knowledge Capital as described in more detail under "Interests of Certain Persons in the Recapitalization," unanimously (i) determined that the Recapitalization and the Articles Amendment are in the best interests of the Company and its shareholders, (ii) approved the Recapitalization and the Articles Amendment; and (iii) directed that the Recapitalization Proposals and the Articles Amendment be submitted to a vote at the Annual Meeting and recommended that the shareholders vote for the Recapitalization Proposals and the Articles Amendment.

**FOR THE REASONS DESCRIBED ABOVE, THE DISINTERESTED MEMBERS OF THE BOARD OF DIRECTORS HAVE UNANIMOUSLY APPROVED THE RECAPITALIZATION AND THE ARTICLES AMENDMENT AND RECOMMEND THAT SHAREHOLDERS VOTE FOR APPROVAL OF THE RECAPITALIZATION PROPOSALS AND THE ARTICLES AMENDMENT.**

**Fairness to Holders of Shares of Series A Preferred Stock**

The Company determined the Recapitalization and the Articles Amendment to be fair to the holders of the Company's outstanding shares of Series A Preferred Stock. As stated elsewhere in this Proxy Statement, Knowledge Capital is the holder of approximately 94.8 percent of the outstanding shares of Series A Preferred Stock and, as a result, holds a significant majority of the outstanding shares and voting power of Series A Preferred Stock. The Company negotiated the terms of the Recapitalization and the Articles Amendment with Knowledge Capital recognizing that, in accordance with the rights, preferences and limitations of the Series A Preferred Stock currently set forth in the Existing Articles, Knowledge Capital would have the voting power to approve, or disapprove, the terms of the Recapitalization and the Articles Amendment on behalf of all holders of Series A Preferred Stock. Knowledge Capital, acting on its own behalf and not on behalf of any other holders of Series A Preferred Stock, negotiated the terms and indicated its approval of the Recapitalization and the Articles Amendment by negotiating and entering into the Amendment Agreement and the Voting Agreement as described elsewhere in this Proxy Statement.

Knowledge Capital's approval of the Recapitalization and the Voting Agreement as evidenced by the executed Amendment Agreement and Voting Agreement supports the conclusion that the Recapitalization and Articles Amendment would be fair to all holders of outstanding shares of Series A Preferred Stock. Knowledge Capital's rights, preferences and limitations as a holder of shares of Series A Preferred Stock, on a per share basis, currently are, and would be following the Recapitalization and Articles Amendment, identical to the rights, preferences and limitations of all other holders of shares of Series A Preferred Stock. Knowledge Capital currently has certain contractual rights that other holders of shares of Series A Preferred Stock do not hold. As a result of the Recapitalization and the Articles Amendment, Knowledge Capital would retain substantially the same contractual rights except to the extent such rights will be modified as described elsewhere in this Proxy Statement, particularly as described in the section in Proposal 5(a) entitled "Description of the Common Stock, Series A Preferred Stock, Series B Preferred Stock and Knowledge Capital Contractual Rights." The Company believes the changes in Knowledge Capital's contractual rights as a result of the Recapitalization and Articles Amendment would not be materially adverse to the rights currently held by other holders of shares of Series A Preferred Stock.

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Additionally, the Company believes the holders of shares of Series A Preferred Stock would generally benefit, or at least not be harmed, from the Recapitalization and the Articles Amendment in at least the following ways:

They would retain substantially the same dividend and liquidation rights as they currently do prior to the Recapitalization as described in more detail above under "Effect of the Recapitalization on Relative Voting Power and Economic Interest."

Notwithstanding that the outstanding shares of Series A Preferred Stock would no longer be convertible into shares of Common Stock, the holders of Shares of Series A Preferred Stock would retain substantially the same right to acquire shares of Common Stock pursuant to the Warrants that would be issued to them. Such holders would also be able to exercise their Warrants at an exercise price of \$8.00 per share, which would be more beneficial to such holders than the current Series A Preferred Stock conversion price of \$14.00 as described in more detail above under "Reasons for and Against the Articles Amendment." Such additional benefit would be tempered by the fact that the Warrants would be outstanding for eight years when, as currently provided, the shares of Series A Preferred Stock may remain convertible indefinitely (unless, under limited circumstances, the Company may become able to repurchase such shares under the terms of the Existing Articles).

The Company's expanded ability to repurchase shares of Series A Preferred Stock as described in more detail above under "Effect of the Recapitalization on Relative Voting Power and Economic Interest" and elsewhere in this Proxy Statement because the Company's status as a potential purchaser of such shares would increase the potential opportunities of holders of such shares to liquidate their shares.

The bifurcation of the current shares of Series A Preferred Stock into Warrants and shares that are no longer convertible into Common Stock would enable holders of such shares potentially to transfer their shares without transferring Warrants, allowing them to sell such shares to obtain a return of their invested capital but still retain a potential interest in the Company upon future exercise of the Warrants.

### **Opinion of Financial Advisor to the Special Committee**

Davidson has acted as financial advisor to the Special Committee in rendering a fairness opinion in connection with the Recapitalization. The Special Committee selected Davidson based on Davidson's experience and expertise. Davidson, as part of its investment banking business, is engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements and valuations for corporate and other purposes.

In connection with Davidson's engagement, the Special Committee requested that Davidson advise it with respect to the fairness of the Recapitalization, from a financial point of view, to the holders of the Company's Common Stock. On November 8, 2004, Davidson rendered its opinion to the effect that, as of that date and based on and subject to the assumptions, limitations and qualifications described therein and described herein, the Recapitalization was fair to the holders of Common Stock from a financial point of view.

Although Davidson evaluated the fairness of the Recapitalization from a financial point of view, the terms of the Recapitalization were determined by the Company and Knowledge Capital through arm's-length negotiations. The Company did not provide specific instructions to, or place any limitation on Davidson with respect to the procedures to be followed or factors to be considered by Davidson in performing its analyses or providing Davidson's opinion.

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Davidson's opinion is addressed to the Special Committee and relates only to the fairness of the Recapitalization to holders of Common Stock from a financial point of view, and does not address any other aspect of the proposed Recapitalization or any related transaction and does not constitute a recommendation to any shareholder as to any matter relating to the Recapitalization. The full text of the written opinion of Davidson, which sets forth the assumptions made, procedures followed, matters considered and limitations on the review undertaken in connection with the opinion, is included as Appendix D to this Proxy Statement and incorporated by reference into this Proxy Statement. The summary of Davidson's opinion set forth in this proxy statement is qualified in its entirety by reference to the full text of the opinion. You are urged to read the opinion carefully and in its entirety.

In arriving at its opinion, Davidson reviewed:

- (i) a draft of the Articles of Restatement of Franklin Covey dated November 2, 2004;
- (ii) a draft of the Amended and Restated Shareholders Agreement dated November 2, 2004;
- (iii) a draft of the Preferred Stock Amendment and Warrant Issuance Agreement dated November 2, 2004;
- (iv) a draft of the form of Warrant dated November 2, 2004;
- (v) a draft of the Amended and Restated Registration Rights Agreement dated November 2, 2004;
- (vi) a draft of the Amended and Restated Monitoring Agreement dated November 2, 2004;
- (vii) a draft of the Voting Agreement dated November 2, 2004;
- (viii) certain financial statements and other historical financial and business information about the Company made available to Davidson from published sources and/or from the internal records of the Company;
- (ix) certain internal financial analyses and forecasts prepared by Company management regarding the Company's business, financial condition, results of operations and prospects;
- (x) the publicly reported historical prices and trading activity for the Common Stock, including a comparison of certain financial and stock market information for Franklin Covey with similar publicly available information for certain other companies the securities of which are publicly traded;
- (xi) the financial terms of similar preferred stock issuances in general, to the extent publicly available;
- (xii) the current market environment generally and the environment in which the Company competes in particular;
- (xiii) the pro forma financial impact of the Recapitalization; and
- (xiv) such other information, financial studies, analyses and investigations and financial, economic and market criteria as Davidson considered relevant.

In addition, Davidson had discussions with the management and other representatives and advisors of the Company concerning the business, financial condition, results of operations and prospects of the Company.



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In arriving at its opinion, Davidson assumed and relied upon the accuracy and completeness of all information supplied or otherwise made available to it, discussed with or reviewed by or for it, or publicly available, and it did not assume responsibility for independently verifying such information or undertaking an independent evaluation or appraisal of any of the assets or liabilities (contingent or

otherwise) of the Company, nor was Davidson furnished with any such evaluation or appraisal. In addition, Davidson did not conduct any physical inspection of the properties or facilities of the Company. With respect to financial projections, Davidson assumed that they had been reasonably prepared on bases reflecting the best currently available estimates and judgments of the Company management as to the future financial performance of the Company.

Davidson assumed that in the course of obtaining necessary regulatory or other consents or approvals (contractual or otherwise) for the Recapitalization, no restrictions, including any amendments or modifications, will be imposed that will have a material adverse affect on the contemplated benefits of the Recapitalization. Davidson expresses no view as to, and its opinion does not address, the relative merits of the Recapitalization as compared to any alternative business strategies that might exist for the Company or the effect of any other transaction in which the Company might engage. Davidson was not requested to, and did not participate in the negotiation or structuring of the Recapitalization. Davidson's opinion is necessarily based upon information available to it and economic, market, financial and other conditions as they exist and can be evaluated on the date of its opinion. Although subsequent developments may affect its opinion, Davidson does not have any obligation to update, revise or reaffirm its opinion.

This opinion is based on a variety of financial and comparative analyses, as described below. Davidson believed that a proper way to determine the fairness of the Amendments was to analyze the estimated value per share of Common Stock on a pre-Recapitalization and a post-Recapitalization basis. The estimated value per share of Common Stock was determined by applying a range of multiples to projected EBITDA in fiscal year 2008 and then discounting that value to a present value by using a range of discount rates. This analysis also considered the impact of the projected cash flows generated through fiscal year 2008 available for the benefit of holders of Common Stock. The range of multiples applied to projected EBITDA in fiscal year 2008 was determined by analyzing selected publicly traded companies. Davidson also believed that it was important to understand the estimated value of the Series A Preferred Stock pre- and post-Recapitalization. The information provided in these sections is not a complete description of the analyses that Davidson used in reaching its opinion, but rather a summary of such analyses. Certain of the analyses include information presented in tabular format. In order to fully understand the financial analyses used by Davidson, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses.

#### *Pro Forma Equity Value Analysis*

In conducting its analysis of the pro forma impact of the Recapitalization, Davidson analyzed the theoretical present value per share of the Common Stock on a pre-Recapitalization and a post-Recapitalization basis, utilizing financial projections prepared by the Company's management.

**Theoretical Present Value of the Company's Common Stock Pre-Recapitalization.** Davidson derived an implied enterprise value range for the Company by applying a range of multiples of projected annual EBITDA of 5.0x, 7.0x, and 9.0x derived from selected publicly traded companies. Davidson analyzed three different projection scenarios for future EBITDA through fiscal year 2008. Within each scenario, and by applying the selected multiple, the analysis resulted in an implied enterprise value range for the Company. Davidson then derived an implied equity value range for the Common Stock by deducting the Company's estimated net debt and estimated outstanding Preferred Stock from the implied enterprise value range derived for the Company. Depending upon the specific circumstances of each projection scenario, Davidson made adjustments to per share equity values to reflect the potential for cash dividends to common shareholders. Davidson applied a discount rate range of 15.0 percent to 20.0 percent, which was determined based on several factors including interest rates, inherent market risk, and Company specific risk. The analysis resulted in a range of theoretical present values per share of the Common Stock for each scenario. For purposes of its analysis, Davidson

gave more weight to the most conservative of the three projection scenarios, which yielded a per share equity value range of \$2.08 - \$2.72.

**Theoretical Present Value of the Company's Common Stock Post-Recapitalization.** Davidson derived an implied enterprise value range for the Company by applying a range of multiples of projected annual EBITDA of 5.0x, 7.0x, and 9.0x derived from selected publicly traded companies. Davidson analyzed three different projection scenarios for future EBITDA through fiscal year 2008. Within each scenario, and by applying the selected multiple, the analysis resulted in an implied enterprise value range for the Company. Davidson then derived an implied equity value range for the Common Stock by deducting the Company's estimated net debt and estimated Preferred Stock outstanding, if applicable, from the implied enterprise value range derived for the Company. Depending upon the specific circumstances of each scenario, Davidson made adjustments to per share equity values to reflect potential repurchases of Common Stock, redemptions of Preferred Stock, and/or cash dividends to common shareholders. Davidson applied a discount rate range of 15.0 percent to 20.0 percent, which was determined based on several factors including interest rates, inherent market risk, and Company specific risk. The analysis resulted in a range of theoretical present values per share of Common Stock for each scenario. For purposes of its analysis, Davidson gave more weight to the most conservative of the three projection scenarios, which yielded a per share equity value range of \$2.64 - \$3.40. Shown below is summary of the valuation ranges under Davidson's most conservative projection scenario:

| <u>Assumed Discount<br/>Rate</u> | <u>Pre-Recapitalization</u> |      | <u>Post-Recapitalization</u> |    |      |        |
|----------------------------------|-----------------------------|------|------------------------------|----|------|--------|
| <b>15.0%</b>                     | \$                          | 2.49 | \$2.72                       | \$ | 3.16 | \$3.40 |
| <b>17.5%</b>                     | \$                          | 2.27 | \$2.61                       | \$ | 2.88 | \$3.11 |
| <b>20.0%</b>                     | \$                          | 2.08 | \$2.51                       | \$ | 2.64 | \$2.84 |

This analysis supports a finding of fairness because the estimated values per share of Common Stock on a post-Recapitalization basis are higher than the estimated values per share of Common Stock on a pre-Recapitalization basis. Davidson also noted and gave consideration to the various restrictions associated with the Series A Preferred Stock pre-Recapitalization and the restrictions of the Series A Preferred Stock post-Recapitalization. In particular, Davidson noted the increased financial flexibility from the Recapitalization, including an increased ability and economic benefit to paying dividends to common shareholders, an increased ability to repurchase Common Stock, and an increased ability to raise additional capital.

To arrive at the range of multiples applied to projected EBITDA in fiscal year 2008 in the Pro Forma Equity Value Analysis, Davidson compared certain financial, operating and stock market data for companies that are comparable to or similar to the Company. The selected publicly traded companies considered by Davidson consisted of two groups: Consulting and Specialty Education companies, and Value-Added Printing Services companies. The Consulting and Specialty Education group consisted of Accenture Ltd., Bearingpoint Inc., Learning Tree Int., and Princeton Review Inc. The Value-Added Printing Services group consisted of Banta Corp., Bowne & Co., Deluxe Corp., John H. Harland, Quebecor World Inc., and RR Donnelley & Sons.

Financial information and valuation measurements reviewed by Davidson included, among other things:

common equity market valuation as October 20, 2004;

operating performance;

ratios of price per share to last twelve months ("LTM") earnings per share ("EPS"), to estimated 2004 EPS and to estimated 2005 EPS;

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ratios of Enterprise Value (defined as common equity market value plus debt minus cash) to LTM earnings before interest, taxes, depreciation and amortization ("EBITDA"), to estimated 2004 EBITDA and to estimated 2005 EBITDA; and

ratios of Enterprise Value (defined as common equity market value plus debt minus cash) to LTM revenue, to estimated 2004 revenue, and to estimated 2005 revenue.

To estimate the trading multiples for the selected comparable companies, Davidson used publicly available information concerning projected financial performance for the years 2004 and 2005 from third party equity research analysts.

Shown below are the excluded averages (the average excluding the high and low values) of the various valuation multiples of the comparable companies:

| Comparable Companies  | Price/EPS |       |       | Enterprise Value/EBITDA |       |       | Enterprise Value/Revenue |       |       |
|---|-----------|-------|-------|-------------------------|-------|-------|--------------------------|-------|-------|
|   | LTM       | CY'04 | CY'05 | LTM                     | CY'04 | CY'05 | LTM                      | CY'04 | CY'05 |
| Consulting & Specialty Education Companies (Excluded Average) | 38.0x     | 28.5x | 17.9x | 10.6x                   | 9.0x  | 6.7x  | 0.9x                     | 0.9x  | 0.8x  |
| Value-Added Printing Services Companies (Excluded Average)    | 19.5x     | 15.6x | 13.9x | 6.9x                    | 6.5x  | 5.8x  | 1.0x                     | 0.9x  | 0.9x  |
| All Companies (Excluded Average)                              | 28.5x     | 19.8x | 15.8x | 8.3x                    | 7.7x  | 6.7x  | 1.0x                     | 0.9x  | 0.9x  |

Although the selected companies were used for comparison purposes, no selected company is either identical or directly comparable to the Company. Accordingly, Davidson's comparison of the selected companies to the Company and analysis of the results of such comparison was not purely mathematical, but instead necessarily involved complex considerations and judgments concerning differences in financial and operating characteristics and other factors that could affect the relative values of the selected companies and the Company. By analyzing the data of comparable companies, Davidson derived an implied enterprise value to annual EBITDA multiple of 5.0x, 7.0x, and 9.0x. These multiples were used to help determine the estimated value for the Company's Common Stock in the Pro Forma Equity Value Analysis.

### *Preferred Stock Analysis*

Davidson analyzed the value of the convertible Series A Preferred Stock pre-Recapitalization to the combined value of the new Series A Preferred Stock post-Recapitalization with the Warrants. Davidson compared the weighted average cost of capital ("WACC") of the Company with the WACC of generally comparable companies. Based on the average WACC, and taking into consideration the financial terms of selected securities generally comparable to the Series A Preferred Stock, an implied yield was determined. The implied yield was then used to determine the present value of the existing Series A Preferred Stock. An estimated value for the conversion option of the pre-Recapitalization Series A Preferred Stock and the Warrants post-Recapitalization was determined based upon the Black-Scholes model. The value of the Series A Preferred Stock pre-Recapitalization was determined to be in the range of \$66.7 million to \$73.7 million. The value of the Series A Preferred Stock post-Recapitalization with Warrants was determined to be in the range of \$63.3 million to \$70.0 million.

The foregoing summary describes analyses and factors that Davidson deemed material in its presentation to the Special Committee, but is not a comprehensive description of all analyses performed and factors considered by Davidson in connection with preparing its opinion. Preparation of a fairness opinion involves various determinations and judgments as to the most appropriate and relevant methods of financial analysis and the application of these methods to the particular circumstances. In arriving at its opinion, Davidson did not attribute any particular weight to any analysis or factor considered by it, but, rather, made qualitative judgments as to the significance and relevance of each analysis and factor. As such, Davidson believes that its analyses must be considered

as a whole and that selecting portions of its analyses and factors without considering all analyses and factors could create a misleading or incomplete view of the processes underlying its opinion.

In its analyses, Davidson made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond control of the Company. Some of Davidson's major assumptions include: projected annual EBITDA exit multiples of 5.0x, 7.0x, and 9.0x; discount rates of 15.0 percent, 17.5 percent and 20.0 percent; a risk-free rate of 5.3 percent; and a market risk premium of 10.6 percent. In addition, Davidson assumed that industry performance, general business and economic conditions would be stable for the foreseeable future.

The estimates contained in Davidson's analyses and the ranges of valuations resulting from any particular analysis are not necessarily indicative of actual values or predictive of future results or values, which may be significantly more or less favorable than those suggested by the analyses. In addition, analyses relating to the value of businesses or securities do not purport to be appraisals or to reflect the prices at which businesses or securities actually may be sold. Accordingly, Davidson's analyses and estimates are inherently subject to substantial uncertainty.

Davidson's opinion provided to the Special Committee was one of a number of factors taken into consideration by the Special Committee in making its determination to recommend the Recapitalization. Consequently, Davidson's analyses described above should not be viewed as determinative of the opinion of the Special Committee with respect to the value of the Company.

The Company has agreed to pay Davidson for its financial advisory services fees that are customary for transactions of this nature. In addition, the Company has agreed to reimburse Davidson for reasonable out-of-pocket expenses incurred in connection with its engagement and to indemnify Davidson for certain liabilities that may arise out of its engagement by the Company and the rendering of its opinion. Davidson is acting as financial advisor to a Special Committee in rendering its fairness opinion in connection with the Recapitalization. Davidson has not performed other investment banking services for the Company in the past.

#### **Interests of Certain Persons in the Recapitalization**

Mr. Donald J. McNamara, who is a director of the Company, is a principal of The Hampstead Group, and therefore may be deemed the beneficial owner of the Common Stock and the Series A Preferred Stock currently owned by Knowledge Capital and the shares of Common Stock into which the Series A Preferred Stock may be converted by Knowledge Capital. Mr. McNamara disclaims beneficial ownership of Knowledge Capital's Common Stock and Series A Preferred Stock and of the Common Stock into which the Series A Preferred Stock may be converted. Robert A. Whitman, the Chairman of the Board of Directors, President and Chief Executive Officer of the Company, beneficially owns a partnership interest in Knowledge Capital, and Brian A. Krisak worked for The Hampstead Group from January 1999 to September 2002.

On December 8, 2004, the Company and Mr. Whitman entered into an agreement ("Mr. Whitman's Agreement") providing that Mr. Whitman would forgo any personal financial benefit from his interest in Knowledge Capital resulting from the Recapitalization in excess of the financial benefit he otherwise would receive from his interest in Knowledge Capital if the Recapitalization never were to occur (which potential financial benefit is referred to as an "Excess Benefit"). According to Mr. Whitman's Agreement, Davidson has expressed to the Special Committee its view that it does not expect that Mr. Whitman will receive any Excess Benefit as a result of the Recapitalization because it has determined that the New Series A Preferred Stock (as defined in Proposal 5(c)) and the Warrants are substantially equivalent in value to the Old Series A Preferred Stock (as defined in Proposal 5(c)).

As of the Record Date, the members of the Board of Directors (including the Special Committee) and the Named Executive Officers as a group beneficially owned 5,899,495 shares of Common Stock, or 26.3 percent of the Common Stock, and beneficially owned 827,859.67 shares of Series A Preferred

Stock, or 94.8 percent of the Series A Preferred Stock. The share numbers listed above include shares held by Knowledge Capital, of which Mr. McNamara disclaims beneficial ownership.

The directors and executive officers are not required to vote for the Amendment Agreement, the Recapitalization or any of the other transactions contemplated by the Amendment Agreement. However, Knowledge Capital has entered into a Voting Agreement with the Company whereby Knowledge Capital has agreed to vote all of the shares of Common Stock and Series A Preferred Stock held by Knowledge Capital (i) in favor of the adoption of the Amendment Agreement and the approval of the Recapitalization, and in favor of the other transactions contemplated by the Amendment Agreement (including the issuance of Warrants), (ii) against any action that could reasonably be expected to delay or compromise approval of the Recapitalization, (iii) against any action or agreement that could reasonably be expected to result in any of the conditions to the Company's obligations under the Amendment Agreement not being fulfilled, and (iv) in favor of adoption by the Company of the other matters reasonably relating to the consummation of the transactions contemplated by the Amendment Agreement.

If the Recapitalization is approved by the shareholders, Hampstead Interests, LP and the Company will enter into an Amended and Restated Monitoring Agreement, Knowledge Capital and the Company will enter into the Shareholders Agreement, and Knowledge Capital and the Company will enter into the Restated Registration Rights Agreement. These documents are described in more detail under "The Amendment Agreement."

The directors and executive officers may have different interests from other shareholders in voting on the Recapitalization.

As of the Record Date, the members of the Special Committee owned shares of the Common Stock as follows: Joel C. Peterson 186,592 shares of Common Stock; Dennis G. Heiner 13,000 shares of Common Stock; and Robert H. Daines 20,002 shares of Common Stock. None of the members of the Special Committee own(s) any shares of the Series A Preferred Stock.

#### **Certain Effects of the Recapitalization**

##### *Trading Market*

Currently, the Series A Preferred Stock is quoted on the OTC Bulletin Board under the symbol "FCCAP.OB." For the 12 months ended December 31, 2004, the average daily trading volume of the Series A Preferred Stock has been approximately thirty-four shares. The following table presents, for the periods indicated, the daily high and low sale prices per share of Series A Preferred Stock quoted for trading on the OTC Bulletin Board. The Series A Preferred Stock was not quoted on the OTC

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Bulletin Board prior to May 2003. Trading in the stock was not prohibited before that time, but trading information was not captured prior to its being quoted on the OTC Bulletin Board.

|                   | Series A Preferred Stock |          |
|-------------------|--------------------------|----------|
|                   | High                     | Low      |
| Fiscal Year       |                          |          |
| <b>2003</b>       |                          |          |
| First Quarter(1)  |                          |          |
| Second Quarter(1) |                          |          |
| Third Quarter     | \$ 70.03                 | \$ 70.03 |
| Fourth Quarter(1) |                          |          |
| <b>2004</b>       |                          |          |
| First Quarter     | 60.00                    | 60.00    |
| Second Quarter    | 80.00                    | 60.00    |
| Third Quarter     | 80.00                    | 61.00    |
| Fourth Quarter    | 80.50                    | 61.00    |
| <b>2005</b>       |                          |          |
| First Quarter     | 67.05                    | 67.05    |

- (1) No shares were traded in the first, second or fourth quarters of fiscal 2003.

### *U.S. Federal Securities Law Consequences*

The Recapitalization, if completed, will be made pursuant to an exemption from registration under Section 3(a)(9) of the Securities Act of 1933, as amended (the "Securities Act"). Shares of New Series A Preferred Stock that may be deemed to be issued in respect of the Old Series A Preferred Stock that are "restricted securities" within the meaning of Rule 144 under the Securities Act will retain the character of the Old Series A Preferred Stock and will be considered restricted securities. The New Series A Preferred Stock issued in respect of Old Series A Preferred Stock that are not restricted securities will retain such character and will not be considered restricted securities. The shares of New Series A Preferred Stock that are not "restricted securities" can be freely transferred, except by persons who are deemed to be affiliates of the Company.

In accordance with the provisions of Rule 144 of the Securities Act, the shares of New Series A Preferred Stock that are restricted securities will not be available for public resale until they have been owned by the holder for a period of one year and the other requirements of Rule 144 of the Securities Act have been satisfied. Rule 144 of the Securities Act permits the holding period of securities surrendered in the Recapitalization to be added, or "tacked," to the holding period of the shares acquired as a result of the Recapitalization for purposes of satisfying the applicable holding periods under Rule 144 of the Securities Act. Accordingly, holders of shares of New Series A Preferred Stock that are restricted securities will be able to "tack" their holding period of New Series A Preferred Stock to their holding period of Old Series A Preferred Stock for purposes of satisfying the applicable holding periods under Rule 144 of the Securities Act. All of the shares of New Series A Preferred Stock that are issued to Knowledge Capital will be restricted securities. Although it is not possible to determine how much of the other New Series A Preferred Stock will be restricted securities, the Company does not believe the number will be significant.

### *Series A Preferred Stock Certificates*

Following the closing of the Recapitalization and the effectiveness of the Articles Amendment, in accordance with the Restated Articles, each certificate representing shares of Series A Preferred Stock must be endorsed with a legend stating that immediately prior to any transfer of the shares of Series A Preferred Stock represented by such certificate, other than transfers to affiliates, five percent equity

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holders, immediate family members or trusts for the benefit of the transferring holder, such shares automatically will convert into shares of Series B Preferred Stock.

There are two ways by which the Company has planned to cause all certificates representing shares of Series A Preferred Stock to be endorsed with the appropriate legend. First, as described in more detail under Proposal 5(c), each Old Series A Certificate (as defined in such section) that is surrendered to the Company or its transfer agent for cancellation and replacement with a New Series A Certificate (also defined in such section) representing a post-split number of shares of Series A Preferred Stock will be endorsed with such legend.

Second, in accordance with the Amendment Agreement and in connection with the issuance of the Warrants to all holders of shares of Series A Preferred Stock other than to Knowledge Capital, as described in more detail under Proposal 5(b) and "The Amendment Agreement," the Company will send to each such holder of shares of Series A Preferred Stock a transmittal letter, requesting, among other things, that such holder return to the Company any certificate or certificates in such holder's possession representing shares of Series A Preferred Stock. Upon receipt of any such certificate or certificates together with a completed transmittal letter, the Company will return to such holder such certificate or certificates having been endorsed with the appropriate legend. However, if such holder has not previously submitted such certificate or certificates for cancellation and replacement with New Series A Certificates in connection with the one-to-four forward split, then the Company will cancel any Old Series A Certificates received together with a completed transmittal letter and replace them with New Series A Certificates that also bear the appropriate legend.

Knowledge Capital, unlike all other holders of shares of Series A Preferred Stock, has separately agreed in the Amendment Agreement that it will, within ten days following the closing of the Recapitalization, deliver to the Company or the Company's transfer agent any certificate or certificates representing shares of Series A Preferred Stock in its possession. Within ten days of the Company's or its transfer agent's receipt of such certificate or certificates, the Company or its transfer agent will return such certificate or certificates to Knowledge Capital endorsed with the appropriate legend.

### *Certain United States Federal Income Tax Considerations*

The following is a discussion of the material federal income tax consequences of the Recapitalization to holders of Series A Preferred Stock (the "Series A Holders"). This discussion is based upon the Code, United States Treasury regulations promulgated under the Code, rulings and decisions in effect as of the date hereof, all of which are subject to change (possibly with retroactive effect) or to different interpretations. The discussion is limited to Series A Holders who are citizens or residents of the United States and who hold shares of Series A Preferred Stock as a capital asset. It does not address taxpayers subject to special treatment under federal income tax laws, such as insurance companies, financial institutions, dealers in securities, mutual funds, tax-exempt organizations, taxpayers that are treated as partnerships for federal income tax purposes and taxpayers that are subject to the alternative minimum tax. In addition, this discussion does not apply to Series A Holders who acquired their shares of Series A Preferred Stock upon the exercise of employee stock options or otherwise as compensation for services or who hold their Series A Preferred Stock as part of a hedge, straddle or conversion transaction.

The tax consequences of the Recapitalization under state, local and foreign laws are not addressed in this discussion. No opinion of counsel or ruling from the Internal Revenue Service has been or will be sought, and this discussion is not binding on the Internal Revenue Service.

Each Series A Holder should consult its own tax advisors regarding the federal income tax consequences of the Recapitalization, and regarding any state, local or foreign tax consequences based on the holder's particular facts and circumstances.



The Company believes that the Recapitalization will qualify as a "reorganization" under Section 368(a)(1)(E) of the Code. Accordingly, provided that the fair market value of the New Series A Preferred Stock and the Warrants is equal to the fair market value of the Old Series A Preferred Stock surrendered in exchange therefor, Series A Holders will not recognize any gain or loss in the Recapitalization, except as described below with respect to cash received in lieu of fractional shares of New Series A Preferred Stock. A Series A Holder's tax basis in its shares of Old Series A Preferred Stock will be allocated between the New Series A Preferred Stock and Warrants based on their relative fair market values on the Recapitalization date. The Company intends to allocate the fair market value of the New Series A Preferred Stock and Warrants to the New Series A Preferred Stock and to the Warrants in connection with the closing of the Recapitalization. The Company's fair market value determinations will not be binding on the Internal Revenue Service. However, a Series A Holder may be bound by such determinations unless the holder discloses on its 2004 federal income tax return that it intends to use different fair market value determinations. A Series A Holder's holding period for the new Series A Preferred Stock and Warrants will include the period during which the Old Series A Preferred Stock surrendered in exchange therefor was held.

A Series A Holder who receives cash in lieu of a fractional share of New Series A Preferred Stock will be treated as having first received the fractional share of New Series A Preferred Stock and then as having received the cash as a distribution in redemption of the fractional share. In such case, the Series A Holder will recognize either capital gain or loss equal to the difference between the cash received and the holder's basis in the fractional share or dividend income equal to the amount of cash received, depending upon whether the redemption qualifies for sale or exchange treatment under the tests set forth in Section 302 of the Code.

### **Appraisal Rights**

Dissenting shareholders are not entitled to appraisal rights under Utah law or under the Company's Existing Articles and Bylaws in connection with the Articles Amendment.

### **The Amendment Agreement**

This section describes the material provisions of the Amendment Agreement dated as of November 29, 2004, between the Company and Knowledge Capital. This summary description of the Amendment Agreement is not complete and is subject to and qualified in its entirety by reference to the full text of the Amendment Agreement, which is attached as Appendix F to this Proxy Statement and is incorporated by reference into this Proxy Statement.

#### *Overview*

Under the terms of the Amendment Agreement, the Company will effect the Recapitalization by (i) amending its Articles of Incorporation to eliminate the conversion feature of the Series A Preferred Stock and to otherwise amend the designations, voting powers, preferences and relative, participating, optional and other special rights, qualifications, limitations and restrictions of the Series A Preferred Stock and (ii) issuing to Knowledge Capital and all other holders of Series A Preferred Stock as of the closing date Warrants to purchase shares of Common Stock.

#### *Amendment and Restatement of the Company's Articles of Incorporation*

Promptly after satisfaction or, to the extent permitted by applicable law, waiver of each of the closing conditions set forth in the Amendment Agreement (or at such later time as the Company and Knowledge Capital may agree), the Company intends to file the Restated Articles with the Division of Corporations to effect the Articles Amendment. The Restated Articles will amend and restate the Existing Articles as described under "General" and elsewhere in this Proxy Statement.

*Anti-takeover Effects*

The Existing Articles and existing bylaws contain provisions that will remain in effect after the Articles Amendment, including those providing for "blank check" preferred stock in the Restated Articles and classification of the Board of Directors in the existing bylaws, which provisions may have the effect of rendering more difficult or discouraging an attempt to obtain control of the Company.

*Issuance of Warrants*

Following acceptance by the Division of Corporations of the Company's Restated Articles, the Amendment Agreement provides for the issuance of a Warrant to each holder of Series A Preferred Stock to purchase 71.43 shares of Common Stock for each \$1,000 of aggregate Liquidation Price (as contemplated in the Existing Articles) attributable to the shares of Series A Preferred Stock held by such holder as of the closing date of the Recapitalization (which number of shares when calculated shall be rounded to the nearest whole number of shares). Knowledge Capital will receive its Warrant at the closing of the Recapitalization. All other holders will receive, within ten days thereafter, a transmittal letter that instructs them to provide to the Company (i) the name in which each Warrant is to be issued, (ii) the address to which it is to be sent and (iii) the certificate or certificates representing their shares of Series A Preferred Stock to be endorsed, as provided in the Restated Articles, by a legend indicating that the outstanding shares of Series A Preferred Stock will be convertible into shares of non-voting Series B Preferred Stock upon transfer except to certain permitted transferees.

Following the receipt from any holder of Series A Preferred Stock of a properly completed transmittal letter, the Company will issue Warrants to the holders of Series A Preferred Stock and return to such holders their certificate or certificates representing their shares of new Series A Preferred Stock endorsed with the legend required by the Restated Articles.

*Closing Deliveries*

At or prior to closing the Recapitalization, the Company and Knowledge Capital shall each deliver to the other, among other things, duly executed copies of the Shareholders Agreement, which supercedes the prior Stockholders Agreement, and the Restated Registration Rights Agreement, which supercedes the prior Registration Rights Agreement dated June 2, 1999 between the Company and Knowledge Capital. The Company and Hampstead Interests, LP, an affiliate of Knowledge Capital, will also deliver the Amended and Restated Monitoring Agreement, which supercedes the prior Monitoring Agreement (the "Restated Monitoring Agreement").

In addition to the description of Knowledge Capital's contractual rights under the Shareholders Agreement in Proposal 5(a) if the Shareholders Agreement becomes effective, any merger, consolidation, combination, recapitalization or reorganization or any disposition of all or substantially all the Company's properties and assets would, with certain exceptions, require the approval of Knowledge Capital so long as it owns 880,000 shares of Series A Preferred Stock (after the one-to-four forward split). The Shareholders Agreement also contains provisions, comparable to the provisions of the currently outstanding Series A Preferred Stock, requiring that as long as Knowledge Capital is entitled to designate at least two directors of the Company, approval by an 80 percent Board vote would be required for incurrence of certain indebtedness, major divestitures and acquisitions by the Company, unless certain financial tests are met. The Shareholders Agreement would continue to provide that, subject to certain exceptions, Knowledge Capital may not acquire more than 25 percent of the total voting power of the Company, unless the acquisition is approved by the members of the Board who are not designees of Knowledge Capital.

If the Restated Registration Rights Agreement becomes effective, among other registration obligations, the Company would be required to use its best efforts to register the resale of all shares of Common Stock and shares of Series B Preferred Stock issuable upon the transfer and conversion of the Series A Preferred Stock held by Knowledge Capital and certain permitted transferees of Knowledge

Capital within 240 days following the initial filing of the registration statement covering such shares. Any failure by the Company to cause such registration statement to be declared effective within the specified time period would require the Company to pay to Knowledge Capital and such permitted transferees a penalty amount for each share equal to two percent per annum of the \$25 face value of the Senior Preferred Stock calculated based upon the number of days that such registration statement has not been declared effective. Additionally, the Company would have the obligation to use its best efforts to register the resale of the shares of Common Stock Knowledge Capital and certain permitted transferees could receive pursuant to the exercise of the Warrant issuable to Knowledge Capital at the closing of the Recapitalization, provided the obligation to register the resale of such shares would be conditioned upon the weighted average sales price of the Common Stock over the previous ten trading days being at least 80 percent of the Warrant exercise price.

If the Restated Monitoring Agreement becomes effective, Hampstead Interests, LP, an affiliate of Knowledge Capital, would continue to agree to provide certain services to the Company in order to assist the Company with the development of its strategic plan, including acquisitions, divestitures, new development and financial matters, for a fee of \$100,000 per quarter, subject to reduction if Knowledge Capital disposes of