

KORN FERRY INTERNATIONAL
Form 10-Q
March 11, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended January 31, 2014

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number 001-14505

KORN/FERRY INTERNATIONAL
(Exact Name of Registrant as Specified in its Charter)

Delaware **95-2623879**
(State or Other Jurisdiction of Incorporation or (I.R.S. Employer Identification Number)
Organization)
1900 Avenue of the Stars, Suite 2600, Los Angeles, California 90067
(Address of principal executive offices) (Zip code)
(310) 552-1834
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The number of shares outstanding of our common stock as of March 6, 2014 was 49,733,326 shares.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****KORN/FERRY INTERNATIONAL AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

	January 31, 2014 (unaudited)	April 30, 2013
	(in thousands, except per share data)	
ASSETS		
Cash and cash equivalents	\$ 247,784	\$ 224,066
Marketable securities	6,337	20,347
Receivables due from clients, net of allowance for doubtful accounts of \$10,125 and \$9,097, respectively	190,982	161,508
Income taxes and other receivables	8,979	8,944
Deferred income taxes	1,857	3,511
Prepaid expenses and other assets	29,834	28,724
Total current assets	485,773	447,100
Marketable securities, non-current	123,083	121,569
Property and equipment, net	55,009	53,628
Cash surrender value of company owned life insurance policies, net of loans	93,748	85,873
Deferred income taxes, net	60,347	63,203
Goodwill	255,792	257,293
Intangible assets, net	51,722	58,187
Investments and other assets	27,359	28,376
Total assets	\$ 1,152,833	\$ 1,115,229
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable	\$ 17,187	\$ 19,460
Income taxes payable	12,879	5,502
Compensation and benefits payable	148,457	160,298
Other accrued liabilities	62,512	83,291
Total current liabilities	241,035	268,551
Deferred compensation and other retirement plans	168,629	159,706
Other liabilities	20,590	22,504

Total liabilities	430,254	450,761
Stockholders' equity:		
Common stock: \$0.01 par value, 150,000 shares authorized, 62,196 and 61,022		
shares issued and 49,707 and 48,734 shares outstanding, respectively	446,542	431,508
Retained earnings	287,570	236,090
Accumulated other comprehensive loss, net	(11,042)	(2,631)
Stockholders' equity	723,070	664,967
Less: notes receivable from stockholders	(491)	(499)
Total stockholders' equity	722,579	664,468
Total liabilities and stockholders' equity	\$ 1,152,833	\$ 1,115,229

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****(unaudited)**

	Three Months Ended		Nine Months Ended	
	January 31,		January 31,	
	2014	2013	2014	2013
	(in thousands, except per share data)			
Fee revenue	\$ 242,184	\$ 202,004	\$ 708,589	\$ 584,929
Reimbursed out-of-pocket engagement expenses	8,753	8,268	26,172	26,165
Total revenue	250,937	210,272	734,761	611,094
Compensation and benefits	162,228	139,788	476,294	400,859
General and administrative expenses	37,265	35,915	112,931	102,675
Reimbursed expenses	8,753	8,268	26,172	26,165
Cost of services	9,056	8,066	29,697	19,848
Depreciation and amortization	6,333	5,088	18,857	13,127
Restructuring charges, net		4,441	3,682	19,936
Total operating expenses	223,635	201,566	667,633	582,610
Operating income	27,302	8,706	67,128	28,484
Other income, net	1,132	3,296	7,751	3,808
Interest expense, net	(873)	(360)	(2,102)	(1,721)
Income before provision for income taxes and equity in earnings of unconsolidated subsidiaries	27,561	11,642	72,777	30,571
Equity in earnings of unconsolidated subsidiaries	470	593	1,492	1,567
Income tax provision	6,727	2,753	22,789	11,042
Net income	\$ 21,304	\$ 9,482	\$ 51,480	\$ 21,096
Earnings per common share:				
Basic	\$ 0.44	\$ 0.20	\$ 1.07	\$ 0.45
Diluted	\$ 0.43	\$ 0.20	\$ 1.05	\$ 0.44
Weighted-average common shares outstanding:				
Basic	48,341	47,367	48,041	47,149
Diluted	49,181	48,015	48,977	47,742

The accompanying notes are an integral part of these consolidated financial statements.

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2014	2013	2014	2013
	(in thousands)			
Net income	\$ 21,304	\$ 9,482	\$ 51,480	\$ 21,096
Other comprehensive income:				
Foreign currency translation adjustments	(9,726)	3,330	(8,384)	(42)
Unrealized gains (losses) on marketable securities, net of taxes	6	(27)	(27)	(10)
Comprehensive income	\$ 11,584	\$ 12,785	\$ 43,069	\$ 21,044

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)**

	Nine Months Ended January 31,	
	2014	2013
	(in thousands)	
Cash flows from operating activities:		
Net income	\$ 51,480	\$ 21,096
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	18,857	13,127
Stock-based compensation expense	8,819	8,820
Provision for doubtful accounts	5,744	4,818
Gain on cash surrender value of life insurance policies	(6,432)	(4,236)
Gain on marketable securities	(7,578)	(4,927)
Deferred income taxes	4,919	8,900
Change in other assets and liabilities, net of effects of acquisition:		
Deferred compensation	8,515	1,242
Receivables due from clients	(35,218)	(17,443)
Income tax and other receivables	82	(6,806)
Prepaid expenses and other assets	(1,110)	(1,035)
Investment in unconsolidated subsidiaries	(1,492)	(1,567)
Income taxes payable	7,394	(3,309)
Accounts payable and accrued liabilities	(16,716)	(22,461)
Other	(4,188)	1,576
Net cash provided by (used in) operating activities	33,076	(2,205)
Cash flows from investing activities:		
Purchase of property and equipment	(17,307)	(9,382)
Cash paid for acquisition, net of cash acquired		(112,064)
Purchase of marketable securities	(23,795)	(44,259)
Proceeds from sales/maturities of marketable securities	43,423	47,778
Change in restricted cash	2,861	7,222
Payment of contingent consideration from acquisition	(15,000)	
Premiums on company-owned life insurance policies	(1,443)	(1,450)
Dividends received from unconsolidated subsidiaries	1,950	1,897
Net cash used in investing activities	(9,311)	(110,258)
Cash flows from financing activities:		
Purchase of common stock	(2,026)	(2,673)
	7,373	1,343

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Proceeds from issuance of common stock upon exercise of employee stock options and in connection with an employee stock purchase plan		
Tax benefit from exercise of stock options	815	203
Net cash provided by (used in) financing activities	6,162	(1,127)
Effect of exchange rate changes on cash and cash equivalents	(6,209)	(180)
Net increase (decrease) in cash and cash equivalents	23,718	(113,770)
Cash and cash equivalents at beginning of period	224,066	282,005
Cash and cash equivalents at end of period	\$ 247,784	\$ 168,235

The accompanying notes are an integral part of these consolidated financial statements.

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

January 31, 2014

1. Organization and Summary of Significant Accounting Policies

Nature of Business

Korn/Ferry International, a Delaware corporation (the Company), and its subsidiaries are engaged in the business of providing talent management solutions, including executive recruitment on a retained basis, recruitment process outsourcing and leadership & talent consulting services. The Company's worldwide network of 87 offices in 37 countries enables it to meet the needs of its clients in all industries.

Basis of Consolidation and Presentation

The accompanying financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended April 30, 2013 for the Company and its wholly and majority owned/controlled domestic and international subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. The preparation of the consolidated financial statements conforms with United States (U.S.) generally accepted accounting principles (GAAP) and prevailing practice within the industry. The consolidated financial statements include all adjustments, consisting of normal recurring accruals and any other adjustments that management considers necessary for a fair presentation of the results for these periods. The results of operations for the interim period are not necessarily indicative of the results for the entire fiscal year.

Investments in affiliated companies, which are 50% or less owned and where the Company exercises significant influence over operations, are accounted for using the equity method.

The Company considers events or transactions that occur after the balance sheet date but before the consolidated financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosures.

Use of Estimates and Uncertainties

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates, and changes in estimates are reported in current operations as new information is learned or upon the amounts becoming fixed and determinable. The most significant areas that require management judgment are revenue recognition, restructuring, deferred compensation, annual performance related bonus, evaluation of the carrying value of receivables, marketable securities, goodwill and other intangible assets, fair value of contingent consideration, share-based payments and the recoverability of deferred income taxes.

Revenue Recognition

Substantially all professional fee revenue is derived from fees for professional services related to executive recruitment performed on a retained basis, recruitment for non-executive professionals, recruitment process outsourcing and leadership & talent consulting services. Fee revenue from executive recruitment activities and recruitment for non-executive professionals is generally one-third of the estimated first year cash compensation of the placed executive or non-executive professional, as applicable, plus a percentage of the fee to cover indirect expenses. The Company generally recognizes revenue on a straight-line basis over a three-month period, commencing upon client acceptance, as this is the period over which the recruitment services are performed. Fees earned in excess of the initial contract amount are recognized upon completion of the engagement, which reflect the difference between the final actual compensation of the placed executive and the estimate used for purposes of the previous billings. Since the initial contract fees are generally not contingent upon placement of a candidate, our assumptions primarily relate to establishing the period over which such service is performed. These assumptions determine the timing of revenue recognition and profitability for the reported period. Any revenue associated with services that are provided on a contingent basis is recognized once the contingency is fulfilled. In addition to recruitment for non-executive professionals, Futurestep provides recruitment process outsourcing (RPO) services and fee revenue is recognized as services are rendered. Fee revenue from Leadership & Talent Consulting (LTC) services is recognized as services are rendered for consulting engagements and other time-based services, measured by total hours

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

January 31, 2014

incurred to the total estimated hours at completion. It is possible that updated estimates for the consulting engagement may vary from initial estimates with such updates being recognized in the period of determination. Depending on the timing of billings and services rendered, the Company accrues or defers revenue as appropriate. LTC revenue is also derived from the sale of solution services, which includes revenue from licenses and from the sale of products. Revenue from licenses is recognized using a straight-line method over the term of the contract (generally 12 months). Products sold by the Company mainly consist of books and automated services covering a variety of topics including performance management, team effectiveness, and coaching and development. The Company recognizes revenue for its products when the product has been sold.

Allowance for Doubtful Accounts

An allowance is established for doubtful accounts by taking a charge to general and administrative expenses. The amount of the allowance is based on his