KORN FERRY INTERNATIONAL
Form 10-Q
March 14, 2011

Table of Contents

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

Form 10-Q

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

For the quarterly period ended January 31, 2011

OR

o **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 Organization)	*(I.R.S. Employer Identification Number)*

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 þ No o

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 þ No o

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

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

The number of shares outstanding of our common stock as of March 10, 2011 was 46,967,787 shares.

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
Table of Contents

Item #	Description	Page
	Part I. Financial Information	
Item 1	Condensed Consolidated Financial Statements	1
	Consolidated Balance Sheets as of January 31, 2011 (unaudited) and April 30, 2010	1
	Unaudited Consolidated Statements of Operations for the three and nine months ended January 31, 2011 and 2010	2
	Unaudited Consolidated Statements of Cash Flows for the nine months ended January 31, 2011 and 2010	3
	Notes to Unaudited Condensed Consolidated Financial Statements	4
Item 2	Management s Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3	Quantitative and Qualitative Disclosures about Market Risk	30
Item 4	Controls and Procedures	31
	Part II. Other Information	
Item 1	Legal Proceedings	32
Item 1A	Risk Factors	32
Item 2	Unregistered Sales of Equity Securities, Use of Proceeds and Issuer Purchases of Equity Securities	32
Item 6	Exhibits	32
	Signatures	33

Exhibit 31.1
Exhibit 31.2
Exhibit 32.1
EX-101 INSTANCE DOCUMENT
EX-101 SCHEMA DOCUMENT
EX-101 CALCULATION LINKBASE DOCUMENT
EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. ***Condensed Consolidated Financial Statements***

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	January 31, 2011 (unaudited)	April 30, 2010
	(in thousands, except per share data)	
ASSETS		
Cash and cash equivalents	$ 181,309	$ 219,233
Marketable securities	19,949	4,114
Receivables due from clients, net of allowance for doubtful accounts of $9,081 and $5,983, respectively	137,408	107,215
Income taxes and other receivables	11,859	6,292
Deferred income taxes	16,251	20,844
Prepaid expenses and other assets	27,898	23,166
Total current assets	394,674	380,864
Marketable securities, non-current	102,301	73,105
Property and equipment, net	39,903	24,963
Cash surrender value of company owned life insurance policies, net of loans	73,257	69,069
Deferred income taxes	62,385	59,742
Goodwill	176,988	172,273
Intangible assets, net	23,697	25,425
Investments and other assets	34,312	21,657
Total assets	$ 907,517	$ 827,098
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable	$ 11,072	$ 11,148
Income taxes payable	11,786	6,323
Compensation and benefits payable	143,037	131,550
Other accrued liabilities	45,300	49,062
Total current liabilities	211,195	198,083
Deferred compensation and other retirement plans	128,552	123,794
Other liabilities	24,518	13,879
Total liabilities	364,265	335,756
Stockholders equity:		
Common stock: $0.01 par value, 150,000 shares authorized, 58,958 and 57,614 shares issued and 46,817 and 45,979 shares outstanding, respectively	398,618	388,717

Retained earnings		128,455		90,220
Accumulated other comprehensive income, net		16,701		12,934
Stockholders equity		543,774		491,871
Less: notes receivable from stockholders		(522)		(529)
Total stockholders equity		543,252		491,342
Total liabilities and stockholders equity	$	907,517	$	827,098

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

1

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2011	2010	2011	2010
	(in thousands, except per share data)			
Fee revenue	$ 186,489	$ 146,742	$ 546,951	$ 403,690
Reimbursed out-of-pocket engagement expenses	7,620	6,158	23,524	19,054
Total revenue	194,109	152,900	570,475	422,744
Compensation and benefits	126,088	102,654	373,851	295,115
General and administrative expenses	31,534	31,635	87,512	86,853
Out-of-pocket engagement expenses	12,756	9,837	38,092	28,090
Depreciation and amortization	3,239	2,755	9,351	8,444
Restructuring (reductions) charges, net		(364)	2,130	20,593
Total operating expenses	173,617	146,517	510,936	439,095
Operating income (loss)	20,492	6,383	59,539	(16,351)
Other income, net	1,948	1,336	3,362	7,082
Interest expense, net	(401)	(443)	(2,467)	(1,718)
Income (loss) before provision (benefit) for income taxes and equity in earnings of unconsolidated subsidiaries	22,039	7,276	60,434	(10,987)
Income tax provision (benefit)	8,598	(244)	23,407	(6,730)
Equity in earnings of unconsolidated subsidiaries, net	534	390	1,508	639
Net income (loss)	$ 13,975	$ 7,910	$ 38,535	$ (3,618)
Earnings (loss) per common share:				
Basic	$ 0.31	$ 0.18	$ 0.86	$ (0.08)
Diluted	$ 0.30	$ 0.17	$ 0.84	$ (0.08)
Weighted-average common shares outstanding:				
Basic	45,349	44,622	45,040	44,290
Diluted	46,720	45,811	46,026	44,290

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

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Nine Months Ended January 31, 2011	2010
	(in thousands)	
Cash flows from operating activities:		
Net income (loss)	$ 38,535	$ (3,618)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	9,351	8,444
Stock-based compensation expense	11,775	13,272
Loss on disposition of property and equipment	77	202
Provision for doubtful accounts	5,983	3,510
Gain on cash surrender value of life insurance policies	(4,395)	(6,675)
Gain on marketable securities classified as trading	(4,187)	(7,526)
Change in fair value of acquisition-related contingent consideration	(1,878)	
Deferred income taxes	1,950	(10,880)
Change in other assets and liabilities:		
Deferred compensation	4,758	8,000
Receivables	(41,743)	(34,604)
Prepaid expenses	(4,732)	(2,309)
Investment in unconsolidated subsidiaries	(1,508)	(639)
Income taxes payable	5,466	551
Accounts payable and accrued liabilities	8,522	(32,691)
Other	(1,332)	(5,799)
Net cash provided by (used in) operating activities	26,642	(70,762)
Cash flows from investing activities:		
Purchase of property and equipment	(22,384)	(4,377)
Purchase of intangible assets		(3,481)
(Purchase of) proceeds from marketable securities, net	(40,893)	7,407
Cash paid for acquisitions, net of cash acquired and contingent consideration		(18,236)
Payment of contingent consideration from acquisitions	(2,795)	
Premiums on life insurance policies	(1,410)	(1,450)
Dividends received from unconsolidated subsidiaries	1,608	157
Net cash used in investing activities	(65,874)	(19,980)
Cash flows from financing activities:		
Borrowings under life insurance policies	1,624	5,252
Purchase of common stock	(13,417)	(1,653)
Proceeds from exercise of warrants	2,983	
Proceeds from issuance of common stock upon exercise of employee stock options and in connection with an employee stock purchase plan	8,015	5,960
Tax benefit (expense) from exercise of stock options	670	(4,614)

Payment of dividends by majority owned consolidated subsidiaries	(300)	
Net cash (used in) provided by financing activities	(425)	4,945
Effect of exchange rate changes on cash and cash equivalents	1,733	6,608
Net decrease in cash and cash equivalents	(37,924)	(79,189)
Cash and cash equivalents at beginning of period	219,233	255,000
Cash and cash equivalents at end of period	$ 181,309	$ 175,811

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

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
January 31, 2011

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 executive recruitment, outsourced recruiting and leadership and talent consulting on a retained basis. The Company s worldwide network of 76 offices in 36 countries enables it to meet the needs of its clients in all industries.

Basis of Consolidation and Presentation

The condensed consolidated financial statements for the three and nine months ended January 31, 2011 and 2010 include the accounts of 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 condensed consolidated financial statements conform with United States (U.S.) generally accepted accounting principles (GAAP) and prevailing practice within the industry. The condensed 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. These financial statements have been prepared consistently with the accounting policies described in the Company s Annual Report on Form 10-K for the fiscal year ended April 30, 2010 (the Annual Report) and should be read together with the Annual Report.

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.

Certain amounts included in the prior fiscal period consolidated financial statements have been reclassified to conform to the current fiscal year presentation.

Use of Estimates and Uncertainties

The preparation of the condensed 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. The most significant areas that require management judgment are revenue recognition, deferred compensation, annual performance related compensation, evaluation of the carrying value of receivables, marketable securities, goodwill and other intangible assets, fair value of contingent consideration and 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, middle-management recruitment and leadership and talent consulting services. Fee revenue from recruitment activities is generally one-third of the estimated first year compensation plus a percentage of the fee to cover indirect expenses. Fee revenue from leadership and talent consulting services is recognized as earned. The Company generally bills clients in three monthly installments commencing the month of client acceptance. Fees earned in excess of the initial contract amount are billed upon completion of the engagement. Any services that are provided on a contingent basis are recognized once the contingency is fulfilled.

Allowance for Doubtful Accounts

A provision is established for doubtful accounts through a charge to general and administrative expenses based on historical loss experience, assessment of the collectability of specific accounts, as well as expectations of future collections based upon trends and the type of work for which services are rendered. After all collection efforts have been exhausted, the Company reduces the allowance for doubtful accounts for balances identified as uncollectible.

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

Marketable Securities

The Company classifies its marketable securities as either trading securities or available-for-sale. These investments are recorded at fair value and are classified as marketable securities in the accompanying consolidated balance sheets. Certain investments, which the Company intends to sell within the next twelve months, are carried as current assets. Investments are made based on the Company s investment policy, which restricts the types of investments that can be made.

Trading securities consist of the Company s investments which are held in trust to satisfy obligations under the Company s deferred compensation plans (see Note 5). The changes in fair values on trading securities are recorded as a component of net income (loss) in other income, net.

Available-for-sale securities consist of corporate bonds, U.S. Treasury and agency securities and commercial paper. The changes in fair values, net of applicable taxes, are recorded as unrealized losses as a component of accumulated other comprehensive income in stockholders equity. When, in the opinion of management, a decline in the fair value of an investment below its cost or amortized cost is considered to be other-than-temporary, the investment s cost or amortized cost is written-down to its fair value and the amount written-down is recorded in the statement of operations in other income, net. The determination of other-than-temporary decline includes, in addition to other relevant factors, a presumption that if the market value is below cost by a significant amount for a period of time, a write-down may be necessary. The amount of any write-down is determined by the difference between cost or amortized cost of the investment and its fair value at the time the other-than-temporary decline is identified. During the three and nine months ended January 31, 2011 and 2010, no other-than-temporary impairment was recognized.

Business acquisitions

Business acquisitions are accounted for under the purchase method by assigning the purchase price to tangible and intangible assets acquired and liabilities assumed. The results are included in the Company s consolidated financial statements from the date of each respective acquisition. Assets acquired and liabilities assumed are recorded at their fair values and the excess of the purchase price over the amounts assigned is recorded as goodwill. Purchased intangible assets with finite lives are amortized over their estimated useful lives. Adjustments to fair value assessments are recorded to goodwill over the purchase price allocation period (generally not longer than twelve months). During the nine months ended January 31, 2011, the Company recorded a $1.9 million reduction in the estimated fair value of contingent consideration relating to a prior acquisition, as a component of general and administrative expenses.

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of assets acquired. The goodwill impairment test compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of a reporting unit exceeds its fair value, goodwill of the reporting unit would be considered impaired. To measure the amount of the impairment loss, the implied fair value of a reporting unit s goodwill is compared to the carrying amount of that goodwill. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. If the carrying amount of a reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. For each of these tests, the fair value of each of the Company s reporting units was determined using a combination of valuation techniques, including a discounted cash flow methodology. Results of the latest impairment test performed as of January 31, 2010, indicated that the fair value of each reporting unit exceeded its carrying amount. As a result, no impairment charge was recognized as of January 31, 2010 or April 30, 2010. The Company s annual impairment test as of January 31, 2011 will be performed in the fourth quarter of fiscal 2011, although there was also no indication of impairment as of January 31, 2011.

5

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

Intangible assets primarily consist of customer lists, non-compete agreements, proprietary databases, intellectual property and trademarks, and are recorded at the estimated fair value at the date of acquisition and are amortized using the straight-line method over their estimated useful lives of five to 24 years. For intangible assets subject to amortization, an impairment loss is recognized if the carrying amount of the intangible assets is not recoverable and exceeds fair value. The carrying amount of the intangible assets is considered not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from use of the asset. As of January 31, 2011 and April 30, 2010, there were no indicators of impairment with respect to the Company s intangible assets.

Restructuring Charges

The Company accounts for its restructuring charges as a liability when the costs are incurred and are recorded at fair value. Changes in the estimates of the restructuring charges are recorded in the period the change is determined.

Compensation and Benefits Expense

Compensation and benefits expense in the accompanying statements of operations consist of compensation and benefits paid to consultants, executive officers, and administrative and support personnel. The most significant portions of this expense are salaries and the annual performance related bonus paid to consultants. Compensation and benefits are recognized when incurred. Management estimates annual performance related bonuses on a quarterly basis based on projected individual performance, analysis of Company performance and additional considerations such as competitive information and material economic developments. At the end of each fiscal year, the Company then determines annual bonuses based upon final Company and individual performance and other factors, such as attainment of strategic objectives and individual performance appraisals. Management reevaluates the estimates up to the payment date, and any changes in the estimate are reported in current operations. These annual performance related bonuses are generally paid within twelve months following the fiscal year end though the Company deferred certain bonuses earned in fiscal 2009 and 2010. The bonuses deferred in fiscal 2009 were paid in December 2010 and the bonuses deferred in fiscal 2010 will be paid in December 2011. Other expenses included in compensation and benefits expense are changes in the deferred compensation liabilities and cash surrender value (CSV) of company owned life insurance (COLI) contracts, amortization of stock compensation awards, payroll taxes and employee insurance benefits.

Stock-Based Compensation

The Company has employee compensation plans under which various types of stock-based instruments are granted. These instruments, principally include stock options, stock appreciation rights (SARs), restricted stock and an Employee Stock Purchase Plan (ESPP). The Company recognizes compensation expense related to restricted stock and SARs and the estimated fair value of stock options and stock purchases under the ESPP.

Fair Value of Financial Instruments

The Company measures the fair values of its financial instruments in accordance with accounting guidance that defines fair value, provides guidance for measuring fair value and requires certain disclosures. The guidance also discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow) and the cost approach (cost to replace the service capacity of an asset or replacement cost). The guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

> *Level 1*: Observable inputs such as quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
>
> *Level 2*: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
>
> *Level 3*: Unobservable inputs that reflect the reporting entity s own assumptions.

6

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

As of January 31, 2011, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included cash equivalents and marketable securities. The carrying amount of cash, cash equivalents and accounts receivable approximates fair value due to the short maturity of these instruments. The fair values of marketable securities classified as trading, are obtained from quoted market prices and the fair values of marketable securities classified as available-for-sale, are obtained from a third party, which are based on quoted prices or market prices for similar assets. As of April 30, 2010, the Company also held auction rate securities (ARS) and a related put option. The fair value for these instruments are determined by the use of pricing models (see Note 5). The ARS were redeemed at full value during the nine months ended January 31, 2011.

Recently Adopted Accounting Standards

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance on Fair Value Measurements and Disclosures: Improving Disclosures about Fair Value Measurements, which amends the disclosure guidance with respect to fair value measurements. Specifically, the new guidance requires disclosure of amounts transferred in and out of Levels 1 and 2 fair value measurements, a reconciliation presented on a gross basis rather than a net basis of activity in Level 3 fair value measurements, greater disaggregation of the assets and liabilities for which fair value measurements are presented and more robust disclosure of the valuation techniques and inputs used to measure Level 2 and 3 fair value measurements. The guidance is effective for interim and annual reporting periods beginning after December 15, 2009, with the exception of the new guidance around the Level 3 activity reconciliation, which is effective for fiscal years beginning after December 15, 2010. The Company adopted the new guidance on February 1, 2010. The adoption did not impact the Company s financial position, results of operations or liquidity.

2. Basic and Diluted Earnings (Loss) Per Share

Basic earnings (loss) per common share was computed by dividing net earnings (loss) attributable to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings per common share reflects the potential dilution that would occur if all in-the-money outstanding options or other contracts to issue common stock were exercised or converted and was computed by dividing net earnings (loss) attributable to common stockholders by the weighted-average number of common shares outstanding plus dilutive common equivalent shares. During the nine months ended January 31, 2011, SARs and options to purchase 0.8 million shares were outstanding but not included in the computation of diluted earnings per share because they were anti-dilutive. During the three months ended January 31, 2011 and 2010, SARs and options to purchase 0.04 million shares and 1.3 million shares, respectively, were outstanding but not included in the computation of diluted earnings per share because they were anti-dilutive. Due to the loss attributable to common stockholders during the nine months ended January 31, 2010, no potentially dilutive shares are included in the loss per share calculation as including such shares in the calculation would be anti-dilutive.

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

The following table summarizes basic and diluted earnings (loss) per share calculations:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2011	**2010**	**2011**	**2010**
	(in thousands, except per share data)			
Net earnings (loss) attributable to common stockholders	$ 13,975	$ 7,910	$ 38,535	$ (3,618)
Weighted-average common shares outstanding:				
Basic weighted-average number of common shares outstanding	45,349	44,622	45,040	44,290
Effect of dilutive securities:				
Restricted stock	791	652	604	
Stock options	579	452	378	
Warrants		74		
ESPP	1	11	4	
Diluted weighted-average number of common shares outstanding	46,720	45,811	46,026	44,290
Net earnings (loss) per common share:				
Basic earnings (loss) per share	$ 0.31	$ 0.18	$ 0.86	$ (0.08)
Diluted earnings (loss) per share	$ 0.30	$ 0.17	$ 0.84	$ (0.08)

3. Comprehensive Income

Comprehensive income is comprised of net income (loss) and all changes to stockholders equity, except those changes resulting from investments by stockholders (changes in paid in capital) and distributions to stockholders (dividends). Total comprehensive income is as follows:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2011	**2010**	**2011**	**2010**
	(in thousands)			
Net income (loss)	$ 13,975	$ 7,910	$ 38,535	$ (3,618)
Foreign currency translation adjustments	(185)	(5,388)	3,789	12,871
Unrealized losses on marketable securities, net of taxes	(63)		(22)	
Comprehensive income	$ 13,727	$ 2,522	$ 42,302	$ 9,253

The components of accumulated other comprehensive income were as follows:

	January 31, 2011	April 30, 2010
	(in thousands)	
Foreign currency translation adjustments	$ 22,689	$ 18,900
Defined benefit adjustments, net of taxes	(5,966)	(5,966)
Unrealized losses on marketable securities, net of taxes	(22)	
Accumulated other comprehensive income	$ 16,701	$ 12,934

8

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

4. Employee Stock Plans

Stock-Based Compensation

The following table summarizes the components of stock-based compensation expense recognized in the Company s condensed consolidated statements of operations for the periods indicated:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2011	2010	2011	2010
	(in thousands)			
Restricted stock	$ 3,481	$ 3,807	$ 10,633	$ 12,360
Stock options and SARs	400	132	847	626
ESPP	88	85	295	286
Total stock-based compensation expense, pre-tax	3,969	4,024	11,775	13,272
Tax benefit from stock-based compensation expense	(1,449)	(1,469)	(4,298)	(4,845)
Total stock-based compensation expense, net of tax	$ 2,520	$ 2,555	$ 7,477	$ 8,427

The Company uses the Black-Scholes option valuation model to estimate the grant date fair value of employee stock options. The expected volatility reflects consideration of the historical volatility in the Company s publicly traded instruments during the period the option is granted. The Company believes historical volatility in these instruments is more indicative of expected future volatility than the implied volatility in the price of the Company s common stock. The expected life of each option is estimated using historical data. The risk-free interest rate is based on the U.S. Treasury zero-coupon issue with a remaining term approximating the expected term of the option. The Company uses historical data to estimate forfeiture rates applied to the gross amount of expense determined using the option valuation model.

The weighted-average assumptions used to estimate the fair value of each employee stock option and SARs were as follows:

	Nine Months Ended January 31,	
	2011	2010
Expected volatility	47.67%	48.91%
Risk-free interest rate	1.83%	2.53%
Expected option life (in years)	5.00	5.00
Expected dividend yield	0.00%	0.00%

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options. The assumptions used in option valuation models are highly subjective, particularly the expected stock price volatility of the underlying stock.

Stock Incentive Plans

The Korn/Ferry International 2008 Stock Incentive Plan, as amended (the 2008 Plan) made available an additional 2,360,000 shares of the Company s common stock for stock-based compensation awards. The 2008 Plan, provides for the grant of awards to eligible participants, designated as either nonqualified or incentive stock options, SARs, restricted stock and restricted stock units, any of which may be performance-based, and incentive bonuses, which may be paid in cash or a combination thereof.

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

Stock Options and SARs

Stock options and SARs transactions under the Company s stock incentive plans were as follows:

	Nine Months Ended January 31, 2011			
	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value
	(in thousands, except per share data)			
Outstanding, April 30, 2010	2,723	$ 14.72		
Granted	211	$ 13.97		
Exercised	(479)	$ 12.24		
Forfeited/expired	(475)	$ 20.57		
Outstanding, January 31, 2011	1,980	$ 13.85	4.05	$ 18,845
Exercisable, January 31, 2011	1,353	$ 14.65	3.23	$ 11,786

Included in the table above are 24,103 SARs outstanding and exercisable as of January 31, 2011 with a weighted-average exercise price of $8.87. As of January 31, 2011, there was $2.8 million of total unrecognized compensation cost related to non-vested awards of stock options and SARs. That cost is expected to be recognized over a weighted-average period of 1.6 years. For stock option awards subject to graded vesting, the Company recognizes the total compensation cost on a straight-line basis over the service period for the entire award.

Additional information pertaining to stock options and SARs:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2011	2010	2011	2010
	(in thousands, except per share data)			
Weighted-average fair value of stock options granted	$ 7.81	$ 7.97	$ 6.07	$ 4.88
Total fair value of stock options and SARs vested	$ 27	$ 11	$ 642	$ 607
Total intrinsic value of stock options exercised	$ 3,330	$ 924	$ 4,015	$ 2,024
Total intrinsic value of SARs paid	$	$ 75	$ 67	$ 75

Restricted Stock

The Company grants restricted stock to executive officers and other senior employees generally vesting over a three to four year period. Restricted stock is granted at a price equal to the fair market value of the Company s common stock on the date of grant. Employees may receive restricted stock annually in conjunction with the Company s performance review as well as upon commencement of employment. The fair value of restricted stock is determined based on the closing price of the Company s common stock on the date of grant.

Restricted stock activity during the nine months ended January 31, 2011, is summarized below:

	Weighted-Average Grant

	Shares		Date Fair Value
	(in thousands, except per share data)		
Non-vested, April 30, 2010	2,480	$	9.93
Granted	555	$	14.51
Vested	(855)	$	14.36
Forfeited/expired	(111)	$	17.14
Non-vested, January 31, 2011	2,069	$	10.02

As of January 31, 2011, there was $20.7 million of total unrecognized compensation cost related to non-vested awards of restricted stock, which is expected to be recognized over a weighted-average period of 2.9 years. For restricted stock awards subject to graded vesting, the Company recognizes the total compensation cost on a straight-line basis over the service period for the entire award. During the three and nine months ended January 31, 2011, 1,378 shares and 192,369 shares of restricted stock totaling $0.1 million and $2.8 million, respectively, were repurchased by the Company at the option of the employee to pay for taxes related to vesting of restricted stock. During the three and nine months ended January 31, 2010, 17,460 shares and 146,114 shares of restricted stock totaling $0.3 million and $1.7 million, respectively, were repurchased by the Company at the option of the employee to pay for taxes related to vesting of restricted stock.

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

Employee Stock Purchase Plan

The Company has an ESPP that, in accordance with Section 423 of the Internal Revenue Code, allows eligible employees to authorize payroll deductions of up to 15% of their salary, or $25,000 annually, to purchase shares of the Company s common stock at 85% of the fair market price of the common stock on the last day of the enrollment period. The maximum number of shares of common stock reserved for ESPP issuance is 1.5 million shares, subject to adjustment for certain changes in the Company s capital structure and other extraordinary events. During the three months ended January 31, 2011 and 2010, employees purchased 45,488 shares at $19.64 per share and 67,917 shares at $14.03 per share, respectively. During the nine months ended January 31, 2011 and 2010, employees purchased 153,913 shares at $14.13 per share and 209,840 shares at $10.66 per share, respectively. At January 31, 2011, the ESPP had approximately 0.2 million shares available for future issuance.

Common Stock

During the three and nine months ended January 31, 2011, the Company issued 378,705 shares and 471,782 shares of common stock, respectively, as a result of the exercise of stock options. During the three and nine months ended January 31, 2010, the Company issued 114,815 shares and 455,695 shares, respectively, of common stock as a result of the exercise of stock options.

In June 2002, the Company issued warrants to purchase 274,207 shares of its common stock at an exercise price of $11.94, subject to anti-dilution provisions. During the nine months ended January 31, 2010, these warrants were exercised for 274,207 shares of common stock in exchange for $3.0 million in cash.

During the nine months ended January 31, 2011, the Company repurchased 724,064 shares of the Company s common stock for $10.6 million. No shares of the Company s common stock were repurchased during the three months ended January 31, 2011 and 2010 or during the nine months ended January 31, 2010.

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

5. Marketable Securities

As of January 31, 2011, marketable securities consisted of the following:

	Trading	Available-for-Sale(2)	Total
		(in thousands)	
Mutual funds (1)	$ 68,613	$	$ 68,613
Corporate bonds		38,739	38,739
U.S. Treasury and agency securities		13,899	13,899
Commercial paper		999	999
Total	68,613	53,637	122,250
Less: current portion of marketable securities	(6,251)	(13,698)	(19,949)
Non-current marketable securities	$ 62,362	$ 39,939	$ 102,301

As of April 30, 2010, marketable securities consisted of the following:

	Trading
	(in thousands)
Mutual funds (1)	$ 69,019
Auction rate securities	7,455
Auction rate securities put option	745
Total	77,219
Less: current portion of marketable securities	(4,114)
Non-current marketable securities	$ 73,105

(1) These investments are held in trust for settlement of the Company s obligations under certain of its deferred compensation plans with $6.2 million and $4.1 million classified as current assets as of January 31, 2011 and April 30, 2010, respectively (see Note 7).

(2) These securities represent excess cash invested, under our investment policy, with a professional money manager. As of January 31, 2011, amortized cost and fair values of marketable securities classified as available-for-sale investments were as follows:

	January 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
Corporate bonds	$ 38,743	$ 81	$ (85)	$ 38,739
U.S. Treasury and agency securities	13,922	4	(27)	13,899

Commercial paper		998		1				999
Total	$	53,663	$	86	$	(112)	$	53,637

Investments in marketable securities are made based on the Company s investment policy, which restricts the types of investments that can be made. As of January 31, 2011, the Company s investments associated with cash equivalents consist of money market funds for which market prices are readily available. Marketable securities classified as available-for-sale consist of corporate bonds, U.S. Treasury and agency securities and commercial paper for which market prices for similar assets are readily available, with maturities ranging from four months to three years. Marketable securities classified as trading consist of mutual funds for which market prices are readily available. The Company s investments in marketable securities, consisting of mutual funds, as of April 30, 2010, were classified as trading. Also classified as trading were ARS, reflected at fair value. The ARS were redeemed at full value during the nine months ended January 31, 2011.

As of January 31, 2011 and April 30, 2010, the Company s marketable securities included $68.6 million (net of unrealized gains of $3.9 million) and $69.0 million (net of unrealized gains of $2.0 million) respectively, held in trust for settlement of the Company s obligations under certain of its deferred compensation plans, of which $62.4 million and $64.9 million, respectively, are classified as non-current. The Company s obligations for which these assets were held in trust totaled $68.9 million and $69.0 million as of January 31, 2011 and April 30, 2010, respectively.

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

The following table represents the Company s fair value hierarchy for financial assets measured at fair value on a recurring basis:

	January 31, 2011			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
Cash equivalents	$ 116,701	$ 116,701	$	$
Mutual funds	68,613	68,613		
Corporate bonds	38,739		38,739	
U.S. Treasury and agency securities	13,899		13,899	
Commercial paper	999		999	
Total	$ 238,951	$ 185,314	$ 53,637	$

	April 30, 2010			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
Cash equivalents	$ 148,238	$ 148,238	$	$
Mutual funds	69,019	69,019		
Auction rate securities	7,455			7,455
Auction rate securities put option	745			745
Total	$ 225,457	$ 217,257	$	$ 8,200

The following table presents the Company s assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the periods indicated:

	Three Months Ended January 31,		Nine Months Ended January 31,	
Auction Rate Securities	2011	2010	2011	2010
	(in thousands)			
Balance, beginning of period	$	$ 11,950	$ 8,200	$ 12,425
Auction rate securities put option			(745)	81
Realized gain included in operations			745	
Unrealized loss included in operations				(81)
Sale of securities		(1,050)	(8,200)	(1,525)
Balance, end of period	$	$ 10,900	$	$ 10,900

13

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

6. Restructuring Liability

During the nine months ended January 31, 2011, the Company increased previously recorded restructuring charges resulting in net restructuring costs of $2.1 million. The increase in restructuring expenses primarily relates to higher facility costs than originally recorded.

Changes in the restructuring liability during the three months ended January 31, 2011 are as follows:

	Severance	Facilities (in thousands)	Total
Liability as of October 31, 2010	$ 1,656	$ 9,724	$ 11,380
Reductions for cash payments	(535)	(4,425)	(4,960)
Exchange rate fluctuations	(29)	(131)	(160)
Liability as of January 31, 2011	$ 1,092	$ 5,168	$ 6,260

Changes in the restructuring liability during the nine months ended January 31, 2011 are as follows:

	Severance	Facilities (in thousands)	Total
Liability as of April 30, 2010	$ 2,714	$ 11,095	$ 13,809
Reductions for cash payments	(1,355)	(8,485)	(9,840)
Other increases (reductions), net	(299)	2,429	2,130
Exchange rate fluctuations	32	129	161
Liability as of January 31, 2011	$ 1,092	$ 5,168	$ 6,260

As of January 31, 2011 and April 30, 2010, the restructuring liability is included in current portion of other accrued liabilities on the consolidated balance sheet, except for $2.5 million and $5.2 million, respectively, of facilities costs which primarily relate to commitments under operating leases, net of sublease income, which are included in other long-term liabilities and will be paid over the next eight years.

The restructuring liability by segment is summarized below:

		January 31, 2011	
	Severance	Facilities (in thousands)	Total
Executive Recruitment			
North America	$	$ 102	$ 102
Europe, Middle East and Africa (EMEA)	986	3,366	4,352
Asia Pacific		445	445
South America	106		106
Total Executive Recruitment	1,092	3,913	5,005
Futurestep		1,255	1,255
Liability as of January 31, 2011	$ 1,092	$ 5,168	$ 6,260

	April 30, 2010		
	Severance	**Facilities** (in thousands)	**Total**
Executive Recruitment			
North America	$ 5	$ 845	$ 850
EMEA	2,429	7,816	10,245
Asia Pacific		773	773
South America	115		115
Total Executive Recruitment	2,549	9,434	11,983
Futurestep	165	1,661	1,826
Liability as of April 30, 2010	$ 2,714	$ 11,095	$ 13,809

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

7. Deferred Compensation and Retirement Plans

The Company has several deferred compensation and retirement plans for vice-presidents that provide defined benefits to participants based on the deferral of current compensation or contributions made by the Company subject to vesting and retirement or termination provisions.

The components of net periodic benefit costs are as follows:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2011	2010	2011	2010
	(in thousands)			
Service cost	$ 34	$ 85	$ 102	$ 255
Interest cost	925	945	2,775	2,835
Amortization of actuarial loss (gain)	105	(20)	315	(60)
Net periodic benefit costs	$ 1,064	$ 1,010	$ 3,192	$ 3,030

The Company has an Executive Capital Accumulation Plan (ECAP), which is intended to provide certain employees an opportunity to defer salary and/or bonus on a pre-tax basis, or make an after-tax contribution. The Company made no contributions to the ECAP in the three months ended January 31, 2011 and $0.3 million during the three months ended January 31, 2010. The Company made contributions to the ECAP of $0.4 million and $0.9 million during the nine months ended January 31, 2011 and 2010, respectively. Participants generally vest in Company contributions over a four year period. The ECAP is accounted for whereby the changes in the fair value of the vested amounts owed to the participants are adjusted with a corresponding charge (or credit) to compensation and benefits costs. During the three and nine months ended January 31, 2011, deferred compensation liability increased; therefore the Company recognized compensation expenses of $2.1 million and $3.4 million, respectively. During the three and nine months ended January 31, 2010, deferred compensation liability increased; therefore the Company recognized compensation expenses of $1.4 million and $5.4 million, respectively.

Table of Contents

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2011

8. Business Segments

The Company operates in two global business segments; executive recruitment and Futurestep. The executive recruitment segment focuses on recruiting board-level, chief executive and other senior executive positions for clients predominantly in the consumer, financial services, industrial, life sciences and technology industries and provides other related recruiting services. Futurestep creates customized, flexible talent acquisition solutions to meet specific workforce needs of organizations around the world. Their portfolio of services include recruitment process outsourcing, talent acquisition and management consulting services, project-based recruitment, mid-level recruitment and interim professionals. The executive recruitment business segment is managed by geographic regional leaders. Futurestep s worldwide operations are managed by the Chief Executive Officer of Futurestep. The executive recruitment geographic regional leaders and the Chief Executive Officer of Futurestep report directly to the Chief Executive Officer of the Company. The Company also operates a Corporate segment to record global expenses of the Company.

Financial highlights by business segment are as follows:

	Three Months Ended January 31, 2011							
	Executive Recruitment							
	North America	EMEA	Asia Pacific	South America	Subtotal	Futurestep	Corporate (1)	Consolidated
	(in thousands)							
Fee revenue	$ 94,991	$ 40,068	$ 20,445	$ 7,638	$ 163,142	$ 23,347	$	$ 186,489
Total revenue	$ 99,357	$ 41,481	$ 20,967	$ 7,767	$ 169,572	$ 24,537	$	$ 194,109
Operating income (loss)	$ 21,650	$ 3,360	$ 2,487	$ 1,559	$ 29,056	$ 1,268	$ (9,832)	$ 20,492

	Three Months Ended January 31, 2010							
	Executive Recruitment							
	North America	EMEA	Asia Pacific	South America	Subtotal	Futurestep	Corporate (1)	Consolidated
	(in thousands)							
Fee revenue	$ 70,187	$ 36,643	$ 16,503	$ 5,829	$ 129,162	$ 17,580	$	$ 146,742
Total revenue	$ 73,924	$ 37,615	$ 16,839	$ 5,959	$ 134,337	$ 18,563	$	$ 152,900
Operating income (loss)	$ 13,353	$ 2,935	$ 1,203	$ 1,010	$ 18,501	$ 555	$ (12,673)	$ 6,383

	Nine Months Ended January 31, 2011	
	Executive Recruitment	
	North	South