

HEIDRICK & STRUGGLES INTERNATIONAL INC

Form 10-K

February 27, 2009

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-K**

x

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2008

**OR**

..

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission File No. 0-25837**

**HEIDRICK & STRUGGLES INTERNATIONAL, INC.**

(Exact Name of Registrant as Specified in its Charter)

**Delaware**  
(State or Other Jurisdiction of

**36-2681268**  
(I.R.S. Employer

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Incorporation or Organization)

Identification Number)

**233 South Wacker Drive, Suite 4200, Chicago, Illinois 60606-6303**

(Address of principal executive offices) (Zip Code)

**(312) 496-1200**

(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title Of Each Class</b>	<b>Name Of Each Exchange On Which Registered</b>
<b>Common Stock, \$.01 par value</b>	<b>The Nasdaq Global Market</b>

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

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

The aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant on June 30, 2008 was approximately \$446,659,681 based upon the closing market price of \$27.37 on that date of a share of Common Stock as reported on the Nasdaq Global Stock Market. As of February 20, 2009, there were 16,373,558 shares of the Company's Common Stock outstanding.

## DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for its Annual Meeting of Stockholders to be held on May 21, 2009, are incorporated by reference into Part III of this Form 10-K.

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**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES**

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**PART I**

**ITEM 1. BUSINESS**

**Overview**

Heidrick & Struggles International, Inc. ( Heidrick & Struggles ) is a leading provider of executive search and leadership advisory services. We help our clients build leadership teams by facilitating the recruitment, management and deployment of senior executives for their executive management and board positions. Focusing on top-level services offers us several advantages that include access to and influence with key decision makers, increased potential for recurring search consulting engagements, higher fees per search, enhanced brand visibility, and leveraged global footprint, which create added barriers to entry for potential competitors. Working at the top of client organizations also allows us to attract and retain high-caliber consultants.

In addition to executive search, we provide a range of leadership advisory services to clients. These services include succession planning, talent retention management, executive assessment, executive development, transition consulting for newly appointed executives, and M&A human capital integration consulting.

Heidrick & Struggles has been in the executive search business for more than 50 years. We provide our services to a broad range of clients through the expertise of approximately 400 consultants located in major cities around the world. For many of our clients, our global access to and knowledge of regional and functional markets and candidate talent is an important differentiator of our business. We provide our executive search services on a retained basis, recruiting senior executives whose first year base salary and bonus averaged approximately \$370,000 in 2008 on a worldwide basis. Our clients include the following:

Fortune 1000 companies

Major non-U.S. companies

Middle market and emerging growth companies

Governmental, higher education and not-for-profit organizations

Other leading private and public entities

The executive search industry is highly fragmented, consisting of several thousand executive search firms worldwide. Executive search firms are generally separated into two broad categories: retained and contingency. Retained executive search firms fulfill their clients' senior leadership needs by identifying potentially qualified candidates and assisting clients in evaluating and assessing these candidates. Retained executive search firms generally are compensated for their services regardless of whether the client employs a candidate identified by the search firm and are generally retained on an exclusive basis. In contrast, contingency search firms are compensated only upon successfully placing a recommended

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candidate. Retained executive search firms normally charge a fee for their services equal to approximately one-third of the first year's total compensation for the position being filled.

We are a retained executive search firm. Our search process typically consists of the following steps:

Analyze the client's business needs in order to understand its organizational structure, relationships, and culture; determine the required set of skills for the position; define the required experience; and identify the other characteristics desired of the successful candidate

Select, contact, interview and evaluate candidates on the basis of experience and potential cultural fit with the client organization

Present confidential written reports on the candidates who potentially fit the position specification

Schedule a mutually convenient meeting between the client and each candidate

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Complete references on the final candidate selected by the client

Assist the client in structuring the compensation package and supporting the successful candidate's integration into the client team

**Available Information**

We maintain an Internet website at <http://www.heidrick.com>. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports are available free of charge on this site as soon as reasonably practicable after the reports are filed with or furnished to the Securities and Exchange Commission. We also post news releases on our financial results, investor presentations and other documents containing additional information related to our company on this site. Our Internet website and the information contained in or accessible from our website are for informational purposes only and are not incorporated into this annual report on Form 10-K.

**Organization**

Our organizational structure, which is arranged by geography and industry/functional practices, is designed to enable us to better understand our clients' cultures, operations, business strategies, industries and regional markets for executive talent.

**Geographic Structure.** We provide senior-level executive search and leadership advisory services to our clients worldwide through a network of more than 65 offices in 35 countries. Major locations are staffed with consultants, research associates, administrative assistants and other support staff. Administrative functions are centralized where possible, although certain support and research functions are situated regionally because of variations in local requirements.

Our worldwide network includes affiliate relationships in Finland, South Africa, Turkey and beginning in 2008 Portugal. We have no financial investment in these affiliates but receive licensing fees from them for the use of our name and our databases. Licensing fees are less than 1% of net revenue.

**Industry Practices.** We report and operate our executive search business in seven broad industry groups: Financial Services, Consumer, Industrial, Technology, Life Sciences, Business and Professional Services and Education/Nonprofit/Other. These industry categories and their relative sizes, as measured by net revenue for 2008 are as follows:

Industry Categories	Percentage of Net Revenue
Financial Services	30%
Industrial	22%
Consumer	17%
Technology	11%
Life Sciences	11%
Business and Professional Services	7%

Education/Nonprofit/ Other	2%
	100%

Within each broad industry group are a number of industry subsectors. Consultants often specialize in one or more subsectors to provide clients with market intelligence and candidate knowledge specific to their industry. For example, within the Financial Services sector our business is diversified among a number of industry



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subsectors including Asset & Wealth Management, Consumer Financial Services, Investment Banking and Capital Markets, Insurance, Private Equity/Venture Capital, and Real Estate.

We service our clients through unified global executive search teams who specialize in industry practices. This go-to-market strategy allows us to better leverage our global diversity and market intelligence to provide better client service. Each client is served by one global account team which we believe is a key differentiator from our competition.

**Functional Practices.** Our executive search consultants also specialize in searches for specific C-level functional positions, which are roles that generally report directly to the chief executive officer. These include chief financial officers, chief information officers, chief legal officers, chief marketing officers and chief human resources officers. Our functional specialists maintain continuous awareness of candidate talent.

Our Global Functional Practices include CEO & Board of Directors; Chief Information Officers; Chief Sales Officers; Chief Marketing Officers; Financial Officers; Chief Human Resources Officers; Legal, Risk & Compliance; Real Estate; Research & Development; and Supply Chain & Transportation.

Executive search consultants may service clients from any one of our offices around the world. For example, an executive search for a chief financial officer of an industrial company located in the United Kingdom may involve a consultant in the United Kingdom with an existing relationship with the client, another executive search consultant in the United States with expertise in our Industrial practice and a third executive search consultant with expertise in recruiting chief financial officers. This same industrial client may also engage us to perform skill-based assessments for each of its senior managers, which could require the expertise of one of our leadership advisory consultants trained in this service.

## **Information by Geographic Segment**

*Americas.* As of December 31, 2008, we had 205 executive search consultants in our Americas segment, which includes the United States, Canada, Mexico and Latin America. Our Americas segment generated approximately 51% of our worldwide net revenue in 2008. The largest offices, as defined by net revenue, are located in New York, Chicago and San Francisco.

*Europe.* As of December 31, 2008, we had 127 executive search consultants in our European segment, which includes the Middle East and Africa. Our European segment generated approximately 33% of our worldwide net revenue in 2008. Our offices in the United Kingdom, Germany and France produced the highest levels of net revenue in this segment.

*Asia Pacific.* As of December 31, 2008, we had 87 executive search consultants in the Asia Pacific segment. This segment generated approximately 16% of our worldwide net revenue in 2008. China (including Hong Kong), Australia and Japan produced the highest levels of net revenue in this segment.

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For financial information relating to each geographic segment, see Note 20, *Segment Information*, in the Notes to Consolidated Financial Statements.

### **Seasonality**

There is no discernible seasonality in our business, although as a percentage of total annual net revenue, the first quarter is typically the lowest. Revenue and operating income have historically varied by quarter and are hard to predict from quarter to quarter. In addition, the volatility in the global economy impacts our quarterly revenue and operating income. On average, the variance between the highest and lowest amount of quarterly net revenue, as expressed as a percentage of annual net revenue, is approximately 4 percentage points.

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### **Clients and Marketing**

Our consultants market the firm's executive search services through two principal means: targeted client calling and industry networking with clients and referral sources. These efforts are supported by proprietary databases, which provide our consultants with information as to contacts made by their colleagues with particular referral sources, candidates and clients. In addition, we benefit from a significant number of referrals generated by our reputation for high quality service and successfully completed assignments, as well as repeat business resulting from our ongoing client relationships.

Either by agreement with the clients or for client relationship purposes, executive search firms generally refrain from recruiting some employees of a client, and possibly other entities affiliated with that client, for a specified period of time but typically not more than one year from the commencement of a search. We seek to mitigate any adverse effects of these off-limits arrangements by strengthening our long-term relationships, allowing us to communicate our belief to prospective clients that we can conduct searches without these off-limits arrangements impeding the quality of our work.

No single client accounted for more than 2% of our net revenue in 2008, 2007 or 2006. Our top ten clients in 2008 in aggregate accounted for less than 9% of total net revenue.

### **Information Management Systems**

We rely on technology to support our consultants and staff in the search process. Our technology infrastructure consists of internally developed databases containing candidate profiles and client records, coupled with online services and industry reference sources. We use technology to manage and share information on current and potential clients and candidates, to communicate to both internal and external constituencies and to support administrative functions.

### **Professional Staff and Employees**

Our executive search professionals are generally categorized either as consultants or associates. Associates assist consultants by conducting research, making initial contact with candidates in some instances and performing other search-related functions. As of December 31, 2008, we had 1,751 full-time equivalent employees, of whom 419 were executive search consultants, 493 were associates and 839 were other search, support and corporate staff.

In each of the past five years, no single consultant accounted for a material portion of our net revenue. We recruit our consultants both from other executive search firms or consultants new to search who have worked in industries represented by our practices. In the latter case, these are often seasoned executives with extensive contacts and outstanding reputations who are entering the search profession as a second career, and who we train in our techniques and methodologies. We are not a party to any collective bargaining agreement, and we consider relations with our employees to be good.

**Competition**

The executive search industry is highly competitive. While we face competition to some degree from all firms in the industry, we believe our most direct competition comes from four established global retained executive search firms that conduct searches primarily for the most senior-level positions within an organization. In particular, our competitors include Egon Zehnder International, Korn/Ferry International, Russell Reynolds Associates, Inc. and Spencer Stuart & Associates. To a lesser extent, we also face competition from smaller boutique or specialty firms that specialize in certain regional markets or industry segments. Each firm with which we compete is also a competitor in the marketplace for effective consultants.

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Overall, the search industry has relatively few barriers to entry. Higher barriers exist, however, for global retained executive search firms like ours that focus primarily on conducting searches for senior-level positions that can provide leadership advisory services at the senior level. At this level, clients rely more heavily on a search firm's reputation, global access and the experience level of its consultants. We believe that the segment of executive search in which we compete is more quality-sensitive than price-sensitive. As a result, we compete on the level of service we offer, reflected by our client services specialties and, ultimately, by the quality of our search results. We believe that our emphasis on senior-level executive search, the depth of experience of our search consultants and our global presence enable us to compete favorably with other executive search firms.

Competition in our leadership advisory services is highly fragmented, with no universally recognized market leaders.

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Our executive officers as of February 27, 2009 are as follows:

<b>Name</b>	<b>Age</b>	<b>Position With Company</b>
L. Kevin Kelly	43	President and Chief Executive Officer; Director
K. Steven Blake	44	Executive Vice President, General Counsel and Secretary
Richard J. Caldera	51	Executive Vice President and Chief Human Resources Officer
Charles G. Davis	51	Managing Partner, Global Practices/Regional Managing Partner, Asia Pacific
Robert L. Hines	59	Managing Partner, Global Operations
Scott J. Krenz	56	Executive Vice President, Chief Financial Officer

There are no family relationships between any executive officer or director. The following information sets forth the business experience for at least the past five years for each of our executive officers as of February 27, 2009:

**L. Kevin Kelly** was elected Chief Executive Officer and a Director in September 2006. He was elected President in May 2007. Previously, Mr. Kelly was President, Europe, Middle East, Africa and Asia Pacific from March 2005 to September 2006; Regional Managing Partner, Asia Pacific from September 2002 to March 2005; and Office Managing Partner, Tokyo from February 2002 to September 2002. He joined us in 1997.

**K. Steven Blake** joined us in July 2005, when he was elected General Counsel and Secretary. He was elected Executive Vice President in January 2007. Previously, Mr. Blake was General Counsel of Aquion Partners, LP from 2001 to 2005; and Associate General Counsel for General Electric Capital Corporation from 1998 to 2001.

**Richard J. Caldera** joined us in May 2008, when he was elected Executive Vice President and Chief Human Resources Officer. Previously, Mr. Caldera was Senior Vice President, Human Resources, Mergers and Acquisitions, for the Healthcare Sector at Royal Philips Electronics N.V. from 2004 to 2008; Senior Vice President, Human Resources, at Skanska AB from 2002 to 2004; and Vice President and Senior Human Resources Officer, Global Operations at CNA Financial Corporation from 1998 to 2002.

**Charles G. Davis** was elected Managing Partner, Global Practices in December 2008. He has been Regional Managing Partner, Asia Pacific since September 2006; Office Managing Partner, Sydney, Australia, since January 2006; and Managing Partner of the Chief Information Officer Practice in Asia Pacific since October 2002. Previously, Mr. Davis was Managing Partner of the Technology and Business and Professional Services Practices in Asia Pacific from April 1999 to December 2005. He joined us in 1998.

**Robert L. Hines** was elected Managing Partner, Global Operations in December 2008. Previously, Mr. Hines was Chief Operating Officer for the Americas from December 2007 to December 2008; Sector Leader for Investment Banking in the Americas from March 2007 to December 2007; Managing Partner for the Boston, Dallas, Houston and Toronto offices from March 2006 to March 2007; and Managing Partner for the

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Toronto office from January 2004 to March 2007.

**Scott J. Krenz** joined us in August 2008, when he was elected Executive Vice President and Chief Financial Officer. Previously, Mr. Krenz was Executive Vice President and Chief Financial Officer at Navigant Consulting from 2007 to 2008; Chief Financial Officer at Sapien Corporation from 2004 to 2006; and held senior finance positions of increasing responsibility at Electronic Data Systems Corporation (EDS) from 1985 to 2004.

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### **ITEM 1A. RISK FACTORS**

In addition to other information in this Form 10-K, the following risk factors should be carefully considered in evaluating our business because such factors may have a significant impact on our business, operating results, cash flows and financial condition. As a result of the risks set forth below and elsewhere in this Form 10-K, and the risks discussed in our other Securities and Exchange Commission filings, actual results could differ materially from those projected in any forward-looking statements.

#### **We depend on attracting and retaining qualified consultants.**

Our success depends upon our ability to attract and retain consultants who possess the skills and experience necessary to fulfill our clients executive search needs. Our ability to hire and retain qualified consultants could be impaired by any diminution of our reputation, decrease in compensation levels relative to our competitors or modifications of our total compensation philosophy or competitor hiring programs. If we cannot attract, hire and retain qualified consultants, our business, financial condition and results of operations may suffer.

#### **We may not be able to prevent our consultants from taking our clients with them to another firm.**

Our success depends upon our ability to develop and maintain strong, long-term relationships with our clients. Although we work on building these relationships between our firm and our clients, in many cases, one or two consultants have primary responsibility for a client relationship. When a consultant leaves one executive search firm and joins another, clients who have established relationships with the departing consultant may move their business to the consultant's new employer. We may also lose clients if the departing consultant has widespread name recognition or a reputation as a specialist in executing searches in a specific industry or management function. Historically, we have not experienced significant revenue loss from this potential client portability. If we fail to limit departing consultants from moving business to another employer, our business, financial condition and results of operations may be adversely affected.

#### **Our success depends on our ability to maintain our professional reputation and brand name.**

We depend on our overall reputation and brand name recognition to secure new engagements and hire qualified consultants. Our success also depends on the individual reputations of our consultants. We obtain many of our new engagements from existing clients or from referrals by those clients. A client who is dissatisfied with our work can adversely affect our ability to secure new engagements. If any factor hurts our reputation, including poor performance, we may experience difficulties in competing successfully for both new engagements and qualified consultants. Failure to maintain our professional reputation and brand name could seriously harm our business, financial condition and results of operations.

#### **Because our clients may restrict us from recruiting their employees we may be unable to fill existing executive search assignments.**

Clients frequently require us to refrain from recruiting certain of their employees when conducting executive searches on behalf of other clients. These restrictions generally remain in effect for no more than one year following the commencement of an engagement. However, the specific



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duration and scope of the off-limits arrangements depend on the length of the client relationship, the frequency with which the client engages us to perform searches, the number of assignments we have performed for the client and the potential for future business with the client.

If a prospective client believes that we are overly restricted by these off-limits arrangements from recruiting the employees of our existing clients, these prospective clients may not engage us to perform their executive searches, and as a result, our business, financial condition and results of operations may suffer.

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### **We face aggressive competition.**

The global executive search industry is extremely competitive and highly fragmented. We compete with other large global executive search firms and with smaller specialty firms. Specialty firms can focus on regional or functional markets or on particular industries. Some of our competitors may possess greater resources, greater name recognition and longer operating histories than we do in particular markets or practice areas. There are limited barriers to entry into the search industry and new search firms continue to enter the market. Many executive search firms that have a smaller client base may be subject to fewer off-limits arrangements. In addition, our clients or prospective clients may decide to perform executive searches using in-house personnel. Finally, competitors sometimes reduce their fees in order to attract clients and increase market share. Because we typically do not discount our fees, we may experience some loss of net revenue. We may not be able to continue to compete effectively with existing or potential competitors. Our inability to meet these competitive challenges could have an adverse impact on our business, financial condition and results of operations.

### **We rely heavily on information management systems.**

Our success depends upon our ability to store, retrieve, process and manage substantial amounts of information. To achieve our goals, we must continue to improve and upgrade our information management systems. We may be unable to license, design and implement, in a cost-effective and timely manner, improved information systems that allow us to compete effectively. In addition, business process reengineering efforts may result in a change in software platforms and programs. Such efforts may result in an acceleration of depreciation expense over the shortened expected remaining life of the software and present transitional problems. In addition, if we experience any interruptions or loss in our information processing capabilities, our business, financial condition and results of operations may suffer.

### **We face the risk of liability in the services we perform.**

We are exposed to potential claims with respect to the executive search process. A client could assert a claim for violations of off-limits arrangements, breaches of confidentiality agreements or professional malpractice. The growth and development of our other leadership advisory services brings with it the potential for new types of claims. In addition, candidates and client employees could assert claims against us. Possible claims include failure to maintain the confidentiality of the candidate's employment search or for discrimination or other violations of the employment laws or malpractice. In various countries, we are subject to data protection laws impacting the processing of candidate information. We maintain professional liability insurance in amounts and coverage that we believe are adequate; however, we cannot guarantee that our insurance will cover all claims or that coverage will always be available. Significant uninsured liabilities could have a negative impact on our business, financial condition and results of operations.

### **Our multinational operations may be adversely affected by social, political, legal and economic risks.**

We generate substantial revenue outside the United States. We offer our services through offices in 35 countries around the world. We are exposed to the risk of changes in social, political, legal and economic conditions inherent in international operations which could have a significant impact on our business, financial condition and results of operations. In particular, we conduct business in countries where the legal systems, local laws and trade practices are unsettled and evolving. Commercial laws in these countries are sometimes vague, arbitrary and inconsistently applied. Under these circumstances, it is difficult for us to determine at all times the exact requirements of such local laws. If we fail to comply with local laws, our business, financial condition and results of operations could suffer. In addition, the global nature of our operations poses challenges to our management, and financial and accounting systems. Failure to meet these challenges could seriously harm our business, financial condition and results of operations.



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### **We may not be able to align our cost structure with net revenue.**

We must ensure that our costs and workforce continue to be in proportion to demand for our services. Failure to align our cost structure and headcount with net revenue could adversely affect our business, financial condition, and results of operations.

### **Our net revenue may be affected by adverse economic conditions.**

Periods of slowed economic activity, such as that currently being experienced can adversely affect our net revenue. In particular, current volatility in the capital markets can affect our net revenue in the Financial Services industry group. If economic conditions fail to improve, our business, financial condition and results of operations could suffer.

### **The global financial crisis could adversely affect our business.**

The ongoing financial crisis has tightened credit markets and lowered liquidity levels. Some of our clients may experience serious financial problems due to reduced access to credit and lower revenues resulting in their inability to meet their payment obligation to us.

### **We do not yet know if salary cap legislation passed or proposed will have an effect on net revenues.**

Our fees for executive search services are generally based on a percentage of a placed executive's first year compensation. As part of its economic stimulus package, the United States Congress has enacted legislation that could cap compensation for certain senior executive positions at organizations, principally in the financial services sector, that have received US taxpayer funds in order to continue operating. In addition, it is possible that our clients may, regardless of the application of the salary cap legislation to their business, impose limits on senior executive pay or reduce compensation levels for the positions they retain us to fill. In either case, lower or capped executive salaries in the future could have a negative impact on our revenues and could adversely affect our business, financial condition, and results of operations.

### **We may not be able to generate sufficient profits to realize the benefit of our net deferred tax assets.**

We establish valuation allowances against deferred tax assets when there is insufficient evidence that we will be able to realize the benefit of these deferred tax assets. We reassess the realizability of the deferred tax assets as facts and circumstances dictate. If after future assessments of the realizability of the deferred tax assets, we determine that a lessor or greater allowance is required, we record a reduction or increase to the income tax expense and the valuation allowance in the period of such determination.

### **Our inability to successfully integrate consultants hired through acquisitions may have an adverse effect on our business.**

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We may continue to grow through selective acquisitions, however, we may not be able to identify appropriate acquisition candidates, consummate acquisitions on satisfactory terms or integrate the acquired businesses effectively and profitably into our existing operations. Our future success will depend in part on our ability to complete the integration of acquisitions successfully into our operations. Failure to successfully integrate new employees and complementary businesses may adversely affect our profitability by creating operating inefficiencies that could increase operating expenses as a percentage of net revenues and reduce operating income. Further, after any acquisition, the acquired businesses' clients may choose not to move their business to us causing an adverse affect on our business, financial condition and results of operations.

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### **We may experience impairment of our goodwill and other intangible assets.**

Periodically, we perform assessments of the carrying value of our goodwill and other intangible assets. In performing these assessments, we must make assumptions regarding the estimated fair value of our goodwill and other intangible assets. These assumptions include estimates of future market growth and trends, forecasted revenue and costs, capital investments, discount rates, and other variables. If the current weakening economic conditions continue to negatively impact our financial performance, we may fail to achieve our projected operating results and may need to record an impairment charge related to goodwill or other indefinite-lived intangible assets. Any resulting impairment loss could have an adverse impact on our business, financial condition and results of operations.

### **We have anti-takeover provisions that make an acquisition of us difficult and expensive.**

Anti-takeover provisions in our Certificate of Incorporation, our Bylaws and the Delaware laws make it difficult and expensive for someone to acquire us in a transaction which is not approved by our Board of Directors. Some of the provisions in our Certificate of Incorporation and Bylaws include:

a classified board of directors

limitations on the removal of directors

limitations on stockholder actions

the ability to issue one or more series of preferred stock by action of our Board of Directors

These provisions could discourage an acquisition attempt or other transaction in which stockholders could receive a premium over the current market price for the common stock.

### **Our ability to access additional credit could be limited.**

In the current economic environment, banks can be expected to strictly enforce the terms of our credit agreement. Although we are currently in compliance with the financial covenants of our revolving credit facility, a further deterioration of economic conditions may negatively impact our business resulting in our failure to comply with these covenants in the future, which could limit our ability to borrow funds under our credit facility. In such circumstances, we may not be able to secure alternative financing or may only be able to do so at significantly higher costs.

## **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our corporate headquarters is located in Chicago, Illinois. We have offices in major metropolitan areas in 31 countries around the world. All of our offices are leased. We do not own any real estate. The aggregate square footage of office space under lease was approximately 764 thousand as of December 31, 2008. These office leases call for future minimum lease payments of approximately \$172 million and have terms that expire between 2009 and 2024, exclusive of renewal options that we can exercise. Approximately 128 thousand square feet of office space has been sublet to third parties.

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**ITEM 3. LEGAL PROCEEDINGS**

We have contingent liabilities from various pending claims and litigation matters arising in the ordinary course of our business, some of which involve claims for damages that are substantial in amount. Some of these matters are covered by insurance. Although our ultimate liability in these matters cannot be determined, based upon information currently available, we believe the ultimate resolution of such claims and litigation will not have a material adverse effect on our financial condition, results of operations or liquidity.

In September 2007, Whitney Group and Whitney Group Asia (collectively Whitney Group ) filed suit against us in the New York Supreme Court, New York County, seeking injunctive relief and damages relating to the resignation, and subsequent hiring by us, of certain Whitney Group employees based in Hong Kong. On December 19, 2007, the parties to the suit agreed to a settlement and release of all claims, both asserted and unasserted. The parties have executed release documents, and the claims have been dismissed.

*Contingencies*

During the fourth quarter of 2005, a European country commenced a tax audit for the years 2001 to 2004, including an examination of our arrangement with professional services companies that provide consulting services to us. On November 24, 2006, the examining tax authority issued a final assessment in the amount of 4.3 million (equivalent to \$6.0 million at December 31, 2008). No penalty has been included in this assessment. This final assessment has been appealed by us and the enforcement of the assessment has been suspended until a final determination of the appeal. We have provided a bank guarantee to the tax authority in the amount of the final assessment as required by local law. See Note 5, *Restricted Cash* and Note 21, *Guarantees*, in the Notes to Consolidated Financial Statements. At this time, we believe that the likelihood of an unfavorable outcome is not probable and that the potential amount of any loss cannot be reasonably estimated. We also believe that the amount of a final assessment, if any, would not be material to our financial condition.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of security holders during the fourth quarter of 2008.



**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market for Registrant's Common Equity**

Our common stock is listed on the Nasdaq Global Stock Market under the symbol HSII. The following table sets forth the high and low stock price per share of the common stock for the periods indicated, as reported on the Nasdaq Global Stock Market.

<b>Year Ended December 31, 2008</b>	<b>High</b>	<b>Low</b>
First Quarter	\$ 37.65	\$ 23.56
Second Quarter	37.98	26.44
Third Quarter	34.99	24.50
Fourth Quarter	30.20	17.86
 <b>Year Ended December 31, 2007</b>		
First Quarter	\$ 49.62	\$ 41.20
Second Quarter	51.59	45.86
Third Quarter	55.22	34.92
Fourth Quarter	45.57	30.96

As of February 20, 2009, the last reported price on the Nasdaq Global Stock Market for our common stock was \$15.63 per share, and there were approximately 131 stockholders of record of the common stock.

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### **Performance Graph**

We have presented below a graph which compares the cumulative total stockholder return on our common shares with the cumulative total stockholder return of the Standard & Poor's SmallCap 600 Index and the Standard & Poor's Composite 1500 Human Resource and Employment Services Index. Cumulative total return for each of the periods shown in the performance graph is measured assuming an initial investment of \$100 on December 31, 2003.

The stock price performance depicted in this graph is not necessarily indicative of future price performance. This graph will not be deemed to be filed as part of this Form 10-K and will not be deemed to be incorporated by reference by any general statement incorporating this Form 10-K into any filing by us under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate this information by reference.

### **Comparison of Five-Year Cumulative Total Return\***

Comparison is among Heidrick & Struggles, the S&P SmallCap 600 Index and the S&P Composite 1500 Human Resource & Employment Services Index. The S&P Composite 1500 Human Resource & Employment Services Index includes 13 companies in related businesses, including Heidrick & Struggles.

\*Assuming \$100 invested on 12/31/03 in HSII or index, including reinvestment of dividends.

Source: Standard & Poor's

### **Dividends**

In September of 2007, our Board of Directors approved the initiation of a quarterly cash dividend program in the amount of \$0.13 per share. In 2008, the cash dividend was \$0.52 per share. In connection with the initiation of a dividend, the Board of Directors also approved the payment of a dividend equivalent on outstanding restricted stock units. The amounts related to the quarterly dividend equivalent for restricted stock units will be accrued over the vesting period and paid upon vesting.

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The following table outlines the cash dividends paid and the payment dates since the initiation of the quarterly cash dividend program in September of 2007:

<b>Cash Dividends Paid as of December 31, 2008</b>		<b>Dividends</b>
<b>Record Date</b>	<b>Payment Date</b>	<b>(in 000,000 s)</b>
November 2, 2007	November 16, 2007	\$2.3
February 1, 2008	February 15, 2008	2.2
May 2, 2008	May 16, 2008	2.2
August 1, 2008	August 15, 2008	2.1
November 7, 2008	November 21, 2008	2.1

Cash dividends payable of \$2.1 million related to the fourth quarter 2008 cash dividend which will be paid in the first quarter of 2009 and \$2.3 million related to the fourth quarter 2007 cash dividend which was paid in the first quarter of 2008 and the related dividend equivalents on outstanding restricted stock units are accrued in the Consolidated Balance Sheets as of December 31, 2008 and 2007.

**Issuer Purchases of Equity Securities**

The following table provides information related to our purchase of common shares for the quarter ended December 31, 2008. For further information of our share repurchase activity, see Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

<b>Period</b>		<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Approximate Dollar Value of Shares That May Yet Be Purchased Under Publicly Announced Plans or Programs</b>
Oct. 1, 2008	Oct. 31, 2008		\$		\$ 22,788,650
Nov. 1, 2008	Nov. 30, 2008				22,788,650
Dec. 1, 2008	Dec. 31, 2008				22,788,650

Total

On May 24, 2006, our Board of Directors authorized management to repurchase shares of our common stock with an aggregate purchase price up to \$50 million. We purchased 1,132,073 shares of our common stock for \$50 million under the May 2006 authorization, which was completed during the third quarter of 2007.

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On May 24, 2007, our Board of Directors authorized management to repurchase shares of our common stock with an aggregate purchase price up to \$50 million. We purchased 1,403,738 shares of our common stock for \$50 million under the May 2007 authorization, which was completed during the first quarter of 2008.

On February 8, 2008, our Board of Directors authorized management to repurchase shares of our common stock with an aggregate purchase price up to \$50 million. We intend from time to time and as business conditions warrant, to purchase shares of our common stock on the open market or in negotiated or block trades. No time limit has been set for completion of this program. As of December 31, 2008, we have purchased 951,160 shares of our common stock for a total of \$27.2 million, and \$22.8 million remains available under the February 2008 authorization.

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA**

The selected financial data presented below have been derived from our audited consolidated financial statements. The data as of December 31, 2008 and 2007 and for the years ended December 31, 2008, 2007 and 2006 are derived from the audited historical consolidated financial statements which are included elsewhere in this Form 10-K. The data as of December 31, 2006, 2005 and 2004 and for the years ended December 31, 2005 and 2004 are derived from audited historical consolidated financial statements that are not included in this report. The data set forth is qualified in its entirety by, and should be read in conjunction with, Management's Discussion and Analysis of Financial Condition and Results of Operations, the audited consolidated financial statements, the notes thereto, and the other financial data and statistical information included in this Form 10-K.

	Year Ended December 31,				
	2008	2007	2006	2005	2004
	(in thousands, except per share and other operating data)				
<b>Statement of Operations Data:</b>					
Revenue:					
Revenue before reimbursements (net revenue)	\$ 615,904	\$ 619,654	\$ 478,523	\$ 412,297	\$ 375,432
Reimbursements	28,956	28,612	23,471	20,553	22,744
<b>Total revenue</b>	<b>644,860</b>	<b>648,266</b>	<b>501,994</b>	<b>432,850</b>	<b>398,176</b>
Operating expenses:					
Salaries and employee benefits	435,306	418,952	328,714	273,949	251,186
General and administrative expenses	125,061	121,198	99,352	94,369	96,533
Reimbursed expenses	28,956	28,612	23,471	20,553	21,247
Restructuring charges (1)			408	22,493	550
<b>Total operating expenses</b>	<b>589,323</b>	<b>568,762</b>	<b>451,945</b>	<b>411,364</b>	<b>369,516</b>
<b>Operating income</b>	<b>55,537</b>	<b>79,504</b>	<b>50,049</b>	<b>21,486</b>	<b>28,660</b>
Non-operating income (expense):					
Interest income, net	5,103	8,035	6,257	5,572	2,391
Other, net	1,613	(404)	(1,040)	1,424	56,048(2)
<b>Net non-operating income</b>	<b>6,716</b>	<b>7,631</b>	<b>5,217</b>	<b>6,996</b>	<b>58,439</b>
<b>Income before income taxes</b>	<b>62,253</b>	<b>87,135</b>	<b>55,266</b>	<b>28,482</b>	<b>87,099</b>
Provision for (benefit from) income taxes	23,179	30,672	21,023	(10,736)(3)	4,791(3)
<b>Net income</b>	<b>\$ 39,074</b>	<b>\$ 56,463</b>	<b>\$ 34,243</b>	<b>\$ 39,218</b>	<b>\$ 82,308</b>
<b>Basic earnings per common share</b>	<b>\$ 2.33</b>	<b>\$ 3.16</b>	<b>\$ 1.91</b>	<b>\$ 2.08</b>	<b>\$ 4.35</b>
<b>Basic weighted average common shares outstanding</b>	<b>16,747</b>	<b>17,854</b>	<b>17,925</b>	<b>18,898</b>	<b>18,941</b>
<b>Diluted earnings per common share</b>	<b>\$ 2.20</b>	<b>\$ 2.97</b>	<b>\$ 1.81</b>	<b>\$ 1.98</b>	<b>\$ 4.11</b>
<b>Diluted weighted average common shares outstanding</b>	<b>17,727</b>	<b>18,984</b>	<b>18,916</b>	<b>19,761</b>	<b>20,012</b>
<b>Dividends per common share</b>	<b>\$ 0.52</b>	<b>\$ 0.26</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Balance Sheet Data (at end of period):</b>					
Working capital	\$ 126,875	\$ 147,861	\$ 135,880	\$ 159,964	\$ 150,198
Total assets	586,957	616,884	513,309(4)	406,409(4)	415,656(4)
Long-term debt, less current maturities					
Stockholders' equity	306,304	309,800	263,705	237,485	216,126
<b>Other Operating Data:</b>					
Average number of consultants during the period	413(5)	401	348	307	299



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**Notes to Selected Financial Data:**

- (1) During 2005, we recorded restructuring charges of \$22.5 million in connection with initiatives to improve operating performance and increase operating margin. These initiatives focused primarily on Europe and included charges of \$14.1 million for severance and other employee-related costs related to reductions in workforce and \$8.4 million related to the consolidation of office space. The workforce reduction affected 57 employees, primarily in Europe, and included 15 executive search consultants. Included in the office-related charge of \$8.4 million is the reversal of \$1.0 million of restructuring accruals, which originated in a prior year, related to a renegotiated lease for one of our search offices. By segment, the restructuring charges recorded in 2005 include \$1.1 million in the Americas, \$19.3 million in Europe and \$2.1 million in Corporate.
- (2) In 2004, we recognized a realized gain of \$57.0 million related to the equity and warrant portfolio, net of the consultants' share of the gain and other costs, including \$56.8 million related to the monetization of our shares of common stock of Google Inc. The realized gain of \$57.0 million was offset by a loss of \$1.0 million consisting primarily of exchange losses on intercompany balances which are denominated in currencies other than the functional currency and are not considered permanent in nature.
- (3) In 2004 and again in 2005, we determined that a reduction to the valuation allowance was required relating to certain deferred tax assets in the U.S. and recorded reductions to the valuation allowance of \$28.5 million and \$24.6 million, respectively.
- (4) In 2007, the Company determined that the UK Employee Benefit Trust should not be consolidated and as a result reduced total assets and liabilities by \$6.5 million, \$4.5 million, and \$5.6 million in 2006, 2005, and 2004, respectively.
- (5) In January 2009, our Board of Directors approved a restructuring plan, which reduced our global workforce by approximately 12%.

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### **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*Management's Discussion and Analysis of Financial Condition and Results of Operations as well as other sections of this annual report on Form 10-K contain forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. The forward-looking statements are based on current expectations, estimates, forecasts and projections about the industry in which we operate and management's beliefs and assumptions. Forward-looking statements may be identified by the use of words such as expects, anticipates, intends, plans, believes, seeks, estimates, projects, forecasts, and similar expressions. Forward-looking statements are not guarantees of future performance and involve certain known and unknown risks, uncertainties and assumptions that are difficult to predict. Actual outcomes and results may differ materially from what is expressed, forecasted or implied in the forward-looking statements. Factors that may affect the outcome of the forward-looking statements include, among other things, our ability to attract and retain qualified executive search consultants; further declines in the global economy and our ability to execute successfully through business cycles; the timing, speed or robustness of any future economic recovery; social or political instability in markets where we operate, the impact of foreign currency exchange rate fluctuations; price competition; the ability to forecast, on a quarterly basis, variable compensation accruals that ultimately are determined based on the achievement of annual results; our ability to realize our tax loss carryforwards; the timing of the establishment or reversal of valuation allowance on deferred tax assets; the mix of profit and loss by country; an impairment of our goodwill and other intangible assets; delays in the development and/or implementation of new technology and systems; and, the ability to meet and achieve the expected savings resulting from cost-reduction initiatives and restructuring activities. For more information on the factors that could affect the outcome of forward-looking statements, see Risk Factors in Item 1A of this Form 10-K. We caution the reader that the list of factors may not be exhaustive. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.*

#### **Executive Overview**

##### *Our Business*

We are a leading provider of executive search and leadership advisory services. We help our clients build leadership teams by facilitating the recruitment, management and deployment of senior executives for their executive management and board positions. Focusing on top-level services offers us several advantages that include access to and influence with key decision makers, increased potential for recurring search consulting engagements, higher fees per search, enhanced brand visibility, and leveraged global footprint, which create added barriers to entry for potential competitors. Working at the top of client organizations also allows us to attract and retain high-caliber consultants.

In addition to executive search, we provide a range of leadership advisory services to clients. These services include succession planning, executive assessment, talent retention management, executive development, transition consulting for newly appointed executives, and M&A human capital integration consulting.

We provide our services to a broad range of clients through the expertise of approximately 400 consultants located in 35 countries throughout the world. Our executive search services are provided on a retained basis. Revenue before reimbursements of out-of-pocket expenses ( net revenue ) consists of retainers and indirect expenses billed to clients. Typically, we are paid a retainer for our executive search services equal to approximately one-third of the estimated first year compensation for the position to be filled. In addition, if the actual compensation of a placed candidate exceeds the estimated compensation, we often are authorized to bill the client for one-third of the excess. Indirect expenses are calculated as a percentage of the retainer with certain dollar limits per search.



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### *Key Performance Indicators*

We manage and assess Heidrick & Struggles performance through various means, with the primary financial and operational measures including net revenue growth, operating income, operating margin, consultant headcount, new search confirmation trends, consultant productivity, and average fee per executive search.

Revenue growth is driven by a combination of additional consultants, an increase in executive searches, higher productivity levels and higher average fees per search or service. With the exception of compensation expense, incremental increases in revenue do not necessarily result in proportionate increases in costs, particularly operating and administrative expenses, thus potentially improving operating margins.

The number of consultants, confirmation trends, number of searches completed, productivity levels and the average fee per search will vary from quarter to quarter, affecting revenue growth and operating margin.

### *Consultant Compensation Model*

At the consultant level, individuals are largely rewarded for their performance based on a system that directly ties a significant portion of their compensation to the amount of net revenue for which they are responsible. Credit towards the variable portion of a consultant's compensation is earned by generating net revenue for winning and for executing search work. Each quarter, we review and update the expected annual performance of all consultants and accrue variable compensation accordingly. The amount of variable compensation that is accrued for each consultant is based on a tiered payout model. The more net revenue that is generated by the consultant, the higher the percentage credited towards the consultant's variable compensation and thus accrued by our company as expense. The mix of individual consultants who generate the revenue can significantly affect the total amount of compensation expense recorded and thus operating margins. This bonus is discretionary and is based on company-wide profitability targets approved by the Human Resources and Compensation Committee of the Board of Directors. As a result, the variable portion of the compensation expense may fluctuate significantly from quarter to quarter.

In the first quarter of 2008, we changed the deferral arrangement of bonuses for consultants and management globally. The portion of the bonus previously deferred into restricted stock units will now be deferred into cash which will be paid ratably over a three-year period. A premium of 10% was applied to the bonus amount deferred in 2008. The portion of the bonus that will be deferred varies between 10% and 15% depending on the employee's level or position. The compensation expense related to the amounts being deferred is recognized on a graded vesting attribution method over the requisite service period, which for 2008, began on January 1, 2008 and continues through the final payment date, which is three years from the date of the original deferral. For 2008, the deferral date will be in the first quarter of 2009. These amounts are recorded as a component of other non-current liabilities in the Consolidated Balance Sheet. We will continue to grant restricted stock units under other existing programs.

### *2008 Overview*

Consolidated net revenue of \$615.9 million decreased 0.6% or \$3.8 million in 2008, compared to 2007. Revenue declined 5.7% in the Americas and 2.9% in Europe and increased 27.3% in Asia Pacific. Consultant productivity measured by average revenue per executive search consultant was \$1.4 million for the year ended December 31, 2008 compared to \$1.5 million for the year ended December 31, 2007. The average fee per executive search was \$122,600 for the year ended December 31, 2008 compared to \$114,900 for the year ended December 31, 2007.

Operating income as a percentage of net revenue decreased to 9.0% in 2008 from 12.8% in 2007 primarily as a result of an increase in salaries and employee benefits expense of 3.9% due to higher employee headcount in

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anticipation of higher revenue and an increase in general and administrative expenses of 3.2% primarily due to higher lease costs. Salaries and employee benefits expense as a percentage of net revenue increased from 67.6% in 2007 to 70.7% in 2008. General and administrative expenses as a percentage of net revenue increased from 19.6% in 2007 to 20.3% in 2008.

We ended the year with a combined cash and cash equivalents balance of \$234.5 million, a decrease of \$48.4 million compared to a combined cash and cash equivalents and short-term investment balance of \$282.9 million at December 31, 2007. We pay the majority of bonuses in the first quarter following the year in which they were earned. Employee bonuses are accrued throughout the year and are based on the Company's performance and the performance of the individual employee. In early 2009, we expect to pay approximately \$130 million related to the 2008 bonus accruals.

### *2009 Outlook*

In 2009, we currently forecast net revenue of between \$450 million to \$500 million and an operating margin of between zero and 5 percent, excluding restructuring charges, for the year ending December 31, 2009. However, continued macroeconomic uncertainty and unprecedented volatility in the capital markets necessarily mean that our current forecasts could change materially during 2009.

In January 2009, our Board of Directors approved a restructuring plan to reduce overall costs and improve operational efficiencies that will result in a first quarter 2009 restructuring charge of as much as \$20 million, substantially all of which will result in cash expenditures during 2009. Under this plan, we reduced our global workforce by approximately 12%, which we expect will result in savings of approximately \$31 million over the next twelve months. Over time, we also aim to reduce real estate expenses and support costs by approximately 30% by closing or consolidating a still undetermined number of our U.S. offices, adopting new technologies to improve productivity, and reducing support costs such as accounting, procurement, and human resources administration.

## **Results of Operations**

We operate our business in three geographic regions: the Americas, Europe, and Asia Pacific.

For segment purposes, reimbursements of out-of-pocket expenses classified as revenue are reported separately and therefore are not included in the net revenue by geographic region. We believe that analyzing trends in revenue before reimbursements (net revenue) and analyzing operating expenses as a percentage of net revenue more appropriately reflects our core operations.

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The following table summarizes, for the periods indicated, the results of operations (in thousands):

	Year Ended December 31,		
	2008	2007	2006
<b>Revenue:</b>			
Revenue before reimbursements (net revenue)	\$ 615,904	\$ 619,654	\$ 478,523
Reimbursements	28,956	28,612	23,471
<b>Total revenue</b>	<b>644,860</b>	<b>648,266</b>	<b>501,994</b>
<b>Operating expenses:</b>			
Salaries and employee benefits	435,306	418,952	328,714
General and administrative expenses	125,061	121,198	99,352
Reimbursed expenses	28,956	28,612	23,471
Restructuring charges			408
<b>Total operating expenses</b>	<b>589,323</b>	<b>568,762</b>	<b>451,945</b>
<b>Operating income</b>	<b>55,537</b>	<b>79,504</b>	<b>50,049</b>
Net non-operating income	6,716	7,631	5,217
<b>Income before income taxes</b>	<b>62,253</b>	<b>87,135</b>	<b>55,266</b>
Provision for income taxes	23,179	30,672	21,023
<b>Net income</b>	<b>\$ 39,074</b>	<b>\$ 56,463</b>	<b>\$ 34,243</b>

The following table summarizes, for the periods indicated, our selected statements of operations data as a percentage of revenue before reimbursements (net revenue):

	Year Ended December 31,		
	2008	2007	2006
<b>Revenue:</b>			
Revenue before reimbursements (net revenue)	100.0%	100.0%	100.0%
Reimbursements	4.7	4.6	4.9
<b>Total revenue</b>	<b>104.7</b>	<b>104.6</b>	<b>104.9</b>
<b>Operating expenses:</b>			
Salaries and employee benefits	70.7	67.6	68.7
General and administrative expenses	20.3	19.6	20.8
Reimbursed expenses	4.7	4.6	4.9
Restructuring charges			0.1
<b>Total operating expenses</b>	<b>95.7</b>	<b>91.8</b>	<b>94.4</b>
<b>Operating income</b>	<b>9.0</b>	<b>12.8</b>	<b>10.5</b>
Net non-operating income	1.1	1.2	1.1
<b>Income before income taxes</b>	<b>10.1</b>	<b>14.1</b>	<b>11.5</b>
Provision for income taxes	3.8	4.9	4.4

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Net income	6.3%	9.1%	7.2%
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*Note: Totals and subtotals may not equal the sum of individual line items due to rounding.*

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The following table sets forth, for the periods indicated, our revenue and operating income by segment (in thousands):

	Year Ended December 31,		
	2008	2007	2006
<b>Revenue:</b>			
Americas	\$ 314,412	\$ 333,561	\$ 265,421
Europe	201,462	207,504	163,605
Asia Pacific	100,030	78,589	49,497
Revenue before reimbursements (net revenue)	615,904	619,654	478,523
Reimbursements	28,956	28,612	23,471
<b>Total</b>	<b>\$ 644,860</b>	<b>\$ 648,266</b>	<b>\$ 501,994</b>
<b>Operating income:</b>			
Americas	\$ 45,783	\$ 67,480	\$ 53,929
Europe	24,479	31,865	14,883
Asia Pacific	15,351	15,946	13,278
Total regions	85,613	115,291	82,090
Corporate	(30,076)	(35,787)	(31,633)
Operating income before restructuring charges	55,537	79,504	50,457
Restructuring charges			(408)
<b>Total</b>	<b>\$ 55,537</b>	<b>\$ 79,504</b>	<b>\$ 50,049</b>

**2008 Compared to 2007**

*Total revenue.* Consolidated total revenue decreased \$3.4 million, or 0.5%, to \$644.9 million in 2008 from \$648.3 million in 2007. The decrease in total revenue was due to the decrease in revenue before reimbursements (net revenue).

*Revenue before reimbursements (net revenue).* Consolidated net revenue decreased \$3.8 million, or 0.6%, to \$615.9 million in 2008 from \$619.7 million in 2007. The positive impact of exchange rate fluctuations offset the decrease by approximately one percentage point in 2008. Net revenue increased in the Asia Pacific region but was more than offset by declines in net revenue in the Americas and European regions in 2008. Revenue growth achieved by the Technology, Life Sciences, Industrial, Education/Nonprofit, and Business and Professional Services industry practice groups partially offset declines in the Financial Services and Consumer practice groups. In 2008, the number of confirmed executive searches decreased 5.7% to 4,812 from 5,102 in 2007. The number of executive search consultants increased to 419 as of December 31, 2008 compared to 386 as of December 31, 2007. Productivity, as measured by annualized revenue per executive search consultant, decreased to \$1.4 million for the year ended December 31, 2008 from \$1.5 million for the year ended December 31, 2007, while the average fee per executive search increased to \$122,600 for the year ended December 31, 2008 compared to \$114,900 for the year ended December 31, 2007.

Net revenue in the Americas was \$314.4 million in 2008, a decrease of \$19.2 million, or 5.7%, from \$333.6 million in 2007. The Technology, Education/Nonprofit and Life Sciences industry groups achieved year-over-year net revenue growth, but this growth only partially offset declines in the other industry groups. The positive impact of exchange rate fluctuations in Canada and Latin America offset the decrease by less

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than one percentage point in 2008. Net revenue in Europe was \$201.5 million in 2008, a decrease of \$6.0 million, or 2.9%, from \$207.5 million in 2007. The Consumer, Life Sciences, Technology, Industrial and Education/Nonprofit industry groups achieved net revenue growth compared to 2007, but this growth was more than offset by declines in the Financial Services and Business and Professional Services industry groups. The positive impact of

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exchange rate fluctuations offset the decrease in net revenue by approximately one percentage point in 2008. In Asia Pacific, net revenue was \$100.0 million in 2008, an increase of \$21.4 million, or 27.3%, from \$78.6 million in 2007. The positive impact of exchange rate fluctuations resulted in an increase in revenue of approximately 4 percentage points year over year. Every industry group in this region achieved net revenue growth, but the Industrial, Financial Services, and Business and Professional Services industry groups were the primary drivers of growth for 2008.

*Salaries and employee benefits.* Consolidated salaries and employee benefits expense increased \$16.4 million, or 3.9%, to \$435.3 million in 2008 from \$419.0 million in 2007. The increase in salaries and employee benefits expense is primarily a result of \$11.1 million in higher fixed salary expense for search support staff and \$2.1 million in severance costs, offset by a \$1.8 million decrease in other salaries and employee benefits-related expenses. Stock-based compensation expense also increased \$5.0 million year over year, as a result of 2008 being the first year in which we incurred the cumulative three year impact of the previously deferred restricted stock unit bonus awards.

Salaries and employee benefits expense as a percentage of net revenue increased from 67.6% in 2007 to 70.7% in 2008.

Excluding a negative impact of \$3.1 million due to exchange rate fluctuations, which management believes provides a better comparison of operational performance, consolidated salaries and employee benefits expense increased approximately 3 percentage points compared to 2007.

*General and administrative expenses.* Consolidated general and administrative expenses increased \$3.9 million, or 3.2%, to \$125.1 million in 2008 from \$121.2 million in 2007. The increase is primarily related to \$6.5 million of premise-related costs for new offices and lease renewals for existing offices and a \$3.7 million increase in bad debt expense, offset by a \$0.5 million decrease in other infrastructure and operating expenses. The net increases were partially offset by several items recorded in 2007 that did not recur in 2008, including \$2.7 million of legal costs incurred for litigation related to our hiring of certain Whitney Group consultants in the Asia Pacific region, fees for professional services of \$2.1 million related to certain consulting assignments in Europe that required third party expertise, and \$1.0 million of expense related to the impairment of a client relationship intangible asset.

General and administrative expenses as a percentage of net revenue increased from 19.6% in 2007 to 20.3% in 2008.

Exchange rate fluctuations had a minimal impact on general and administrative expenses for the year ended December 31, 2008 compared to the year ended December 31, 2007.

*Operating income.* Our consolidated operating income was \$55.5 million in 2008 compared to \$79.5 million in 2007 a decrease of 30.1%. The decrease in consolidated operating income of \$24.0 million was primarily due to increases in salaries and benefits expense of \$16.4 million and in general and administrative expenses of \$3.9 million and a decrease in revenue of \$3.8 million.

In the Americas, operating income decreased \$21.7 million to \$45.8 million in 2008 from \$67.5 million in 2007. The decrease is due to lower net revenue of \$19.2 million and increases in general and administrative expenses of \$3.0 million, offset by a decrease in salaries and employee benefits expense of \$0.5 million. The increase in general and administrative expenses primarily relates to a \$3.6 million increase in premise related expenses and lease renewals for existing offices primarily in New York and an increase in bad debt expense of \$0.9 million, offset by a \$1.0 million impairment of a client relationship intangible asset in 2007. The increase in salaries and employee benefits expense is primarily related to higher fixed salaries for associates and search support staff.





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In Europe, operating income decreased \$7.4 million in 2008, to \$24.5 million, from \$31.9 million in 2007. The decrease is due to lower net revenue of \$6.0 million and an increase in general and administrative expenses of \$2.0 million offset by a decrease in salaries and employee benefits expense of \$0.6 million. The increase in general and administrative expenses primarily reflects a \$2.4 million increase in bad debt expenses, a \$0.3 million increase in premise-related costs and a \$1.4 million increase in other operating and infrastructure expenses offset by \$2.1 million in professional services fees related to certain consulting assignments which required third party expertise in 2007. The decrease in salaries and employee benefits expense is due a decrease in performance-related compensation expense due to lower net revenue and operating margin levels partially offset by higher fixed salaries for search support staff and stock-based compensation expense. Severance-related expenses decreased by \$1.1 million during 2008 as compared to 2007.

In Asia Pacific, operating income was \$15.3 million in 2008, a decrease of \$0.6 million, compared to \$15.9 million in 2007. The decrease in operating income is a result of increases of \$19.0 million in salaries and employee benefits expense and \$3.0 million in general and administrative expenses offset by higher net revenue of \$21.4 million. The increase in salaries and employee benefits expense represents planned investments to grow the region, including a 16.9% increase in year-over-year headcount, \$3.2 million of increased year-over-year sign-on bonus expense and amortization of other minimum guarantee bonuses, \$1.9 million of increased stock-based compensation expense and \$1.9 million of increased support staff leverage costs. The increase in general and administrative expenses is primarily due to increased infrastructure costs of \$3.4 million related to new and existing offices. The remaining increase is due to higher general spending resulting from overall growth in the region in 2008 as compared to 2007, offset by \$2.7 million of expense incurred in 2007 for litigation related to our hiring of certain Whitney Group consultants in the region.

Corporate expenses decreased \$5.7 million in 2008, to \$30.1 million from \$35.8 million in 2007. The decrease was primarily the result of a \$4.3 million decrease in general and administrative expenses and a \$1.4 million decrease in compensation expense. The decrease in general and administrative expenses is due to lower professional services expenses and lower travel and entertainment-related expenses in 2008 due to cost containment initiatives and also reflects the absence of \$2.5 million in costs related to the worldwide consultants meeting that was held in the second quarter of 2007. The decrease in compensation-related expenses is primarily due to lower fixed salary expense.

*Net non-operating income.* Net non-operating income decreased \$0.9 million in 2008 to \$6.7 million compared to \$7.6 million in 2007.

Net interest income in 2008 was \$5.1 million, compared to \$8.0 million for 2007. The decrease in net interest income as compared to 2007 is due to lower investment balances and lower interest rates.

Net other non-operating income was \$1.6 million in 2008, compared to net other non-operating expense of \$0.4 million in 2007. As a result of the sale of our Portugal business during the second quarter, we recognized previously capitalized exchange gains, which resulted in other non-operating income of \$1.0 million. The remaining non-operating income of \$0.6 million primarily consists of exchange gains and losses on cash and intercompany balances, which are denominated in currencies other than the functional currency and are not considered permanent in nature.

*Income taxes.* In 2008, we reported income before taxes of \$62.3 million and recorded an income tax provision of \$23.2 million. The effective tax rate for 2008 was 37.2%.

In 2007, we reported income before taxes of \$87.1 million and recorded an income tax provision of \$30.7 million. The effective tax rate for 2007 was 35.2%. This rate reflects a benefit of \$7.3 million associated with the reversal of valuation allowance on foreign tax credits.



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**2007 Compared to 2006**

*Total revenue.* Consolidated total revenue increased \$146.3 million, or 29.1%, to \$648.3 million in 2007 from \$502.0 million in 2006. The increase in total revenue was due primarily to the increase in revenue before reimbursements (net revenue).

*Revenue before reimbursements (net revenue).* Consolidated net revenue increased \$141.1 million, or 29.5%, to \$619.7 million in 2007 from \$478.5 million in 2006. The positive impact of exchange rate fluctuations resulted in an increase in revenue in 2007 of approximately 5 percentage points year over year. Net revenue increased across all regions in 2007. Strong results from the Financial Services, Industrial and Life Sciences industry groups contributed to the year over year revenue growth in 2007 as compared to 2006. In 2007, the number of confirmed executive searches increased 15% to 5,102 from 4,447 in 2006. We believe this increase reflects our success in winning business and the successful integration of former Highland Partners consultants. The number of executive search consultants decreased to 386 as of December 31, 2007 compared to 388 as of December 31, 2006. Consultant productivity measured by average revenue per executive search consultant increased to \$1.5 million for the year ended December 31, 2007 from \$1.3 million for the year ended December 31, 2006. The average fee per executive search was \$114,900 for the year ended December 31, 2007 compared to \$101,100 for the year ended December 31, 2006.

Net revenue in the Americas was \$333.6 million in 2007, an increase of \$68.1 million, or 25.7%, from \$265.4 million in 2006. The Life Sciences, Business and Professional Services and Industrial industry groups realized the largest year-over-year revenue growth in 2007. The positive impact of exchange rate fluctuations in Canada and Latin America contributed to less than one percentage point of revenue growth in 2007. Net revenue in Europe was \$207.5 million in 2007, an increase of \$43.9 million, or 26.8%, from \$163.6 million in 2006. The year-over-year revenue growth in 2007 was driven by especially strong results in the Industrial, Financial Services and Consumer industry groups. The positive impact of exchange rate fluctuations resulted in an increase in net revenue of approximately 10 percentage points in 2007. In Asia Pacific, net revenue was \$78.6 million in 2007, an increase of \$29.1 million, or 58.8%, from \$49.5 million in 2006. The positive impact of exchange rate fluctuations resulted in an increase in revenue of approximately 8 percentage points year over year. Business was strong across the region with significant revenue contribution from the Financial Services, Industrial and Consumer industry groups.

*Salaries and employee benefits.* Consolidated salaries and employee benefits expense increased \$90.2 million, or 27.5%, to \$419.0 million in 2007 from \$328.7 million in 2006. Fixed salaries and employee benefits expense increased \$44.5 million and performance-related compensation expense increased \$45.7 million. Fixed salaries and employee benefits expense includes stock-based compensation expense earned under prior year equity awards requiring satisfaction of both service and performance conditions.

During the third quarter of 2006, we revised our policy relating to the vesting of certain restricted stock units upon the eligible retirement of employees that hold such awards. This policy revision constituted a modification of those equity awards. According to the Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R), we are required to recognize the original grant date fair value compensation cost over an accelerated service period (through the earliest date each equity award holder is eligible to retire) for those awards affected by the modification. During 2006, we recorded an additional \$2.7 million of non-cash compensation expense related to the accelerated vesting of these restricted stock unit awards.

Fixed salaries and employee benefits expense increased \$44.5 million or 19.9% in 2007 compared to 2006. Fixed cash-based compensation expense increased \$41.9 million in 2007 compared to 2006 primarily due to a 15.2% increase in average consultant headcount and higher year over year base salaries for existing consultants. In addition, 2007 includes an additional \$1.9 million of amortization expense related to Highland Partner retention awards, offset by \$4.4 million of additional severance related costs in 2006 associated with a



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realignment of management responsibilities for the new CEO's senior team and a realignment of management in Germany. Fixed stock-based compensation expense increased \$2.6 million in 2007 compared to 2006 due in part to approximately \$1.2 million of additional expense recorded in the second quarter of 2007 associated with the continued vesting of all outstanding unvested equity awards for Thomas J. Friel, who retired as chairman in May 2007. Fixed stock-based compensation expense also increased due to a higher number of restricted stock units granted to retain our largest revenue producers partially offset by increased forfeitures during 2007. Stock option expense decreased by \$0.7 million in 2007 compared to 2006 as a result of Company granting fewer options in 2007 versus prior years and the vesting of previously granted options.

Performance-related compensation expense increased \$45.7 million in 2007 compared to 2006 as a result of higher net revenue levels and increased average consultant headcount.

Salaries and employee benefits expense as a percentage of net revenue decreased from 68.7% in 2006 to 67.6% in 2007.

Excluding a negative impact of \$12.7 million due to exchange rate fluctuations, which management believes provides a better comparison of operational performance, consolidated salaries and employee benefits expense increased approximately 23.6% compared to 2006.

*General and administrative expenses.* Consolidated general and administrative expenses increased \$21.8 million, or 22.0%, to \$121.2 million in 2007 from \$99.4 million in 2006. Fees for professional services increased \$10.4 million of which \$2.7 million relates to legal costs incurred for litigation related to our hiring of certain Whitney Group consultants in the Asia Pacific region, \$2.1 million relates to certain consulting assignments in Europe which required third party expertise and \$5.6 million of other fees for professional services. In 2007, general and administrative expenses were also higher due to an additional \$2.5 million of expense related to the worldwide consultants' meeting held in the second quarter of 2007 and \$1.5 million of expense associated with our acquisition of Highland Partners, including the amortization of intangible assets and costs related to the transitional services agreement. In the Americas, one of the remaining two principal consultants from our 2000 acquisition of the executive search company, Lynch Miller Moore O'Hara, Inc., retired from the Company triggering the review of the remaining client relationship intangible asset and resulted in an impairment charge of \$1.0 million in the third quarter of 2007. Premise-related costs increased by \$4.8 million in 2007 compared to 2006 due to new offices and new lease agreements for existing offices. Other operating and infrastructure expenses increased \$1.6 million.

General and administrative expenses as a percentage of net revenue decreased from 20.8% in 2006 to 19.6% in 2007.

Excluding a negative impact of \$4.0 million due to exchange rate fluctuations, which management believes provides a better comparison of operational performance, consolidated general and administrative expenses increased approximately 18% compared to 2006.

*Operating income.* Our consolidated operating income was \$79.5 million in 2007 compared to \$50.0 million in 2006, an increase of 58.9%. The increase in consolidated operating income was primarily due to higher net revenue and improved profitability, decreased restructuring charges and cost control, partially offset by increased operating expenses.

In the Americas, operating income increased to \$67.5 million in 2007 from \$53.9 million in 2006. The increase is the result of year over year increased net revenue of \$68.1 million offset by higher salaries and employee benefits expense of \$46.3 million, and general and administrative expenses of \$8.2 million. The increase in salaries and employee benefits expense is primarily a result of increased expenses associated with

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higher net revenue levels. The increase in general and administrative expenses of \$8.2 million is due to \$2.6 million in premise-related costs due to new lease agreements for existing offices, the impairment of intangible

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assets related to the acquisition of the executive search firm, Lynch Miller Moore O Hara, Inc., of \$1.0 million, \$1.5 million due to increased practice and business development related spending and \$3.1 million of increased other operating and infrastructure expenses.

In Europe, operating income increased \$17.0 million in 2007, to \$31.9 million, from \$14.9 million in 2006. The increase in operating income was a result of higher net revenue of \$43.9 million offset by increases in salaries and employee benefits expense of \$23.3 million and general and administrative expenses of \$3.6 million. The increase in salaries and employee benefits expense is primarily a result of a 5.2% increase in headcount over last year offset by \$2.9 million in severance costs associated with a realignment of management in Germany in 2006. The increase in general and administrative expenses is primarily due to additional professional services fees of \$2.7 million of which \$2.1 million relates to certain consulting arrangements which required third party expertise and \$1.5 million in premise-related costs due to new offices and new lease agreements for existing offices and depreciation expense.

In Asia Pacific, operating income was \$15.9 million in 2007, an increase of \$2.6 million, compared to \$13.3 million in 2006. The increase in operating income was a result of higher net revenue of \$29.1 million offset by an increase of \$19.7 million of salaries and employee benefits expense and \$6.8 million of general and administrative expenses. The increase in salaries and employee benefits expense was primarily a result of a 36.9% increase in headcount in 2007 compared to 2006. The increase in general and administrative expenses is primarily due to legal costs in the 2007 third and fourth quarters of \$2.7 million incurred for litigation related to our hiring of certain Whitney Group consultants in the region, \$1.7 million in premise-related costs due to new offices and new lease agreements for existing offices and \$1.3 million in additional professional services fees.

Corporate expenses increased \$4.2 million in 2007, to \$35.8 million from \$31.6 million in 2006. The increase is due to increases of \$1.0 million in salaries and employee benefits expense and \$3.2 million in general and administrative expenses. The increase in salaries and employee benefits expense is primarily due to a charge of approximately \$1.2 million associated with the continued vesting of all outstanding unvested equity awards for Thomas J. Friel, who retired as chairman in May 2007 offset by a decrease in other salaries and employee benefits expense due to severance expense recorded in 2006. The increase in general and administrative expenses is primarily due to increases of \$2.5 million related to the worldwide consultants meeting, and \$3.2 million in fees for professional services offset by a year over year decrease in expenses associated with our acquisition of Highland Partners, including costs related to the transitional service agreement.

In 2007, there were no restructuring charges taken. In 2006, we revised our estimates related to previous restructuring initiatives and recorded an additional charge of \$0.4 million related to property reserves. Cash outlays in 2007 related to restructuring charges accrued at December 31, 2006 were \$3.3 million.

*Net non-operating income.* Primarily due to higher cash balances and higher returns on invested cash, net non-operating income increased \$2.4 million in 2007 to \$7.6 million compared to \$5.2 million in 2006.

Net interest income in 2007 increased \$1.8 million to \$8.0 million primarily due to higher cash balances and higher returns on invested cash.

Net other non-operating expense was \$0.4 million in 2007, compared to \$1.0 million in 2006. In the third quarter of 2007, we became aware of certain revaluation amounts included in various balance sheet accounts, primarily in the Asia Pacific region, that were not properly stated in prior years. As a result of adjusting these revaluation amounts, we recorded an exchange loss of \$0.8 million in the third quarter of 2007. Other non-operating income (expense) consists primarily of exchange gains and losses on intercompany balances which are denominated in currencies other than the functional currency and are not considered permanent in nature.



*Income taxes.* In 2007, we reported income before taxes of \$87.1 million and recorded an income tax provision of \$30.7 million. The effective tax rate for 2007 was 35.2%. This rate reflects a benefit of \$7.3 million associated with the reversal of valuation allowance on foreign tax credits.

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In 2006, we reported income before taxes of \$55.3 million and recorded an income tax provision of \$21.0 million. The effective tax rate for 2006 was 38.0%. This rate reflects a net benefit of \$1.6 million from the correction of prior year misstatements associated with refund opportunities for past taxes paid in the U.S. taxing jurisdiction.

## **Liquidity and Capital Resources**

*General.* We continually evaluate our liquidity requirements, capital needs and availability of capital resources based on our operating needs. We believe that our existing cash and cash equivalents balances together with the funds expected to be generated from operations and funds available under our committed revolving credit facility will be sufficient to finance our operations for the foreseeable future, as well as to finance the cash payments associated with our restructuring charges, stock repurchase program and cash dividends. Our ability to undertake major acquisitions may depend, in part, on access to additional funds.

We pay the non-deferred portion of annual bonuses in the first quarter following the year in which they are earned. Employee bonuses are accrued throughout the year and are based on our performance and the performance of the individual employee.

In the first quarter of 2008, we changed the deferral arrangement of bonuses for consultants and management globally. The portion of the bonus previously deferred into restricted stock units will now be deferred into cash which will be paid ratably over a three-year period. A premium of 10% was applied to the bonus amount deferred in 2008. The portion of the bonus that will be deferred varies between 10% and 15% depending on the employee's level or position. The compensation expense related to the amounts being deferred is recognized on a graded vesting attribution method over the requisite service period, which for 2008, began on January 1, 2008 and continues through the final payment date, which is three years from the date of the original deferral. For 2008, the deferral date will be in the first quarter of 2009. These amounts are recorded as a component of other non-current liabilities in the consolidated balance sheet. We will continue to grant restricted stock units under other existing programs.

We do not have material off-balance sheet arrangements, special purpose entities, trading activities of non-exchange traded contracts or material transactions with related parties.

*Lines of credit.* Since October 2006, we have had a \$100 million committed unsecured revolving facility (the Facility). Under the Facility, we may borrow U.S. dollars, euros, or other major traded currencies as agreed by the banks. Borrowings under the Facility bear interest at the existing Alternate Base Rate or LIBOR plus a spread as determined by our leverage ratio. A facility fee is charged even if no portion of the Facility is used. The Facility expires in October 2011.

There were no borrowings outstanding under the Facility at December 31, 2008 or 2007, nor were there any borrowings during the years ended December 31, 2008 and 2007. During 2008 and 2007, we were in compliance with the financial covenants of the Facility and no event of default existed.

*Cash, cash equivalents and short-term investments.* Cash and cash equivalents at December 31, 2008 were \$234.5 million, a decrease of \$48.4 million, compared to cash, cash equivalents and short-term investments of \$282.9 million at December 31, 2007. We expect to pay approximately \$130 million in bonuses in early 2009. In December 2006, we entered into a bank guarantee in the amount of \$7.9 million with regard to a tax assessment in a European country and increased the associated collateral amount to \$8.3 million during 2007 due to foreign

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currency fluctuations. These amounts have been classified as restricted cash in the Consolidated Balance Sheets as of December 31, 2008 and 2007. Refer to Note 5, *Restricted Cash* in the Notes to Consolidated Financial Statements.

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Certain reclassifications have been made to prior year financial information to conform to current year presentations, which have no effect on the Consolidated Statements of Operations for any prior periods presented. Refer to Note 1, *Basis of Presentation* in the Notes to Consolidated Financial Statements.

*Cash from operating activities.* In 2008, cash provided by operating activities was \$51.4 million, principally reflecting our net income and other non-cash charges offset by decreases in accrued expenses, income taxes recoverable and other assets and liabilities.

In 2007, cash provided by operating activities was \$112.9 million, principally reflecting our increase in net income plus an increase in bonus related accruals and other non-cash charges, less the payment of cash bonuses of approximately \$98 million in March 2007.

In 2006, cash provided by operating activities was \$102.0 million, principally reflecting our net income plus an increase in bonus related accruals and other non-cash charges partially offset by an increase in trade receivables related to higher 2006 revenues.

*Cash from investing activities.* Cash used in investing activities was \$6.6 million in 2008, primarily as a result of cash paid for acquisitions of \$14.8 million, capital expenditures of \$13.4 million, and purchases of cost and equity method investments of \$2.8 million, offset by net proceeds from sales of short-term investments of \$22.3 million and proceeds from the sale of a business of \$1.6 million.

Cash provided by investing activities was \$38.1 million in 2007, primarily as a result of net proceeds from sales and purchases of short-term investments of \$51.1 million offset by capital expenditures of \$8.0 million, \$2.2 million for the purchase of a cost method investment, \$1.3 million paid in connection with the acquisition of Renton James and a \$1.8 million increase in restricted cash.

Cash used in investing activities was \$122.2 million in 2006, primarily as a result of net purchases and sales of short-term investments of \$73.4 million, \$36.0 million paid in connection with the acquisition of Highland Partners and a \$7.9 million increase in restricted cash.

Capital expenditures were \$13.4 million, \$8.0 million, and \$5.5 million in 2008, 2007 and 2006, respectively. Capital expenditures in 2008 were primarily related to leasehold improvements related to the consolidation and relocation of our New York office and ongoing capital expenditures. We anticipate that our capital expenditures for 2009 will be approximately \$17 million to \$21 million which primarily reflects our new search system, final leasehold improvement expenditures related to the New York office, as well as ongoing capital expenditures.

*Cash from financing activities.* Cash used in financing activities in 2008 was \$64.7 million primarily as a result of repurchasing \$48.1 million of our common stock, paying cash dividends of \$8.8 million and \$8.8 million for payments of employee tax withholdings by restricted stock units offset by \$0.9 million of proceeds from stock options exercised during the year.

Cash used in financing activities in 2007 was \$47.7 million primarily as a result of the repurchase of \$67.8 million of our common stock and the payment of \$2.3 million of cash dividends under a dividend payment policy adopted in September 2007, offset by \$19.4 million of proceeds from stock options exercised during the year, \$8.0 million of tax benefits associated with the exercise or vesting of equity awards and \$5.0 million for payments of employee tax withholdings by restricted stock units.

Cash used in financing activities in 2006 was \$39.7 million primarily as a result of the repurchase of \$51.7 million of our common stock offset by proceeds from stock options exercised during the year. Cash flows for 2006 also includes \$4.2 million of tax benefits associated with the exercise or vesting of equity awards and \$2.3 million for payments of employee tax withholdings by restricted stock units.

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On September 16, 2005, our Board of Directors authorized management to repurchase shares of our common stock with an aggregate total amount up to \$50 million. We purchased 1,476,809 shares of our common stock for \$50 million under the September 2005 authorization, which was completed during the second quarter of 2006.

On May 24, 2006, our Board of Directors authorized management to repurchase shares of our common stock with an aggregate total amount up to \$50 million. We purchased 1,132,073 shares of our common stock for \$50 million under the May 2006 authorization, which was completed during the third quarter of 2007.

On May 24, 2007, our Board of Directors authorized management to repurchase shares of our common stock with an aggregate total amount up to \$50 million. We purchased 1,403,738 shares of our common stock for \$50 million under the May 2007 authorization, which was completed during the first quarter of 2008.

On February 8, 2008, our Board of Directors authorized management to repurchase shares of our common stock with an aggregate total amount up to \$50 million. We intend from time to time and as business conditions warrant, to purchase shares of our common stock on the open market or in negotiated or block trades. No time limit has been set for completion of this program. As of December 31, 2008, we have repurchased 951,160 shares of our common stock for \$27.2 million under the February 2008 authorization and \$22.8 million remains available under this authorization.

*Subsequent developments.* In January 2009, our Board of Directors approved a restructuring plan to reduce overall costs and improve operational efficiencies that will result in a first quarter 2009 restructuring charge of as much as \$20 million, substantially all of which will result in cash expenditures during 2009. Under this plan, we reduced our global workforce by approximately 12%, which we expect will result in savings of approximately \$31 million over the next twelve months.

In February 2009, we completed the acquisition of the Warsaw, Poland office of Ray & Berndtson, a leading retained executive search firm. As a result of the acquisition as well as additional hires made at the same time, we increased our consultant headcount within the European region by seven.

*Contractual obligations.* The following table presents our known contractual obligations as of December 31, 2008 and the expected timing of cash payments related to these contractual obligations (in millions):

	Payments due for the years ended December 31,				
	Total	2009	2010 and 2011	2012 and 2013	Thereafter
<b>Contractual obligations:</b>					
Office space and equipment lease obligations (1)	\$ 171.8	\$ 34.7	\$ 42.0	\$ 21.1	\$ 74.1
Asset retirement obligations (2)	1.1	0.9	0.2		
<b>Total</b>	<b>\$ 172.9</b>	<b>\$ 35.6</b>	<b>\$ 42.2</b>	<b>\$ 21.1</b>	<b>\$ 74.1</b>

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- (1) See Note 22, *Commitments and Contingencies*, in the Notes to Consolidated Financial Statements for additional information.
- (2) Represents the fair value of the obligation associated with the retirement of tangible long-lived assets, primarily related to our obligation at the end of the lease term to return office space to the landlord in its original condition. The obligation is recorded in accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations*.

In addition to the contractual obligations included in the above table, we have liabilities related to certain employee benefit plans. These liabilities are recorded in our Consolidated Balance Sheet at December 31, 2008.

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The obligations related to these employee benefit plans are described in Note 13, *Employee Benefit Plans*, and Note 14, *Pension Plan and Life Insurance Contract*. As the timing of cash disbursements related to these employee benefit plans is uncertain, we have not included these obligations in the above table. The table excludes our liability for uncertain tax positions including accrued interest and penalties, which totaled \$7.0 million as of January 1, 2008 and \$4.8 million as of December 31, 2008, since we cannot predict with reasonable reliability the timing of cash settlements to the respective taxing authorities.

## **Application of Critical Accounting Policies and Estimates**

*General.* Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our Consolidated Financial Statements, which have been prepared using accounting principles generally accepted in the United States (GAAP). Our significant accounting policies are discussed in Note 2, *Summary of Significant Accounting Policies*, in the Notes to Consolidated Financial Statements. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. If actual amounts are ultimately different from previous estimates, the revisions are included in our results of operations for the period in which the actual amounts become known.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the financial statements. Management believes the following critical accounting policies reflect its more significant estimates and assumptions used in the preparation of the Consolidated Financial Statements:

*Revenue recognition.* Revenue before reimbursements for out-of-pocket expenses ( net revenue ) is recognized when earned and realizable and therefore when the following criteria have been met in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition* ( SAB 104 ): (a) persuasive evidence of an arrangement exists; (b) services have been rendered; (c) the fee to our client is fixed or determinable; and (d) collectibility is reasonably assured. Net revenue consists of retainers and indirect expenses billed to clients. Typically, we are paid a retainer for our executive search services equal to approximately one-third of the estimated first year compensation of the position to be filled. If actual compensation of the placed candidate exceeds the estimated compensation, we are generally authorized to bill the client for one-third of the excess. Net revenue from executive search engagements is recognized over the expected average period of performance, in proportion to the estimated personnel time incurred to fulfill our obligations under the arrangements. Net revenue in excess of the retainer, resulting from actual compensation of the placed candidate exceeding estimated compensation, is recognized upon completion of the executive search when the amount of the additional fee is known. Our assumptions about the duration of the time and extent of efforts for search teams to complete our services in an executive search engagement require significant judgment as these variables have fluctuated in the past and are expected to continue to do so. These assumptions are updated annually or whenever conditions exist to indicate that more frequent updates are necessary.

*Restructuring charges.* The Company accounts for its restructuring charges in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* ( SFAS No. 146 ). Under SFAS No. 146, a liability is recognized when the costs are incurred and are recorded at fair value.

Inherent in these accruals are estimates concerning vacancy periods, expected sublease income, and costs to terminate the leases. These accruals are periodically updated to reflect information concerning the commercial





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real estate markets in which the offices are located. During 2006, we revised estimates of previously announced restructuring initiatives and recorded restructuring charges of \$0.4 million, primarily related to the final determination of certain severance accruals and the refinement of cost estimates concerning certain sublet properties. During 2008 and 2007, there were no restructuring charges taken. We believe that the accounting estimate related to accruals for the consolidation and closing of offices is a critical accounting estimate because it is highly susceptible to changes in the commercial real estate markets and the local regional economic factors where this leased office space is located.

*Income taxes.* Determining the consolidated provision for income tax expense, income tax liabilities and deferred tax assets and liabilities involves judgment. As a global company, we calculate and provide for income taxes in each of the tax jurisdictions in which we operate. This involves estimating current tax exposures in each jurisdiction as well as making judgments regarding the recoverability of deferred tax assets. Tax exposures can involve complex issues and may require an extended period to resolve. Changes in the geographic mix or estimated level of annual income before taxes can affect the overall effective tax rate.

We apply an estimated annual effective tax rate to our cumulative quarterly operating results to determine the provision for income tax expense. In the event there is a significant unusual or infrequent item recognized in our quarterly operating results, the tax attributable to that item is recorded in the interim period in which it occurs. Our effective tax rate for the year ended December 31, 2008 was 37.2%.

No deferred tax liabilities have been recorded for U.S. income taxes and foreign withholding taxes related to undistributed foreign earnings that are planned to be indefinitely reinvested. If future events, including material changes in estimates of cash, working capital and long-term investment requirements, necessitate that these earnings be distributed, an additional provision for taxes may apply, which could materially affect our future effective tax rate.

As a matter of course, we are regularly audited by various taxing authorities, and sometimes these audits result in proposed assessments where the ultimate resolution may result in our owing additional taxes. We establish reserves in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* – an interpretation of FASB Statement No. 109 (FIN 48) on uncertain tax return positions that do not meet the more likely than not recognition criteria. We evaluate these reserves each quarter and adjust the reserves and the related accrued interest in light of changing facts and circumstances regarding the uncertainty of realizing tax benefits, such as the ultimate settlement of tax audits or the expiration of a statute of limitations. We believe the estimates and assumptions used to support our evaluation of tax benefit realization are reasonable. However, final determinations of prior-year tax liabilities, either by settlement with tax authorities or expiration of statutes of limitations, could be materially different than estimates reflected in assets and liabilities and historical income tax provisions. The outcome of these final determinations could have a material effect on our income tax provision, net income, or cash flows in the period in which that determination is made. We believe our tax positions comply with applicable tax law and that we have adequately provided for any known tax reserves in accordance with FIN 48.

*Goodwill and other intangible assets.* We review goodwill for impairment annually and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*. 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. 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. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination is determined. The fair value of each of our reporting units was determined using a combination of valuation techniques, including a discounted cash flow methodology and comparable public company methodology, with the assistance of an independent valuation firm.

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The discounted cash flow approach is dependent on a number of factors including estimates of future market growth and trends, forecasted revenue and costs, capital investments, appropriate discount rates, certain assumptions to allocate shared assets and liabilities, and other variables to calculate the carrying values for each of our reporting units. We base our fair value estimates on assumptions we believe to be reasonable, but which are unpredictable and inherently uncertain. Actual future results may differ from those estimates. These assumptions are updated annually, at a minimum, to reflect information concerning our reportable segments.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, long-lived assets, such as property, equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge, equal to the amount by which the carrying amount of the asset exceeds the fair value of the asset, is recognized.

We believe that the accounting estimate related to goodwill and other intangible asset impairment is a critical accounting estimate because the assumptions used are highly susceptible to changes in the operating results and cash flows of our reportable segments.

*Allowance for doubtful accounts.* Accounts receivable from our customers are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in existing accounts receivable balances. We determine the allowance for doubtful accounts through an analysis of several factors, including the aging of our accounts receivable, historical write-off experience, and specific account analyses. We consider current and projected economic conditions and historical trends when determining the allowance for doubtful accounts. Actual collections of accounts receivable could differ from our estimates due to changes in future economic or industry conditions or specific customers' financial condition.

The allowance for doubtful accounts is recorded as a reduction in revenue to the extent the provision relates to fee adjustments and other discretionary pricing adjustments. To the extent the provision relates to a customer's inability to make required payments on accounts receivables, the provision is recorded within operating expenses.

*Stock-based compensation.* We account for our stock-based compensation in accordance with SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R), which requires us to measure the fair value of the share-based payment on the date of grant. We apply a forfeiture rate to our share-based awards that represents our best estimate of the amount of awards that will be forfeited. Our estimate is based on our historical experience and specific analysis. We review our forfeiture rate quarterly or whenever events or changes in circumstances indicate our estimate may need to be revised. Actual forfeitures could differ from our estimates due to changes in retention rates of our employee population.

## **Recently Adopted Financial Accounting Standards**

On January 1, 2008, we adopted SFAS No. 157 *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. See Note 7, *Fair Value Measurements*, for disclosures required by SFAS No. 157. In February 2008, the FASB released FASB Staff Position (FSP FAS 157-2 *Effective Date of FASB Statement No. 157*), which delayed the effective date of SFAS No. 157 for nonfinancial assets, such as goodwill and long-lived assets, and nonfinancial liabilities, subject to certain exceptions, until January 1, 2009. The adoption of SFAS No. 157 for financial assets and liabilities did not have a material impact on our financial condition or results of operations.



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On January 1, 2008, we adopted SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of SFAS No. 115 ( SFAS No. 159 ). SFAS No. 159 permits entities to choose to elect, at specified election dates, to measure eligible financial instruments at fair value. The adoption of SFAS No. 159 did not have a material impact on our financial condition or results of operations.

**Recently Issued Financial Accounting Standards**

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ( SFAS No. 141(R) ). SFAS No. 141(R) requires that all business combinations be accounted for by applying the acquisition method. Under the acquisition method, the acquirer recognizes and measures the identifiable assets acquired, the liabilities assumed, and any contingent consideration and contractual contingencies, as a whole, at their fair values as of the acquisition date. It further requires that acquisition-related costs be recognized separately from the acquisition and expensed as incurred, restructuring costs generally be expensed in periods subsequent to the acquisition date, and changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period be recorded against income tax expense. The adoption of SFAS No. 141(R) changes our accounting treatment for business combinations on a prospective basis effective January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 ( SFAS No. 160 ). SFAS No. 160 changes the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS No. 160 is effective for us on a prospective basis for business combinations with an acquisition date beginning as of January 1, 2009. Currently, we do not have any material minority interests.

**Quarterly Financial Information**

The following table sets forth certain financial information for each quarter of 2008 and 2007. The information is derived from our quarterly consolidated financial statements which are unaudited but which, in the opinion of management, have been prepared on the same basis as the audited annual consolidated financial statements included in this document. The consolidated financial data shown below should be read in conjunction with the consolidated financial statements and notes thereto. The operating results for any quarter are not necessarily indicative of results for any future period.

	2008				2007			
	March 31	June 30	Sept. 30	Dec. 31	March 31	June 30	Sept. 30	Dec. 31
Revenue before reimbursements (net revenue)	\$ 153,139	\$ 169,518	\$ 158,318	\$ 134,929	\$ 143,126	\$ 160,053	\$ 162,901	\$ 153,574
Operating income	10,876	18,667	20,858	5,136	16,327	19,512	25,457	18,208
Income before income taxes	11,830	20,554	22,538	7,331	18,339	21,515	26,608	20,673
Provision for income taxes	4,762	7,810	8,559	2,048	8,263	496	10,476	11,437
Net income	7,068	12,744	13,979	5,283	10,076	21,019	16,132	9,236
Basic earnings per common share	0.41	0.75	0.85	0.32	0.56	1.17	0.90	0.53
Diluted earnings per common share	0.38	0.72	0.80	0.30	0.53	1.11	0.84	0.49
Cash dividends paid per share	0.13	0.13	0.13	0.13				0.13

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**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

*Currency market risk.* With our operations in the Americas, Europe and Asia Pacific we conduct business using various currencies. Revenue earned in each country is generally matched with the associated expenses incurred, thereby reducing currency risk to earnings. However, because certain assets and liabilities are denominated in currencies other than the U.S. dollar, changes in currency rates may cause fluctuations in the valuation of such assets and liabilities. As the local currency of our subsidiaries has generally been designated as the functional currency, we are affected by the translation of foreign currency financial statements into U.S. dollars. A 1% change in the average exchange rate for currencies of all foreign countries in which we operate would have increased or decreased our 2008 net income by approximately \$0.2 million. For financial information by geographic segment, see Note 20, *Segment Information*, in the Notes to Consolidated Financial Statements.

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES**

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**CONSOLIDATED FINANCIAL STATEMENTS**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders

Heidrick & Struggles International, Inc.:

We have audited the accompanying consolidated balance sheets of Heidrick & Struggles International, Inc. and subsidiaries (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2008. We also have audited the Company's internal control over financial reporting as of December 31, 2008 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heidrick & Struggles International, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring



Organizations of the Treadway Commission.

As discussed in Note 14 to the consolidated financial statements, the Company changed its method of accounting for pension and postretirement benefits effective December 31, 2006.

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As discussed in Note 19 to the consolidated financial statements, the Company changed its method of accounting for uncertain income tax positions effective January 1, 2007.

As discussed in Note 7 to the consolidated financial statements, the Company changed its method of accounting for financial instruments that are measured at fair value on a recurring basis effective January 1, 2008.

KPMG LLP

Chicago, Illinois

February 27, 2009

**Table of Contents****HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(In thousands, except share amounts)**

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>Current assets:</b>		
Cash and cash equivalents	\$ 234,531	\$ 260,580
Short-term investments		22,275
Accounts receivable, net	68,233	82,240
Other receivables	8,586	5,868
Prepaid expenses	19,520	15,026
Other current assets	1,788	1,419
Income taxes recoverable, net	7,719	
Deferred income taxes, net	13,893	15,290
<b>Total current assets</b>	<b>354,270</b>	<b>402,698</b>
<b>Non-current assets:</b>		
Property and equipment, net	28,172	18,730
Restricted cash	9,655	9,826
Assets designated for retirement and pension plans	24,973	26,067
Investments	12,594	7,832
Other non-current assets	7,203	6,296
Goodwill	101,234	84,217
Other intangible assets, net	13,543	15,363
Deferred income taxes, net	35,313	45,855
<b>Total non-current assets</b>	<b>232,687</b>	<b>214,186</b>
<b>Total assets</b>	<b>\$ 586,957</b>	<b>\$ 616,884</b>
<b>Current liabilities:</b>		
Accounts payable	\$ 11,977	\$ 8,699
Accrued salaries and employee benefits	163,695	197,954
Other current liabilities	51,723	47,189
Income taxes payable, net		995
<b>Total current liabilities</b>	<b>227,395</b>	<b>254,837</b>
<b>Non-current liabilities:</b>		
Retirement and pension plans	27,503	28,831
Other non-current liabilities	25,755	23,416
<b>Total non-current liabilities</b>	<b>53,258</b>	<b>52,247</b>
<b>Total liabilities</b>	<b>280,653</b>	<b>307,084</b>
<b>Commitments and contingencies (Note 22)</b>		

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<b>Stockholders equity:</b>		
Preferred stock, \$.01 par value, 10,000,000 shares authorized, no shares issued at December 31, 2008 and 2007		
Common stock, \$.01 par value, 100,000,000 shares authorized, 19,585,777 shares issued, 16,369,640 and 17,272,005 shares outstanding at December 31, 2008 and 2007, respectively		
	196	196
Treasury stock at cost, 3,216,137 and 2,313,772 shares at December 31, 2008 and 2007, respectively	(110,838)	(88,871)
Additional paid in capital	273,731	273,287
Retained earnings	131,061	100,624
Accumulated other comprehensive income	12,154	24,564
Total stockholders equity	306,304	309,800
<b>Total liabilities and stockholders equity</b>	<b>\$ 586,957</b>	<b>\$ 616,884</b>

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

**Table of Contents****HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share amounts)

	Year Ended December 31,		
	2008	2007	2006
<b>Revenue:</b>			
Revenue before reimbursements (net revenue)	\$ 615,904	\$ 619,654	\$ 478,523
Reimbursements	28,956	28,612	23,471
Total revenue	644,860	648,266	501,994
<b>Operating expenses:</b>			
Salaries and employee benefits	435,306	418,952	328,714
General and administrative expenses	125,061	121,198	99,352
Reimbursed expenses	28,956	28,612	23,471
Restructuring charges			408
Total operating expenses	589,323	568,762	451,945
<b>Operating income</b>	<b>55,537</b>	<b>79,504</b>	<b>50,049</b>
<b>Non-operating income (expense):</b>			
Interest income, net	5,103	8,035	6,257
Other, net	1,613	(404)	(1,040)
Net non-operating income	6,716	7,631	5,217
<b>Income before income taxes</b>	<b>62,253</b>	<b>87,135</b>	<b>55,266</b>
Provision for income taxes	23,179	30,672	21,023
<b>Net income</b>	<b>\$ 39,074</b>	<b>\$ 56,463</b>	<b>\$ 34,243</b>
Basic weighted average common shares outstanding	16,747	17,854	17,925
Diluted weighted average common shares outstanding	17,727	18,984	18,916
Basic earnings per common share	\$ 2.33	\$ 3.16	\$ 1.91
Diluted earnings per common share	\$ 2.20	\$ 2.97	\$ 1.81
Cash dividends paid per share	\$ 0.52	\$ 0.13	\$

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

Table of Contents**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND  
COMPREHENSIVE INCOME****(In thousands)**

	Common Stock		Treasury Stock		Additional Paid in Capital	Retained Earnings	Accumulated Other Compre- hensive Income	Deferred Stock- Based Compensation	Total
	Shares	Amount	Shares	Amount					
<b>Balance at December 31, 2005</b>	<b>19,586</b>	<b>\$ 196</b>	<b>1,008</b>	<b>\$ (28,156)</b>	<b>\$ 263,228</b>	<b>\$ 14,631</b>	<b>\$ 2,955</b>	<b>\$ (15,369)</b>	<b>\$ 237,485</b>
Net income						34,243			34,243
Other comprehensive income:									
Unrealized gain on available-for-sale investments							133		133
Foreign currency translation adjustment							7,477		7,477
Other comprehensive income						34,243	7,610		41,853
Treasury and common stock transactions:									
Reclassify deferred stock-based compensation upon adoption of SFAS No. 123R					(15,369)			15,369	
Cumulative effect of forfeitures					(351)				(351)
Issuance of restricted stock units previously classified as liabilities					4,370				4,370
Stock-based compensation					18,095				18,095
Exercise of stock options			(502)	15,699	(5,562)				10,137
Vesting of restricted stock units, net of tax withholdings			(175)	4,888	(7,146)				(2,258)
Purchases of treasury stock			1,510	(51,726)					(51,726)
Tax benefits related to stock-based compensation					3,914				3,914
Adjustment to initially apply SFAS No. 158, net of income taxes							2,186		2,186
<b>Balance at December 31, 2006</b>	<b>19,586</b>	<b>\$ 196</b>	<b>1,841</b>	<b>\$ (59,295)</b>	<b>\$ 261,179</b>	<b>\$ 48,874</b>	<b>\$ 12,751</b>	<b>\$</b>	<b>\$ 263,705</b>
Net income						56,463			56,463
Other comprehensive income:									
Unrealized gain on available-for-sale investments							236		236
Foreign currency translation adjustment							9,712		9,712
Pension adjustment, net of tax							1,865		1,865
Other comprehensive income						56,463	11,813		68,276
Adjustment for the adoption of FASB Interpretation No. 48						(167)			(167)
Treasury and common stock transactions:									
Issuance of restricted stock units previously classified as liabilities					7,524				7,524
Stock-based compensation					20,570				20,570
Exercise of stock options			(834)	29,139	(9,786)				19,353
Vesting of restricted stock units, net of tax withholdings			(301)	10,393	(15,334)				(4,941)
Purchases of treasury stock			1,615	(69,357)					(69,357)
Issuance of treasury stock			(7)	249	87				336

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Cash dividends declared (\$0.26 per share)						(4,546)			(4,546)
Tax benefits related to stock-based compensation						9,047			9,047
<b>Balance at December 31, 2007</b>	<b>19,586</b>	<b>\$ 196</b>	<b>2,314</b>	<b>\$ (88,871)</b>	<b>\$ 273,287</b>	<b>\$ 100,624</b>	<b>\$ 24,564</b>	<b>\$</b>	<b>\$ 309,800</b>
Net income						39,074			39,074
Other comprehensive income:									
Unrealized loss on available-for-sale investments							(1,746)		(1,746)
Foreign currency translation adjustment							(10,819)		(10,819)
Pension adjustment, net of tax							155		155
Other comprehensive income:						39,074	(12,410)		26,664
Treasury and common stock transactions:									
Issuance of restricted stock units previously classified as liabilities						10,536			10,536
Stock-based compensation						23,887			23,887
Exercise of stock options			(64)	2,369		(1,472)			897
Vesting of restricted stock units, net of tax withholdings			(571)	21,822		(30,584)			(8,762)
Purchases of treasury stock			1,546	(46,466)					(46,466)
Issuance of treasury stock			(9)	308		(70)			238
Cash dividends declared (\$0.52 per share)							(8,628)		(8,628)
Dividend equivalents on restricted stock units							(9)		(9)
Tax deficit related to stock-based compensation						(1,853)			(1,853)
<b>Balance at December 31, 2008</b>	<b>19,586</b>	<b>\$ 196</b>	<b>3,216</b>	<b>\$ (110,838)</b>	<b>\$ 273,731</b>	<b>\$ 131,061</b>	<b>\$ 12,154</b>	<b>\$</b>	<b>\$ 306,304</b>

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

**Table of Contents****HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

	<b>Year Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>Cash flows from operating activities:</b>			
Net income	\$ 39,074	\$ 56,463	\$ 34,243
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	10,544	11,279	10,382
Impairment of intangible assets		1,029	
(Gain) loss on sale of property and equipment	67	346	(13)
Deferred income taxes	11,960	(21,990)	(9,612)
Net realized and unrealized gains (losses) on equity and warrant portfolio	42	116	(510)
Stock-based compensation expense, net	24,772	30,689	24,800
Restructuring charges			408
Cash paid for restructuring charges	(2,841)	(3,294)	(7,117)
Other, net		(1,115)	
Changes in assets and liabilities, net of effects of acquisitions:			
Trade and other receivables	2,925	4,244	(14,467)
Accounts payable	(349)	(311)	556
Accrued expenses	(13,549)	41,986	60,443
Income taxes recoverable (payable), net	(10,061)	2,143	2,589
Retirement and pension plan assets and liabilities	(2,642)	(3,230)	(3,698)
Prepayments	(5,696)	(4,792)	(610)
Other assets and liabilities, net	(2,855)	(644)	4,631
<b>Net cash provided by operating activities</b>	<b>51,391</b>	<b>112,919</b>	<b>102,025</b>
<b>Cash flows from investing activities:</b>			
Restricted cash	129	(1,840)	(7,900)
Acquisition of businesses, net of cash acquired	(14,801)	(1,277)	(36,018)
Capital expenditures	(13,402)	(7,998)	(5,524)
Purchases of cost and equity method investments	(2,812)	(2,172)	
Proceeds from sales of equity securities	797	444	1,198
Payments to consultants related to sales of equity securities	(333)	(219)	(740)
Proceeds from sales of short-term investments	22,275	207,075	117,500
Purchases of short-term investments		(155,975)	(190,875)
Proceeds from sale of a business, net	1,559		
Other, net	5	16	110
<b>Net cash provided by (used in) investing activities</b>	<b>(6,583)</b>	<b>38,054</b>	<b>(122,249)</b>
<b>Cash flows from financing activities:</b>			
Proceeds from stock options exercised	897	19,353	10,137
Purchases of treasury stock	(48,071)	(67,752)	(51,726)
Excess tax benefits related to stock-based compensation		7,977	4,170
Cash dividends paid	(8,750)	(2,295)	
Payment of employee tax withholdings from equity transactions	(8,764)	(4,978)	(2,273)
<b>Net cash used in financing activities</b>	<b>(64,688)</b>	<b>(47,695)</b>	<b>(39,692)</b>
<b>Effect of foreign currency exchange rates on cash and cash equivalents</b>	<b>(6,169)</b>	<b>9,862</b>	<b>3,667</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(26,049)</b>	<b>113,140</b>	<b>(56,249)</b>



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Cash and cash equivalents at beginning of period	260,580	147,440	203,689
Cash and cash equivalents at end of period	234,531	260,580	\$ 147,440
<b>Supplemental disclosures of cash flow information</b>			
Cash paid for			
Interest	\$ 58	\$ 34	\$ 15
Income taxes, net	22,542	43,534	23,069
<b>Supplemental schedule of noncash financing and investing activities</b>			
Unrealized gain (loss) on available-for-sale investments	\$ (1,746)	\$ 221	\$ 162
Beginning of period	Accrued treasury stock purchases	\$ 1,605	\$
Treasury stock purchases		46,466	69,357
Cash paid for treasury stock purchases		(48,071)	(67,752)
			(51,726)
Accrued treasury stock purchases	\$	\$ 1,605	\$

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

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**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(All tables in thousands, except per share figures)**

**1. Basis of Presentation**

Heidrick & Struggles International, Inc. and Subsidiaries (the Company) is engaged in providing executive search and leadership consulting services to clients on a retained basis. The Company operates in the Americas, Europe and Asia Pacific.

The consolidated financial statements include Heidrick & Struggles International, Inc. and its wholly-owned subsidiaries and have been prepared using accounting principles generally accepted in the United States (GAAP). The preparation of these financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses and certain financial statement disclosures. Significant items subject to estimates and assumptions include revenue recognition, allowance for doubtful accounts, allowances for deferred tax assets, assessment of goodwill and other intangible assets for impairment, accruals related to the consolidation and closing of offices recorded in conjunction with the Company's restructuring charges, and stock-based compensation. Given that global economies are undergoing a period of substantial uncertainty, estimates are subject to a greater degree of uncertainty, and actual results could differ from these estimates.

Certain reclassifications have been made to prior year financial information to conform to current year presentations, which have no effect on the Consolidated Statements of Operations for any prior periods presented. In addition, revisions were made to reclassify payments of employee tax withholdings related to equity awards from cash flows provided by operating activities to cash flows used in financing activities, and a revision was made to reclassify the payment for a cost method investment from cash flows provided by operating activities to cash flows used in investing activities. As a result, cash flows provided by operating activities increased by \$2.3 million and \$7.2 million in 2006 and 2007, respectively. Cash flows provided by investing activities decreased by \$2.2 million in 2007 and cash flows used in financing activities increased by \$2.3 million and \$5.0 million in 2006 and 2007, respectively.

**2. Summary of Significant Accounting Policies**

*Cash and Cash Equivalents*

The Company considers all highly liquid instruments with an original maturity of three months or less to be cash equivalents.

*Short-term Investments*

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Historically, short-term investments represented auction rate securities. The Company's auction rate securities were classified as available-for-sale and were stated at current market value in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 115, Accounting for Certain Investments in Debt and Equity Securities. In January 2008, the Company liquidated all of its investments in auction rate securities given the current market conditions. The Company did not realize any loss in value upon liquidating these investments.

### *Concentration of Risk*

The Company is potentially exposed to concentrations of risk associated with its accounts receivable. However, this risk is limited due to the Company's large number of clients and their dispersion across many different industries and geographies. At December 31, 2008, the Company had no significant concentrations of risk.

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**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Accounts Receivable*

The Company's accounts receivable primarily consist of trade receivables. The allowance for doubtful accounts is developed based upon several factors including the age of the Company's accounts receivable, historical write-off experience and specific account analysis. These factors may change over time, impacting the allowance level.

*Fair Value of Financial Instruments*

Cash and cash equivalents are stated at cost, which approximates fair market value. The carrying value for receivables from clients, accounts payable, deferred revenue and other accrued liabilities reasonably approximate fair market value due to the nature of the financial instruments and the short term nature of the items.

*Property and Equipment*

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful life of the asset or, for leasehold improvements, the shorter of the lease term or the estimated useful life of the asset, as follows:

Office furniture, fixtures and equipment	5 - 10 years
Computer equipment and software	3 - 8 years

Depreciation is calculated for tax purposes using accelerated methods, where applicable.

*Long-lived Assets*

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company reviews its long-lived assets, including property and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge, equal to the amount by which the carrying amount of the asset exceeds the fair value of the asset, is recognized.

*Investments*

The Company receives warrants for equity securities in client companies, in addition to the cash fee, for services rendered on some searches. Some of the warrants meet the definition of a derivative instrument under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and its subsequent amendments. SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. These derivative instruments are initially recorded at their fair value, using a Black-Scholes model, in the Consolidated Balance Sheets, with a corresponding amount recorded as net revenue in the Consolidated Statements of Operations. Bonus expense related to this net revenue is also recorded. Subsequent changes in the fair value of these derivative instruments are recorded in the Consolidated Statements of Operations as unrealized gains (losses), net of the consultants' share of the gains (losses).

Other warrants received and which do not meet the definition of a derivative instrument under SFAS No. 133 are initially recorded at their fair value, using a Black-Scholes model, in the Consolidated Balance

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**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Sheets, with a corresponding amount recorded as net revenue in the Consolidated Statements of Operations. Bonus expense related to this net revenue is also recorded. These warrants are accounted for using the cost method, and subsequent changes in fair value are not recognized. However, these warrants are regularly reviewed for other-than-temporary declines in fair value. Any permanent declines in the fair value of these warrants are recorded in the Consolidated Statements of Operations as realized losses, net of the consultants' share of the losses.

Upon a value event such as an initial public offering or an acquisition, any changes in the fair value of the warrants, both derivatives and non-derivatives, are recorded in the Consolidated Statements of Operations as unrealized gains (losses), net of the consultants' share of the gains (losses).

Any equity securities arising from the exercise of a warrant are accounted for as available-for-sale investments in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Subsequent changes in the fair value of these available-for-sale investments are recorded as a component of accumulated other comprehensive income. Upon the sale of these investments, the Company records a realized gain (loss), net of the consultants' share of the gain (loss) and other costs.

The equity method of accounting is used to account for investments in which the Company has the ability to exercise significant influence, but not control, over an investee. Significant influence is generally deemed to exist if the Company has an ownership interest in the voting stock of an investee of between 20% and 50%.

*Goodwill and Other Intangible Assets*

Pursuant to the requirements of SFAS No. 142, "Goodwill and Other Intangible Assets," the Company evaluates its goodwill for impairment on an annual basis during the fourth quarter, or whenever indicators of impairment exist. 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. 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. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination is determined. 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 and comparable public company methodology, with the assistance of an independent valuation firm.

Other intangible assets acquired are amortized either using the straight-line method over their estimated useful lives or based on the projected cash flow associated with the respective intangible assets and have been segregated as a separate line item on the Consolidated Balance Sheets.

*Restructuring Charges*

The Company accounts for its restructuring charges in accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities ( SFAS No. 146 ). Under SFAS No. 146, a liability is recognized when the costs are incurred and are recorded at fair value.

*Revenue Recognition*

Revenue before reimbursements of out-of-pocket expenses ( net revenue ) consists of retainers and indirect expenses billed to clients. For each assignment, the Company and its client enter into a contract that outlines the

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**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

general terms and conditions of the assignment. Typically, the Company is paid a retainer for its executive search services equal to approximately one-third of the estimated first year compensation for the position to be filled. In addition, if the actual compensation of a placed candidate exceeds the estimated compensation, the Company often will be authorized to bill the client for one-third of the excess. Indirect expenses are calculated as a percentage of the retainer with certain dollar limits per search. The Company generally bills its clients for its retainer and indirect expenses in one-third increments over a three-month period commencing in the month of a client's acceptance of the contract.

Net revenue is recognized when earned and realizable and therefore when the following criteria have been met: (a) persuasive evidence of an arrangement exists, (b) services have been rendered, (c) the fee to our client is fixed or determinable, and (d) collectibility is reasonably assured. Net revenue from executive search engagements is recognized over the expected average period of performance, in proportion to the estimated personnel time incurred to fulfill our obligations under the arrangements. Net revenue in excess of the retainer, resulting from actual compensation of the placed candidate exceeding the estimated compensation, is recognized upon completion of the executive search when the amount of the additional fee is known.

*Reimbursements*

The Company incurs certain out-of-pocket expenses that are reimbursed by its clients. The Company accounts for its reimbursed out-of-pocket expenses as revenue in its Consolidated Statements of Operations in accordance with EITF Issue No. 01-14, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred."

*Salaries and Employee Benefits*

Salaries and employee benefits consist of compensation and benefits paid to consultants, executive officers, and administrative and support personnel, of which the most significant elements are salaries and annual performance-related bonuses. Other items in this category are expenses related to signing bonuses and minimum guaranteed bonuses (often incurred in connection with the hiring of new consultants), restricted stock unit amortization, payroll taxes, profit sharing and retirement benefits, and employee insurance benefits.

Salaries and employee benefits are recognized on an accrual basis. Certain signing bonuses and minimum guaranteed compensation are capitalized and amortized up to a maximum of three years, consistent with the terms associated with these payments.

During 2006 and 2007, a portion of consultant and management bonuses were paid in the form of restricted stock units that vest ratably over a three-year period from the date of grant. The amount paid in the form of restricted stock units varies between 10% and 20% (plus a premium of 10% on the restricted stock units received) depending on the employee's level or position. The restricted stock units are issued in the quarter



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following the year in which the performance portion of the awards is earned. Compensation expense related to awards requiring satisfaction of both service and performance conditions is recognized using a graded vesting attribution method over the requisite service period which begins on January 1 of the applicable year and continues through the final vesting date, which is generally three years from the date of grant.

In the first quarter of 2008, the Company changed the deferral arrangement of bonuses for consultants and management globally. The portion of the bonus previously deferred into restricted stock units will now be deferred into cash which will be paid ratably over a three-year period. A premium of 10% was applied to the bonus amount deferred in 2008. The portion of the bonus that will be deferred varies between 10% and 15%

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**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

depending on the employee's level or position. The compensation expense related to the amounts being deferred is recognized on a graded vesting attribution method over the requisite service period, which for 2008, began on January 1, 2008 and continues through the final payment date, which is three years from the date of the original deferral. For 2008, the deferral date will be in the first quarter of 2009. These amounts are recorded as a component of other non-current liabilities in the Consolidated Balance Sheet. The Company will continue to grant restricted stock units under other existing programs.

*Stock-Based Compensation*

The Company accounts for stock-based compensation in accordance with SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R). This statement requires that the costs of all employee share-based payments be measured at fair value on the award's grant date and be recognized in the financial statements over the requisite service period.

*Consultants' Share of Gains Related to Warrant Monetizations*

Historically, the Company's policy with respect to warrants was that 55% of the net proceeds resulting from the monetizations of warrants was payable to the consultants involved in the search. For warrants received by the Company after April 1, 2005, the portion of the net proceeds payable to consultants was reduced from 55% to 50% and is limited to \$10.0 million per monetization. In addition, of the 50% of the net proceeds retained by the Company, 20% (or 10% of the total net proceeds) will be reserved for discretionary distributions to the broader employee population.

*Income Taxes*

Deferred tax assets and liabilities are determined based on the differences between the financial statement and tax basis of assets and liabilities, applying enacted statutory tax rates in effect for the year in which the tax differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

*Earnings per Common Share*

Basic earnings per common share is computed by dividing net income by weighted average common shares outstanding for the year. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or

converted. Common equivalent shares are excluded from the determination of diluted earnings per share in periods in which they have an anti-dilutive effect.

*Translation of Foreign Currencies*

The translation of financial statements into U.S. dollars has been performed in accordance with SFAS No. 52, Foreign Currency Translation. Generally, the local currency for all subsidiaries has been designated as the functional currency. Assets and liabilities have been translated into U.S. dollars at the current rate of exchange prevailing at the balance sheet date. Revenue and expenses have been translated at a monthly average exchange rate for the period. Translation adjustments are reported as a component of accumulated other comprehensive income.

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**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Recently Adopted Financial Accounting Standards*

On January 1, 2008, the Company adopted SFAS No. 157 Fair Value Measurements ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. See Note 7, *Fair Value Measurements*, for disclosures required by SFAS No. 157. In February 2008, the FASB released FASB Staff Position (FSP FAS 157-2 Effective Date of FASB Statement No. 157), which delayed the effective date of SFAS No. 157 for nonfinancial assets, such as goodwill and long-lived assets, and nonfinancial liabilities, subject to certain exceptions, until January 1, 2009. The adoption of SFAS No. 157 for financial assets and liabilities did not have a material impact on the Company's financial condition or results of operations.

On January 1, 2008, the Company adopted SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of SFAS No. 115 ( SFAS No. 159 ). SFAS No. 159 permits entities to choose to elect, at specified election dates, to measure eligible financial instruments at fair value. The adoption of SFAS No. 159 did not have a material impact on the Company's financial condition or results of operations.

*Recently Issued Financial Accounting Standards*

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ( SFAS No. 141(R) ). SFAS No. 141(R) requires that all business combinations be accounted for by applying the acquisition method. Under the acquisition method, the acquirer recognizes and measures the identifiable assets acquired, the liabilities assumed, and any contingent consideration and contractual contingencies, as a whole, at their fair values as of the acquisition date. It further requires that acquisition-related costs be recognized separately from the acquisition and expensed as incurred, restructuring costs generally be expensed in periods subsequent to the acquisition date, and changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period be recorded against income tax expense. The adoption of SFAS No. 141(R) changes the Company's accounting treatment for business combinations on a prospective basis effective January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 ( SFAS No. 160 ). SFAS No. 160 changes the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS No. 160 is effective for the Company on a prospective basis for business combinations with an acquisition date beginning as of January 1, 2009. Currently, the Company does not have any material minority interests.

**3. Allowance for Doubtful Accounts**

The following table summarizes the activity of the allowance for doubtful accounts for the years ending:

	2008	December 31,	
		2007	2006
Balance at January 1,	\$ 4,262	\$ 4,603	\$ 2,668
Provision charged to income	3,338	1,047	2,057
Write-offs	(1,954)	(1,133)	(438)
Highland Partners acquisition (1)			511
Currency	162	(255)	(195)
Balance at December 31,	\$ 5,808	\$ 4,262	\$ 4,603

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- (1) In connection with the acquisition of Highland Partners in 2006, the Company acquired the allowance for doubtful accounts associated with the acquired accounts receivable.

**Table of Contents****HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****4. Property and equipment**

The components of the Company's property and equipment at December 31, are as follows:

	<b>2008</b>	<b>2007</b>
Leasehold improvements	\$ 36,630	\$ 29,051
Office furniture, fixtures and equipment	24,975	24,296
Computer equipment and software	41,948	40,049
Property and equipment, gross	103,553	93,396
Accumulated depreciation	(75,381)	(74,666)
Property and equipment, net	\$ 28,172	\$ 18,730

In 2008, the Company wrote off \$19.4 million of computer equipment and software that was fully depreciated and has reclassified the prior year amounts to conform to the current year presentation, which has no effect on net property and equipment.

**5. Restricted Cash**

The Company had deposits of \$8.3 million at December 31, 2008 and 2007, respectively, in a U.S dollar bank account in support of a \$5.7 million (equivalent to \$7.9 million at December 31, 2008) bank guarantee related to a tax audit in a European country. The Company earns a market rate of interest on this cash deposit, which is reviewed quarterly. The bank guarantee is determined based upon the tax audit assessment of \$4.3 million (equivalent to \$6.0 million at December 31, 2008) plus future accrued interest on that assessment amount. See Note 22, *Commitments and Contingencies* for a discussion of the tax audit.

Based on the restrictions of the use of the pledged cash and the terms of the guarantee, the Company has reported these funds as restricted cash in non-current assets in the Consolidated Balance Sheets as of December 31, 2008 and 2007. At this time, the Company is not able to determine when a settlement will be reached.

In 2008, the restricted cash balance included \$1.3 million of restricted cash in support of lease guarantees. In accordance with the terms of the lease agreements, the cash balances are restricted through the term of the lease agreements, which extend through 2013.

**6. Investments**

The components of the Company's investments at December 31, are as follows:

	<b>2008</b>	<b>2007</b>
U.S. non-qualified deferred compensation plan	\$ 5,262	\$ 4,301
JobKoo	3,306	
VisualCV, Inc.	2,977	2,172
Warrants and equity securities	1,049	1,359
<b>Total</b>	<b>\$ 12,594</b>	<b>\$ 7,832</b>

The aggregate cost of the Company's cost method investments totaled \$4.0 million and \$3.4 million at December 31, 2008 and 2007, respectively, none of which were evaluated for impairment since there were no triggering events in the respective years. The aggregate cost of the Company's equity method investment totaled \$3.3 million in 2008.

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**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In November 2007, the Company invested \$2.2 million in Series A-1 preferred stock of VisualCV, Inc. and in November 2008, invested an additional \$0.8 million in Series B preferred stock of VisualCV, Inc. VisualCV, Inc. is the developer of VisualCV.com, a new approach to creating and sharing Internet-based resumes that takes advantage of Web 2.0 capabilities such as information keyword pop-ups, video, attachments, and social networking.

In 2008, the Company entered into a transaction with Beijing JobKoo Information Technology Co., Ltd. to create a joint venture named Shanghai JobKoo Information Technology Co., Ltd. (JobKoo) under which each partner would have an equal 50% ownership. Under the terms of the joint venture, the Company invested \$2.0 million and committed to an additional investment of \$1.3 million to be paid in 2009. Jobkoo's products and services focus on creating an interface between job seekers and employers through its online executive talent management solutions. The Company has recorded this investment, along with certain capitalized expenses using the equity method of accounting.

**7. Fair Value Measurements**

On January 1, 2008, the Company adopted SFAS No. 157 for all financial instruments accounted for at fair value on a recurring basis. Fair value is defined by SFAS No. 157 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1 Quoted prices in active markets for identical assets and liabilities.

Level 2 Quoted prices in active markets for similar assets and liabilities, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

Substantially all of the Company's financial assets that are measured at fair value on a recurring basis are measured using Level 1 inputs.

**8. Other Non-current Assets**



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At December 31, 2008 and 2007, the Company had \$7.2 million and \$6.3 million of other non-current assets, respectively. Other non-current assets consist of \$4.3 million of prepaid rent and \$2.9 million of prepaid sign-on bonuses as of December 31, 2008 and \$6.2 million of prepaid rent and \$0.1 million of prepaid sign-on bonuses as of December 31, 2007.

### **9. Acquisitions**

#### *Highland Partners*

In October 2006, the Company acquired Highland Partners, a leading retained executive search boutique and a division of Hudson Highland Group, Inc., through an asset purchase funded from existing cash for \$36.0 million including \$1.2 million of capitalized acquisition costs, less a \$1.8 million working capital adjustment. As

**Table of Contents****HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

part of the purchase price, the Company acquired \$13.3 million of assets and assumed \$15.6 million of liabilities. The Company also recorded \$12.8 million of identifiable intangible assets and \$25.4 million of goodwill. Hudson Highland Group, Inc. was eligible to receive up to \$15 million in earnout payments based on the acquired consultants achieving certain revenue metrics in 2007 and 2008, for a total purchase price of \$51.0 million. During 2008, the Company paid \$3.4 million related to 2007 performance and has accrued \$11.6 million related to 2008 performance, which will be paid in the first quarter of 2009. All 48 of the Highland Partners consultants who were offered employment accepted and joined the Company. The results of operations of Highland Partners are included in the Company's financial statements from the date of acquisition.

The following table summarizes the pro forma results of operations for 2006 as though the business combination had been completed at the beginning of the year.

	<b>2006 Pro Forma Results</b>
Net revenue	\$ 523,237
Operating income (1)	51,998
Net income	35,498
Basic earnings per common share	1.98
Diluted earnings per common share	1.88

(1) Includes \$1.8 million of intangible amortization in 2006.

*RentonJames*

In January 2007, the Company acquired RentonJames, a privately held executive search and leadership consultancy boutique based in New Zealand for a total cash payment of \$1.2 million. The previous owners of RentonJames, who are now Heidrick & Struggles employees, are eligible to receive earnout payments up to \$2.8 million based on the achievement of certain revenue metrics in 2007, 2008 and 2009 such that the total purchase price will not exceed \$4.0 million. During 2008, the Company paid \$1.3 million related to 2007 performance and accrued \$0.8 million related to 2008 performance, which will be paid in the first quarter of 2009.

*Advantage Recruitment (Thailand) Ltd.*

In January 2008, the Company acquired Advantage Recruitment (Thailand) Ltd. ( Advantage Recruitment ) pursuant to an asset purchase for \$0.2 million, which was funded from existing cash. The Company recorded \$0.2 million of goodwill related to the acquisition. The previous owner, who is now a Heidrick & Struggles employee, is eligible to receive up to an additional \$0.2 million in earnout payments.

*Schwab Enterprise, LLC*

In April 2008, the Company acquired Schwab Enterprise, LLC ( Schwab ), an executive search boutique firm in the United States, specializing in the hedge fund sector. The Company acquired Schwab for \$1.6 million plus \$0.1 million of capitalized acquisition costs pursuant to a stock purchase, which was funded from existing cash. In July 2008, the Company paid an additional \$0.2 million related to the final working capital settlement. As part of the purchase price, the Company acquired \$0.5 million of assets and assumed \$0.2 million of liabilities. The Company also recorded \$0.3 million of identifiable intangible assets and \$1.4 million of goodwill. The previous owners of Schwab, who are now Heidrick & Struggles employees, are eligible to receive earnout payments of up to \$4.2 million based on the achievement of certain revenue metrics in 2009, 2010, and 2011 such that total cash consideration paid to the sellers will not exceed \$6.0 million.

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**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*IronHill Partners, LLC*

In May 2008, the Company acquired IronHill Partners, LLC ("IronHill"), an executive search boutique firm in the United States, specializing in the venture capital sector with a particular focus on technology companies. The Company acquired IronHill for \$4.5 million plus \$0.2 million of capitalized acquisition costs pursuant to an asset purchase, which was funded from existing cash. In July 2008, the Company paid an additional \$0.1 million related to the final working capital settlement. As part of the purchase price, the Company acquired \$1.2 million of assets and assumed \$0.4 million of liabilities. The Company also recorded \$0.5 million of identifiable intangible assets and \$3.6 million of goodwill. The previous owners of IronHill, who are now Heidrick & Struggles employees, are eligible to receive earnout payments up to \$4.4 million based on the achievement of certain revenue metrics in 2009, 2010, and 2011 such that total cash consideration paid to the sellers will not exceed \$9.0 million.

*75 Search Partners, LLC*

In August 2008, the Company acquired 75 Search Partners, LLC ( 75 Search ), an executive search boutique firm in the United States, specializing in the asset management sector. The Company acquired 75 Search for \$3.2 million pursuant to an asset purchase, which was funded from existing cash. In addition, the Company recorded \$0.3 million of identifiable intangible assets and \$2.9 million of goodwill. The previous owners of 75 Search, who are now Heidrick & Struggles employees, are eligible to receive earnout payments up to \$2.8 million based on the achievement of certain revenue metrics in 2009, 2010, and 2011 such that total cash consideration paid to the sellers will not exceed \$6.0 million.

All of the 2007 and 2008 acquisitions were accounted for using the purchase method of accounting for business combinations, and the results of operations of these entities have been included in the consolidated financial statements since their respective acquisition dates. Additionally, none of these acquisitions are considered material to the Company, and, therefore, pro-forma information has not been presented. The purchase price allocation recorded at December 31, 2008 associated with the 2008 acquisitions could change as a result of subsequent purchase accounting adjustments and additional earnout amounts that may become payable based on performance within the respective earnout periods. The Company does not believe these changes, if any, would be material.

**Table of Contents****HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****10. Goodwill and Other Intangible Assets***Goodwill*

Changes in the carrying amount of goodwill by segment for the years ended December 31, 2008 and 2007 were as follows:

	Americas	Europe	Asia Pacific	Total
Balance at December 31, 2006	\$ 56,924	\$ 17,206	\$ 1,831	\$ 75,961
Acquisitions:				
RentonJames			862	862
Earnouts:				
Highland Partners	3,295	11	69	3,375
RentonJames			1,638	1,638
Adjustments:				
Highland Partners (1)	(1,302)	(913)		(2,215)
Other (2)		2,746		2,746
Exchange rate fluctuations	424	1,359	67	1,850
Balance at December 31, 2007	59,341	20,409	4,467	84,217
Acquisitions:				
Advantage Recruitment			171	171
Schwab	1,362			1,362
IronHill	3,615			3,615
75 Search	2,974			2,974
Earnouts:				
Highland Partners	11,348	38	239	11,625
RentonJames, net			483	483
Exchange rate fluctuations	(584)	(1,948)	(681)	(3,213)
Balance at December 31, 2008	\$ 78,056	\$ 18,499	\$ 4,679	\$ 101,234

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- (1) In 2007, the Company recorded \$2.2 million of adjustments to the initial purchase price allocation of the Highland Partners acquisition, as discussed in Note 9, *Acquisitions*. Of the \$2.2 million adjustment, \$1.2 million is a result of the final settlement of certain liabilities that were based on estimates recorded at the time of acquisition and \$1.0 million is the reduction of goodwill to account for the amount of deferred tax assets that will provide the Company with future tax deductions.
  - (2) During the fourth quarter of 2007, the Company revised its deferred tax liability associated with the 1999 merger of Heidrick & Struggles Inc. with Heidrick & Struggles International, Inc. This revision increased the current carrying value of goodwill by \$2.7 million, established a deferred tax liability of \$1.3 million, and resulted in a foreign currency translation adjustment of \$0.3 million

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and an income tax benefit of \$1.1 million. These adjustments resulted in immaterial misstatements to prior period financial statements.

During the 2008 fourth quarter, the Company, with the assistance of an independent valuation firm, conducted its annual goodwill impairment evaluation. This impairment evaluation indicated that the fair value of each of the Company's reporting unit exceeded its carrying amount. As a result, no impairment charge was recorded. The estimated fair value of the Americas and Asia Pacific reporting units were significantly in excess of their net asset carrying values. However, the estimated fair value