KORN FERRY INTERNATIONAL
Form 10-Q
September 08, 2017
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended July 31, 2017

or

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

For the transition period from _________ to ___________

Commission File Number 001-14505

KORN/FERRY INTERNATIONAL

(Exact Name of Registrant as Specified in its Charter)

Delaware	**95-2623879**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

1900 Avenue of the Stars, Suite 2600, Los Angeles, California 90067

(Address of principal executive offices) (Zip Code)

(310) 552-1834

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares outstanding of our common stock as of September 5, 2017 was 56,492,489 shares.

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KORN/FERRY INTERNATIONAL

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Item 1. Consolidated Financial Statements

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	July 31, 2017 (unaudited)	April 30, 2017
	(in thousands, except per share data)	
ASSETS		
Cash and cash equivalents	$ 282,019	$ 410,882
Marketable securities	11,651	4,363
Receivables due from clients, net of allowance for doubtful accounts of $16,088 and $15,455 at July 31, 2017 and April 30, 2017, respectively	365,657	345,314
Income taxes and other receivables	44,035	31,573
Prepaid expenses and other assets	62,525	51,542
Total current assets	765,887	843,674
Marketable securities, non-current	114,608	115,574
Property and equipment, net	112,787	109,567
Cash surrender value of company owned life insurance policies, net of loans	113,866	113,067
Deferred income taxes, net	19,387	20,175
Goodwill	583,265	576,865
Intangible assets, net	213,910	217,319
Investments and other assets	90,617	66,657
Total assets	$ 2,014,327	$ 2,062,898
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable	$ 32,658	$ 37,481
Income taxes payable	7,204	4,526
Compensation and benefits payable	145,752	248,354
Term loan	19,754	19,754
Other accrued liabilities	153,386	148,464
Total current liabilities	358,754	458,579
Deferred compensation and other retirement plans	220,894	219,905
Term loan, non-current	231,284	236,222
Deferred tax liabilities	18,758	7,014
Other liabilities	55,886	54,130

Total liabilities		885,576		975,850
Stockholders equity:				
Common stock: $0.01 par value, 150,000 shares authorized, 71,480 and 70,811 shares issued at July 31, 2017 and April 30, 2017, respectively, and 57,246 and 56,938 shares outstanding at July 31, 2017 and April 30, 2017, respectively		694,146		692,527
Retained earnings		485,194		461,976
Accumulated other comprehensive loss, net		(54,691)		(71,064)
Total Korn/Ferry International stockholders equity		1,124,649		1,083,439
Noncontrolling interest		4,102		3,609
Total stockholders equity		1,128,751		1,087,048
Total liabilities and stockholders equity	$	2,014,327	$	2,062,898

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

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

	Three Months Ended July 31, 2017	Three Months Ended July 31, 2016
	(in thousands, except per share data)	
Fee revenue	$ 401,254	$ 375,621
Reimbursed out-of-pocket engagement expenses	13,663	17,312
Total revenue	414,917	392,933
Compensation and benefits	273,954	262,967
General and administrative expenses	58,261	55,342
Reimbursed expenses	13,663	17,312
Cost of services	15,813	16,832
Depreciation and amortization	12,209	11,444
Restructuring charges, net	280	24,520
Total operating expenses	374,180	388,417
Operating income	40,737	4,516
Other income, net	3,532	4,259
Interest expense, net	(2,660)	(3,061)
Income before provision for income taxes and equity in earnings of unconsolidated subsidiaries	41,609	5,714
Equity in earnings of unconsolidated subsidiaries, net	30	79
Income tax provision	12,210	1,725
Net income	29,429	4,068
Net income attributable to noncontrolling interest	(388)	(860)
Net income attributable to Korn/Ferry International	$ 29,041	$ 3,208
Earnings per common share attributable to Korn/Ferry International:		
Basic	$ 0.52	$ 0.06

Diluted	$	0.51	$	0.06
Weighted-average common shares outstanding:				
Basic		55,795		56,189
Diluted		56,403		56,576
Cash dividends declared per share:	$	0.10	$	0.10

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

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(unaudited)

	Three Months Ended July 31,	
	2017	**2016**
	(in thousands, except per share data)	
Net income	$ 29,429	$ 4,068
Other comprehensive income (loss):		
Foreign currency translation adjustments	16,189	(13,274)
Deferred compensation and pension plan adjustments, net of tax	352	462
Net unrealized loss on interest rate swap, net of tax	(63)	
Comprehensive income (loss)	45,907	(8,744)
Less: comprehensive income attributable to noncontrolling interest	(493)	(714)
Comprehensive income (loss) attributable to Korn/Ferry International	$ 45,414	$ (9,458)

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

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Three Months Ended July 31, 2017	2016
	(in thousands)	
Cash flows from operating activities:		
Net income	$ 29,429	$ 4,068
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	12,209	11,444
Stock-based compensation expense	4,696	4,915
Provision for doubtful accounts	3,070	2,577
Gain on cash surrender value of life insurance policies	(2,485)	(2,498)
Gain on marketable securities	(3,429)	(3,915)
Deferred income taxes	8,562	5,410
Change in other assets and liabilities:		
Deferred compensation	8,288	(5,866)
Receivables due from clients	(23,413)	(28,586)
Income tax and other receivables	(10,930)	(8,093)
Prepaid expenses and other assets	(10,983)	(10,066)
Investment in unconsolidated subsidiaries	(30)	(79)
Income taxes payable	6,463	(4,014)
Accounts payable and accrued liabilities	(109,034)	(93,866)
Other	(21,986)	(7,137)
Net cash used in operating activities	(109,573)	(135,706)
Cash flows from investing activities:		
Purchase of property and equipment	(9,529)	(15,079)
Cash paid for acquisition, net of cash acquired		(2,880)
Purchase of marketable securities	(4,600)	(5,430)
Proceeds from sales/maturities of marketable securities	1,734	13,764
Premium on company-owned life insurance policies	(403)	(401)
Proceeds from life insurance policies	971	
Dividends received from unconsolidated subsidiaries	60	230
Net cash used in investing activities	(11,767)	(9,796)
Cash flows from financing activities:		
Proceeds from term loan facility		275,000

Principal payment on term loan facility		(5,156)		(140,000)
Payment of contingent consideration from acquisition		(485)		(1,070)
Repurchases of common stock		(4,026)		
Payments of tax withholdings on restricted stock		(3,346)		(4,161)
Proceeds from issuance of common stock upon exercise of employee stock options and in connection with an employee stock purchase plan		3,984		2,430
Dividends paid to shareholders		(5,823)		(5,909)
Payments on life insurance policy loans		(414)		
Net cash (used in) provided by financing activities		(15,266)		126,290
Effect of exchange rate changes on cash and cash equivalents		7,743		(9,967)
Net decrease in cash and cash equivalents		(128,863)		(29,179)
Cash and cash equivalents at beginning of period		410,882		273,252
Cash and cash equivalents at end of period	$	282,019	$	244,073

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

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

July 31, 2017

1. Organization and Summary of Significant Accounting Policies

Nature of Business

Korn/Ferry International, a Delaware corporation (the Company), and its subsidiaries are engaged in the business of providing talent management solutions, including executive search on a retained basis, recruitment for non-executive professionals, recruitment process outsourcing and leadership & talent consulting services.

Basis of Consolidation and Presentation

The accompanying financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended April 30, 2017 for the Company and its wholly and majority owned/controlled domestic and international subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. The preparation of the consolidated financial statements conform with United States (U.S.) generally accepted accounting principles (GAAP) and prevailing practice within the industry. The consolidated financial statements include all adjustments, consisting of normal recurring accruals and any other adjustments that management considers necessary for a fair presentation of the results for these periods. The results of operations for the interim period are not necessarily indicative of the results for the entire fiscal year.

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

The Company has control of a Mexico subsidiary and consolidates the operations of this subsidiary. Noncontrolling interest, which represents the Company s 51% noncontrolling interest in the Mexico subsidiary, is reflected on the Company s consolidated financial statements.

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

Use of Estimates and Uncertainties

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

Revenue Recognition

Substantially all fee revenue is derived from fees for professional services related to executive search performed on a retained basis, recruitment for non-executive professionals, recruitment process outsourcing, people and organizational advisory services and the sale of product services. Fee revenue from executive search activities and recruitment for non-executive professionals is generally one-third of the estimated first year compensation of the placed executive or non-executive professional, as applicable, plus a percentage of the fee to cover indirect engagement related expenses. The Company generally recognizes such revenue on a straight-line basis over a three-month period, commencing upon client acceptance, as this is the period over which the recruitment services are performed. Fees earned in excess of the initial contract amount are recognized upon completion of the engagement, which reflect the difference between the final actual compensation of the placed executive and the estimate used for purposes of the previous billings. Since the initial contract fees are typically not contingent upon placement of a candidate, our assumptions primarily relate to establishing the period over which such service is performed. These assumptions determine the timing of revenue recognition and profitability for the reported period. Any revenues associated with services that are provided on a contingent basis are recognized once the contingency is resolved. In addition to recruitment for non-executive professionals, Futurestep provides recruitment process outsourcing (RPO) services and fee revenue is recognized as services are rendered and/or as milestones are achieved. Fee revenue from Hay Group (formerly known as Leadership & Talent Consulting (Legacy LTC) which was combined with HG (Luxembourg) S.à.r.l (Legacy Hay) in December 2015) is recognized as services are rendered for consulting engagements and other time-based services, measured by total hours incurred to the total estimated hours at completion. It is possible that updated estimates for the consulting engagement may vary from initial estimates with such updates being recognized in the period of determination.

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NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

July 31, 2017 (continued)

Depending on the timing of billings and services rendered, the Company accrues or defers revenue as appropriate. Hay Group revenue is also derived from the sale of product services, which includes revenue from licenses and from the sale of products. Revenue from licenses is recognized using a straight-line method over the term of the contract (generally 12 months). Under the fixed term licenses, the Company is obligated to provide the licensee with access to any updates to the underlying intellectual property that are made by the Company during the term of the license. Once the term of the agreement expires, the client s right to access or use the intellectual property expires and the Company has no further obligations to the client under the license agreement. Revenue from perpetual licenses is recognized when the license is sold since the Company s only obligation is to provide the client access to the intellectual property but is not obligated to provide maintenance, support, updates or upgrades. Products sold by the Company mainly consist of books and automated services covering a variety of topics including performance management, team effectiveness, and coaching and development. The Company recognizes revenue for its products when the product has been sold or shipped in the case of books. As of July 31, 2017 and April 30, 2017, the Company included deferred revenue of $93.6 million and $95.8 million, respectively, in other accrued liabilities.

Reimbursements

The Company incurs certain out-of-pocket expenses that are reimbursed by its clients, which are accounted for as revenue in its consolidated statements of income.

Allowance for Doubtful Accounts

An allowance is established for doubtful accounts by taking a charge to general and administrative expenses. The amount of the allowance is based on historical loss experience, assessment of the collectability of specific accounts, as well as expectations of future collections based upon trends and the type of work for which services are rendered. After the Company exhausts all collection efforts, the amount of the allowance is reduced for balances identified as uncollectible.

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. As of July 31, 2017 and April 30, 2017, the Company s investments in cash equivalents consist of money market funds for which market prices are readily available.

Marketable Securities

The Company currently has investments in mutual funds that are classified as trading securities based upon management s intent and ability to hold, sell or trade such securities. The classification of the investments in mutual funds is assessed upon purchase and reassessed at each reporting period. The investments in mutual funds (for which market prices are readily available) are held in trust to satisfy obligations under the Company s deferred compensation plans. Such investments are based upon the employees investment elections in their deemed accounts in the Executive Capital Accumulation Plan and similar plans in Asia Pacific and Canada (ECAP) from a pre-determined set of securities and the Company invests in marketable securities to mirror these elections. These investments are recorded at fair value and are classified as marketable securities in the accompanying consolidated balance sheets. The investments that the Company may sell within the next twelve months are carried as current assets. Realized gains (losses) on marketable securities are determined by specific identification. Interest is recognized on an accrual basis; dividends are recorded as earned on the ex-dividend date. Interest, dividend income and the changes in fair value in trading securities are recorded in the accompanying consolidated statements of income in other income, net.

Fair Value of Financial Instruments

Fair value is the price the Company would receive to sell an asset or transfer a liability (exit price) in an orderly transaction between market participants. For those assets and liabilities recorded or disclosed at fair value, the Company determines the fair value based upon the quoted market price, if available. If a quoted market price is not available for identical assets, the fair value is based upon the quoted market price of similar assets. The fair values are assigned a level within the fair value hierarchy as defined below:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3: Unobservable inputs that reflect the reporting entity s own assumptions.

As of July 31, 2017 and April 30, 2017, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included cash, cash equivalents, accounts receivable, marketable securities, foreign currency forward

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

July 31, 2017 (continued)

contracts and interest rate swap. The carrying amount of cash, cash equivalents and accounts receivable approximates fair value due to the short maturity of these instruments. The fair values of marketable securities classified as trading are obtained from quoted market prices, and the fair values of foreign currency forward contracts or the interest rate swap are obtained from a third party, which are based on quoted prices or market prices for similar assets and financial instruments.

Derivative Financial Instruments

The Company is exposed to interest rate risk due to the outstanding senior secured credit agreement entered on June 15, 2016. The Company has entered into an interest rate swap agreement to effectively convert its variable debt to a fixed-rate basis. The principal objective of these contracts is to eliminate or reduce the variability of the cash flows in interest payments associated with the Company s long-term debt, thus reducing the impact of interest rate changes on future interest payment cash flows. The Company has determined that the interest rate swap qualifies as a cash flow hedge in accordance with Accounting Standards Codification 815, *Derivatives and Hedging*. Changes in the fair value of an interest rate swap agreement designated as a cash flow hedge are recorded as a component of accumulated other comprehensive income (loss) within stockholders equity and are amortized to interest expense over the term of the related debt.

Foreign Currency Forward Contracts Not Designated as Hedges

The Company has established a program that primarily utilizes foreign currency forward contracts to offset the risks associated with the effects of certain foreign currency exposures. These foreign currency forward contracts are neither used for trading purposes nor are they designated as hedging instruments pursuant to Accounting Standards Codification 815, *Derivatives and Hedging*. Accordingly, the fair value of these contracts is recorded as of the end of the reporting period in the accompanying consolidated balance sheets, while the change in fair value is recorded to the accompanying consolidated statements of income.

Business Acquisitions

Business acquisitions are accounted for under the acquisition method. The acquisition method requires the reporting entity to identify the acquirer, determine the acquisition date, recognize and measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquired entity, and recognize and measure goodwill or a gain from the purchase. The acquiree s results are included in the Company s consolidated financial statements from the date of acquisition. Assets acquired and liabilities assumed are recorded at their fair values and the excess of the purchase price over the amounts assigned is recorded as goodwill, or if the fair value of the assets acquired exceeds the purchase price consideration, a bargain purchase gain is recorded. Adjustments to fair value assessments are generally recorded to goodwill over the measurement period (not longer than twelve months). The acquisition method also requires that acquisition-related transaction and post-acquisition restructuring costs be charged to expense as committed, and requires the Company to recognize and measure certain assets and liabilities including those arising from contingencies and contingent consideration in a business combination.

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of assets acquired. The goodwill impairment test compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of a reporting unit exceeds its fair value, goodwill of the reporting unit would be considered impaired. To measure the amount of the impairment loss, the implied fair value of a reporting unit s goodwill is compared to the carrying amount of that goodwill. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. If the carrying amount of a reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. For each of these tests, the fair value of each of the Company s reporting units is determined using a combination of valuation techniques, including a discounted cash flow methodology. To corroborate the discounted cash flow analysis performed at each reporting unit, a market approach is utilized using observable market data such as comparable companies in similar lines of business that are publicly traded or which are part of a public or private transaction (to the extent available). Results of the annual impairment test performed as of January 31, 2017, indicated that the fair value of each reporting unit exceeded its carrying amount and no reporting units were at risk of failing the impairment test. As a result, no impairment charge was recognized. There was also no indication of potential impairment as of July 31, 2017 and April 30, 2017 that would have required further testing.

Intangible assets primarily consist of customer lists, non-compete agreements, proprietary databases, intellectual property and trademarks and are recorded at their estimated fair value at the date of acquisition and are amortized in a pattern in which the asset is consumed if that pattern can be reliably determined, or using the straight-line method over their estimated useful lives which range from one to 24 years. For intangible assets subject to amortization, an impairment loss is recognized if the carrying amount of the intangible assets is not recoverable and exceeds fair value. The carrying amount of the intangible assets is considered not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from use of the asset. Intangible assets with indefinite lives are not amortized, but are reviewed annually for impairment or more frequently

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

July 31, 2017 (continued)

whenever events or changes in circumstances indicate that the fair value of the asset may be less than its carrying amount. As of July 31, 2017 and April 30, 2017, there were no indicators of impairment with respect to the Company s intangible assets.

Compensation and Benefits Expense

Compensation and benefits expense in the accompanying consolidated statements of income consist of compensation and benefits paid to consultants (employees who originate business), executive officers and administrative and support personnel. The most significant portions of this expense are salaries and the amounts paid under the annual performance related bonus plan to employees. The portion of the expense applicable to salaries is comprised of amounts earned by employees during a reporting period. The portion of the expenses applicable to annual performance related bonuses refers to the Company s annual employee performance related bonus with respect to a fiscal year, the amount of which is communicated and paid to each eligible employee following the completion of the fiscal year.

Each quarter, management makes its best estimate of its annual performance related bonuses, which requires management to, among other things, project annual consultant productivity (as measured by engagement fees billed and collected by executive search consultants and revenue and other performance/profitability metrics for Hay Group and Futurestep consultants), the level of engagements referred by a consultant in one line of business to a different line of business, Company performance including profitability, competitive forces and future economic conditions and their impact on the Company s results. At the end of each fiscal year, annual performance related bonuses take into account final individual consultant productivity (including referred work), Company/line of business results including profitability, the achievement of strategic objectives and the results of individual performance appraisals, and the current economic landscape. Accordingly, each quarter the Company reevaluates the assumptions used to estimate annual performance related bonus liability and adjusts the carrying amount of the liability recorded on the consolidated balance sheet and reports any changes in the estimate in current operations.

Because annual performance-based bonuses are communicated and paid only after the Company reports its full fiscal year results, actual performance-based bonus payments may differ from the prior year s estimate. Such changes in the bonus estimate historically have been immaterial and are recorded in current operations in the period in which they are determined. The performance related bonus expense was $41.6 million and $42.4 million during the three months ended July 31, 2017 and 2016, respectively, included in compensation and benefits expense in the consolidated statements of income.

Other expenses included in compensation and benefits expense are due to changes in deferred compensation and pension plan liabilities, changes in cash surrender value (CSV) of company owned life insurance (COLI) contracts, amortization of stock compensation awards, payroll taxes and employee insurance benefits. Investments and other assets include long-term retention awards that are generally amortized over four to five years.

Restructuring Charges, Net

The Company accounts for its restructuring charges as a liability when the obligations are incurred and records such charges at fair value. Such charges included one-time employee termination benefits and the cost to terminate an office lease including remaining lease payments. Changes in the estimates of the restructuring charges are recorded in the period the change is determined.

Stock-Based Compensation

The Company has employee compensation plans under which various types of stock-based instruments are granted. These instruments principally include restricted stock units, restricted stock, stock options and an Employee Stock Purchase Plan (ESPP). The Company recognizes compensation expense related to restricted stock units, restricted stock and the estimated fair value of stock options and stock purchases under the ESPP on a straight-line basis over the service period for the entire award.

Recently Adopted Accounting Standards

In March 2016, the FASB issued guidance on accounting for certain aspects of share-based payments to employees. The new guidance requires excess tax benefits and tax deficiencies to be recorded in the income statement when the awards vest or are settled. Furthermore, cash flows related to excess tax benefits will no longer be separately classified as a financing activity apart from other income tax cash flows. The guidance also allows companies to repurchase more of an employee s shares for tax withholding purposes without triggering liability accounting, clarifying that all cash payments made on an employee s behalf for withheld shares should be presented as a financing activity in the consolidated statements of cash flows and provides an accounting policy election to account for forfeitures as they occur. The provisions of the guidance are effective for fiscal years beginning after December 15, 2016, and were adopted by the Company effective May 1, 2017. The primary impact of the adoption was the recognition of excess tax benefits in our provision for income taxes in the current year compared to recording it previously as a component of equity. Additional amendments to the accounting for income taxes and

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

July 31, 2017 (continued)

minimum statutory withholding tax requirements had no impact to retained earnings, where the cumulative effect of these changes are required to be recorded. The Company elected to apply the presentation for cash flows related to excess tax benefits retrospectively for all periods presented which resulted in a decrease to cash used in operations and cash provided by financing activities of $0.3 million for the three months ended July 31, 2016. The presentation requirements for cash flows related to employee taxes paid for withheld shares had no impact on any of the periods presented on our consolidated cash flows statements since such cash flows have historically been presented as a financing activity. The Company elected to account for forfeitures as they occur, rather than estimating the expected forfeitures over the vesting period. This election did not have an impact on the consolidated financial statements.

Recently Proposed Accounting Standards

In May 2014, the FASB issued guidance that supersedes revenue recognition requirements regarding contracts with customers to transfer goods or services or for the transfer of nonfinancial assets. Under the new guidance, entities are required to recognize revenue that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step analysis to be performed on transactions to determine when and how revenue is recognized. The guidance permits two transition methods of adoption 1) the full retrospective method, in which case the standard would be applied to all reporting periods presented, or 2) the modified retrospective method, with a cumulative-effect adjustment as of the date of adoption. In July 2015, the FASB decided to approve a one-year deferral of the effective date as well as providing an option to early adopt the standard on the original effective date. This new guidance is effective for fiscal years and interim periods within those annual years beginning after December 15, 2017. The Company will adopt this guidance in its fiscal year beginning May 1, 2018. The Company has organized a team and developed a project plan to guide the implementation. The project plan includes working sessions to review, evaluate and document the arrangements with customers under our various reporting units to identify potential differences that would result from applying the requirements of the new standard. The Company is currently in the process of developing an updated accounting policy utilizing a bottoms-up approach by reviewing our current contracts with customers by various revenue streams, evaluating new disclosure requirements and identifying and implementing appropriate changes to business processes, systems and controls to support revenue recognition and disclosure under the new standard. The Company is still evaluating the impact of ASU No. 2014-09 on our financial statements. Based on our evaluation to date, under the new standard revenue on the majority of our contracts will continue to be recognized over time as services are rendered. In addition, capitalization of costs associated with obtaining contracts will be required upon adoption of the new standard. The Company expects to finalize the evaluation in upcoming quarters and will provide updates on our progress including decisions made on method of adoption in future filings.

In February 2016, the FASB issued guidance on accounting for leases that generally requires all leases to be recognized on the consolidated balance sheet. The provisions of the guidance are effective for fiscal years beginning after December 15, 2018, and early adoption is permitted. The Company plans to adopt this guidance in fiscal year beginning May 1, 2019. The provisions of the guidance are to be applied using a modified retrospective approach. The Company is currently evaluating the effect this guidance will have on the consolidated financial statements.

In August 2016, the FASB issued guidance on the classification of certain cash receipts and cash payments in the statement of cash flows. The new guidance provides clarification on specific cash flow issues regarding presentation and classification in the statement of cash flows with the objective of reducing the existing diversity in practice. The amendments in this update are effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The Company plans to adopt this guidance in its fiscal year beginning May 1, 2018. The provisions of the guidance are to be applied using a retrospective transition method. The adoption of this guidance is not anticipated to have a material impact on the consolidated financial statements.

In January 2017, the FASB issued guidance that clarifies the definition of a business. The new guidance assists a company when evaluating whether transactions should be accounted for as acquisitions (disposals) of assets or businesses. The provisions of the guidance require that if the fair value of the gross assets acquired (or disposed of) is substantially concentrated in a single identifiable asset or a group of similar identifiable assets, then it is not a business. The provisions of the guidance are effective for annual years beginning after December 15, 2017, including interim periods, with early adoption permitted. The Company plans to adopt this guidance in its fiscal year beginning May 1, 2018. The provisions of the guidance are to be applied prospectively. The adoption of this guidance is not anticipated to have a material impact on the consolidated financial statements.

In January 2017, the FASB issued guidance simplifying the test for goodwill impairment. The new guidance simplifies the test for goodwill impairment by removing Step 2 from the goodwill impairment test. Companies will now perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, recognizing an impairment charge for the amount by which the carrying amount exceeds the reporting unit s fair value not to exceed the total amount of goodwill allocated to that reporting unit. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The amendments of this standard are effective for goodwill

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July 31, 2017 (continued)

impairment tests in fiscal years beginning after December 15, 2019, with early adoption permitted for goodwill impairment tests performed after January 1, 2017. The Company is evaluating the adoption timeline and the effects that the standard will have on the consolidated financial statements.

In March 2017, the FASB issued guidance that improves the presentation of net periodic pension cost and net periodic postretirement benefit cost. The new guidance will change the presentation of net periodic benefit cost related to employer sponsored defined benefit plans and other postretirement benefits. Service cost will be included within the same income statement line item as other compensation costs arising from services rendered during the period, while other components of net periodic benefit pension cost will be presented separately outside of operating income. Additionally, only service costs may be capitalized in assets. The amendments of this standard are effective for fiscal years beginning after December 15, 2017, including interim periods within those years. The Company will adopt this guidance in its fiscal year beginning May 1, 2018. The adoption of this standard is not anticipated to have a material impact on the consolidated financial statements.

In May 2017, the FASB issued guidance clarifying the scope of modification accounting for stock compensation. The new standard provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. This pronouncement is effective for annual reporting periods beginning after December 15, 2017, but early adoption is permitted. The Company will adopt this guidance in its fiscal year beginning May 1, 2018. The Company is currently evaluating the impact of adopting this guidance.

2. Basic and Diluted Earnings Per Share

Accounting Standards Codification 260, *Earnings Per Share*, requires companies to treat unvested share-based payment awards that have non-forfeitable rights to dividends prior to vesting as a separate class of securities in calculating earnings per share. We have granted and expect to continue to grant to certain employees under our restricted stock agreements, grants that contain non-forfeitable rights to dividends. Such grants are considered participating securities. Therefore, we are required to apply the two-class method in calculating earnings per share. The two-class method of computing earnings per share is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. The dilutive effect of participating securities is calculated using the more dilutive of the treasury method or the two-class method.

Basic earnings per common share was computed using the two-class method by dividing basic net earnings attributable to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings per common share was computed using the two-class method by dividing diluted net earnings attributable to common stockholders by the weighted-average number of common shares outstanding plus dilutive common equivalent shares. Dilutive common equivalent shares include all in-the-money outstanding options or other contracts to issue common stock as if they were exercised or converted. Financial instruments that are not in the form of common stock, but when converted into common stock increase earnings per share are anti-dilutive, and are not included in the computation of diluted earnings per share.

During the three months ended July 31, 2017 and 2016, restricted stock awards of 0.6 million and 0.5 million were outstanding, respectively, but not included in the computation of diluted earnings per share because they were anti-dilutive.

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July 31, 2017 (continued)

The following table summarizes basic and diluted earnings per common share attributable to common stockholders:

	Three Months Ended July 31, 2017		Three Months Ended July 31, 2016	
	(in thousands, except per share data)			
Net income attributable to Korn/Ferry International	$	29,041	$	3,208
Less: distributed and undistributed earnings to nonvested restricted stockholders		288		44
Basic net earnings attributable to common stockholders		28,753		3,164
Add: undistributed earnings to nonvested restricted stockholders		232		
Less: reallocation of undistributed earnings to nonvested restricted stockholders		230		
Diluted net earnings attributable to common stockholders	$	28,755	$	3,164
Weighted-average common shares outstanding:				
Basic weighted-average number of common shares outstanding		55,795		56,189
Effect of dilutive securities:				
Restricted stock		588		316
Stock options		12		60
ESPP		8		11
Diluted weighted-average number of common shares outstanding		56,403		56,576
Net earnings per common share:				
Basic earnings per share	$	0.52	$	0.06
Diluted earnings per share	$	0.51	$	0.06

3. Stockholders Equity

The following table summarizes the changes in stockholders equity for the three months ended July 31, 2017:

	Total Korn/Ferry International Stockholders Equity	Noncontrolling Interest (in thousands)	Total Stockholders Equity
Balance as of April 30, 2017	$ 1,083,439	$ 3,609	$ 1,087,048
Comprehensive income (loss):			
Net income	29,041	388	29,429
Foreign currency translation adjustments	16,084	105	16,189
Deferred compensation and pension plan adjustments, net of tax	352		352
Net unrealized loss on interest rate swap, net of tax	(63)		(63)
Dividends paid to shareholders	(5,823)		(5,823)
Purchase of stock	(7,372)		(7,372)
Issuance of stock	4,586		4,586
Stock-based compensation	4,405		4,405
Balance as of July 31, 2017	$ 1,124,649	$ 4,102	$ 1,128,751

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The following table summarizes the changes in stockholders equity for the three months ended July 31, 2016:

	Total Korn/Ferry International Stockholders Equity	Noncontrolling Interest (in thousands)	Total Stockholders Equity
Balance as of April 30, 2016	$ 1,045,300	$ 2,001	$ 1,047,301
Comprehensive income (loss):			
Net income	3,208	860	4,068
Foreign currency translation adjustments	(13,128)	(146)	(13,274)
Deferred compensation and pension plan adjustments, net of tax	462		462
Dividends paid to shareholders	(5,909)		(5,909)
Purchase of stock	(4,161)		(4,161)
Issuance of stock	2,784		2,784
Stock-based compensation	4,739		4,739
Tax benefit from exercise of stock options and vesting of restricted stock	332		332
Balance as of July 31, 2016	$ 1,033,627	$ 2,715	$ 1,036,342

4. Comprehensive Income (Loss)

Comprehensive income (loss) is comprised of net income (loss) and all changes to stockholders equity, except those changes resulting from investments by stockholders (changes in paid in capital) and distributions to stockholders (dividends) and is reported in the accompanying consolidated statements of comprehensive income (loss). Accumulated other comprehensive loss, net of taxes, is recorded as a component of stockholders equity.

The components of accumulated other comprehensive loss were as follows:

	July 31, 2017	April 30, 2017
	(in thousands)	
Foreign currency translation adjustments	$ (39,275)	$ (55,359)

Deferred compensation and pension plan adjustments, net of tax		(14,775)		(15,127)
Interest rate swap unrealized loss, net of taxes		(641)		(578)
Accumulated other comprehensive loss, net	$	(54,691)	$	(71,064)

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The following table summarizes the changes in each component of accumulated other comprehensive income (loss) for the three months ended July 31, 2017:

	Foreign Currency Translation	Deferred Compensation and Pension Plan (1)	Unrealized (losses) on interest rate swap (2)	Accumulated Other Comprehensive Income (Loss)
		(in thousands)		
Balance as of April 30, 2017	$ (55,359)	$ (15,127)	$ (578)	$ (71,064)
Unrealized gains (losses) arising during the period	16,084		(234)	15,850
Reclassification of realized net losses to net income		352	171	523
Balance as of July 31, 2017	$ (39,275)	$ (14,775)	$ (641)	$ (54,691)

The following table summarizes the changes in each component of accumulated other comprehensive income (loss) for the three months ended July 31, 2016:

	Foreign Currency Translation	Deferred Compensation and Pension Plan (1)	Accumulated Other Comprehensive Income (Loss)
		(in thousands)	
Balance as of April 30, 2016	$ (36,339)	$ (21,572)	$ (57,911)
Unrealized losses arising during the period	(13,128)		(13,128)
Reclassification of realized net losses to net income		462	462
Balance as of July 31, 2016	$ (49,467)	$ (21,110)	$ (70,577)

(1) The tax effect on the reclassifications of realized net losses was $0.2 million and $0.3 million for the three months ended July 31, 2017 and 2016, respectively.

(2) The tax effect on unrealized (losses) was $0.1 million for the three months ended July 31, 2017. The tax effect on the reclassification of realized net losses to net income was $0.1 million for the three months ended July 31, 2017.

5. Employee Stock Plans

Stock-Based Compensation

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

	Three Months Ended July 31, 2017	2016
	(in thousands)	
Restricted stock	$ 4,405	$ 4,739
ESPP	291	176
Total stock-based compensation expense, pre-tax	4,696	4,915
Tax benefit from stock-based compensation expense	(1,378)	(1,484)
Total stock-based compensation expense, net of tax	$ 3,318	$ 3,431

Stock Incentive Plans

At the Company s 2016 Annual Meeting of Stockholders, held on October 6, 2016, the Company s stockholders approved an amendment and restatement to the Korn/Ferry International Amended and Restated 2008 Stock Incentive Plan (the 2016 amendment and restatement being The Third A&R 2008 Plan), which among other things, increased the number of shares under the plan by 5,500,000 shares, increasing the current maximum number of shares that may be issued under the plan to 11,200,000 shares, subject to certain changes in the Company s capital structure and other extraordinary events. The Third A&R 2008 Plan provides for the grant of awards to eligible participants, designated as either nonqualified or incentive stock options, restricted stock and restricted stock units, any of which may be performance-based or market-based, and incentive bonuses, which may be paid in cash or stock or a combination thereof. Under the Third A&R 2008 Plan, the ability to issue full-value awards is limited by requiring full-value stock awards to count 2.3 times as much as stock options.

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Restricted Stock

The Company grants time-based restricted stock awards to executive officers and other senior employees generally vesting over a four-year period. In addition, certain key management members typically receive time-based restricted stock awards upon commencement of employment and may receive them annually in conjunction with the Company s performance review. Time-based restricted stock awards are granted at a price equal to fair value, which is determined based on the closing price of the Company s common stock on the grant date. The Company recognizes compensation expense for time-based restricted stock awards on a straight-line basis over the vesting period.

The Company also grants market-based and performance-based restricted stock units to executive officers and other senior employees. The market-based units vest after three years depending upon the Company s total stockholder return over the three-year performance period relative to other companies in its selected peer group. The fair value of these market-based restricted stock units are determined by using extensive market data that is based on historical Company and peer group information. The Company recognizes compensation expense for market-based restricted stock units on a straight-line basis over the vesting period.

Performance-based restricted stock units vest after three years depending upon the Company meeting certain objectives that are set at the time the restricted stock unit is issued. Performance-based restricted stock units are granted at a price equal to the fair value, which is determined based on the closing price of the Company s common stock on the grant date. At the end of each reporting period, the Company estimates the number of restricted stock units expected to vest, based on the probability that certain performance objectives will be met, exceeded, or fall below target levels, and the Company takes into account these estimates when calculating the expense for the period.

Restricted stock activity during the three months ended July 31, 2017 is summarized below:

	Shares	Weighted-Average Grant Date Fair Value
	(in thousands, except per share data)	
Non-vested, April 30, 2017	1,581	$ 29.74
Granted	574	$ 34.10
Vested	(368)	$ 26.32
Forfeited/expired	(62)	$ 33.19
Non-vested, July 31, 2017	1,725	$ 31.79

As of July 31, 2017, there were 0.7 million shares and 0.2 million shares outstanding relating to market-based and performance-based restricted stock units, respectively, with total unrecognized compensation totaling $11.0 million and $7.0 million, respectively.

As of July 31, 2017, there was $42.1 million of total unrecognized compensation cost related to all non-vested awards of restricted stock, which is expected to be recognized over a weighted-average period of 2.7 years. During the three months ended July 31, 2017 and 2016, 97,483 shares and 185,754 shares of restricted stock totaling $3.3 million and $4.2 million, respectively, were repurchased by the Company, at the option of the employee, to pay for taxes related to vesting of restricted