KORN FERRY INTERNATIONAL
Form 10-Q
March 09, 2018

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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 January 31, 2018

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 March 5, 2018 was 56,524,927 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

	January 31, 2018 (unaudited)	April 30, 2017
	(in thousands, except per share data)	
ASSETS		
Cash and cash equivalents	$ 389,990	$ 410,882
Marketable securities	14,807	4,363
Receivables due from clients, net of allowance for doubtful accounts of $17,990 and $15,455 at January 31, 2018 and April 30, 2017, respectively	397,845	345,314
Income taxes and other receivables	25,985	31,573
Prepaid expenses and other assets	63,409	51,542
Total current assets	892,036	843,674
Marketable securities, non-current	124,196	115,574
Property and equipment, net	116,767	109,567
Cash surrender value of company owned life insurance policies, net of loans	118,248	113,067
Deferred income taxes, net	23,222	20,175
Goodwill	586,561	576,865
Intangible assets, net	206,733	217,319
Investments and other assets	98,769	66,657
Total assets	$ 2,166,532	$ 2,062,898
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable	$ 28,359	$ 37,481
Income taxes payable	17,128	4,526
Compensation and benefits payable	234,411	248,354
Term loan	23,192	19,754
Other accrued liabilities	163,784	148,464
Total current liabilities	466,874	458,579
Deferred compensation and other retirement plans	233,595	219,905
Term loan, non-current	217,969	236,222
Deferred tax liabilities	7,619	7,014
Other liabilities	59,581	54,130
Total liabilities	985,638	975,850

Stockholders equity:				
Common stock: $0.01 par value, 150,000 shares authorized, 71,606 and 70,811 shares issued at January 31, 2018 and April 30, 2017, respectively and 56,518 and 56,938 shares outstanding at January 31, 2018 and April 30, 2017, respectively		679,277		692,527
Retained earnings		537,353		461,976
Accumulated other comprehensive loss, net		(38,671)		(71,064)
Total Korn/Ferry International stockholders equity		1,177,959		1,083,439
Noncontrolling interest		2,935		3,609
Total stockholders equity		1,180,894		1,087,048
Total liabilities and stockholders equity	$	2,166,532	$	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 January 31,		Nine Months Ended January 31,	
	2018	2017	2018	2017
	(in thousands, except per share data)			
Fee revenue	$ 447,581	$ 381,918	$ 1,291,853	$ 1,159,456
Reimbursed out-of-pocket engagement expenses	13,189	12,277	39,302	42,626
Total revenue	460,770	394,195	1,331,155	1,202,082
Compensation and benefits	310,751	262,438	885,748	796,014
General and administrative expenses	58,516	56,818	175,380	166,294
Reimbursed expenses	13,189	12,277	39,302	42,626
Cost of services	17,467	16,545	53,163	52,251
Depreciation and amortization	12,225	11,774	36,881	34,970
Restructuring charges, net		3,801	78	28,321
Total operating expenses	412,148	363,653	1,190,552	1,120,476
Operating income	48,622	30,542	140,603	81,606
Other income, net	7,689	4,200	14,847	7,580
Interest expense, net	(2,665)	(2,402)	(7,904)	(8,199)
Income before provision for income taxes and equity in earnings of unconsolidated subsidiaries	53,646	32,340	147,546	80,987
Equity in earnings of unconsolidated subsidiaries, net	97	113	187	221
Income tax provision	26,316	8,075	54,145	21,706
Net income	27,427	24,378	93,588	59,502
Net income attributable to noncontrolling interest	(180)	(481)	(969)	(2,245)
Net income attributable to Korn/Ferry International	$ 27,247	$ 23,897	$ 92,619	$ 57,257

Earnings per common share:								
Basic	$	0.49	$	0.42	$	1.65	$	1.01
Diluted	$	0.48	$	0.42	$	1.63	$	1.00
Weighted-average common shares outstanding:								
Basic		55,252		56,173		55,479		56,325
Diluted		55,997		56,702		56,236		56,917
Cash dividends declared per share:	$	0.10	$	0.10	$	0.30	$	0.30

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

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2018	2017	2018	2017
		(in thousands)		
Net income	$ 27,427	$ 24,378	$ 93,588	$ 59,502
Other comprehensive income:				
Foreign currency translation adjustments	17,839	(1,583)	29,773	(20,016)
Deferred compensation and pension plan adjustments, net of tax	361	465	1,065	1,392
Unrealized gain on interest rate swap, net of tax	1,077		1,470	
Comprehensive income	46,704	23,260	125,896	40,878
Less: comprehensive income attributable to noncontrolling interest	(226)	(219)	(884)	(1,809)
Comprehensive income attributable to Korn/Ferry International	$ 46,478	$ 23,041	$ 125,012	$ 39,069

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

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Nine Months Ended January 31,	
	2018	2017
	(in thousands)	
Cash flows from operating activities:		
Net income	$ 93,588	$ 59,502
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	36,881	34,970
Stock-based compensation expense	15,800	14,101
Provision for doubtful accounts	9,933	8,373
Gain on cash surrender value of life insurance policies	(6,020)	(3,316)
Gain on marketable securities	(14,022)	(7,090)
Deferred income taxes	5,373	7,812
Change in other assets and liabilities:		
Deferred compensation	25,587	(22)
Receivables due from clients	(62,464)	(35,503)
Income tax and other receivables	4,445	(3,249)
Prepaid expenses and other assets	(11,867)	(8,882)
Investment in unconsolidated subsidiaries	(187)	(221)
Income taxes payable	18,217	(3,450)
Accounts payable and accrued liabilities	(15,569)	(45,891)
Other	(40,103)	(3,393)
Net cash provided by operating activities	59,592	13,741
Cash flows from investing activities:		
Purchase of property and equipment	(31,133)	(41,616)
Cash paid for acquisition, net of cash acquired		(2,880)
Purchase of marketable securities	(7,462)	(9,526)
Proceeds from sales/maturities of marketable securities	2,515	42,533
Premium on company-owned life insurance policies	(1,339)	(1,337)
Proceeds from life insurance policies	5,175	
Dividends received from unconsolidated subsidiaries	60	455
Net cash used in investing activities	(32,184)	(12,371)
Cash flows from financing activities:		
Proceeds from term loan facility		275,000
Principal payment on term loan facility	(15,469)	(150,313)

Payment of contingent consideration from acquisition		(485)		(1,070)
Repurchases of common stock		(32,568)		(16,318)
Payments of tax withholdings on restricted stock		(3,657)		(4,377)
Proceeds from issuance of common stock upon exercise of employee stock options and in connection with an employee stock purchase plan		6,885		4,981
Dividends noncontrolling interest		(1,558)		(1,229)
Dividends paid to shareholders		(17,242)		(17,546)
Payments on life insurance policy loans		(464)		
Net cash (used in) provided by financing activities		(64,558)		89,128
Effect of exchange rate changes on cash and cash equivalents		16,258		(12,445)
Net (decrease) increase in cash and cash equivalents		(20,892)		78,053
Cash and cash equivalents at beginning of period		410,882		273,252
Cash and cash equivalents at end of period	$	389,990	$	351,305

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

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

January 31, 2018

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.

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

January 31, 2018 (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 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 January 31, 2018 and April 30, 2017, the Company included deferred revenue of $110.9 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 January 31, 2018 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 January 31, 2018 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 contracts and an 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), net 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. The Company s annual impairment test will be performed in the fourth quarter of fiscal 2018. There was also no indication of potential impairment as of January 31, 2018 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 whenever events or changes in circumstances indicate that the fair value of the asset may be less than its carrying amount. As of January 31, 2018 and April 30, 2017, there were no indicators of impairment with respect to the Company s intangible assets.

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

January 31, 2018 (continued)

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, 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 $155.2 million and $136.2 million during the nine months ended January 31, 2018 and 2017, respectively, included in compensation and benefits expense in the consolidated statements of income. During the three months ended January 31, 2018 and 2017, the performance related bonus expense was $56.8 million and $41.1 million, respectively.

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 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 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 Financial Accounting Standards Board (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 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 minimal impact to cash used in operations and cash provided

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

January 31, 2018 (continued)

by financing activities for the nine months ended January 31, 2017. 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 Company s financial statements.

Recently Issued Accounting Standards - Not Yet Adopted

In May 2014, the FASB issued ASU 2014-09, which superseded revenue recognition requirements regarding contracts with customers to transfer goods or services or for the transfer of nonfinancial assets. Under this 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. In addition, the guidance permits companies to choose between the following two transition methods of adopting ASU 2014-09: (1) the full retrospective method, in which case the standard would be applied to all reporting periods presented and (2) the modified retrospective method, with a cumulative-effect adjustment as of the date of adoption.

The 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 and expects to apply the modified retrospective method in adopting ASU 2014-09. The Company 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 has completed its initial evaluation of the impact of ASU 2014-09 on executive search activities and recruitment for non-executive professionals and recruitment process outsourcing. As to executive search and recruitment for non-executive professionals we expect the implementation of ASU 2014-09 to result in timing differences in the recognition of uptick revenue (uptick revenue occurs when a placement s actual compensation is higher than the original estimated compensation). Currently the Company recognizes uptick revenue as the amount becomes fixed and determinable. Under ASU 2014-09, however, upticks are considered variable consideration and the Company will be required to estimate upticks at contract inception and recognize the revenue over the service period. Based on our initial evaluation the impact of ASU 2014-09 on the recruitment process outsourcing revenue stream is not expected to be material. The Company expects to finalize its evaluation of the impact of ASU No. 2014-09 by the end of the fiscal year.

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 still evaluating the effect this guidance will have on the consolidated financial statements. Based on our initial assessment, the Company expects that upon adoption it will report an increase in assets and liabilities on our consolidated balance sheet as a result of recognizing right-of-use assets and lease liabilities related to lease agreements.

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 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 changes 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.

In August 2017, the FASB issued guidance amending and simplifying accounting for hedging activities. The new guidance will refine and expand strategies that qualify for hedge accounting and simplify the application of hedge accounting in certain situations. The amendments of this standard are effective for fiscal years beginning after December 15, 2018. The Company will adopt this guidance in its fiscal year beginning May 1, 2019. The Company is currently evaluating the impact of adopting this guidance.

In February 2018, the FASB issued ASU 2018-02 which provides companies the option to reclassify stranded tax effects within accumulated other comprehensive income (loss), net to retained earnings resulting from the Tax Cuts and Jobs Act (the Tax Act). The new guidance requires companies to disclose whether they decided to reclassify the income tax effects of the Tax Act from accumulated other comprehensive income (loss), net to retained earnings and to disclose a policy for releasing the income tax effects from accumulated other comprehensive income (loss), net. The guidance is effective for annual reporting periods beginning after December 15, 2018, but early adoption is permitted. If companies elect to reclassify the stranded tax effects the guidance allows it to be recorded in the period of adoption or retrospectively to each period in which the effect of the Tax Act is recognized. 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 and nine months ended January 31, 2018, restricted stock awards of 0.6 million were outstanding, but not included in the computation of diluted earnings per share because they were anti-dilutive. During the three and nine months ended January 31, 2017, restricted stock awards of 0.5 million and 0.6 million were outstanding, respectively, but not included in the computation of diluted earnings per share because they were anti-dilutive.

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January 31, 2018 (continued)

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

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2018	2017	2018	2017
	(in the thousands, except per share data)			
Net income attributable to Korn/Ferry International	$ 27,247	$ 23,897	$ 92,619	$ 57,257
Less: distributed and undistributed earnings to nonvested restricted stockholders	295	227	982	505
Basic net earnings attributable to common stockholders	26,952	23,670	91,637	56,752
Add: undistributed earnings to nonvested restricted stockholders	235	172	804	356
Less: reallocation of undistributed earnings to nonvested restricted stockholders	232	171	793	353
Diluted net earnings attributable to common stockholders	$ 26,955	$ 23,671	$ 91,648	$ 56,755
Weighted-average common shares outstanding:				
Basic weighted-average number of common shares outstanding	55,252	56,173	55,479	56,325
Effect of dilutive securities:				
Restricted stock	738	505	744	540
Stock options	3	20	6	24
ESPP	4	4	7	28
Diluted weighted-average number of common shares outstanding	55,997	56,702	56,236	56,917
Net earnings per common share:				
Basic earnings per share	$ 0.49	$ 0.42	$ 1.65	$ 1.01
Diluted earnings per share	$ 0.48	$ 0.42	$ 1.63	$ 1.00

3. Stockholders Equity

The following table summarizes the changes in stockholders equity for the three months ended January 31, 2018:

	Total Korn/Ferry International Stockholders Equity	Noncontrolling Interest (in thousands)	Total Stockholders Equity
Balance as of October 31, 2017	$ 1,132,014	$ 2,709	$ 1,134,723
Comprehensive income (loss):			
Net income	27,247	180	27,427
Foreign currency translation adjustments	17,793	46	17,839
Deferred compensation and pension plan adjustments, net of tax	361		361
Unrealized gain on interest rate swap, net of tax	1,077		1,077
Dividends paid to shareholders	(5,705)		(5,705)
Purchase of stock	(3,503)		(3,503)
Issuance of stock	3,412		3,412
Stock-based compensation	5,263		5,263
Balance as of January 31, 2018	$ 1,177,959	$ 2,935	$ 1,180,894

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NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

January 31, 2018 (continued)

The following table summarizes the changes in stockholders   equity for the nine months ended January 31, 2018:

	Total Korn/Ferry International Stockholders Equity	Noncontrolling Interest	Total Stockholders Equity
		(in thousands)	
Balance as of April 30, 2017	$ 1,083,439	$ 3,609	$ 1,087,048
Comprehensive income (loss):			
Net income	92,619	969	93,588
Foreign currency translation adjustments	29,858	(85)	29,773
Deferred compensation and pension plan adjustments, net of tax	1,065		1,065
Unrealized gain on interest rate swap, net of tax	1,470		1,470
Dividends paid to shareholders	(17,242)		(17,242)
Dividends paid to noncontrolling interest		(1,558)	(1,558)
Purchase of stock	(36,225)		(36,225)
Issuance of stock	7,998		7,998
Stock-based compensation	14,977		14,977
Balance as of January 31, 2018	$ 1,177,959	$ 2,935	$ 1,180,894

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

	Total Korn/Ferry International Stockholders Equity	Noncontrolling Interest	Total Stockholders Equity
		(in thousands)	
Balance as of October 31, 2016	$ 1,050,553	$ 3,591	$ 1,054,144
Comprehensive income (loss):			
Net income	23,897	481	24,378
Foreign currency translation adjustments	(1,321)	(262)	(1,583)
Deferred compensation and pension plan adjustments, net of tax	465		465
Dividends paid to shareholders	(5,796)		(5,796)
Dividends paid to noncontrolling interest		(1,229)	(1,229)

Purchase of stock	(9,578)		(9,578)
Issuance of stock	2,778		2,778
Stock-based compensation	4,406		4,406
Tax benefit from exercise of stock options and vesting of restricted stock	17		17
Balance as of January 31, 2017	$ 1,065,421	$ 2,581	$ 1,068,002

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

	Total Korn/Ferry International Stockholders Equity	**Noncontrolling Interest**	**Total Stockholders Equity**
		(in thousands)	
Balance as of April 30, 2016	$ 1,045,300	$ 2,001	$ 1,047,301
Comprehensive income (loss):			
Net income	57,257	2,245	59,502
Foreign currency translation adjustments	(19,580)	(436)	(20,016)
Deferred compensation and pension plan adjustments, net of tax	1,392		1,392
Dividends paid to shareholders	(17,546)		(17,546)
Dividends paid to noncontrolling interest		(1,229)	(1,229)
Purchase of stock	(20,695)		(20,695)
Issuance of stock	5,746		5,746
Stock-based compensation	13,497		13,497
Tax benefit from exercise of stock options and vesting of restricted stock	50		50
Balance as of January 31, 2017	$ 1,065,421	$ 2,581	$ 1,068,002

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NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

January 31, 2018 (continued)

4. Comprehensive Income

Comprehensive income is comprised of net income 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. Accumulated other comprehensive income (loss), net of taxes, is recorded as a component of stockholders equity.

The components of accumulated other comprehensive income (loss), net were as follows:

	January 31, 2018	April 30, 2017
	(in thousands)	
Foreign currency translation adjustments	$ (25,501)	$ (55,359)
Deferred compensation and pension plan adjustments, net of tax	(14,062)	(15,127)
Interest rate swap unrealized gain (loss), net of taxes	892	(578)
Accumulated other comprehensive loss, net	$ (38,671)	$ (71,064)

The following table summarizes the changes in each component of accumulated other comprehensive income (loss), net for the three months ended January 31, 2018:

	Foreign Currency Translation	Deferred Compensation and Pension Plan (1)	Unrealized (Losses) Gains on Interest Rate Swap (2)	Accumulated Other Comprehensive Income (Loss)
		(in thousands)		
Balance as of October 31, 2017	$ (43,294)	$ (14,423)	$ (185)	$ (57,902)
Unrealized gains arising during the period	17,793		973	18,766
Reclassification of realized net losses to net income		361	104	465
Balance as of January 31, 2018	$ (25,501)	$ (14,062)	$ 892	$ (38,671)

The following table summarizes the changes in each component of accumulated other comprehensive income (loss), net for the nine months ended January 31, 2018:

	Foreign Currency Translation	Deferred Compensation and Pension Plan (1)	Unrealized (Losses) Gains 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 arising during the period	29,858		1,061	30,919
Reclassification of realized net losses to net income		1,065	409	1,474
Balance as of January 31, 2018	$ (25,501)	$ (14,062)	$ 892	$ (38,671)

(1) The tax effect on the reclassifications of realized net losses was $0.2 million and $0.7 million for the three and nine months ended January 31, 2018, respectively.

(2) The tax effect on unrealized gains was $0.6 million and $0.6 million for the three and nine months ended January 31, 2018, respectively. The tax effect on the reclassification of realized net losses to net income was $0.1 million and $0.3 million for the three and nine months ended January 31, 2018, respectively.

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NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

January 31, 2018 (continued)

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

	Foreign Currency Translation	Deferred Compensation and Pension Plan (1)	Accumulated Other Comprehensive Income (Loss)
		(in thousands)	
Balance as of October 31, 2016	$ (54,598)	$ (20,645)	$ (75,243)
Unrealized losses arising during the period	(1,321)		(1,321)
Reclassification of realized net losses to net income		465	465
Balance as of January 31, 2017	$ (55,919)	$ (20,180)	$ (76,099)

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

	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	(19,580)		(19,580)
Reclassification of realized net losses to net income		1,392	1,392
Balance as of January 31, 2017	$ (55,919)	$ (20,180)	$ (76,099)

(1) The tax effect on the reclassifications of realized net losses was $0.3 million and $0.9 million for the three and nine months ended January 31, 2017, respectively.

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 income for the periods indicated:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2018	2017	2018	2017
	(in thousands)			
Restricted stock	$ 5,263	$ 4,406	$ 14,977	$ 13,497
ESPP	254	175	823	604
Total stock-based compensation expense, pre-tax	5,517	4,581	15,800	14,101
Tax benefit from stock-based compensation expense	(2,750)	(1,111)	(5,798)	(3,778)
Total stock-based compensation expense, net of tax	$ 2,767	$ 3,470	$ 10,002	$ 10,323

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.

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

January 31, 2018 (continued)

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 is 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 nine months ended January 31, 2018 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	623	$ 37.46
Vested	(419)	$ 26.01
Forfeited	(68)	$ 33.28
Non-vested, January 31, 2018	1,717	$ 33.31

As of January 31, 2018, 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 $9.9 million and $4.3 million, respectively.

As of January 31, 2018, there was $35.1 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 2.4 years. During the three and nine months ended January 31, 2018, 4,653 shares and 105,024 shares of restricted stock totaling $0.2 million and $3.6 million, respectively, were repurchased by the Company, at the option of employees, to pay for taxes related to vesting of restricted stock. During the three and nine months ended January 31, 2017, 7,151 shares and 193,668 shares of restricted stock totaling $0.2 million and $4.4 million, respectively, were repurchased by the Company, at the option of employees, to pay for taxes related to vesting of restricted stock.

Employee Stock Purchase Plan

The Company has an ESPP that, in accordance with Section 423 of the Internal Revenue Code, allows eligible employees to authorize payroll deductions of up to 15% of their salary to purchase shares of the Company s common stock at 85% of the fair market price of the common stock on the last day of the enrollment period. Employees may not purchase more than $25,000 in stock during any calendar year. The maximum number of shares that may be issued under the ESPP is 3.0 million shares. During the three and nine months ended January 31, 2018, employees purchased 82,464 shares at $35.17 per share and 198,749 shares at $31.77 per share, respectively. During the three and nine months ended January 31, 2017, employees purchased 93,130 shares at $25.01 per share and 207,141 shares at $20.93 per share, respectively. As of January 31, 2018, the ESPP had approximately 1.1 million shares remaining available for future issuance.

Common Stock

During the nine months ended January 31, 2018, the Company issued 41,075 shares of common stock, as a result of the exercise of stock options, with cash proceeds from the exercise of $0.6 million. No stock options were exercised during the three months ended January 31, 2018. During the three and nine months ended January 31, 2017, the Company issued 2,510 shares and

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January 31, 2018 (continued)

46,600 shares of common stock, respectively, as a result of the exercise of stock options, with cash proceeds from the exercise of $0.03 million and $0.6 million, respectively.

During the three and nine months ended January 31, 2018, the Company repurchased (on the open market) 80,800 shares and 974,079 shares of the Company s common stock for $3.3 million and $32.6 million, respectively. During the three and nine months ended January 31, 2017, the Company repurchased (on the open market) 383,598 shares and 719,098 shares of the Company s common stock for $9.4 million and $16.3 million, respectively.

6. Financial Instruments

The following tables show the Company s financial instruments and balance sheet classification as of January 31, 2018 and April 30, 2017:

	January 31, 2018								
	Fair Value Measurement				Balance Sheet Classification				
	Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Marketable Securities, Current	Marketable Securities, Non-current	Income Taxes & Other Receivables	Other Accrued Liabilities
	(in thousands)								
Level 1:									
Cash	$ 388,962	$	$	$ 388,962	$ 388,962	$	$	$	$
Money market funds	1,028			1,028	1,028				
Mutual funds (1)	124,202	15,489	(688)	139,003		14,807	124,196		
Total	$ 514,192	$ 15,489	$ (688)	$ 528,993	$ 389,990	$ 14,807	$ 124,196	$	$
Level 2:									
Foreign currency forward contracts	$	$ 814	$ (1,992)	$ (1,178)	$	$	$	$ 78	$ (1,256)
Interest rate swap	$	$ 1,390	$	$ 1,390	$	$	$	$ 1,390	$

	April 30, 2017								
	Fair Value Measurement				Balance Sheet Classification				
	Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash	Marketable Securities, Current	Marketable Securities, Non-current	Income Taxes & Other	Other Accrued Liabilities

					Equivalents			**Receivables**	
					(in thousands)				
Level 1:									
Cash	$ 409,824	$	$	$ 409,824	$ 409,824	$	$	$	$
Money market funds	1,058			1,058	1,058				
Mutual funds (1)	113,818	6,697	(578)	119,937		4,363	115,574		
Total	$ 524,700	$ 6,697	$ (578)	$ 530,819	$ 410,882	$ 4,363	$ 115,574	$	$
Level 2:									
Foreign currency forward contracts	$	$ 129	$ (846)	$ (717)	$	$	$	$	$ (717)
Interest rate swap	$	$	$ (947)	$ (947)	$	$	$	$	$ (947)

(1) These investments are held in trust for settlement of the Company s vested obligations of $122.3 million and $99.5 million as of January 31, 2018 and April 30, 2017, respectively, under the ECAP (see Note 7 *Deferred Compensation and Retirement Plans*). During the three and nine months ended January 31, 2018, the fair value of the investments increased; therefore, the Company recognized income of $7.2 million and $14.0 million, respectively, which was recorded in other income, net. During the three and nine months ended January 31, 2017, the fair value of the investments increased; therefore, the Company recognized income of $3.9 million and $7.1 million, respectively, which was recorded in other income, net.

Investments in marketable securities classified as trading are based upon employee elections from a pre-determined set of securities in the ECAP and the Company invests in marketable securities to mirror these elections. As of January 31, 2018 and April 30, 2017, the Company s investments in marketable securities classified as trading consist of mutual funds for which market prices are readily available.

Designated Derivatives - Interest Rate Swap Agreement

In March 2017, the Company entered into an interest rate swap contract with a notional amount of $129.8 million, to hedge the variability to changes in cash flows attributable to interest rate risks caused by changes in interest rates related to its variable rate debt. The Company has designated the swap as a cash flow hedge. The notional amount will be amortized so that the amount is always half of the principal balance of the debt outstanding. As of January 31, 2018, the notional amount was $122.0 million. The interest rate swap agreement matures on June 15, 2021 and locks the interest rates on half the debt outstanding at 1.919%, exclusive of the credit spread on the debt.

The fair value of the derivative designated as a cash flow hedge instrument is as follows:

	January 31, 2018		April 30, 2017	
	(in thousands)			
Derivative asset:				
Interest rate swap contract	$	1,390	$	
Derivative liability:				
Interest rate swap contract	$		$	947

During the three and nine months ended January 31, 2018, the Company recognized the following gains and losses on the interest rate swap:

	Three Months Ended		Nine Months Ended	
	January 31, 2018			
	(in thousands)			
Gains recognized in other comprehensive income (net of tax effects of $553 and $609, respectively)	$	973	$	1,061
Losses reclassified from accumulated other comprehensive income into interest expense, net	$	167	$	667

As the critical terms of the hedging instrument and the hedged forecasted transaction are the same, the Company has concluded that the changes in the fair value or cash flows attributable to the risk being hedged are expected to completely offset at inception and on an ongoing basis.

We estimate that the amount included in accumulated other comprehensive income as of January 31, 2018 that will be reclassified into interest expense, net within the following 12 months is less than $0.1 million in income. The cash flows related to the interest rate swap contract are included in net cash provided by operating activities.

Non-Designated Derivatives Foreign Currency Forward Contracts

The fair value of derivatives not designated as hedge instruments are as follows:

		January 31, 2018		April 30, 2017
		(in thousands)		
Derivative assets:				
Total gross amount of foreign currency forward contracts	$	814	$	
Gross derivatives offset on the balance sheet (1)		(736)		
Net amounts presented on the balance sheet	$	78	$	
Derivative liabilities:				
Total gross amount of foreign currency forward contracts	$	1,992	$	846
Gross derivatives offset on the balance sheet (1)		(736)		(129)
Net amounts presented on the balance sheet	$	1,256	$	717

(1) These amounts represent the impact of netting derivative assets and derivative liabilities when a legally enforceable master netting agreement exists and fair value of adjustments related to our counterparty credit risk.

As of January 31, 2018, the total notional amounts of the forward contracts purchased and sold were $19.7 million and $57.2 million, respectively. As of April 30, 2017, the total notional amounts of the forward contracts purchased and sold were $19.4

million and $70.0 million, respectively. During the three and nine months ended January 31, 2018, the Company incurred losses of $1.9 million and $4.2 million, respectively, related to forward contracts which is recorded in general and administrative expenses in the accompanying consolidated statements of income. These losses offset foreign currency gains that result from transactions denominated in a currency other than the Company s functional currency. During the three and nine months ended January 31, 2017, the Company incurred gains of $1.1 million and $1.3 million, respectively, related to forward contracts. These gains offset foreign currency losses that result from transactions denominated in a currency other than the Company s functional currency. The cash flows related to foreign currency forward contracts are included in net cash used in operating activities.

7. Deferred Compensation and Retirement Plans

The Company has several deferred compensation and retirement plans for eligible consultants and vice presidents that provide defined benefits to participants based on the deferral of current compensation or contributions made by the Company subject to vesting and retirement or termination provisions. Among these plans is a defined benefit pension plan for certain Hay Group employees in the United States. The assets of this plan are held separately from the assets of the sponsors in self-administered funds. The plan is funded consistent with local statutory requirements. All other defined benefit obligations from other plans are unfunded.

The components of net periodic benefit costs are as follows:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2018	2017	2018	2017
	(in thousands)			
Service cost	$ 3,235	$ 1,793	$ 8,526	$ 3,981
Interest cost	958	1,062	2,876	3,185
Amortization of actuarial loss	577	763	1,731	2,289
Expected return on plan assets (1)	(398)	(389)	(1,195)	(1,169)
Net periodic benefit costs	$ 4,372	$ 3,229	$ 11,938	$ 8,286

(1) The expected long-term rate of return on plan assets is 6.50% for January 31, 2018 and 2017.

The Company purchased COLI contracts insuring the lives of certain employees eligible to participate in the deferred compensation and pension plans as a means of funding benefits under such plans. The gross CSV of these contracts of $185.0 million and $180.3 million as of January 31, 2018 and April 30, 2017, respectively, is offset by outstanding policy loans of $66.8 million and $67.2 million in the accompanying consolidated balance sheets as of January 31, 2018 and April 30, 2017, respectively. The CSV value of the underlying COLI investments increased by $1.8 million and $6.0 million during the three and nine months ended January 31, 2018, respectively, and is recorded as a decrease in compensation and benefits expense in the accompanying consolidated statements of income. The CSV value of the underlying COLI investments increased by $0.1 million and $3.3 million during the three and nine months ended January 31, 2017, respectively, and is recorded as a decrease in compensation and benefits expense in the accompanying consolidated statements of income.

The Company s ECAP is intended to provide certain employees an opportunity to defer salary and/or bonus on a pre-tax basis. In addition, the Company, as part of its compensation philosophy, makes discretionary contributions into the ECAP and such contributions may be granted to key employees annually based on the employee s performance. Certain key management may also receive Company ECAP contributions upon commencement of employment. The Company amortizes these contributions on a straight-line basis over the service period, generally a four- to five-year period. Participants have the ability to allocate their deferrals among a number of investment options and may receive their benefits at termination, retirement or in service either in a lump sum or in quarterly installments over one to 15 years. The ECAP amounts that are expected to be paid to employees over the next 12 months are classified as a current liability included in compensation and benefits payable on the accompanying balance sheet.

The ECAP is accounted for whereby the changes in the fair value of the vested amounts owed to the participants are adjusted with a corresponding charge (or credit) to compensation and benefits costs. During the three and nine months ended January 31, 2018, deferred compensation liability increased; therefore, the Company recognized an increase in compensation expense of $7.2 million and $14.4 million, respectively. Offsetting the increase in compensation and benefits expense was an increase in the fair value of marketable securities classified as trading (held in trust to satisfy obligations under the ECAP) of $7.2 million and $14.0 million during the three and nine months ended January 31, 2018, respectively, recorded in other income, net on the consolidated statements of income. During the three and nine months ended January 31, 2017, deferred compensation liability increased; therefore, the Company recognized an increase in compensation expense of $4.1 million and $6.7 million, respectively. Offsetting the increase in compensation and benefits expense was an increase in the fair value of marketable securities classified as trading (held in trust to satisfy obligations under the ECAP) of $3.9 million and $7.1 million during the three and nine months ended January 31, 2017, respectively, recorded in other income, net on the consolidated statements of income (see Note 6 *Financial Instruments*).

8. Restructuring Charges, Net

During fiscal 2016, the Company implemented a restructuring plan in order to rationalize its cost structure by eliminating redundant positions and consolidating office space due to the acquisition of Legacy Hay on December 1, 2015. The Company continued the implementation of the fiscal 2016 restructuring plan in fiscal 2018 in order to integrate the Hay Group entities that were acquired in fiscal 2016 by consolidating premises.

Changes in the restructuring liability during the three months ended January 31, 2018 are as follows:

	Severance	Facilities	Total
		(in thousands)	
Liability as of October 31, 2017	$ 1,541	$ 4,716	$ 6,257
Reductions for cash payments	(231)	(1,063)	(1,294)
Exchange rate fluctuations	123	55	178
Liability as of January 31, 2018	$ 1,433	$ 3,708	$ 5,141

Changes in the restructuring liability during the nine months ended January 31, 2018 are as follows:

	Severance	Facilities	Total
		(in thousands)	
Liability as of April 30, 2017	$ 5,341	$ 8,354	$ 13,695
Restructuring charges, net		78	78
Reductions for cash payments	(4,178)	(5,328)	(9,506)
Exchange rate fluctuations	270	604	874
Liability as of January 31, 2018	$ 1,433	$ 3,708	$ 5,141

As of January 31, 2018 and April 30, 2017, the restructuring liability is included in the current portion of other accrued liabilities on the consolidated balance sheets, except for $1.6 million and $4.6 million, respectively, of facilities costs which primarily relate to commitments under operating leases, net of sublease income, which are included in other long-term liabilities.

The restructuring liability by segment is summarized below:

	Severance	January 31, 2018 Facilities (in thousands)	Total
Executive Search			
North America	$	$ 262	$ 262
Asia Pacific		5	5
Total Executive Search		267	267
Hay Group	1,433	3,340	4,773
Futurestep		101	101
Liability as of January 31, 2018	$ 1,433	$ 3,708	$ 5,141

	Severance	April 30, 2017 Facilities (in thousands)	Total
Executive Search			
North America	$ 134	$ 250	$ 384
Europe, Middle East and Africa (EMEA)	393		393
Asia Pacific		6	6
Latin America		87	87
Total Executive Search	527	343	870
Hay Group	4,814	7,879	12,693
Futurestep		132	132
Liability as of April 30, 2017	$ 5,341	$ 8,354	$ 13,695

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

January 31, 2018 (continued)

9. Business Segments

The Company currently operates in three global businesses: Executive Search, Hay Group and Futurestep. The Executive Search segment focuses on recruiting Board of Director and C-level positions, in addition to research-based interviewing and onboarding solutions, for clients predominantly in the consumer, financial services, industrial, life sciences/healthcare and technology industries. Hay Group assists clients with ongoing assessment, compensation and development of their senior executives and management teams, and addresses four fundamental needs: Talent Strategy, Succession Management, Leadership Development and Rewards, Motivation and Engagement, all underpinned by a comprehensive array of world-leading intellectual property, products and tools. Futurestep is a global industry leader in high-impact talent acquisition solutions. Its portfolio of services includes global and regional RPO, project recruitment, individual professional search and consulting. The Executive Search business segment is managed by geographic regional leaders and Hay Group and Futurestep worldwide operations are managed by their Chief Executive Officers. The Executive Search geographic regional leaders and the Chief Executive Officers of Hay Group and Futurestep report directly to the Chief Executive Officer of the Company. The Company also operates a Corporate segment to record global expenses of the Company.

The Company evaluates performance and allocates resources based on the Company s chief operating decision maker s review of (1) fee revenue and (2) adjusted earnings before interest, taxes, depreciation and amortization (Adjusted EBITDA). To the extent that such charges occur, Adjusted EBITDA excludes restructuring charges, net, integration/acquisition costs, certain separation costs and certain non-cash charges (goodwill, intangible asset and other than temporary impairment). The accounting policies for the reportable segments are the same as those described in the summary of significant accounting policies, except the items described above are excluded from EBITDA to arrive at Adjusted EBITDA. For the nine months ended January 31, 2017, Adjusted EBITDA includes deferred revenue adjustment related to the Legacy Hay acquisition, reflecting revenue that the Hay Group would have realized if not for business combination accounting that requires a company to record the acquisition balance sheet at fair value and write-off deferred revenue where no future services are required to be performed to earn that revenue.

Financial highlights by business segment are as follows:

				Three Months Ended January 31, 2018			
		Executive Search					
North America	EMEA	Asia Pacific	Latin America	Subtotal	Hay Group	Futurestep	Corpor
				(in thousands)			
102,716	$ 46,782	$ 24,493	$ 6,425	$ 180,416	$ 198,056	$ 69,109	$
106,332	$ 47,763	$ 24,942	$ 6,456	$ 185,493	$ 201,961	$ 73,316	$

21,313	$	7,329	$	5,289	$	408	$	34,339	$	27,079	$	10,056	$	(2
990		458		361		113		1,922		7,882		733		
585		37		185		40		847		370		2		
97								97						
22,985		7,824		5,835		561		37,205		35,331		10,791		(1
										1,593				
22,985	$	7,824	$	5,835	$	561	$	37,205	$	36,924	$	10,791	$	(1

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NOTES TO CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

January 31, 2018 (continued)

	Three Months Ended January 31, 2017							
	Executive Search							
	North America	EMEA	Asia Pacific	Latin America	Subtotal	Hay Group	Futurestep	Corporate
					(in thousands)			
	$ 84,827	$ 39,147	$ 21,012	$ 7,835	$ 152,821	$ 175,662	$ 53,435	$
	$ 87,975	$ 39,965	$ 21,336	$ 7,856	$ 157,132	$ 178,962	$ 58,101	$
erest								
net								
s of								
ion								
	$ 17,718	$ 8,175	$ 2,086	$ 1,352	$ 29,331	$ 15,988	$ 6,549	$ (21,326)
	996	226	268	(21)	1,469	8,061	789	1,455
s),								
	316	19	60	61	456	122	(2)	3,624
s of								
	113				113			
	19,143	8,420	2,414	1,392	31,369	24,171	7,336	(16,247)
rges,								
			893	309	1,202	2,519	80	
ition								
						3,364		1,466
A	$ 19,143	$ 8,420	$ 3,307	$ 1,701	$ 32,571	$ 30,054	$ 7,416	$ (14,781)

	Nine Months Ended January 31, 2018							
	Executive Search							
	North America	EMEA	Asia Pacific	Latin America	Subtotal	Hay Group	Futurestep	Corporate
					(in thousands)			
	$ 296,093	$ 128,249	$ 71,983	$ 22,048	$ 518,373	$ 577,462	$ 196,018	$
	$ 305,866	$ 130,894	$ 73,009	$ 22,114	$ 531,883	$ 589,093	$ 210,179	$
erest								
t								
net								
s of								
ion								
	$ 66,253	$ 20,349	$ 12,811	$ 2,961	$ 102,374	$ 72,532	$ 27,702	$ (62,005)
	2,923	1,345	1,052	331	5,651	24,110	2,313	4,807
t	1,157	136	384	99	1,776	459	10	12,602
s of								
	187				187			
	70,520	21,830	14,247	3,391	109,988	97,101	30,025	(44,596)
rges								
			313		313	(241)	6	
ition								
						6,455		199
A	$ 70,520	$ 21,830	$ 14,560	$ 3,391	$ 110,301	$ 103,315	$ 30,031	$ (44,397)

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

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January 31, 2018 (continued)