KORN FERRY INTERNATIONAL
Form 10-Q
September 09, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended July 31, 2016

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 Number)**

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

(Address of principal executive offices) (Zip code)

(310) 552-1834

(Registrant s telephone number, including area code)

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

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

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

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

The number of shares outstanding of our common stock as of September 6, 2016 was 57,901,738 shares.

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

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

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	July 31, 2016 (unaudited)		April 30, 2016	
	(in thousands, except per share data)			
ASSETS				
Cash and cash equivalents	$	244,073	$	273,252
Marketable securities		3,475		11,338
Receivables due from clients, net of allowance for doubtful accounts of $12,674 and $11,292, respectively		341,984		315,975
Income taxes and other receivables		28,672		20,579
Prepaid expenses and other assets		53,196		43,130
Total current assets		671,400		664,274
Marketable securities, non-current		133,502		130,092
Property and equipment, net		99,980		95,436
Cash surrender value of company owned life insurance policies, net of loans		110,195		107,296
Deferred income taxes, net		26,232		27,163
Goodwill		587,615		590,072
Intangible assets, net		228,992		233,027
Investments and other assets		67,447		51,240
Total assets	$	1,925,363	$	1,898,600
LIABILITIES AND STOCKHOLDERS EQUITY				
Accounts payable	$	33,719	$	26,634
Income taxes payable		4,351		8,396
Compensation and benefits payable		147,617		266,211
Term loan		19,754		30,000
Other accrued liabilities		149,865		145,023
Total current liabilities		355,306		476,264
Deferred compensation and other retirement plans		217,957		216,113
Term loan, non-current		251,038		110,000
Deferred tax liabilities		13,664		5,088
Other liabilities		51,056		43,834

Total liabilities	889,021	851,299
Stockholders equity:		
Common stock: $0.01 par value, 150,000 shares authorized, 70,576 and 69,723 shares issued and 57,898 and 57,272 shares outstanding, respectively	705,792	702,098
Retained earnings	398,412	401,113
Accumulated other comprehensive loss, net	(70,577)	(57,911)
Total Korn/Ferry International stockholders equity	1,033,627	1,045,300
Noncontrolling interest	2,715	2,001
Total stockholders equity	1,036,342	1,047,301
Total liabilities and stockholders equity	$ 1,925,363	$ 1,898,600

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, 2016	Three Months Ended July 31, 2015
	(in thousands, except per share data)	
Fee revenue	$ 375,621	$ 267,394
Reimbursed out-of-pocket engagement expenses	17,312	11,941
Total revenue	392,933	279,335
Compensation and benefits	262,967	179,456
General and administrative expenses	55,342	37,491
Reimbursed expenses	17,312	11,941
Cost of services	16,832	10,120
Depreciation and amortization	11,444	7,423
Restructuring charges, net	24,520	
Total operating expenses	388,417	246,431
Operating income	4,516	32,904
Other income (loss), net	4,259	(74)
Interest expense, net	(3,061)	(299)
Income before provision for income taxes and equity in earnings of unconsolidated subsidiaries	5,714	32,531
Equity in earnings of unconsolidated subsidiaries, net	79	725
Income tax provision	1,725	10,174
Net income	4,068	23,082
Net income attributable to noncontrolling interest	(860)	
Net income attributable to Korn/Ferry International	$ 3,208	$ 23,082
Earnings per common share attributable to Korn/Ferry International:		
Basic	$ 0.06	$ 0.46
Diluted	$ 0.06	$ 0.46
Weighted-average common shares outstanding:		
Basic	56,189	49,493

Diluted		56,576		50,014
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 (LOSS)/INCOME

(unaudited)

	Three Months Ended July 31,	
	2016	**2015**
	(in thousands)	
Net income	$ 4,068	$ 23,082
Other comprehensive (loss) income:		
Foreign currency translation adjustments	(13,274)	(15,632)
Deferred compensation and pension plan adjustments, net of tax	462	447
Unrealized losses on marketable securities, net of tax		(4)
Comprehensive (loss) income	(8,744)	7,893
Less: comprehensive income attributable to noncontrolling interest	(714)	
Comprehensive (loss) income attributable to Korn/Ferry International	$ (9,458)	$ 7,893

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, 2016	2015
	(in thousands)	
Cash flows from operating activities:		
Net income	$ 4,068	$ 23,082
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	11,444	7,423
Stock-based compensation expense	4,915	3,691
Provision for doubtful accounts	2,577	2,068
Gain on cash surrender value of life insurance policies	(2,498)	(2,494)
Gain on marketable securities	(3,915)	(665)
Deferred income taxes	5,410	5,124
Change in other assets and liabilities:		
Deferred compensation	(5,866)	(1,820)
Receivables due from clients	(28,586)	(13,058)
Income tax and other receivables	(8,093)	1,145
Prepaid expenses and other assets	(10,066)	(4,869)
Investment in unconsolidated subsidiaries	(79)	(725)
Income taxes payable	(4,346)	(1,990)
Accounts payable and accrued liabilities	(93,866)	(96,737)
Other	(7,137)	(10,368)
Net cash used in operating activities	(136,038)	(90,193)
Cash flows from investing activities:		
Purchase of property and equipment	(15,079)	(5,485)
Cash paid for acquisition, net of cash acquired	(2,880)	
Purchase of marketable securities	(5,430)	(9,116)
Proceeds from sales/maturities of marketable securities	13,764	16,364
Premium on company-owned life insurance policies	(401)	(404)
Proceeds from life insurance policies		1,659
Dividends received from unconsolidated subsidiaries	230	806
Net cash (used in) provided by investing activities	(9,796)	3,824
Cash flows from financing activities:		
Proceeds from term loan facility	275,000	
Principal payment on term loan facility	(140,000)	
Payment of contingent consideration from acquisition	(1,070)	

Purchase of common stock	(4,161)	(6,573)
Proceeds from issuance of common stock upon exercise of employee stock options and in connection with an employee stock purchase plan	2,430	2,379
Tax benefit related to stock-based compensation	332	4,064
Dividends paid to shareholders	(5,909)	(5,115)
Payments on life insurance policy loans		(1,151)
Net cash provided by (used in) financing activities	126,622	(6,396)
Effect of exchange rate changes on cash and cash equivalents	(9,967)	(11,559)
Net decrease in cash and cash equivalents	(29,179)	(104,324)
Cash and cash equivalents at beginning of period	273,252	380,838
Cash and cash equivalents at end of period	$ 244,073	$ 276,514

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

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

July 31, 2016

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. The Company s worldwide network of 128 offices in 52 countries enables it to meet the needs of its clients in all industries.

Basis of Consolidation and Presentation

The accompanying financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended April 30, 2016 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 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 productized 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 is recognized as services are rendered for consulting engagements and other time based services,

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

July 31, 2016

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. 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 productized 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, 2016 and April 30, 2016, the Company included deferred revenue of $88.9 million and $95.9 million, respectively, in other accrued liabilities.

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, 2016 and April 30, 2016, 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 (see Note 6 *Financial Instruments*). 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 and dividend income are recorded in the accompanying consolidated statements of income in other income (loss), net.

Foreign Currency Forward Contracts Not Designated as Hedges

Beginning in the third quarter of fiscal 2016, the Company established a program that primarily utilizes foreign currency forward contracts to offset the risks associated with the effects of certain foreign currency exposures which increased as a result of the Hay Group acquisition. 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 are 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.

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

July 31, 2016

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, 2016 and April 30, 2016, 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 and foreign currency forward contracts. 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 are obtained from a third party, which are based on quoted prices or market prices for similar financial instruments.

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 non-controlling 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, 2016, 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 were no indicators of impairment as of July 31, 2016 and April 30, 2016 that would have required further testing.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

July 31, 2016

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 July 31, 2016 and April 30, 2016, 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 metrics for Hay Group and Futurestep consultants), the level of engagements referred by a fee earner 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 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 $42.4 million and $41.8 million during the three months ended July 31, 2016 and 2015, 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.

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.

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

July 31, 2016

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 April 2015, the Financial Accounting Standards Board (the FASB) issued guidance simplifying the presentation of debt issue costs. The guidance requires debt issuance costs related to a debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, rather than being classified as an asset. The Company adopted this guidance during the three months ended July 31, 2016 and as a result, $4.2 million of unamortized debt issuance costs associated with its senior secured Credit Agreement were classified as a direct deduction to the term loan as of July 31, 2016, of which $0.9 million was recorded to term loan, current, and $3.3 million was recorded to term loan, non-current. The adoption did not have a material impact on the consolidated financial statements as of April 30, 2016.

In September 2015, the FASB issued guidance requiring an acquirer to recognize adjustments to provisional amounts recorded in an acquisition that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The acquirer is required to record, in the same period s financial statements, the effect on earnings of changes in depreciation, amortization or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. The acquirer is also required to present separately on the face of the income statement or disclose in the footnotes, the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustments had been recognized as of the acquisition date. The Company adopted this guidance during the three months ended July 31, 2016 and the adoption did not have an impact on the financial statements of the Company.

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 in order to depict 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 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 as opposed to the original effective date of December 15, 2016. The Company will adopt this guidance in its fiscal year beginning May 1, 2018. The Company is currently evaluating the effect the guidance will have on our financial condition and results of operations.

In January 2016, the FASB issued guidance on the classification and measurement of financial instruments, which requires that (i) all equity investments, other than equity-method investments, in unconsolidated entities, generally be measured at fair value through earnings and (ii) when the fair value option has been elected for financial liabilities, changes in fair value due to instrument-specific credit risk, be recognized separately in other comprehensive income. Additionally, it changes the disclosure requirements for financial instruments. The new guidance is effective for fiscal years beginning after December 15, 2017, with early adoption permitted for certain provisions. The Company is currently evaluating the effect the guidance will have on the consolidated financial statements.

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

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; early adoption is permitted. The Company is currently evaluating the effect that this guidance will have on the consolidated financial statements.

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

July 31, 2016

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.

During the three months ended July 31, 2016 and 2015, all shares of outstanding options were included in the computation of diluted earnings per share. During both the three months ended July 31, 2016 and 2015, restricted stock awards of 0.5 million were outstanding but not included in the computation of diluted earnings per share because they were anti-dilutive.

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

	Three Months Ended July 31,	
	2016	2015
	(in thousands, except per share data)	
Net income attributable to Korn/Ferry International	$ 3,208	$ 23,082
Less: distributed and undistributed earnings to nonvested restricted stockholders	44	224
Basic net earnings attributable to common stockholders	3,164	22,858
Add: undistributed earnings to nonvested restricted stockholders		176

Less: reallocation of undistributed earnings to nonvested restricted stockholders				174
Diluted net earnings attributable to common stockholders	$	3,164	$	22,860
Weighted-average common shares outstanding:				
Basic weighted-average number of common shares outstanding		56,189		49,493
Effect of dilutive securities:				
Restricted stock		316		452
Stock options		60		66
ESPP		11		3
Diluted weighted-average number of common shares outstanding		56,576		50,014
Net earnings per common share:				
Basic earnings per share	$	0.06	$	0.46
Diluted earnings per share	$	0.06	$	0.46

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

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July 31, 2016

3. Stockholders Equity

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	Total Stockholders Equity
		(in thousands)	
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 declared	(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 (Loss) Income

Comprehensive (loss) 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 (loss)/income. 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, 2016	April 30, 2016

	(in thousands)	
Foreign currency translation adjustments	$ (49,467)	$ (36,339)
Deferred compensation and pension plan adjustments, net of tax	(21,110)	(21,572)
Accumulated other comprehensive loss, net	$ (70,577)	$ (57,911)

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)	Unrealized Gains (Losses) on Marketable Securities	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)

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

July 31, 2016

The following table summarizes the changes in each component of accumulated other comprehensive income (loss) for the three months ended July 31, 2015:

	Foreign Currency Translation	Deferred Compensation and Pension Plan (1)	Unrealized Gains (Losses) on Marketable Securities	Accumulated Other Comprehensive Income (Loss)
		(in thousands)		
Balance as of April 30, 2015	$ (20,919)	$ (19,708)	$ 4	$ (40,623)
Unrealized losses arising during the period	(15,632)		(4)	(15,636)
Reclassification of realized net losses to net income		447		447
Balance as of July 31, 2015	$ (36,551)	$ (19,261)	$	$ (55,812)

(1) The tax effect on the reclassifications of realized net losses was $0.3 million for both the three months ended July 31, 2016 and 2015.

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 July 31, 2016	Three Months Ended July 31, 2015
	(in thousands)	
Restricted stock	$ 4,739	$ 3,554

ESPP	176	120
Stock options		17
Total stock-based compensation expense, pre-tax	4,915	3,691
Tax benefit from stock-based compensation expense	(1,484)	(1,154)
Total stock-based compensation expense, net of tax	$ 3,431	$ 2,537

Stock Incentive Plans

At the Company s 2012 Annual Meeting of Stockholders, held on September 27, 2012, the Company s stockholders approved an amendment and restatement to the Korn/Ferry International Amended and Restated 2008 Stock Incentive Plan (the 2012 amendment and restatement being the Second A&R 2008 Plan), which among other things, increased the current maximum number of shares that may be issued under the plan to 5,700,000 shares, subject to certain changes in the Company s capital structure and other extraordinary events. The Second 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 a combination thereof. Under the Second A&R 2008 Plan, the ability to issue full-value awards is limited by requiring full-value stock awards to count 1.91 times as much as stock options.

Restricted Stock

The Company grants time-based restricted stock awards to executive officers and other senior employees generally vesting over a three to 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

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

July 31, 2016

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. The Company recognizes compensation expense for performance-based restricted stock units on a straight-line basis over the vesting period. 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, 2016 is summarized below:

	Shares	Weighted-Average Grant Date Fair Value
	(in thousands, except per share data)	
Non-vested, April 30, 2016	1,506	$ 34.12
Granted	718	$ 19.89
Vested	(666)	$ 21.80
Forfeited/expired	(11)	$ 26.35
Non-vested, July 31, 2016	1,547	$ 32.87

As of July 31, 2016, there were 0.6 million shares and 0.1 million shares outstanding relating to market-based and performance-based restricted stock units, respectively, with total unrecognized compensation totaling $11.7 million and $9.3 million, respectively.

As of July 31, 2016, there was $41.6 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, 2016 and 2015, 185,754 shares and 188,104 shares of restricted stock totaling $4.2 million and $6.6 million, respectively, were repurchased by the Company, at the option of the employee, 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 months ended July 31, 2016, employees purchased 114,011 shares at $17.60 per share. During the three months ended July 31, 2015, employees purchased 44,334 shares at $29.55 per share. As of July 31, 2016, the ESPP had approximately 1.4 million shares remaining available for future issuance.

Common Stock

During the three months ended July 31, 2016 and 2015, the Company issued 32,470 shares and 71,428 shares of common stock, respectively, as a result of the exercise of stock options, with cash proceeds from the exercise of $0.4 million and $1.1 million, respectively.

No shares were repurchased during the three months ended July 31, 2016 and 2015, other than to satisfy minimum tax withholding requirements upon the vesting of restricted stock as described above.

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July 31, 2016

6. Financial Instruments

The following tables show the Company s cash, trading securities and foreign currency forward contracts cost, gross unrealized gains, gross unrealized losses and fair value by significant category recorded as cash and cash equivalents, current portion of current marketable securities, non-current marketable securities, or other accrued liabilities as of July 31, 2016 and April 30, 2016:

	July 31, 2016							
	Fair Value Measurement				Balance Sheet Classification			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Marketable Securities, Current	Marketable Securities, Non-current	Other Accrued Liabilities
	(in thousands)							
Level 1:								
Cash	$ 119,660	$	$	$ 119,660	$ 119,660	$	$	$
Money market funds	124,413			124,413	124,413			
Mutual funds (1)	134,447	3,477	(947)	136,977		3,475	133,502	
Total	$ 378,520	$ 3,477	$ (947)	$ 381,050	$ 244,073	$ 3,475	$ 133,502	$
Level 2:								
Foreign currency forward contracts	$	$ 419	$ (966)	$ (547)	$	$	$	$ (547)

	April 30, 2016							
	Fair Value Measurement				Balance Sheet Classification			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Marketable Securities, Current	Marketable Securities, Non-current	Other Accrued Liabilities
	(in thousands)							
Level 1:								
Cash	$ 155,702	$	$	$ 155,702	$ 155,702	$	$	$
Money market funds	117,550			117,550	117,550			

Mutual funds (1)	142,588	1,395	(2,553)	141,430		11,338	130,092