KORN FERRY INTERNATIONAL
Form 10-Q
March 12, 2010

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

Form 10-Q

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

For the quarterly period ended January 31, 2010

OR

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

For the transition period from __________ to __________

Commission File Number 001-14505

KORN/FERRY INTERNATIONAL
(Exact Name of Registrant as Specified in its Charter)

Delaware	**95-2623879**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification Number)*

1900 Avenue of the Stars, Suite 2600, Los Angeles, California 90067
(Address of principal executive offices) (Zip code)
(310) 552-1834
(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
The number of shares outstanding of our common stock as of March 10, 2010 was 46,005,103 shares.

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
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PART I. FINANCIAL INFORMATION

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

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	January 31, 2010 (unaudited)	April 30, 2009
	(in thousands, except per share data)	
ASSETS		
Cash and cash equivalents	$ 175,811	$ 255,000
Marketable securities	3,928	4,263
Receivables due from clients, net of allowance for doubtful accounts of $8,924 and $11,197, respectively	108,098	67,308
Income taxes and other receivables	6,466	9,001
Deferred income taxes	20,249	14,583
Prepaid expenses and other assets	26,851	21,442
Total current assets	341,403	371,597
Marketable securities, non-current	71,475	70,992
Property and equipment, net	25,618	27,970
Cash surrender value of company owned life insurance policies, net of loans	65,988	63,108
Deferred income taxes	50,355	45,141
Goodwill	171,001	133,331
Intangible assets, net	26,091	16,928
Investments and other assets	16,308	11,812
Total assets	$ 768,239	$ 740,879
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable	$ 10,519	$ 10,282
Income taxes payable	4,698	2,059
Compensation and benefits payable	102,055	116,705
Other accrued liabilities	44,014	44,301
Total current liabilities	161,286	173,347
Deferred compensation and other retirement plans	107,238	99,238
Other liabilities	18,554	9,195
Total liabilities	287,078	281,780
Stockholders equity:		
Common stock: $0.01 par value, 150,000 shares authorized, 57,528 and 56,185 shares issued and 45,982 and 44,729 shares outstanding, respectively	381,232	368,430
Retained earnings	81,304	84,922

Accumulated other comprehensive income, net		19,156		6,285
Stockholders equity		481,692		459,637
Less: notes receivable from stockholders		(531)		(538)
Total stockholders equity		481,161		459,099
Total liabilities and stockholders equity	$	768,239	$	740,879

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

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

	Three Months Ended January 31, 2010	Three Months Ended January 31, 2009	Nine Months Ended January 31, 2010	Nine Months Ended January 31, 2009
	(in thousands, except per share data)			
Fee revenue	$ 146,742	$ 136,210	$ 403,690	$ 531,243
Reimbursed out-of-pocket engagement expenses	6,158	8,283	19,054	30,459
Total revenue	152,900	144,493	422,744	561,702
Compensation and benefits	102,654	93,978	295,115	365,849
General and administrative expenses	31,635	30,963	86,853	97,316
Out-of-pocket engagement expenses	9,837	11,041	28,090	39,071
Depreciation and amortization	2,755	2,924	8,444	8,637
Restructuring (reductions) charges, net	(364)	16,845	20,593	16,845
Total operating expenses	146,517	155,751	439,095	527,718
Operating income (loss)	6,383	(11,258)	(16,351)	33,984
Interest and other income (loss), net	2,238	(14,794)	9,410	(13,294)
Interest expense	1,345	1,267	4,046	3,571
Income (loss) before (benefit) provision for income taxes and equity in earnings of unconsolidated subsidiaries	7,276	(27,319)	(10,987)	17,119
Income tax (benefit) provision	(244)	(4,549)	(6,730)	12,327
Equity in earnings of unconsolidated subsidiaries, net	390	414	639	2,316
Net income (loss)	$ 7,910	$ (22,356)	$ (3,618)	$ 7,108
Earnings (loss) per common share:				
Basic	$ 0.18	$ (0.52)	$ (0.08)	$ 0.16
Diluted	$ 0.17	$ (0.52)	$ (0.08)	$ 0.16
Weighted-average common shares outstanding:				
Basic	44,622	43,406	44,290	43,538
Diluted	45,811	43,406	44,290	44,352

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

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

	Nine Months Ended January 31, 2010	Nine Months Ended January 31, 2009
	(in thousands)	
Cash flows from operating activities:		
Net (loss) income	$ (3,618)	$ 7,108
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation and amortization	8,444	8,637
Stock-based compensation expense	13,272	12,396
Loss on disposition of property and equipment	202	248
Provision for doubtful accounts	3,510	7,223
(Gain) loss on cash surrender value of life insurance policies	(6,675)	3,799
Gain on marketable securities classified as trading	(7,526)	
Realized loss on available-for-sale marketable securities		1,264
Other-than temporary impairment on marketable securities		15,893
Deferred income taxes	(10,880)	10,298
Change in other assets and liabilities:		
Deferred compensation	8,000	(5,052)
Receivables	(34,604)	18,536
Prepaid expenses	(2,309)	(1,772)
Investment in unconsolidated subsidiaries	(639)	(2,316)
Income taxes payable	551	(19,954)
Accounts payable and accrued liabilities	(32,691)	(92,706)
Other	(5,799)	1,444
Net cash used in operating activities	(70,762)	(34,954)
Cash flows from investing activities:		
Purchase of property and equipment	(4,377)	(10,300)
Purchase of intangible assets	(3,481)	
Proceeds from (purchase of) marketable securities, net	7,407	(3,290)
Cash paid for acquisitions, net of cash acquired	(18,236)	(12,900)
Premiums on life insurance policies	(1,450)	(1,479)
Dividends received from unconsolidated subsidiaries	157	2,952
Net cash used in investing activities	(19,980)	(25,017)
Cash flows from financing activities:		
Payments on life insurance policy loans		(367)
Borrowings under life insurance policies	5,252	1,459
Purchase of common stock	(1,653)	(9,539)
Proceeds from issuance of common stock upon exercise of employee stock options and in connection with an employee stock purchase plan	5,960	3,480
Tax (expense) benefit from exercise of stock options	(4,614)	174

Net cash provided by (used in) financing activities	4,945	(4,793)
Effect of exchange rate changes on cash and cash equivalents	6,608	(23,046)
Net decrease in cash and cash equivalents	(79,189)	(87,810)
Cash and cash equivalents at beginning of period	255,000	305,296
Cash and cash equivalents at end of period	$ 175,811	$ 217,486

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

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
January 31, 2010

1. Organization and Summary of Significant Accounting Policies

Nature of Business

Korn/Ferry International, a Delaware corporation (the Company), and its subsidiaries are engaged in the business of providing executive search, outsourced recruiting and leadership and talent consulting on a retained basis. The Company s worldwide network of 78 offices in 37 countries enables it to meet the needs of its clients in all industries.

Basis of Consolidation and Presentation

The condensed consolidated financial statements for the three and nine months ended January 31, 2010 and 2009 include the accounts of the Company and its wholly and majority owned/controlled domestic and international subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. The preparation of the condensed consolidated financial statements conform with United States (U.S.) generally accepted accounting principles (GAAP) and prevailing practice within the industry. The condensed consolidated financial statements include all adjustments, consisting of normal recurring accruals and any other adjustments that management considers necessary for a fair presentation of the results for these periods. These financial statements have been prepared consistently with the accounting policies described in the Company s Annual Report on Form 10-K for the fiscal year ended April 30, 2009 (the Annual Report) and should be read together with the Annual Report.

Investments in affiliated companies which are 50% or less owned and where the Company exercises significant influence over operations are accounted for using the equity method. Dividends and other distributions of earnings from cost-method investments are included in other income when declared.

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. The most significant areas that require management judgment are revenue recognition, deferred compensation, marketable securities, evaluation of the carrying value of receivables, goodwill and other intangible assets and deferred income taxes.

Revenue Recognition

Substantially all professional fee revenue is derived from fees for professional services related to executive recruitment, middle-management recruitment and related services performed on a retained basis. Fee revenue from recruitment activities is generally one-third of the estimated first year compensation plus a percentage of the fee to cover indirect expenses. Other fee revenue is recognized as earned. The Company generally bills clients in three monthly installments commencing the month of client acceptance. Fees earned in excess of the initial contract amount are billed upon completion of the engagement. Any services that are provided on a contingent basis are recognized once the contingency is fulfilled.

Cash and Cash Equivalents

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

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2010

Marketable Securities

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

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

Available-for-sale securities consist of time deposits. The changes in fair values, net of applicable taxes, are recorded as unrealized gains (losses) as a component of accumulated other comprehensive income (loss) in stockholders equity. When, in the opinion of management, a decline in the fair value of an investment below its cost or amortized cost is considered to be other-than-temporary, the investment s cost or amortized cost is written-down to its fair value and the amount written-down is recorded in the statement of operations in interest and other income (loss), net. The determination of other-than-temporary decline includes, in addition to other relevant factors, a presumption that if the market value is below cost by a significant amount for a period of time, a write-down may be necessary. The amount of any write-down is determined by the difference between cost or amortized cost of the investment and its fair value at the time the other-than-temporary decline is identified. During the three and nine months ended January 31, 2010, no other-than-temporary impairment was recognized, compared to a write-down of $15.3 million and $15.9 million for the three and nine months ended January 31, 2009, respectively.

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of assets acquired. Purchased intangible assets primarily consist of customer lists, non-compete agreements, proprietary databases, intellectual property and trademarks, and are recorded at the estimated fair value at the date of acquisition and are amortized using the straight-line method over their estimated useful lives of five to 24 years.

The Company s annual goodwill impairment test is performed as of January 31. 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 shall be 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 shall be 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. Results of the latest impairment tests as of January 31, 2009, indicated that the fair value of each reporting unit exceeded its carrying amount. As a result, no impairment charge was recognized as of January 31, 2009 or April 30, 2009. The Company s annual impairment test as of January 31, 2010 will be performed in the fourth quarter of fiscal 2010, although there was also no indication of impairment as of January 31, 2010.

As of January 31, 2010 and April 30 2009, there were no indicators of impairment with respect to the Company s intangible assets.

Stock-Based Compensation

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

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2010

Restructuring Charges

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

Fair Value of Financial Instruments

Effective May 1, 2008, the Company adopted Statement of Financial Accounting Standards (SFAS) 157, *Fair Value Measurements* (SFAS 157) for financial assets and liabilities, which defines fair value, provides guidance for measuring fair value and requires certain disclosures. SFAS 157 discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow) and the cost approach (cost to replace the service capacity of an asset or replacement cost). The statement establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

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

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

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

As of January 31, 2010 and April 30, 2009, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included cash equivalents, marketable securities and a put option. 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, other than auction rate securities, are obtained from quoted market prices. The fair value of the auction rate securities and put option are determined by the use of pricing models. The guidance for SFAS 157 may now be found in Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*.

Recently Adopted Accounting Standards

In August 2009, the Financial Accounting Standards Board (FASB) issued authoritative guidance to provide clarification on measuring liabilities at fair value when a quoted price in an active market is not available. In these circumstances, a valuation technique should be applied that uses either the quote of the liability when traded as an asset, the quoted prices for similar liabilities or similar liabilities when traded as assets, or another valuation technique consistent with existing fair value measurement guidance, such as an income approach or a market approach. The new guidance also clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. This guidance became effective for the Company s fiscal 2010 third quarter and did not have an impact on the Company s consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS 141R). SFAS 141R expands the definition of transactions and events that qualify as business combinations; requires that the acquired assets and liabilities including contingencies and any noncontrolling interests in the acquiree, be recorded at the fair value determined on the acquisition date and changes thereafter be reflected in earnings, rather than goodwill; changes the recognition timing for restructuring costs; and requires acquisition costs to be expensed as incurred. SFAS 141R also includes a substantial number of new disclosure requirements. SFAS 141R will have an impact on accounting for business combinations but the effect is dependent upon acquisitions at that time. For acquisitions completed prior to May 1, 2009, the new standard requires that changes in deferred tax valuation allowances and acquired income tax uncertainties after the measurement period must be recognized in earnings rather than as an adjustment to the cost of the acquisition. The adoption of SFAS 141R did not have a material impact on the Company s consolidated financial position and results of operations. The guidance for SFAS 141R may now be found in ASC 805, *Business Combinations*.

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
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January 31, 2010

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51* (SFAS 160). SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent s equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. The Company currently does not have significant minority interests in its consolidated subsidiaries and as such SFAS 160 did not have an impact on the Company s condensed consolidated financial statements. The guidance for SFAS 160 may now be found in ASC 810, *Consolidation*.

In April 2009, the FASB issued FASB Staff Position No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP 157-4). FSP 157-4 provides guidance on (1) estimating the fair value of an asset or liability when the volume and level of activity for the asset or liability have significantly decreased and (2) identifying transactions that are not orderly. FSP 157-4 was effective for interim and annual periods ending after June 15, 2009. The adoption of FSP 157-4 did not have a material impact on the Company s condensed consolidated financial statements. The guidance for FSP 157-4 may now be found in ASC 820-10-65-4, *Fair Value Measurements and Disclosures*.

In April 2009, the FASB issued FASB Staff Position No. 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP 107-1). FSP 107-1 requires disclosures about the fair value of financial instruments in interim reporting periods of publicly traded companies as well as in annual financial statements. FSP 107-1 was effective for interim periods ending after June 15, 2009. The adoption of FSP 107-1 did not have a material impact on the Company s condensed consolidated financial statements. The guidance for FSP 107-1 may now be found in ASC 825-10-65-1, *Financial Instruments.*

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165). SFAS 165 provides guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 also requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. SFAS 165 is effective for interim and annual periods ending after June 15, 2009, and accordingly, the Company adopted this standard during the three months ended July 31, 2009. The implementation of this standard did not have any impact on the financial statements of the Company. Subsequent events through the filing date of this Form 10-Q have been evaluated for disclosure and recognition and the Company concluded that no subsequent events have occurred that would require recognition in the condensed consolidated financial statements. The guidance for SFAS 165 may now be found in ASC 855, *Subsequent Events*.

In June 2009, the FASB issued SFAS No. 168*, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a Replacement of FASB Statement No. 162* (SFAS 168). SFAS 168 establishes the FASB Accounting Standards Codification (the Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. GAAP, except for rules and interpretive releases of the Securities and Exchange Commission (SEC), which are sources of authoritative GAAP for SEC registrants. The Codification does not change current U.S. GAAP, but is intended to simplify user access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place. The Codification is effective for interim and annual periods ending after September 15, 2009. The Company adopted SFAS 168 in the second fiscal quarter 2009. As the Codification was not intended to change or alter existing GAAP, it did not impact the Company s condensed consolidated financial statements. The guidance for SFAS 168 may now be found in ASC 105, *Generally Accepted Accounting Principles.*

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2010

2. Basic and Diluted Earnings (Loss) Per Share

Basic earnings (loss) per common share was computed by dividing net earnings (loss) by the weighted-average number of common shares outstanding. Diluted earnings per common share reflects the potential dilution that would occur if all in-the-money outstanding options or other contracts to issue common stock were exercised or converted and was computed by dividing net earnings (loss) attributable to common stockholders by the weighted-average number of common shares outstanding plus dilutive common equivalent shares. During the three months ended January 31, 2010 and the nine months ended January 31, 2009, SARs and options to purchase 1.3 million shares and 1.9 million shares, respectively, were outstanding but not included in the computation of diluted earnings per share because they were anti-dilutive. Due to the loss attributable to common stockholders during the nine months ended January 31, 2010 and the three months ended January 31, 2009, no potentially dilutive shares are included in the loss per share calculation as including such shares in the calculation would be anti-dilutive.

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

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2010	**2009**	**2010**	**2009**
	(in thousands, except per share data)			
Net earnings (loss) attributable to common stockholders	$ 7,910	$ (22,356)	$ (3,618)	$ 7,108
Weighted-average common shares outstanding:				
Basic weighted-average number of common shares outstanding	44,622	43,406	44,290	43,538
Effect of dilutive securities:				
Warrants	74			54
Restricted stock	652			132
Stock options	452			593
ESPP	11			35
Diluted weighted-average number of common shares outstanding	45,811	43,406	44,290	44,352
Net earnings (loss) per common share:				
Basic earnings (loss) per share	$ 0.18	$ (0.52)	$ (0.08)	$ 0.16
Diluted earnings (loss) per share	$ 0.17	$ (0.52)	$ (0.08)	$ 0.16

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KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2010

3. Comprehensive Income (Loss)

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

Total comprehensive income (loss) is as follows:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2010	2009	2010	2009
	(in thousands)			
Net income (loss)	$ 7,910	$ (22,356)	$ (3,618)	$ 7,108
Foreign currency translation adjustments	(5,388)	(2,208)	12,871	(44,923)
Unrealized losses on marketable securities, net of taxes		(846)		(7,105)
Reclassification of unrealized losses on marketable securities, net of taxes to other-than temporary impairment		8,995		8,995
Comprehensive income (loss)	$ 2,522	$ (16,415)	$ 9,253	$ (35,925)

The components of accumulated other comprehensive income were as follows:

	January 31, 2010	April 30, 2009
	(in thousands)	
Foreign currency translation adjustments	$ 16,394	$ 3,523
Defined benefit pension adjustments, net of taxes	2,762	2,762
Accumulated other comprehensive income	$ 19,156	$ 6,285

4. Employee Stock Plans

Stock-Based Compensation

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

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2010	2009	2010	2009
	(in thousands)			
Stock options and SARs	$ 132	$ (115)	$ 626	$ 109
Restricted stock	3,807	3,889	12,360	11,947
ESPP	85	94	286	340
Total stock-based compensation expense, pre-tax	4,024	3,868	13,272	12,396
	(1,469)	(1,412)	(4,845)	(4,525)

Tax benefit from stock-based compensation expense								
Total stock-based compensation expense, net of tax	$	2,555	$	2,456	$	8,427	$	7,871

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

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
January 31, 2010

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

	Nine Months Ended January 31,	
	2010	2009
Expected volatility	48.91%	44.11%
Risk-free interest rate	2.53%	3.27%
Expected option life (in years)	5.00	4.25
Expected dividend yield	0.00%	0.00%

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

Stock Incentive Plans

The Korn/Ferry International 2008 Stock Incentive Plan (the 2008 Plan) was amended by the Company s stockholders on September 10, 2009, at the 2009 Annual Stockholder Meeting. The amendment made available an additional 2,360,000 shares of the Company s common stock for stock-based compensation awards. The 2008 Plan, as amended, provides for the grant of awards to eligible participants, designated as either nonqualified or incentive stock options, SARs, restricted stock and restricted stock units, any of which may be performance-based, and incentive bonuses, which may be paid in cash or a combination thereof.

Stock Options and SARs

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

	Nine Months Ended January 31, 2010			
	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value
	(in thousands, except per share data)			
Outstanding, April 30, 2009	3,113	$ 14.83		
Granted	569	$ 10.85		
Exercised	(464)	$ 8.17		
Forfeited/expired	(419)	$ 17.39		
Outstanding, January 31, 2010	2,799	$ 14.74	3.75	$ 7,532
Exercisable, January 31, 2010	2,269	$ 15.68	3.12	$ 5,333

Included in the table above are 45,235 SARs outstanding and exercisable as of January 31, 2010 with a weighted-average exercise price of $11.87. As of January 31, 2010, there was $2.2 million of total unrecognized compensation cost related to non-vested awards of stock options and SARs. That cost is expected to be recognized over a weighted-average period of 1.9 years. For stock option awards subject to graded vesting, the Company recognizes the total compensation cost on a straight-line basis over the service period for the entire award.

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Additional information pertaining to stock options and SARs:

	Three Months Ended January 31,				Nine Months Ended January 31,			
	2010		2009		2010		2009	
	(in thousands, except per share data)							
Weighted-average fair value of stock options granted	$	7.97	$	5.01	$	4.88	$	5.77
Total fair value of stock options and SARs vested	$	11	$	23	$	607	$	1,931
Total intrinsic value of stock options exercised	$	924	$	20	$	2,024	$	630
Total intrinsic value of SARs paid	$	75	$		$	75	$	

Restricted Stock

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

Restricted stock activity is summarized below:

	Nine Months Ended January 31,		
	Shares	Weighted-Average Grant Date Fair Value	
	(in thousands, except per share data)		
Non-vested, April 30, 2009	2,387	$	15.50
Granted	982	$	10.33
Vested	(734)	$	20.47
Forfeited/expired	(154)	$	17.55
Non-vested, January 31, 2010	2,481	$	12.92

As of January 31, 2010, there was $28.5 million of total unrecognized compensation cost related to non-vested awards of restricted stock, which is expected to be recognized over a weighted-average period of 2.3 years. For restricted stock awards subject to graded vesting, the Company recognizes the total compensation cost on a straight-line basis over the service period for the entire award. In the three and nine months ended January 31, 2010, 17,460 shares and 146,114 shares of restricted stock totaling $0.3 million and $1.7 million, respectively, were repurchased by the Company at the option of the employee to pay for taxes related to vesting of restricted stock. In the three and nine months ended January 31, 2009, 3,936 shares and 130,245 shares of restricted stock totaling $0.1 million and $2.2 million, respectively, were repurchased by the Company at the option of the employee to pay for taxes related to vesting of restricted stock.

Common Stock

In the three and nine months ended January 31, 2010, the Company issued 114,815 shares and 455,695 shares of common stock as a result of the exercise of stock options. In the three and nine months ended January 31, 2009, the Company issued 15,390 shares and 111,802 shares of common stock, respectively, as a result of the exercise of stock options.

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Employee Stock Purchase Plan

In October 2003, the Company implemented 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. The maximum number of shares of common stock reserved for ESPP issuance is 1.5 million shares, subject to adjustment for certain changes in the Company s capital structure and other extraordinary events. During the three months ended January 31, 2010 and 2009, employees purchased 67,917 shares at $14.03 per share and 90,895 shares at $9.71 per share, respectively. During the nine months ended January 31, 2010 and 2009, employees purchased 209,840 shares at $10.66 per share and 209,510 shares at $11.78 per share, respectively.

5. Marketable Securities

As of January 31, 2010 marketable securities consisted of the following:

	Trading (in thousands)
Auction rate securities	$ 9,723
Auction rate securities put option	1,177
Mutual funds (1)	64,503
Total	75,403
Less: current portion of marketable securities	(3,928)
Non-current marketable securities	$ 71,475

As of April 30, 2009 marketable securities consisted of the following:

	Trading	Available-for-Sale(2) (in thousands)	Total
Auction rate securities	$ 11,329	$	$ 11,329
Auction rate securities put option	1,096		1,096
Mutual funds (1)	60,828		60,828
Time deposits		2,002	2,002
Total	73,253	2,002	75,255
Less: current portion of marketable securities	(2,261)	(2,002)	(4,263)
Non-current marketable securities	$ 70,992	$	$ 70,992

(1) These investments are held in trust for settlement of the Company s obligations

under certain of its deferred compensation plans with $3.9 million and $2.3 million classified as current assets as of January 31, 2010 and April 30, 2009, respectively.

(2) Due to the short maturities for these instruments, fair value approximates amortized cost.

Investments in marketable securities are made based on the Company s investment policy which restricts the types of investments that can be made. The Company s investments associated with cash equivalents and marketable securities consist of money market funds, United States government and government agency bonds and equity securities for which market prices are readily available. The Company s investments in marketable securities also include student loan portfolios (ARS), which are classified as noncurrent marketable securities and reflected at fair value.

As of January 31, 2010 and April 30, 2009, the Company s marketable securities included $64.5 million (net of unrealized losses of $1.3 million) and $60.8 million (net of unrealized losses of $10.0 million) respectively, held in trust for settlement of the Company s obligations under certain of its deferred compensation plans, of which $60.6 million and $58.5 million are classified as noncurrent. The Company s obligations for which these assets were held in trust totaled $64.5 million and $60.7 million as of January 31, 2010 and April 30, 2009, respectively. Based upon a review of the Company s available-for-sale securities, as of January 31, 2009, the Company determined that the unrealized losses were other-than-temporary as a result of the severity and duration of the change in fair value of these securities. Therefore, as of January 31, 2009, the Company recorded an other-than-temporary impairment charge of $15.9 million in the accompanying statement of operations in interest and other income (loss), net.

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

	January 31, 2010			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
Cash equivalents	$ 104,094	$ 104,094	$	$
Auction rate securities	9,723			9,723
Auction rate securities put option	1,177			1,177
Mutual funds	64,503	64,503		
Total	$ 179,497	$ 168,597	$	$ 10,900

	April 30, 2009			
	Total	Level 1	Level 2	Level 3
	(in thousands)			
Cash equivalents	$ 165,590	$ 165,590	$	$
Auction rate securities	11,329			11,329
Auction rate securities put option	1,096			1,096
Mutual funds	60,828	60,828		
Time deposits	2,002	2,002		
Total	$ 240,845	$ 228,420	$	$ 12,425

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

	Auction Rate Securities			
	Three Months Ended January 31,		Nine Months Ended January 31,	
	2010	2009	2010	2009
	(in thousands)			
Balance, beginning of period	$ 11,950	$ 17,577	$ 12,425	$ 20,475
Auction rate securities put option		(758)	81	880
Reversal of unrealized loss associated with transfer of security to trading				780
Unrealized gain (loss) included in operations		758	(81)	(880)
Unrealized loss included in accumulated other comprehensive income				(586)
Sale of securities	(1,050)	(5,775)	(1,525)	(9,025)
Reversal of unrealized loss associated with sales of securities at par		623		781
Balance, ending of period	$ 10,900	$ 12,425	$ 10,900	$ 12,425

KORN/FERRY INTERNATIONAL AND SUBSIDIARIES
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6. Restructuring Charges

During the nine months ended January 31, 2010, the Company reorganized its operating structure and as a result incurred restructuring charges of $25.8 million against operations. This restructuring expense was partially offset by $5.2 million of recoveries from previously estimated restructuring charges resulting in net restructuring costs of $20.6 million during the nine months ended January 31, 2010. The Company s basic and diluted (loss) earnings per share for the nine months ended January 31, 2010 would have decreased by $0.08 per share had recoveries of previously recorded restructuring charges of $5.2 million (or $3.3 million, net of taxes) not been recorded.

Changes in the restructuring liability during the three months ended January 31, 2010 are as follows:

	Severance	Facilities (in thousands)	Total
Liability as of October 31, 2009	$ 10,876	$ 14,252	$ 25,128
Additions charged to expense			
Reductions		(364)	(364)
Non-cash items			
Reductions for cash payments	(6,098)	(2,448)	(8,546)
Exchange rate fluctuations	164	(233)	(69)
Liability as of January 31, 2010	$ 4,942	$ 11,207	$ 16,149

Changes in the restructuring liability during the nine months ended January 31, 2010 are as follows:

	Severance	Facilities (in thousands)	Total
Liability as of April 30, 2009	$ 10,554	$ 12,807	$ 23,361
Additions charged to expense	15,940	9,835	25,775
Reductions	(1,911)	(3,271)	(5,182)
Non-cash items	(370)	(2,341)	(2,711)
Reductions for cash payments	(20,015)	(6,362)	(26,377)
Exchange rate fluctuations	744	539	1,283
Liability as of January 31, 2010	$ 4,942	$ 11,207	$ 16,149

Changes in the restructuring liability during the three and nine months ended January 31, 2009 was as follows:

	Severance	Facilities (in thousands)	Total
Liability as of April 30, 2008 and October 31, 2008	$	$	$
Additions charged to expense	13,006	2,572	15,578
Reductions			
Non-cash items	462	805	1,267
Reductions for cash payments	(5,492)	(67)	(5,559)
Exchange rate fluctuations	(295)	(29)	(324)
Liability as of January 31, 2009	$ 7,681	$ 3,281	$ 10,962

As of January 31, 2010 and April 30, 2009, the restructuring liability is included in the current portion of other accrued liabilities on the consolidated balance sheet, except for $3.2 million and $5.4 million, respectively, of facilities costs which primarily relate to commitments under operating leases, net of sublease income, which are included in other long-term liabilities and will be paid over the next eight years.

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The restructuring liability by segment is summarized below:

	January 31, 2010		
	Severance	Facilities	Total
	(in thousands)		
Executive Recruitment			
North America	$ 370	$ 1,353	$ 1,723
EMEA	4,217	7,166	11,383
Asia Pacific		723	723
South America	155		155
Total Executive Recruitment	4,742	9,242	13,984
Futurestep	200	1,965	2,165
Liability as of January 31, 2010	$ 4,942	$ 11,207	$ 16,149

	April 30, 2009		
	Severance	Facilities	Total
	(in thousands)		
Executive Recruitment			
North America	$ 3,052	$ 3,187	$ 6,239
EMEA	4,714	2,514	7,228
Asia Pacific	48	1,243	1,291
South America	787	334	1,121
Total Executive Recruitment	8,601	7,278	15,879
Futurestep	1,953	5,529	7,482
Liability as of April 30, 2009	$ 10,554	$ 12,807	$ 23,361

7. Deferred Compensation and Retirement Plans

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

The components of net periodic benefit costs are as follows:

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2010	2009	2010	2009
	(in thousands)			
Service cost	$ 85	$ 174	$ 255	$ 522
Interest cost	945	910	2,835	2,730
Amortization of actuarial gain	(20)	(21)	(60)	(63)
Amortization of net transition obligation		53		159

Net periodic benefit costs	$ 1,010	$ 1,116	$ 3,030	$ 3,348

The Company also has an Executive Capital Accumulation Plan (ECAP) which is intended to provide certain employees an opportunity to defer salary and/or bonus on a pre-tax basis, or make an after-tax contribution. The Company made contributions of $0.3 million to the ECAP in each of the three months ended January 31, 2010 and 2009. The Company made contributions to the ECAP during the nine months ended January 31, 2010 and 2009, of $0.9 million and $15.0 million, respectively. Participants generally vest in Company contributions over a four year period. The ECAP is accounted for whereby the changes in the fair value of the vested amounts owed to the participants are adjusted with a corresponding charge (or credit) to compensation and benefits costs. During the three and nine months ended January 31, 2010, deferred compensation liability increased; therefore the Company recognized a compensation expense of $1.4 million and $5.4 million, respectively. The reduction in the deferred compensation liability recognized in income during the three and nine months ended January 31, 2009 was $2.0 million and $10.6 million, respectively.

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8. Business Segments

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

Financial highlights by business segment are as follows:

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

	Three Months Ended January 31, 2009							
	Executive Recruitment							
	North America	EMEA	Asia Pacific	South America	Subtotal	Futurestep	Corporate	Consolidated
	(in thousands)							
Fee revenue	$ 66,978	$ 30,423	$ 13,591	$ 5,650	$ 116,642	$ 19,568	$	$ 136,210
Total revenue	$ 72,118	$ 31,552	$ 13,942	$ 5,731	$ 123,343	$ 21,150	$	$ 144,493
Operating income (loss)	$ 10,767	$ (6,291)	$ 367	$ 373	$ 5,216	$ (8,309)		