Korn Ferry

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George Tong: Okay. Let's go ahead and get started. I'm very pleased to have Korn Ferry with us today. I'm joined by Bob Rozek, who's CFO of the company. Bob, thank you for being here with us today.

Robert Rozek: Thank you for the invite.

George Tong: Of course.

So, let's start at a high level with Korn Ferry's strategy. The company has expanded well beyond executive search over the past couple of years, pushing into consulting, digital, workforce solutions. Recently acquired AMS, which I know we'll talk more about. Can you discuss how this broader portfolio has changed Korn Ferry's growth profile and overall cyclicality?

Robert Rozek: So, part of the initial strategy in terms of expanding our solution set with our clients was really all about moving away from a highly cyclical, highly transactional monoline business into something that has more revenue durability, resilience, and so on.

If you think about our Executive Search business, George, it converts from signing to closure within three months. So, you constantly have to go out and sell the next search.

Whereas, now we have long-term relationships. At the end of the first quarter, we were about a $1.9 billion in backlog. So, that's work that we've sold but have yet to deliver. So, very different.

Then with AMS coming on board, they have very large client relationships, and their backlog is about a $1.5 billion. And if you think about us at a $1.9 billion, we're a $3 billion company. They're at $1.5 billion, and they're about a $650 million company. That shows you the size and scale of their client engagements.

And so, today, we're going to have almost a $3.5 billion backlog. So, very different profile for our organization.

Not to mention, when you look at the assets that we have and the services and solutions we provide, we basically fulfill every talent need that a client has, not just finding a body when somebody leaves or they get terminated, but providing end-to-end talent solutions for clients.

George Tong: Recently, the company has shifted to more of a regional operating model, carving the business up into the Americas, EMEA and APAC as the primary integrators of solutions across the company. What changes operationally under this new model? And how do you think it's going to improve execution and growth?

Robert Rozek: So, really, what changes, this is all about becoming much more client-centric. And in order to do so, you have to meet clients where they're at, which is on a local basis. And what we've found over time as Gary and I would manage the business, we were really focused on solutions. So, I'd go to Mathias, say, "Hey, what's going on in digital," or Lesley, "What's going on in consulting?" And we were creating divisiveness within the business, so everybody becomes siloed.

And as we stepped back and we said, "Okay, that worked for us to a point, but it's not going to help us get to the next level. We have to bring our organization together before we split it up." And so, the whole concept behind the regions was to do that and really focus on clients.

And what we've done operationally now, so Gary drives all of our go-to-market activities, and we get on a call every other Monday. We look at all the new business we've won. We look at all of our marquee and diamond accounts, all our must-win opportunities, and he's got his whole leadership team doing that. So, no longer are we going, again, to the individual solutions and seeing what they're doing; it's what we're doing collectively as a team.

And then on the operating side, that's where my responsibilities come in. And I still look at the business regionally and by solution groupings, because as I think about resource decisions and so on, it would be really hard to do it just at the regional level.

So, we've kind of broken it up, and that's the operating model that we've got in place that we're following now.

And on the go-to-market side, if I go back to May 1 of last year, what we measure is what we call our business referrals; so, when one solution refers something to another solution. It was about 25%. We were stuck there for about four quarters. And then as we started with this new operating model, we saw that start to ramp up and we just finished Q1 at almost 29.5%. So, we're seeing real kind of cause and effect, if you will.

George Tong: And on that topic of cross referrals, where do you think that 30% can go to over time?

Robert Rozek: I'd be surprised if we don't get it up to at least 35% at some point in time.

And I think bringing AMS on I think is going to be a real accelerant for us, in that they're probably – not probably – definitely the most buttoned-up company that we've bought. Really good talent in the organization. And their solutions sort of complement, even though it's some of the same stuff, they complement ours. So, they're strong in financial services. We're strong in industrial. They've got – we have an Interim business where we place individuals. They have what they call Contingent Workforce Solutions, where they're actually outsourcing the acquisition of contract labor. So, it's not like you're taking two things and just bringing them together. They're actually additive to each other.

George Tong: Let's talk more about AMS, because it really does significantly expand Korn Ferry's Workforce Solutions. What made AMS the right strategic fit for the company? And why is this the right time for the transaction?

Robert Rozek: So, they had been owned by private equity. I think OMERS was the most recent. It was their third private equity. So, it was probably about a 15-year period. And they built – they have a really nice business. They're very buttoned up. And I think they got themselves to the point where they were tired of getting ground down by PE. And they were looking for how do we take this organization to the next level, and we happen to have a phenomenal platform that we could plug them into. And I think, as I said, the complementary nature of it, it just made sense at this point in time for us to do that.

George Tong: AMS specifically adds Contingent Workforce Solutions, early career, skill creation, tech consulting, all of those solutions. Which capabilities do you think represent the largest incremental revenue opportunity for Korn Ferry?

Robert Rozek: The one that – maybe you get a different answer if you ask Gary versus me. I personally think the Contingent Workforce Solutions. As a CFO, if somebody came in to me and said, "Hey, your contract spending is probably inefficient, you're probably spending more than you even think you are, I'll take that over for you, we'll get it all organized and I'm going to save you, whatever, 6%, 7%, 8% a year," that's a fairly easy value proposition and an interesting one.

Gary's pretty excited about the – it's called ECC – the early career and campus recruiting. They do that primarily in Europe, and they service PwC, Deloitte, Goldman Sachs, firms like that. Bringing that over to the U.S. I think is also a huge, huge opportunity.

George Tong: Now, AMS is quite large. It's going to basically double your employee count, your colleague base and then also expand your geographic presence to 120 countries. What do you think are the most important integration priorities given this scale? And what are the potential execution risks as you think about the next year?

Robert Rozek: I would say one of the most important things that we're going to do is obviously we have to bring them onto our system. And we've got a great integration playbook to do that. Our plan is to have them flipped over onto our systems come May 1 of next year. It's going to be a heavy lift, but I'm extremely confident that we're going to get there. The team that I have in place is phenomenal.

The one thing that I find very interesting about this is we're $3 billion, with about 9,000 people. They're $650 million, with 8,000 people. But what they've done is they've created these global capability centers – so, in Pune, in the Philippines, Monterrey. And us being able to leverage those I think is a real huge opportunity when we go through the integration aspect, because they've got very low-cost labor in those locations. So, that's what I'm excited about.

And I think the other, all the go-to-market activities, which again that's kind of what Gary's driving, to me, that's the biggest opportunity coming through all this.

But we've talked about taking a business that's $650 million revenue, $100 million of adjusted EBITDA, and taking that up to $140 million within a year. Very, very confident that we'll be able to do that. As we exit the one-year anniversary, the run rate of EBITDA at that point will absolutely be at the $140 million level.

George Tong: Right. And so, the $650 million in revenue, how would you characterize the growth of AMS standalone? Is the growth accretive, growth neutral to Korn Ferry?

Robert Rozek: I would say it's – if I go back and look at us historically and them historically and I take out M&A for us, I would say we're probably about the same.

George Tong: Okay. Similar growth profile.

Robert Rozek: Figure 6%, 7%.

George Tong: And then, so getting the $100 million EBITDA at AMS up to $140 million EBITDA for AMS in a year, how much of that $40 million growth comes from synergies, revenue synergies and/or cost synergies? And how much comes from just inherent growth within the business from scale, operating leverage, et cetera?

Robert Rozek: Right now we're just planning on getting there through synergies.

George Tong: Synergies alone. Okay.

Robert Rozek: Through synergies, yes.

And I would say we, again, have a phenomenal playbook. So, we'll get – we're very confident we'll get there. The lion's share of it early on will probably be more aligned to cost synergies. They've got a lot of G&A costs. They had a lot of costs that the PE guys put on. That stuff just goes away. So, we'll have the lion's share through cost synergies. And then over time, as we become more familiar with them and they become more familiar with us, that's when we would see the revenue synergies kick in.

George Tong: Makes sense. And then, can you walk a little bit us through the EPS accretion dynamics near term and then longer term when you would expect it to be EPS accretive?

Robert Rozek: So, when we initially did the modeling – in the companies that we buy, when you do the valuation for the opening balance sheet, one of the assets that are on there is customer relationships. And for us, historically, those have been about 15% of the purchase price. In this case, we knew their relationships were stronger. So, when we modeled it, we modeled it at about 20%. PwC does our valuation work. It actually came back at 33%. So, the amortization is higher than what we had anticipated. But if I step back from that, to me, that's actually a good thing because that means that those customer relationships are very valuable. And that's what's important for us.

If you look at where we are today and you look at what the guidance is for the second quarter, the EPS ticked down from – we did $1.43 down to, we guided to a $1.35. Their EBITDA covers the incremental amortization and so on. It's actually the incremental shares that we issued that make it dilutive.

But if you step back and you take the $40 million tax effect at our effective tax rate, it ends up with about $29 million of net income. And you divide that by 55 million shares, and you're creating $0.52, $0.53 of value right there. And that assumes that we don't pay down any debt, we don't buy any shares back. So, there's upside to that. And then when you start to get the revenue synergies, further upside.

George Tong: So, first quarter is going to be EPS-dilutive, but by the end of the first year EPS-accretive.

Robert Rozek: Yes.

George Tong: Got it. Let's talk a little bit more about revenue drivers for the company. So, Korn Ferry has now delivered six consecutive quarters of positive fee revenue growth. What are the more cyclical businesses of the company telling you or currently signaling about the current economy and broader labor market?

Robert Rozek: I would say that if you look at that 6% growth, a good chunk of it has been delivered through the talent acquisition businesses, whether it's Executive Search, Pro Search, RPO, or Interim. And we're starting to see a lot more confidence in hiring decisions being made. And each business is a little bit different. Executive Search, you have – we call it Peak 65 – you have a lot of baby boomers who are reaching retirement age, and either they want to go off and do something different or maybe they just want to work part-time. And so, we're seeing a lot of volume through our Executive Search business.

On the Professional Search side, we're actually adding fee earners. And if you think about that business, George, Exec Search is probably a $5 billion or $10 billion marketplace, somewhere in between there. Pro Search is about $25 billion, and our Exec Search business is roughly $1 billion today. Our Pro Search business is probably about $250 million. So, there's an enormous amount of market for us to go after.

On the Interim side, we're starting to see that business really pick up. And I think if you look at our peer set, we're actually doing better than they are because of being part of the Korn Ferry ecosystem. It's real easy for people to refer work into Interim because it's kind of what we do, talent acquisition.

George Tong: And AMS will make that stronger.

Robert Rozek: Absolutely.

George Tong: So, within your Search business, you've moved upmarket more. You're winning more deals that are senior-level assignments. What's your outlook for engagement volumes and pricing given that mix shift upmarket? And how much additional runway do you see from this upmarket shift?

Robert Rozek: I think from a pricing perspective, I mean, the pricing model stays the same. It's a third of the first-year cash comp. But as you move upmarket, obviously, you're dealing with people who make more money. So, you get a higher average fee. And we've seen that grow over the past four or five years.

The one area that – it's part of what Gary does with his client centricity. So, every day we get emails on all the new business we won the day before. And at first, it's like, "Oh, man, I've got to go through another 50 emails." But now, I actually – as you pay attention to it, the one C-suite area that I'm finding really predominant now is CFOs. There's been a – I see a lot of CFO churn happening at this point in time.

I think there's really good runway left in terms of people getting to the point where it's time to hang it up and go on and do something different. This Peak 65 I think is in the early stages.

I would say on Professional Search, again, we're playing at higher levels; so, somewhat insulated from AI. I think some of the early narrative around AI was nobody was ever going to work again, and now you're back to, "No, that's not really. It's going to be more of an efficiency tool." And I think as people got the tool out into employees' hands, if you just let everybody do it to their own liking, how do you ever capture that productivity? Beause you're doing something different, I'm doing something different.

And so, one of the things we're doing is, I said to our guys, "Okay, we've got the tool in everybody's hands, but now we've got to figure out an organized way to capture that productivity." And when you start to do that and you start to look at a job and deconstruct that job, it's pretty easy to realize AI is not going to replace that job. It might impact certain tasks, but it's not going to replace it.

So, I think the pendulum has swung on the whole AI thing, and it's creating actually a tailwind for us, where I need people with different skills. It's creating new jobs that we haven't seen in the past. So, on the Pro Search side, that's where I think we're seeing a lot of the uptick in volume that we are.

I think Interim is – it went through a very rough time. It declined for, whatever it was, 36 months in a row. And I think we're starting to see that pick back up again.

In our RPO business, if I think about what we guided for Q2, they're back into triple-digit fee revenues now.

George Tong: If we look at performance across the different regions, what would you say is driving the differences in performance across the Americas, EMEA, and APAC? And how would you characterize the pipeline in each of those regions?

Robert Rozek: I would say the pipeline for each of the regions is good. I would say Asia is probably the most impacted by the conflict in the Middle East, which early on was kind of a surprise to me, but probably shouldn't have been. They're very reliant on resources coming through the Strait. And so, they've really been impacted. That business for us is kind of just stable right now, not growing dramatically.

Europe was somewhat immune to the Middle East, and now we're starting to see it have some impact. So, our growth in Europe in the first quarter was about 4% or 5%. It was down, but it was about 4% or 5%.

And Americas seems to just be chugging along, as if the Middle East is not an issue.

George Tong: If we look at performance within your Talent and Organizational Solutions business, what do you think it would take for that business to accelerate in growth and potentially reach a target of double-digit growth?

Robert Rozek: I think a couple of things. As we elevate the level of engagement that we're doing in that business, you're naturally extending the sales cycle. And I think given some of the uncertainty with the Middle East and so on, the sales cycle that's longer already, people are taking longer and longer to sign deals. So, I think we need resolution on some of the uncertainties that exist in the macro environment today.

The other thing we've done in the digital business, we have a annual performance cycle that we go through, and we have a number of underperforming, call it, enterprise sellers in digital that we asked to move on. Hired new people on. And so, they need some time to ramp up. So, it's probably going to be through the end of this fiscal year before they really hit their stride.

But I think it's a combination of that and then the macro settling down a bit.

George Tong: You've combined consulting and digital together into the new segment. Can you dissect how those two businesses are performing? If they're separating in performance or if they're growing similarly together?

Robert Rozek: Both those businesses are growing similar. We separated them, I don't know, I can't remember if it was five or six years ago, and the thought process as well. If you isolate the digital business, it's going to help our trading multiple, and those businesses really belong together. In fact, I tell everybody, "There should never be a consulting engagement that doesn't include digital, and there should never be digital that doesn't include consulting." Because digital is where we have all of our foundational assets. Think about data, IP, science, behavioral science. And if our consultants aren't consulting around that, then what are they talking about? So, those two businesses really belong together.

So, I'm looking forward to it. And we've got two good leaders now that are very collaborative. Lesley and Mathias get along really well. So, it's just we've just got to get the macro to settle down and have the new folks ramp up, and that business will be fine.

George Tong: Recently, you launched your new Talent Suite, and that does have a benefit to your digital business and other parts of your business. Can you talk about how much Talent Suite should be a catalyst for Korn Ferry?

Robert Rozek: I think it – one of the things I'm trying to get folks to do is to separate Talent Suite from digital. I mean, it happens to be associated with digital because that's where the tech is built, if you will. But it really supports the whole firm. If you think about it, everything that we do, all the assets that we have, whether it's assessments, it's pay data, it's development content, all of that lifts the entire firm.

So, what Talent Suite did is it put it all on a common platform and made it easier to access, easier to use. I think with the work that we're doing on AI, it's going to make it a lot easier to take bits and pieces and bring it together to create unique and interesting insights that nobody else can do, because nobody has the type of data or assets that we have.

And one of the things we're working on right now is sort of repositioning that in the market. Because I think there's a misconception that people think that this is Talent Suite, and it's not. It's just – Talent Suite is an enabling platform, and really what we're selling is talent intelligence. And so, that's the work that we're doing now on trying to reposition it. But it should be – any software you roll out – we had some stability issues. We're past all that now. And now we now need to really just drive it into everything that we do in the firm.

George Tong: You've seen some pretty healthy RPO new business activity in recent quarters. Can you talk about that? What's driving the new logo wins? And then, within existing RPO contracts, how volumes are performing?

Robert Rozek: Volumes are definitely coming back within the existing contracts. That's why they're back into triple digits in terms of fee revenue.

We have a pretty differentiated offering. What that business has done over time, they've done a really nice job of integrating our foundational assets into their offering. So, the assessments. Like, if you're going into a company, you're going to hire 1,000 people at this level a year, we'll take the top 25, assess them, and you create a profile of what good looks like in that organization. And then as our recruiters are out recruiting for them, people that they're talking to take the same assessment. So, when we show up, you have resumes of individuals that look like what good looks like in that organization.

They bring our pay data into the offering. So, we know if you only want to pay somebody, whatever, $60,000 a year or $70,000 a year, it's going to take longer because the standard is actually $85,000.

So, all of that intel we bring into the recruiting process. It gives us a bit of a differentiated offering.

George Tong: Your largest clients are known as marquee and diamond accounts. Can you talk about how your largest clients are performing? How growth within marquee and diamond accounts compares versus your overall revenue?

Robert Rozek: For the most part, those accounts every quarter grow faster than the rest of the company. Today, they represent about 40% of our consolidated fee revenue. If you go back in time, it was probably down in the low 30%'s. And so, we continue to invest in those accounts.

What I'm really excited about – and we're going through that right now – is bringing the very large AMS clients into our program. And that's going to have the impact of that really supercharging the size of that program relative to the rest of the company.

George Tong: And how do marquee and diamond accounts grow relative to overall Korn Ferry? Faster by "x" percentage points?

Robert Rozek: I would say, if you go back over the past three or four years, it's probably 300 to 400 basis points faster.

George Tong: Great. Let's talk a little bit about margins. So, Korn Ferry saw 17% EBITDA margins in Fiscal 1Q. It's targeting medium- to longer-term margins of 16% to 18%. What are the primary drivers that you think could move margins above or below that range?

Robert Rozek: I would say there's nothing that comes to mind that would drive us below that range. I would say once we – if you just take AMS and you drive them from $100 million to $140 million, you're at the top end of that range right there. So, to the extent – and we do have a great track record. To the extent we go past the $40 million, that gives us the opportunity to go above that range.

And I think to the extent that the Search businesses continue to fire on all cylinders, that's very profitable for us. And once we get the digital component of Talent and Org where we need it to be, it does 30%, 31% EBITDA margins.

So, I see a real opportunity to go above that range. I don't see us falling below even where we're at now, the 17%.

George Tong: Now, Interim Search does have lower margins than the other businesses of Korn Ferry. Can you talk about how mix could impact margin performance and if there are other areas of the business that you may push into that could be accretive or additionally dilutive to margins?

Robert Rozek: Actually, with the Interim business, when we buy them, their margins are kind of 6% to 7%. Our Interim business today is doing the same as our RPO business. It's right around 15%. So, we've driven a lot of synergies into it. And we have an organization that's plug-and-play. And most of those businesses are underinvested, not well-managed. So, it's easy for us to pick them up and bring them into our system. And then once we do that and you start to get the flywheel effect from the revenue synergies, you get a lot more volume going across a pretty stable cost base. So, we've been able to take those up to about 15%.

I would say if if we went out and bought just another interim business the size of AMS, that would obviously have downward pressure because just the mix of our earnings would change.

But to me, it's more about getting the synergies right now on AMS and getting the digital portion of Talent and Org Solutions where we need it to be.

George Tong: Right. The AMS deal does transform your balance sheet a bit. You are taking on around $600 million, $580 million of additional revolver proceeds to finance the deal. You used around $300 million of cash on hand. Can you talk about what your expectations are for de-levering the balance sheet, how quickly you can do that, and then plans for free cash flow deployment after that?

Robert Rozek: So, right now, we've got a little bit north of $1 billion of debt on the balance sheet, and our gross leverage ratio is about 1.7x. From a capital deployment perspective, if I go back over the past two years, two years ago we bought back about $100 million of stock. Last year, we bought about $115 million. And that's capital that we had the ability to make a decision with.

Now, some of that will get consumed as we drive cost synergies. I would say, as I look forward to the end of this year, I would say a minimum of $50 million to $60 million of that will be available for us, and our inclination is to pay down debt, first. Now, having said that, if there were some substantial dislocation, it would be an opportunity to buy stock. But we would do the math, and whichever made more sense we would do. But right now, our inclination is focused on debt pay-down.

George Tong: And then once you get the debt paid down, presumably you would be open to M&A. How are you thinking about your M&A strategy following this large transaction? Are strategic larger acquisitions off the table for now as you ingest and digest this larger deal? Or are you going to be back to the markets looking for transformative strategic deals?

Robert Rozek: I would say you probably won't see us do something of this size within the next year. We've got to digest the bite we just took. And then, after that, there's not – think about the target environment. It's not rich with companies of this size. They come along every now and then. You'll probably see us go back to more of the $100 million, maybe $150 million, $200 million tuck-in type deals.

George Tong: And as you think about those tuck-ins, which areas of the business are you most interested in growing inorganically?

Robert Rozek: The Interim business is interesting to us for a whole host of reasons. One, I think the change in the dynamics in the labor market would lend that to – lead us to say, well, that's an area we want to continue to invest in. I think the success we're seeing with the cross-selling, referring across, is also something that's interesting to us as well. So, you'd probably see us continue on the Interim side. Leadership and professional development is something that we would be interested in doing as well.

George Tong: Great. Well, we're just about out of time. Bob, thank you for the great discussion.

Robert Rozek: Very good. Thanks, George.