Korn Ferry

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George Tong: Good afternoon, and welcome. I'm George Tong. I'm the business services analyst at Goldman, and I'm really pleased to be joined by Bob Rozek, CFO, and Mathias Herzog, Head of Korn Ferry's digital business and president of the firm's global technology practice. Bob and Mathias, thanks for joining us today.

Bob Rozek: Happy to be here.

George Tong: Great. Let's start with strategy. Korn Ferry has diversified its business over the years well beyond executive search and the business now includes consulting, digital solutions, interim search. Why is it an advantage to have all of these businesses within the portfolio?

Bob Rozek: Listen, I think to me the key advantage of it is the ability to drive topline synergies across. If you think about all our core solution areas, George, we have Org Strategy, Assessment & Succession, Talent Acquisition, Leadership & Professional Development, and Total Rewards. As you're selling into your clients, there's such connective tissue between all those solution areas. And we're the only firm in the world that has all those core solution areas. When we approach our clients, it's kind of one stop shopping. Common science, common language, and so on. And the ability to sell across is very, very easy.

George Tong: Makes sense. It also certainly makes the business more macro resilient.

Bob Rozek: It does. You have to go back to the Great Recession, peak quarter, trough quarter, and we were predominantly Exec Search at the time, we were down 51%. You go back to COVID which wasn't necessarily a recession, but it behaved like one, and we were down 28% or 29% and the business mix had changed dramatically.

George Tong: How would you describe the cyclicality of your various business lines? Which are more cyclical? Which are least cyclical? Which are in between?

Bob Rozek: I would say that the talent acquisition businesses, Exec Search, Pro Search and RPO, are probably the most cyclical. For RPO recs, you're seeing that for the first time this time. In the past, it hasn't been quite as cyclical. I would say Consulting and Digital are probably half as much as what you would see in the Talent Acquisition businesses. In Digital, as we continue to grow the subscription and license base, it ought to become less and less cyclical.

George Tong: Makes sense. I guess speaking of cyclicality, what do your more procyclical businesses tell you about where we are in the cycle?

Bob Rozek: Good question. Listen, I think we're -- we've been waiting for this recession to happen for a long, long time. Really what we're hearing now from our folks in the field is that the levels of business activities are still pretty high. What's happening now is clients are just taking longer and longer to sign engagements. We've had some clients, even outside the U.S., talk about we're not going to do anything until we see how the U.S. election resolves itself.

George Tong: Now, Mathias, you're responsible for leading the firm's Digital business. This segment deploys and sells IP related to products around Korn Ferry's HR technology and various functional cross area lines of businesses. Can you talk a little bit more about the Digital business, its strategy and its various unique assets?

Mathias Herzog: Yeah. Happy to. Thaks for the question. Digital for us, it's essentially our HR tech business, where we have our products, our software applications, our solutions. It's about a $360 million, $370 million business today. 40% of that is subscription revenue. And we have products that address a wide range of talent use cases. Everything from helping our clients add scale with the definition of what good looks like in a given role, if you think about job profiles, job descriptions, job architectures. And then other products that our customers use to assess against what those definition are also adds scale. And so we have a variety of products in that portfolio that our customers subscribe to over a term license.

George Tong: Your longer term growth target for the Digital business is 10% to 15%. Right now, you are in the mid-single digit range. When do you think the growth can get to your targeted growth range and what are the catalysts?

Mathias Herzog: Yeah, it's a good question. We're doing a number of things to the business to get it on that trajectory. I think the foundation is really strong, the IP is really strong, the size of our products is really strong. There are really 4 growth levers that we're aggressively going after. The first one is One Korn Ferry. We really want all of Korn Ferry to lean in. There's a lot of synergies that come from working cross lines of businesses, as Bob mentioned earlier, especially when we package our products together with Consulting services. Really getting that engine going at another level is one of the focus areas.

The second area of focus for us to get the growth trajectory to where we want it to be is sales productivity. We have a dedicated commercial team focused on selling our products, selling those SaaS applications. And there are levers that we're pursuing around territory optimization, things that just lift the seller productivity where I think we have a lot of room to drive momentum.

A big one for us is the product investments and the product innovation itself. A lot of the products that we have to date exist as point solutions. And we, based on what our customers are telling us, see a lot of opportunity in bringing these products together into a comprehensive talent suite on one cloud platform that drives increased consumption and adoption. Which then translates into ARR growth.

And the fourth area is another one where we're leaning in pretty heavily, which is working with partners, building a partner ecosystem, common playbook in tech. We're following that playbook, leaning in with organizations like Salesforce. We have products that run on Salesforce, in conjunction with Salesforce, and then other partnerships that we are building specifically with the prominent HCM platforms where the in-app experiences that we're going to provide, will be providing here in short order, create further room for growth. So that's going on in the business.

We do have the aspiration to double that business, and as we're looking to get to that scale, we're also going to shift the business mix to increase the subscription revenue in the business. Because we really like that sticky ARR at high margins and that's a key focus for us to get there as soon as possible.

George Tong: Right. And sort of related to that, could you talk a little bit more about how clients are consuming KF Digital today? And how could that evolve in the future?

Mathias Herzog: Yeah, a variety of ways. The cloud products, like the SaaS applications, some of them are sold as subscriptions. Most of them are term licenses. And so our customers can subscribe to those products. For many of these products, we have attached services. To give you an example, I mentioned the Salesforce partnership. We have an application that's called Korn Ferry Sell that's focused on driving seller productivity, sales effectiveness. The evergreen topic for most organizations. When -- that product, we built using the IP that we bought with the Miller Heiman acquisition, so it's a product tied to IP that integrates seamlessly with Salesforce. But we also sell training that goes with that, so we can train large salesforces on that methodology. We create then the stickiness for the adoption of that sales methodology though products. We put the software in place for that sales transformation and the sales productivity increases to really take hold. And so we provide those attached services I would call them as well in conjunction with the software.

Bob Rozek: And Mathias, maybe talk a little bit about what you're doing in terms of the platform to make it easier for not just how they consume, but to consume at all.

Mathias Herzog: Yeah. One of the things that we're addressing, also not uncommon for an organization that has multiple products, some of which came into Korn Ferry through acquisitions is, they're at point -- the point that we're at right now, but they were more point solutions, so they were bought as individual subscriptions. But when you connect the dots and you look at the use cases that these products address, they should be used in conjunction.

An example here is, if a customer of ours uses our Profile Manager application to help them with their job architecture design or define what good looks like in a given role, or define job roles and job descriptions, we also have products that our customers can subscribe to, to then assess individuals against the job profiles.

And then we have products that can support our clients to act on the insights, the talent insights that come out of these assessments. Coaching, the coaching platform, learning products, so think about Ed Tech, Learning Tech. And the direction of play that we're moving into is to bring all of these applications together so that then you drive more connected use cases and wider adoption and more consumption of all the products.

Bob Rozek: Yeah, today it's a little clunky for clients, so you kind of log in, log out, log in, log out.

Mathias Herzog: Yeah, so this is -- if you think about single orchestration layer or single sign-on, it's common landing pages, those types of integration activities that we're pursuing.

George Tong: Right. You mentioned the subscription revenue mix is around 40% within Digital today. Here do you think that can go and what are some of the products that can get you there?

Mathias Herzog: Yeah, I think we have the products that we need to get us there. The product innovations that we're putting in are going to drive more consumption and active usage. The integration activities like bringing all these products on a common platform is going to contribute to the growth in that subscription business mix.

I think as a target, we're looking to grow that to about 60%, 65%. I think there's always going to be some product attached services, because we're also doing implementations of the products. There's the training services that we provide around these products and that's important for us because it drives consumption, it drives stickiness. I think there's always going to be a portion of the business that is services related, but we want to get that percentage of subscription revenue to about 65%.

George Tong: Got it. Let's take a step back and talk about broader revenue trends. In the fiscal first quarter, you saw some additional signs of stabilization in some of your more procyclical businesses, albeit off depressed levels, so no positive inflection yet. Can you talk a little bit more about some of these trends in Exec Search and --

Bob Rozek: Yeah, well in Exec Search, we actually did see a little bit of positive inflection. We grew about 2%, maybe 3% in constant currency in the quarter. But in our Pro Search business, that was down 7%, something like that, around 7%, 8%. And it was kind of flat year-over-year, or quarter sequentially, but the decline in the business. We also saw our interim business was down about 17% year over year. And again, sequentially it was roughly flat, so we are starting to see parts of Talent Acquisition flatten out. We saw a little bit of positive inflection in Executive Search. And then the last one is RPO and that business has been fairly flat for the past 2 or 3 quarters now. And we expect it, when you think about what we guided to, we expect those businesses to roughly continue to be flat.

George Tong: Right. Within Executive Search, are there certain geographies that are growing or performing stronger than others? And are there any reasons why some of the recent trends may deviate from historical performance?

Bob Rozek: Yeah, I would say -- if I go back to our fourth quarter last year and our first quarter this year and I look at new business, it's been very interesting. The fourth quarter, the first 2 months of the quarter were soft. This is in Exec Search. Then the last month was very strong. We saw the exact same thing happen in the first quarter of this year. In fact, the North American business had an extremely strong month in the month of July.

But I would -- I think as I look at where we are with each of those areas, the one area that's really been a surprise to me all along is Europe, how well the Executive Search business has continued to do there. They ended up with a fairly strong first quarter, it came in as a strong part of our guide in Q2 as well. That business has really held up. I think a lot of it is due to we have an extremely good management team in place there. And they actually function very well together as what I would call One Korn Ferry. Everybody is attached, we all know what we're doing, and we go to market on a combined basis. I think that's what's allowing us to enjoy some of the success that we are in Europe.

George Tong: Got it. You're targeting Consulting revenue growth in the 10% to 15% range or similar to Digital. What are some of the catalysts that can jumpstart Consulting growth from what currently is around the low single digit range?

Bob Rozek: I would say there's probably a couple of things. One, it's kind of funny, you think about the chaos that's going on in the world, and every time there is chaos or chaotic events that are out there, companies are trying to figure out how do I navigate? That creates a tailwind for us. As I look at the Consulting business today, our Org Strategy business is doing extremely well. And it's a part of the business where we're actually helping clients think about the transformation of the workforce. Different work needs to get done, it needs to be done differently, and so on. One area I'm really excited about is our Assessment business and using the assessments that Mathias talked about. Gary made a comment in one of our management meetings one day, he said, assessments are to Korn Ferry what hamburgers are to McDonald's. And you think about the assessment, that drives development, it drives talent acquisition, it drives succession planning. And there's so many things that we do that feed off the assessment business that I think it's going to be one of our critical growth drivers going forward.

Another area that I'm pretty excited about is Leadership & Professional Development. We've had 2 very large tech companies and one very large financial institution come to us over the past 18 months and say, hey, we love your coaches, we love your content, will you take the next level of leadership in our firm in development for us? So you get 2, 3, 4-year contracts that are in the $15 million, $20 million range and you do that for folks. I think those are going to be some of the, as I look forward, some of the real drivers of growth in Consulting.

Mathias Herzog: Maybe building on that, because that also feeds into some of the synergies between the lines of business, so as we're -- the assessment business for Digital is a very high potential business for us as well. When we think about what can operate as a catalyst for consumption of other products, it is assessments. I think once you do assessments at scale, you identify talent gaps. When you identify -- you need to do something about those assessment insights. And usually, what you end up doing with the insights of what organizations ought to be doing is, you take action. Whether that's through development, intervention or coaching. And so, there is a lot of synergies that happen when we do things, assessments at the top of the house and organizations start to get exposure to the IP and to science that's embedded in the work that we do. And more often than not, the question comes up, well, this is great stuff, but can we scale this? And we have the talent suite lined up to then provide that scale and use these technologies using subscription services to really allow our customers to tap into all the science and the IP that we have.

Bob Rozek: And get the insights from. We've got a team right now that are really going after gaining insights from analytics. Just to give an example, Gary was a call with the CEO of a very large healthcare company about 2 months ago. He had this team go in and we've assessed a lot of their executives over time, and he went into the conversation with a whole sheet of insights. Did you know that your workforce looked like this? Or relative to itself or relative to industries? And the CEO at the company was blown away by what Gary was able to tell him about his workforce.

George Tong: Right. Now, given both your Digital and Consulting businesses have the 10% to 15% medium term target, which of the 2 do you think will get there first and why? And Bob, what's your favorite?

Bob Rozek: I would say, and I'm not playing favorites because he's sitting there, but I would say Digital will get there first. Yeah, digital will get there first because you've got the ability to sell without having to have people to execute. Where with Consulting, you can sell all the work you want, but if you don't have the capacity to deliver, you're not going to get the revenue. Where in Digital, we'll sell licenses and you kind of make money while you sleep. I think Digital has probably a better chance of getting there quicker.

George Tong: I know that Digital was put together through a combination of multiple M&A pieces with different tech stacks. What are some of the things that you might have to do to integrate and normalize all the tech stacks together?

Bob Rozek: Yeah, that's what Mathias was talking about. Because right now, we're in the process of doing it, but they're not. As you go and you do an assessment, and the assessment tells you that you have got this gap in your skillset. You log in and do that assessment, you log out. Then you go over to our Leadership Development, you log in, you log out. It's kind of clunky for people to consume those assets. Whereas once Mathias is done this year, that will be single sign-on. I go on, I do that and then I get redirected right over to the development activities.

Mathias Herzog: It's an engineering lift. In the Digital organization, we have north of 400 engineers now, so they are working on that platform integration and really bringing these applications together for a seamless user experience. There's also data integration work that needs to happen. Think about the massive amount of data that we have. The example we like to give, we've done over 100 million assessments, again, to see what good looks in a given role. That's a massive amount of proprietary data. Pair that with all the pay data that we have from our Pay subscription business, the path that we're on is to essentially bring all those data assets together, integrate the applications under one technology platform, and then we're off to the races. It's an engineering lift.

George Tong: Got it. Korn Ferry is also in the RPO business. Can you briefly talk about what the RPO business is for those that might not be familiar?

Bob Rozek: Sure. To me, RPO is recruiting at scale. Companies will come to us and say, hey, we're going to hire, pick a number, 5,000, 7,000 people over the course of the next year. And we want to outsource that function to you, Korn Ferry. For us today that's roughly about a $400 million business. It has grown nicely prior to the pandemic. Right now, it's kind of flat. They're doing about roughly $90 million of business a quarter. It's been up as high as $114 million I think at one point. But once we get past the current environment that we're in and things look better and we start to see the base of our clients elevating their talent requirements, then we'll get back to normal levels. And if you simply were to take all the contracts we have in place today and bring them back to their original contract value versus the depressed levels that we're at, that would add about another $50 million, $55 million in fee revenue.

The other thing that we've seen over the course of the past year in that business, George, is if I go back to '22 and '23, we had roughly $600 million in new business both of those years. And 70% of that was a new client, so we call it a new logo. 30% was renewal. We had such success with new clients, as those things are coming to the end of the term, what we're seeing now is a lot more renewals. We've seen that during FY'24 and we saw it in Q1, but we do expect that to flip back to I would say probably 50/50 going forward. And we'll be well above the current levels of new business that we're at today.

George Tong: Got it. That's helpful. Typically, the RPO business is going to be driven by new business wins that can be lumpy and then ongoing hiring volumes or base volumes from existing clients. Where are you seeing most I guess sensitivity to cyclical trends? Is it the base performance or is the new client wins?

Bob Rozek: I would say it's probably the base, the base performance. We had this phenomenon we talked about couple of earnings calls ago. Gary referred to it as labor hoarding, where companies weren't downsizing their recruiting organizations. They were hanging onto people, and rather than giving volumes to us, they were keeping it. And the reason why they did that was, if you go back to the pandemic recovery, the slope of that curve was really, really steep. At one point, there was even an article in The Journal that talked about the hardest job to recruit for is a recruiter. So companies were kind of hanging on.

We're not seeing that as much anymore, so I think right now it's really just the base and as the world gets better, that base recovers.

George Tong: Got it. Interim Search is a relatively new business for Korn Ferry. Revenues are currently declining double digits. Can you talk about how Korn Ferry's Interim business is different or better than other temp staffers out there?

Bob Rozek: Yeah, I would say there's probably 2 things as I think about our business that's different and/or better. One, if you look at like a Robert Half or a Manpower, they provide staffing at virtually all levels of an organization. Where our Interim business mirrors our executive search and professional search. We do C-suite down to professional levels. We don't go anywhere below that in an organization. That's one.

I think second is, if you think about creating cross line of business referrals and synergies, as a search partner, it's really easy for me to understand what interim is. And even if I get an opportunity to do a search, I can very easily say, hey, let me get you an interim body until I find your perm hire. We're seeing the level of activity between the lines of business for the newly acquired Interim businesses pick up a bit.

George Tong: If you sort of dive into the Interim Search business, are there certain pockets, either end markets or geographies, that are experiencing more pressure than others?

Bob Rozek: Right now, we're feeling a bit more pressure in finance and accounting. If you went back to Q3/Q4 of last year, it was more in IT. I think -- we bought a business called [Continuum]. They do C-suite. That business has stayed relatively consistent. The other thing is, right now our business is heavily concentrated in the U.S. Opportunities for us are obviously to expand into Europe, Asia and so on.

George Tong: Right. One of the key advantages of having a diversified business model is the cross selling. Can you talk about what your rates of cross line referral activity is right now and where it can go to over time?

Bob Rozek: Yeah. Right now, we're hovering somewhere close to 27%, maybe a little bit below that level. We've had it up as high as 29% and where it dropped down was one, going through the bad or challenging economic times. The RPO business was one where we had a lot of cross line of business referral activity. And as those volumes came down, that impacted us.

And then by buying the interim business, because it takes a while to ramp those up, and so we had a sort of denominator/numerator effect going on. My gut is, once we get through the current environment and things get better, we should be 30% plus on our cross line of business activities. We've actually -- we have a referral program we've put in place, and this year we actually sweetened it a bit and we opened it up to more parts of the business. Virtually everybody in the company now that refers a piece of work in or outside our line of business gets compensated for it. We moved the award up from 10% of the value of the engagement to 12.5%.

George Tong: Gotcha. Most of your cross selling typically happens among your larger customers, your marquis and your regional accounts. Can you talk about what revenue mix your marquis and regional accounts represent and how fast those accounts are growing?

Bob Rozek: Yeah, I would say right now we have 350 accounts that we classify as marquis and regional. Just to give you some perspective, today we have roughly say 14,000 clients. We have a lot of clients that buy one-off type things, so if you carve those out, we're probably somewhere 9,000 to 10,000 that we consider real clients. And 350 of those are the marquis and regional accounts. They generate 37% of our revenue. Obviously, a large portion. Over 60% of those accounts use more than one line of business. And what we found over time is, when you sell more than one line of business into a client, the revenue opportunities are 4x to 5x greater than just a monoline client.

George Tong: I'll pause there for a moment to see if there are any questions from the audience? Okay. Let's turn to margins. Your guidance points to roughly 250 bps of year-over-year margin expansion in fiscal 2Q. What's driving that significant amount of margin expansion and how sustainable is it?

Bob Rozek: I would say that right now, if you go to the midpoint of our guidance, it's 16.5% which is a 250-basis point improvement. It's definitely sustainable. We've done a lot in terms of managing our cost base. If we look at our real estate for example, we've taken out about 35% of our footprint because we just don't need it. People aren't going into the office like they used to. When you look at our -- before the pandemic, our travel, business development budget, we'd spend $10 million, $11 million a quarter. Today it's about $5 million because there's so much stuff happening virtually. We've been driving enormous productivity into our workforce. And we're closely managing costs going forward.

In fact, we were so confident in our ability to continue it at this level, we took our dividend up in 2Q last year 83% in that quarter, and then we actually bumped up again at yearend. Today, our EBITDA this quarter did about $111 million. I would say if you look at our share buybacks and our dividends on an annual basis, it's probably $170 million to $180 million combined. And we're very confident that we'll be able to continue at that level.

George Tong: Some of your newer business ventures like Interim Search, carry lower margin profiles. How much of a revenue benefit would you need to see from these businesses for you to get comfortable with the margin profile?

Bob Rozek: I think we're comfortable with it today, because you have to look at the company as a portfolio. If we get Mathias growing at the rate that we expect him to grow, that's a 30% margin. We're going to get some pluses and minuses when Talent Acquisition bounces back. Exec Search is somewhere between 25%, 27%. Pro Search is probably closer to 28% to 30%. So as the mix moves and evolves, we're not particularly concerned about the Interim business coming in. And quite honestly, when you buy those businesses, they're typically doing about an 8% EBITDA margin. They're pretty poorly managed, really underinvested, and we're plug and play. We have a platform that has common systems, common processes, controls across the globe. We literally pick the business up and plug it in. We're able to get a lot of cost synergies out just by doing that.

In fact, when we take a deal to our board, we never like juice up the revenues. We keep revenue fairly conservative and we're able to make the math work just on the cost takeouts.

George Tong: In the fiscal quarter 2Q, your margin guidance like you said is 16.5%. What is your longer-term target for EBITDA margins? How do you bridge that gap?

Bob Rozek: Well, well right now we're within the range. We talk about our long-term targets in the 16% to 18% range. And again, a lot of it is going to depend at any one point in time what the revenue mix looks like. If we double or triple down on Interim, it will push it down towards the lower end. If Digital pops back down, Talen Acquisition pops back, it'll push it up towards the upper end. My gut is, we're staying at 16% to 18%, but if we really get the Digital business where we want it to be, we could blow through the top end of that.

George Tong: And then lastly, capital allocation. What are your current capital allocation priorities? And if you're looking at M&A, where do you see the most opportunity?

Bob Rozek: Sure. We've always followed sort of a balanced approach to capital. Our priority is always going to be to put that money back into the business first. That's hiring talent, teams, it's investing back into other stuff that Mathias is doing in Digital with CapEx. And then it's doing M&A work. And we do generate a lot of cash, so we're always going to be above and beyond what we can consume internally and so that's when we put the dividend and the buybacks into place.

I would say from an opportunistic perspective, I mean Gary would love to do a strategy firm, but there's just not a lot of assets out there. I don't think you'll see us do that. I think the opportunities in my book are going to be more in the Leadership & Professional Development space potentially as well as to continue investing in the Interim space. The Interim space is a massive market, worth $300 million. We look at it from a growth perspective as being just a huge opportunity for us.

George Tong: Great. Well Bob, Mathias, thank you so much for time and the insights.

Bob Rozek: Very good. Thanks, George.

George Tong: Please join me in thanking the management team.

Bob Rozek: Thanks, everybody.