

Q3 2023 Korn Ferry Earnings Conference Call

GREG: Ladies and gentlemen, thank you for standing by. And welcome to the Korn Ferry third quarter fiscal year 2023 conference call. At this time, all participants are in a listen only mode.

Following the prepared remarks, we will conduct a question and answer session. As a reminder, this conference call is being recorded for replay purposes. We have also made available in the Investor Relations section of our website at kornferry.com a copy of the financial presentation that we will be reviewing with you today.

Before we turn the call over to your host, Mr. Gary Burnison, let me first read a cautionary statement to investors. Certain statements made in the call today, such as those relating to future performance, plans, and goals, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Although the company believes the expectations reflected in such forward-looking statements are based on reasonable assumptions, investors are cautioned not to place undue reliance on such statements.

Actual results in future periods may differ materially from those currently expected or desired because of a number of risks and uncertainties which are beyond the company's control. Additional information concerning such risks and uncertainties can be found in the release relating to this presentation and in the periodic and other reports filed by the company with the SEC, including the company's annual report for fiscal year 2022 and the company's soon to be filed quarterly report for the quarter ended January 31, 2023.

Also, some of the comments today may reference non-GAAP financial measures such as constant currency amounts, EBITDA, and adjusted EBITDA. Additional information concerning these measures including reconciliations to the most directly comparable GAAP financial measure is contained in the financial presentation and earnings release relating to this call, both of which are posted in the Investor Relations section of the company's website at www.kornferry.com. With that, I'll turn the call over to Gary Burnison. Please go ahead, Gary.

GARY BURNISON: Hey. Thanks, Greg. And good afternoon, everybody. Thanks for joining us. Number one, I'm very proud of our third quarter performance, particularly in light of the macroeconomic environment. Given our scale and the depth and breadth of our IP data and content, we are incredibly well positioned to enable our clients to navigate an economy in transition.

Our strategy is working. We've built synergistic businesses around executive search that are generating more durable fee revenues. We're going to continue to prioritize investment into larger, faster growing, less cyclical markets that set our firm and our clients up for success.

As an example, the recent addition of Salo now brings our interim services to be more than 10% of our firm's revenue on a pro forma basis. This wasn't even a business for us a year ago. And yeah, this might be the most anticipated downturn ever.

But this is also a transitory time. And like others in the past, it also brings opportunity. It's a proving ground for the efficiency of our strategy, the strength of our culture, the resilience of our colleagues, and the potency of the Korn Ferry brand. With that, Bob, I'll turn it over to you.

BOB: Great. Thanks, Gary. And good afternoon or good morning, everyone. Our results in the third quarter continue to provide proof that our growth strategy is working.

For instance, excuse me, we continue to demonstrate the ability to drive top line synergies between our solutions. As an example, our recent acquisitions in the interim space, which we believe provides real outsized opportunities for growth, they have created almost 700 additional engagement wins resulting in an incremental \$43 million in fee revenue since the third quarter of fiscal year '22 when we acquired the Lucas Group. And this is all through cross sales between the acquired entities and legacy Korn Ferry.

Cross sales between our other lines of business and both our marquee and regional accounts both continue to also perform very well in the quarter. I recently celebrated my 11th year with Korn Ferry. And one of the reasons why I joined the company was the growth strategy. It really resonated with me. And I believe more deeply in it today.

We are relentlessly driving an integrated solutions based go-to-market strategy, delivering unparalleled client excellence, extending the Korn Ferry brand, advancing Korn Ferry as the premier career destination. And we're pursuing transformational opportunities at the intersection of talent and strategy. This growth strategy served us well back in 2012, excuse me, when I joined. And it continues to do so and even more today. Let me turn the call over to Greg who will take you through some of the overall company financial highlights.

GREG:

Thanks, Bob. Turning to our third quarter financial results, fee revenue was \$681 million for the quarter, which was flat year over year and up 4% at constant currency. By line of business, fee revenue was mixed as demand in executive search and permanent placement professional search moderated from post-pandemic recovery highs, while our consulting digital RPO and interim solutions remained relatively stable.

Measured year over year at constant currency, consulting was up 4%. Digital was essentially flat. And RPO was up 9%. Including revenue from recently acquired businesses, professional search and interim was up 33% at constant currency, while executive search was down 9%.

In the third quarter, consolidated new business excluding RPO was up 5% year over year at constant currency and up approximately 1% at actual rates with growth in all lines of business except executive search. In the third quarter, adjusted EBITDA was \$96 million with an adjusted EBITDA margin of 14%, which was in line with our guidance. Earnings and profitability were impacted by an overall mix shift in fee revenue to lower margin lines of business, investments in fee earner, and execution capacity, and to a lesser extent wage inflation.

Adjusted fully diluted earnings per share in the third quarter were \$1.01 which was down \$0.58 or 36% year over year. Adjusted fully diluted earnings per share excludes an after tax charge of \$42 million or \$0.80 per share related to the realignment of our workforce and the impairment of certain real estate assets. GAAP totally diluted earnings per share in the third quarter were \$0.21.

Our investable cash position remains strong. And our current capital deployment continued to be balanced. For all of fiscal '23 through the end of the third quarter, we repurchased approximately \$80 million of our stock, paid cash dividends of approximately 25 million, deployed \$99 million for business acquisitions, and funded about \$48 million of capital expenditures, most of which was directed towards product development initiatives for our digital business. With that, I'll now turn the call over to Tiffany to review our operating segments in more detail.

TIFFANY:

Thanks, Greg. Starting with KF Digital, global fee revenue in the third quarter was \$85 million, which was down 6% year over year and approximately flat at constant currency. Digital subscription and license fee revenue in the third quarter was \$30 million, which was approximately 31% of fee revenue for the quarter. Global new business for KF Digital was 109 million with 39 million or 35% of the total tied to subscription and license sales. Earnings and profitability in the quarter were impacted by investments and product development initiatives and a slight uptick in SG&A.

For consulting, fee revenue in the third quarter grew to 162 million, which was flat year over year and up approximately 4% at constant currency. Fee revenue growth was strongest in organizational strategy, which grew 12% versus prior year. Additionally, global new business for consulting in the third quarter was up 9% year over year at constant currency.

The professional search and interim new business increased 30% in the third quarter versus last year, driven by double digit strength in North America, aided by the current year acquisitions. Total fee revenue was 118 million, up 28 million or 31% over the same time period. Breaking down the quarter, growth in the interim business was more than enough to offset the expected deceleration in the permanent placement portion of the segment. Interim services fee revenue grew to 53 million from 15 million in the same quarter of the prior year, driven in part by the recent acquisitions of Patina and ICS. Permanent placement fee revenue declined by 10 million to 65 million year over year down 13% at actual and down 11% at constant currency.

Moving on to our recruitment process outsourcing, new business for the third quarter was 44 million, and total revenue under contract at the end of the quarter was approximately 837 million. Fee revenue totaled 104 million, which was up 5 million or 5% year over year, and up approximately 9% at constant currency. The pipeline remains strong as RPO continues to win new business by offering a differentiated tech enabled solution across a variety of markets and industries.

The volume from these new wins offsets some of the volume moderation seen over the last few quarters positioning the RPO business for strong growth when the moderation in the base abates. Finally, global fee revenue for executive search in the third quarter was 212 million. And as expected, experienced a year over year decline of 9% at constant currency compared to the high growth rates enjoyed during the pandemic recovery last year.

Growth in EMEA was offset by slower demand in North America and APAC. Global new business in the third quarter for executive search was down 13% year over year and down approximately 10% at constant currency. I will now turn the call back over to Bob to discuss our outlook for the fourth quarter of fiscal '23.

BOB:

Great. Thanks, Tiffany. Assuming no new major pandemic related lockdowns or further changes in worldwide geopolitical conditions, economic conditions, financial markets, and foreign exchange rates, we expect fee revenue in the fourth quarter of fiscal '23 to range from \$690 million to \$710 million. Our adjusted EBITDA margin to be approximately 14%. And our consolidated adjusted diluted earnings per share to range from \$0.97 to \$1.05. Finally, we expect our GAAP diluted earnings per share in the fourth quarter to range from \$0.89 to \$0.98.

Now in closing, we continue to believe strongly that our differentiated and diversified offerings and solutions, the organizational consultancy we have built will ensure our clients find solutions for their organizational and talent challenges for both the near term as well as in the long term. With that, we would be glad to answer any questions you may have.

GREG: Ladies and gentlemen, if you'd like to ask a question, please press one then zero on your telephone keypad. You may withdraw your question at any time by repeating the one zero command. If you are using a speakerphone, please pick up the handset before pressing the numbers. Once again, if you have a question, please press one then zero at this time. And one moment, please, for your first question.

Your first question comes from the line of George Tong from Goldman Sachs. Please go ahead.

GEORGE TONG: Hi. Thanks. Good morning. Can you discuss how new business trends-- hi, new business trends performed in the month of February? And if you have any insight as well into the month of early March?

GARY BURNISON:

Bob, you want to do that?

BOB: Sure. Yeah. Our new business trends in February when we closed out the month, George, the new business came in right where we expected it to be. And actually, it was up about 7%-- excluding RPO, was up about 7% year over year. RPO had another good, really good month this month. They did a close to \$45 million in new business in the month of February.

For March, it's too early to really talk about it. It was only we got three or four days in now, so there's really not much to say. The way that the new business comes in, at times, it tends to come more towards the end of the month. So it would be probably too premature to give you any insight into March yet.

GEORGE TONG: OK. Got it. That's helpful. And then on the digital side--

BOB: Yeah. I was going to say, the other thing I would add is the patterns that we're seeing in the month of February were exactly what we saw in the third quarter by line of business.

GEORGE TONG: Got it. That's helpful. Switching gears to the digital business, revenue growth there moderated from 15% year over year growth in fiscal 2Q to roughly flat constant currency this quarter fiscal 3Q. Can you elaborate on the reasons behind this change in growth, when you expect a re-acceleration in growth, and what the drivers will be for growth acceleration?

GARY BURNISON: Well, I think there's a couple short-term drivers, and then there's some medium to long-term drivers. The medium to long-term drivers revolve around our success with our tech platform that we're building. And that is a set of IP that is anchored around developing technologies using our developmental library of competencies and the like. So that's one factor that will increase the medium to long-term.

The second is to the extent that we're successful at bringing in partners within our ecosystem to distribute our IP. The third thing I would mention is that when you look at our sales force within the digital channel, you have to remember that almost 30% of the sales force is relatively new in the last call it six to nine months. And so it naturally takes time for those people to ramp up.

And I'd also point out a shift that we made going back a couple of years, but really a year and a half ago is moving that business to a SaaS model. And so when you look at that, and you go back say a year, year and a half ago, the subscription backlog was probably revenue under contract was 300 million. Now, it's moved up to about 350 million. And so there's been a massive shift that we've made over the last two to three years in that business from immediately recognizing revenue to creating a more sustainable business model.

So you don't necessarily see that in the revenue. But there's a major, major transformation happening. And then the final thing I'd say is that obviously, it's an environment where everybody is watching costs. And we saw it in this last quarter in the digital business from some of our technology clients cutting back on some of the things that they were getting from us, particularly around assessment. I think those are the factors that I would look to on both a short and medium to long-term basis.

GEORGE TONG: Very helpful. Thank you.

GREG: Your next question comes from the line of Tobey Sommer from Truist Securities. Please, go ahead.

JASPER BIBB: Hey, good morning, everyone. This is Jasper Bibb on for Toby. Just two quick clarification questions on the guidance. First, does the 4Q guidance it reflect the full impact of the restructuring program on margin. And then secondly, how much incremental revenue from Salo is in the guidance?

GARY BURNISON: Bob, why don't you handle the incremental cost. We're expecting for Salo in the quarter about \$30 million of incremental revenue in the fourth quarter.

BOB: Yeah. And then in terms of the guidance, we executed the plan that we talked about on the last earnings call. We spent between taking out positions and reducing our real estate footprint. We spent approximately \$51 million. We're going to get somewhere in the \$50 to \$55 million range for saves.

But we're also forecasting for the fourth quarter is continued moderation in what I would call the exec search and the professional search perm placement business. And as you know, it's high yielding in terms of the EBITDA margin for us. And so as that continues to decline, that will consume some of the savings.

Then we're also reinvesting back into the business in terms of fee earners and delivery capacity to meet our client demand as well as we're going to continue to accelerate the investments that we made or that we're making into digital. And so those will net out. And then as the perm placement portion of the business troughs out and then starts to recover, we'll see the margins start to come pop up and come back again.

JASPER BIBB: Thanks. That makes sense. And then on the search consultant productivity, down to 1.4 million this quarter, pretty much in line with pre-COVID levels. If demand continues to soften in that segment, how should we think about managing to a productivity threshold versus keeping capacity for an eventual cyclical rebound?

GARY BURNISON: Well, right now, we're positioned to maintain capacity. And when you look at our consulting business, our digital business, and in the search businesses where our view is to hold capacity. And so it really depends on what happens here with the economy. But the million four, obviously, if demand falls, that will likely decline. But my orientation right now is to maintain capacity.

JASPER BIBB: Got it. Last one for me. I was hoping you could speak to your long-term EBITDA margin targets. Do you still think those are feasible? And how should we think about the increased interim exposure via your recent acquisitions maybe changing the long-term gross margin profile of the business as part of that?

GARY BURNISON: Yeah. It's a great question. I think number one, look, this was a business that didn't exist. And so during the pandemic, we looked around and said, how is the world going to change? And professionals wanting more flexibility in their life. And with an aging baby boomer population, maybe people that didn't want to work full time but still wanted to contribute in meaningful ways to society.

And so we very purposefully said, let's go into this market. And we've taken that now from basically zero to a run rate now of about \$320, \$330 million in the span of 18 months. This will be for sure a billion dollar business for us. There's no question about it.

Now, as we do that, and we address these bigger markets that I think have proven over time to be less cyclical than say the legacy business of executive search, the margin profile is going to change. There's no doubt about it. And I can have Bob-- Bob, you can describe the quantitative impact of that. But if we get this business to \$1 billion, which we think we can, and everything else were to stay the same, which it's not going to stay the same.

But if it did, you're probably talking 200 to 300 basis points I would think of a margin shift. But we really are excited about this. We are seeing incredible levels of cross referrals, of ways to create deeper meaning, deeper impact with clients.

And so I do think that overall, much like the strategy when I started-- I mean, this is my 84th earnings call. And going back to day one, the entire business was essentially executive search. And now, executive search today is 31% of the company.

And I think what we've demonstrated now is we're building a platform that has more client impact. The change is more people's lives, that enables people and organizations to be more than. And it also provides a much more stable company for shareholders.

And you can just see it in the numbers. And you can see it in the new business over the last several months in terms of what's happening, barring some sort of economic disaster. But, Bob, maybe you could comment on the quantitative aspect of the margin.

BOB: Sure. So Josh, when we buy these businesses, they generally come with about, I would say, around an 8% EBITDA margin. And our goal as we go through the integration, as you know, we've kind of built a company that's kind of plug and play. So we're able to get cost synergies fairly easily just by plugging the acquired companies into our network. And our goal is to take those margins up to the 12% to 15% range over time. And as Gary alluded to, the trade-off margin for us is the opportunity for growth and the stability that those revenue streams bring to the organization.

JASPER BIBB: Appreciate the detail there. Thanks for taking the questions, guys.

GREG: Your next question comes from the line of Marc Riddick from Sidoti. Please, go ahead.

MARC RIDDICK: Hi, there. Good morning.

GARY Hey, Marc.

BURNISON:

MARC RIDDICK: So I was wondering if you'd talk a little bit about if there were any changes in particular demand drivers, and I'm specifically talking about particular trends that you've noticed maybe over the last few months that have sort of changed or shifted, whether it's from a standpoint of some of the things that were driving demand over the last couple of years. Are there any particular areas that have sort of picked up that maybe we haven't been talking about or thinking about? Or maybe some things that have waned a bit beyond recessionary impacts?

GARY Well, industrial has certainly been a bright spot. And that's been a change. When I look year over year, industrial
BURNISON: is up about 10%. So that certainly, that's good considering it's almost 30% of the company's portfolio.

Clearly, going back to August of last summer, at the end of last summer, with the move by central banks and particularly the Fed to become more hawkish, companies are clearly looking at their cost. And so there was this massive upswing after the pandemic in terms of hiring. And as you would expect, that is moderated. And that's exactly what we've seen.

So we've seen moderation in the perm parts of our recruiting business. Wage growth is still at elevated levels. It's probably 6%, 7%. People that are jumping jobs are not getting what they were getting coming out of the pandemic. It's more like a 15% uptick in wages.

And so that clearly has moderated. And I would expect that that moderation is going to continue on the perm side, particularly given the comments yesterday and the day before by the Fed. The RPO business has always has, I mean, it's held up incredibly, incredibly well. And yes, we've seen some degradation of the base business, a kind of a nominal amount.

Going back to last fall, it was around the technology sector. But we've also picked up some just enormous wins both in the industrial area and health care. And then you look at the consulting and digital business in the quarter on a constant currency basis.

Consulting was up 9% new business and digital was up 6%. So it's basically, I mean, it's really playing out as the strategy was designed. I mean, the strategy is absolutely working.

MARC RIDDICK: That's really helpful. Thank you. And then, I was sort of curious about-- it seemed as though we were starting to see a bit of a pickup in business travel, and then maybe starting to see a little bit more face-to-face activity and being in front of clients again.

But I would say it seems as though it's kind of that might be the recessionary impact. But that's kind of been a back and forth a little bit. I was wondering if you maybe had any thoughts as to maybe what you're seeing if clients are doing the face to face with you a little bit more? Do you see more of a pickup in travel, entertainment going forward? Or how should we be thinking about that?

GARY Well, the genie is out of the bottle. And so I think that all of us enjoy the flexibility that unfortunately the
BURNISON: pandemic brought about. And so when this whole thing started, I said three years ago, I said this thing travel, all this stuff, how you're entertained, how you consume, how you produce, it's going to be about 50% of what it was.

Now, it's not 50% of what it was. And so clearly, yes, we are seeing a desire for sure. There's no substitute for being in person with another human being. But it's not even at the 50% level of what it was.

I think that's a generational change. I mean, that could take 5 to 10 years to truly play out. So it's clearly increased over the last several months. But nothing at all, nothing at all like it was.

Then we'll see with quote "China" setting aside the geopolitical aspect. We'll see what happens with China. It's only been two, three, four weeks since, quote, "it's opened up."

China has had an enormous drag on not only multinational companies in the Asia-Pacific region, but also on our business. As you would expect, it's been a drag on the top line. It could be as much as \$40 to \$50 million a year for us.

MARC RIDDICK: Thank you. I appreciate it.

GREG: And Mr. Burnison, it appears there are no further questions.

GARY BURNISON: OK. Well, we appreciate everybody taking the time to listen. First and foremost, I want to thank our colleagues all around the world for just an incredible performance. And thanks to Bob, and Greg, and Tiffany. And we'll talk to you next time. See you. Bye-bye.

GREG: Ladies and gentlemen, this conference will be available for replay for one week starting today at 3:00 PM Eastern time, running through the day March 15, 2023 ending at midnight. You may access the AT&T executive playback service by dialing 866-207-1041 and entering the access code 7037839. International participants may dial 402-970-0847.

Additionally, the replay will be available for playback at the company's website. That does conclude your conference for today. Thank you for your participation and for using AT&T teleconference. You may now disconnect.