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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 10-Q**

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- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended October 31, 2004 or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-14505

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**KORN/FERRY INTERNATIONAL**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State of other jurisdiction of  
incorporation or organization)

**95-2623879**  
(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)

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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, and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of shares outstanding of our common stock as of December 7, 2004 was 39,489,689.

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[Table of Contents](#)

**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES**  
**Table of Contents**

	<u>Page</u>
<b>PART I. <a href="#">FINANCIAL INFORMATION</a></b>	
Item 1. <a href="#">Financial Statements</a>	
<a href="#">Consolidated Balance Sheets as of October 31, 2004 (unaudited) and April 30, 2004.</a>	3
<a href="#">Unaudited Consolidated Statements of Operations for the three and six months ended October 31, 2004 and 2003</a>	4
<a href="#">Unaudited Consolidated Statements of Cash Flows for the six months ended October 31, 2004 and 2003</a>	5
<a href="#">Notes to Unaudited Condensed Consolidated Financial Statements</a>	6
Item 2. <a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a>	13
Item 3. <a href="#">Quantitative and Qualitative Disclosures About Market Risk</a>	19
Item 4. <a href="#">Controls and Procedures</a>	20
<b>PART II. <a href="#">OTHER INFORMATION</a></b>	
Item 6. <a href="#">Exhibits</a>	21
<a href="#">SIGNATURE</a>	22
<b>CERTIFICATIONS</b>	

[Table of Contents](#)**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****KORN/FERRY INTERNATIONAL AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except per share amounts)**

	As of October 31, 2004  (unaudited)	As of April 30, 2004
<b>ASSETS</b>		
Cash and cash equivalents	\$ 116,219	\$ 108,102
Marketable securities	6,092	—
Receivables due from clients, net of allowance for doubtful accounts of \$8,894 and \$6,159	71,858	52,306
Income tax and other receivables	6,743	5,812
Deferred income taxes	9,320	9,320
Prepaid expenses	11,938	10,128
	<hr/>	<hr/>
Total current assets	222,170	185,668
Property and equipment, net	19,209	19,603
Cash surrender value of company owned life insurance policies, net of loans	60,503	58,868
Deferred income taxes	27,996	27,352
Goodwill	101,945	98,481
Deferred financing costs, investments and other	8,177	7,670
	<hr/>	<hr/>
Total assets	\$ 440,000	\$ 397,642
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Accounts payable	\$ 8,530	\$ 8,676
Income taxes payable	10,569	2,956
Compensation and benefits payable	56,076	60,957
Other accrued liabilities	29,115	24,785
	<hr/>	<hr/>
Total current liabilities	104,290	97,374
Deferred compensation and other retirement plans	56,676	53,018
Long-term debt	44,852	44,400
Other	8,649	11,456
7.5% Convertible mandatorily redeemable preferred stock, net of unamortized discount and issuance costs, redemption value \$11,674	10,698	10,512
	<hr/>	<hr/>
Total liabilities	225,165	216,760
Stockholders' equity		
Common stock: \$0.01 par value, 150,000 shares authorized, 40,223 and 39,363 shares issued and 39,074 and 38,170 shares outstanding	318,782	307,003
Retained deficit	(104,123)	(121,204)
Unearned restricted stock compensation	(4,982)	(2,341)
Accumulated other comprehensive income (loss)	5,932	(1,596)
	<hr/>	<hr/>
Stockholders' equity	215,609	181,862
Less: Notes receivable from stockholders	(774)	(980)
	<hr/>	<hr/>
Total stockholders' equity	214,835	180,882
	<hr/>	<hr/>
Total liabilities and stockholders' equity	\$ 440,000	\$ 397,642

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

[Table of Contents](#)

**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share amounts)

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
	(unaudited)		(unaudited)	
Fee revenue	\$ 108,505	\$ 76,650	\$ 211,313	\$ 149,237
Reimbursed out-of-pocket engagement expenses	5,036	5,315	10,411	11,061
<b>Total revenue</b>	<b>113,541</b>	<b>81,965</b>	<b>221,724</b>	<b>160,298</b>
Compensation and benefits	69,009	51,355	133,885	102,673
General and administrative expenses	21,402	17,492	42,246	34,302
Out-of-pocket engagement expenses	5,520	5,460	11,158	11,256
Depreciation and amortization	2,140	2,500	4,382	5,287
Restructuring charges	—	—	—	8,526
<b>Total operating expenses</b>	<b>98,071</b>	<b>76,807</b>	<b>191,671</b>	<b>162,044</b>
<b>Operating income (loss)</b>	<b>15,470</b>	<b>5,158</b>	<b>30,053</b>	<b>(1,746)</b>
Interest and other income, net	372	9	776	470
Interest expense	2,720	2,714	5,272	5,423
<b>Income (loss) before provision for income taxes and equity in earnings of unconsolidated subsidiaries</b>	<b>13,122</b>	<b>2,453</b>	<b>25,557</b>	<b>(6,699)</b>
Provision for income taxes	4,905	475	9,391	931
Equity in earnings of unconsolidated subsidiaries	492	243	915	414
<b>Net income (loss)</b>	<b>\$ 8,709</b>	<b>\$ 2,221</b>	<b>\$ 17,081</b>	<b>\$ (7,216)</b>
Basic earnings (loss) per common share	\$ 0.23	\$ 0.06	\$ 0.45	\$ (0.19)
Basic weighted average common shares outstanding	38,399	37,491	38,100	37,457
Diluted earnings (loss) per common share	\$ 0.21	\$ 0.06	\$ 0.40	\$ (0.19)
Diluted weighted average common shares outstanding	46,262	39,669	46,349	37,457

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

[Table of Contents](#)

**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Six Months Ended October 31,	
	2004	2003
	(unaudited)	
<b>Cash from operating activities:</b>		
Net income (loss)	\$ 17,081	\$ (7,216)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,382	5,287
Interest paid in kind and amortization of discount on convertible securities	932	2,243
(Gain) loss on disposition of property and equipment	(5)	83
Provision for doubtful accounts	4,186	1,833
Gain on cash surrender value of life insurance policies	(2,200)	(2,203)
Deferred income taxes	(644)	(1,026)
Tax benefit from exercise of stock options	1,783	—
Asset impairment charge	—	464
Non-cash compensation arrangements	2,077	1,391
Change in other assets and liabilities:		
Deferred compensation	2,492	2,801
Receivables	(25,008)	1,955
Prepaid expenses	(1,810)	429
Investment in unconsolidated subsidiaries	(82)	331
Income taxes payable	7,613	—
Accounts payable and accrued liabilities	(947)	(16,287)
Other	(3,672)	(1,386)
	<u>6,178</u>	<u>(11,301)</u>
<b>Net cash provided by (used in) operating activities</b>		
<b>Cash from investing activities:</b>		
Purchase of property and equipment	(2,787)	(948)
Purchase of marketable securities	(6,092)	—
Business acquisitions	(419)	—
Premiums on life insurance policies	(720)	(1,127)
Surrender of life insurance policies	—	1,917
Proceeds from life insurance policy benefits	339	—
Purchase of Futurestep minority shares	—	(570)
	<u>(9,679)</u>	<u>(728)</u>
<b>Net cash used in investing activities</b>		
<b>Cash from financing activities:</b>		
Payment of acquisition notes	—	(5,099)
Payments on life insurance policy loans	(308)	(1,574)
Borrowings under life insurance policies	1,593	1,421
Purchase of common stock	(2,341)	(676)
Proceeds from issuance of common stock upon exercise of employee stock options and in connection with an employee stock purchase plan	8,729	126
Receipts on stockholders' notes	206	271
	<u>7,879</u>	<u>(5,531)</u>
<b>Net cash provided by (used in) financing activities</b>		
Effect of exchange rate changes on cash flows	3,739	(722)
	<u>8,117</u>	<u>(18,282)</u>
Net increase (decrease) in cash and cash equivalents		
Cash and cash equivalents at beginning of the period	108,102	82,685
	<u>\$116,219</u>	<u>\$ 64,403</u>
Cash and cash equivalents at end of the period		

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

**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(in thousands, except per share amounts)**

**1. Summary of Significant Accounting Policies**

*Basis of Presentation*

The consolidated financial statements for the three and six months ended October 31, 2004 and 2003 include the accounts of Korn/Ferry International and all of its wholly and majority owned domestic and international subsidiaries (collectively, the "Company"). The consolidated financial statements are unaudited, but 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, 2004 ("Annual Report") and should be read together with the Annual Report.

*Critical Accounting Policies and Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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 financial statements and the reported amounts of revenue and expenses during the reporting period. As a result, actual results could differ from these estimates. The most significant areas that require management judgment are revenue recognition, deferred compensation and the carrying values of goodwill and deferred income taxes.

*Cash and Cash Equivalents*

The Company considers cash equivalents to be only those investments which are highly liquid, readily convertible and mature within three months from the date of purchase.

*Available for Sale Securities*

The Company considers its investment portfolio and marketable securities available-for-sale as defined in SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." These investments are recorded at fair value in the accompanying balance sheet.

*Stock Based Compensation*

The Company accounts for its employee stock options under the recognition and measurement principles of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees and related interpretations" (APB 25). Under APB No. 25, no stock-based compensation is reflected in operations, as all options granted under the plans have an exercise price equal to the fair market value of the underlying common stock on the date of grant and the related number of shares granted is fixed at that point in time.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS No. 148"), effective for fiscal years ending after December 15, 2002. SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-based Compensation" ("SFAS No. 123"), to provide several alternatives for adopting the stock option expense provisions of SFAS No. 123, as well as additional required financial statement disclosures. SFAS No. 148 does not require companies to expense stock options in operations. The Company has not adopted the provisions of SFAS No. 123 for expensing stock based compensation; however, the Company adopted the additional disclosure provisions required by SFAS 148.

[Table of Contents](#)

**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**  
(in thousands, except per share amounts)

The following table illustrates the effect on net income (loss) and earnings (loss) per share as if the Company had applied the fair value recognition provisions of SFAS No. 123:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
Net income (loss), as reported	\$ 8,709	\$ 2,221	\$17,081	\$ (7,216)
Stock-based employee compensation charges, net of related tax effects*:				
Employee stock compensation expense included in net income (loss), as reported	281	1,011	621	1,368
Employee stock compensation expense determined under the fair-value based method	(1,757)	(4,230)	(3,911)	(7,738)
Net income (loss), as adjusted	<u>\$ 7,233</u>	<u>\$ (998)</u>	<u>\$13,791</u>	<u>\$ (13,586)</u>
Interest expense on convertible securities, net of related tax effects*	785		1,560	
Net income adjusted for computation of diluted EPS, as adjusted	<u>\$ 8,018</u>		<u>\$15,351</u>	
Basic EPS				
As reported	\$ 0.23	\$ 0.06	\$ 0.45	\$ (0.19)
Pro forma	\$ 0.19	\$ (0.03)	\$ 0.36	\$ (0.36)
Diluted EPS				
As reported	\$ 0.21	\$ 0.06	\$ 0.40	\$ (0.19)
Pro forma	\$ 0.17	\$ (0.03)	\$ 0.33	\$ (0.36)

\* For Fiscal 2005 only

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with a zero dividend rate. The following assumptions were used by the Company for options granted in the respective periods:

	Quarter Ended October 31	
	2004	2003
Expected stock volatility	63.1%	63.5%
Risk-free interest rate	3.69%	3.60%
Expected option life (in years)	4.50	4.50

The Black-Scholes option valuation 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. In management's opinion, existing valuation models do not provide a reliable, single measure of the fair value of its employee stock options because changes in these subjective input assumptions can materially affect the fair value estimate. For purposes of pro forma disclosures, the estimated fair values of the options are amortized over the options' vesting periods.

*Common Stock*

The Company issued 143,000 and 747,000 common shares relating to the exercise of stock options and 98,000 and 98,000 common shares in conjunction with the Company's employee stock purchase plan in the three and six months ended October 31, 2004, respectively.

[Table of Contents](#)

**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**  
(in thousands, except per share amounts)

*Reclassifications*

Certain prior year amounts have been reclassified to conform with the current year presentation.

*New Accounting Pronouncements*

In December 2003, the FASB issued FASB Interpretation No. 46(R), "Consolidation of Variable Interest Entities", effective as of the first reporting period beginning after March 15, 2004. The impact upon adoption of this standard did not have a material impact on the results of the Company's operations or the Company's financial position.

In March 2004, the FASB issued an Exposure Draft, "Share-Based Payment - An Amendment of FASB Statements No. 123 and 95" ("Proposed SFAS 123R"). The Proposed SFAS 123R may be effective for interim or annual periods beginning after June 15, 2005 and would eliminate the ability to account for share-based compensation transactions using APB 25. The Company would be required to recognize compensation expense, using a fair-value based method, for stock options and employee stock purchase plans.

**2. Basic and Diluted Earnings (Loss) Per Share**

Basic earnings (loss) per common share ("basic EPS") was computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted earnings (loss) per common share ("diluted EPS") 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 adjusted net income (loss), after assumed conversion of subordinated notes and preferred stock, by the weighted average number of common shares outstanding plus dilutive common equivalent shares. The following is a reconciliation of the numerator and denominator (shares in thousands) used in the computation of basic and diluted EPS:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
<b>Net income (loss) (Numerator):</b>				
Net income (loss) for basic EPS	\$ 8,709	\$ 2,221	\$17,081	\$ (7,216)
Interest expense on convertible securities, net of related tax effects	785	254	1,560	
Net income for diluted EPS	<u>\$ 9,494</u>	<u>\$ 2,475</u>	<u>\$18,641</u>	
<b>Shares (Denominator):</b>				
Weighted average shares for basic EPS	38,399	37,491	38,100	37,457
Effect of convertible subordinated notes	4,470		4,470	
convertible preferred stock	1,117	1,067	1,118	
warrants	274		274	
restricted stock	110	43	139	
stock options	1,888	1,064	2,242	
employee stock purchase plan	4	4	6	
Adjusted weighted average shares for diluted EPS	<u>46,262</u>	<u>39,669</u>	<u>46,349</u>	<u>37,457</u>
<b>Basic earnings (loss) per share</b>	<u>\$ 0.23</u>	<u>\$ 0.06</u>	<u>\$ 0.45</u>	<u>\$ (0.19)</u>
<b>Diluted earnings (loss) per share</b>	<u>\$ 0.21</u>	<u>\$ 0.06</u>	<u>\$ 0.40</u>	<u>\$ (0.19)</u>



[Table of Contents](#)

**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**  
(in thousands, except per share amounts)

Assumed exercises or conversions have been excluded in computing the diluted earnings per share when their inclusion would be anti-dilutive. If the assumed exercises of convertible notes, preferred stock and in-the-money options and warrants had been used, the fully diluted shares outstanding for the six months ended October 31, 2003 would have been 39,288.

**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 owners (changes in paid in capital) and distributions to owners (dividends).

Total comprehensive income (loss) is as follows:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
Net income (loss)	\$ 8,709	\$2,221	\$17,081	\$(7,216)
Foreign currency translation adjustment	5,741	2,056	6,388	1,392
Unrealized gain on marketable securities, net of related tax effects	1,140	—	1,140	—
<b>Comprehensive income (loss)</b>	<b>\$15,590</b>	<b>\$4,277</b>	<b>\$24,609</b>	<b>\$(5,824)</b>

The accumulated other comprehensive income of \$4.8 million and \$1.1 million at October 31, 2004 is comprised of foreign currency translation adjustments and unrealized gains on marketable securities, respectively.

**4. Deferred Compensation, Retirement Plans and Pension Plan**

The Company has a defined benefit pension plan, referred to as the Worldwide Executive Benefit Plans covering all of the Company's employees in the United States and certain employees in foreign countries. The components of net periodic benefit cost are as follows:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
<i>Components of net periodic benefit costs:</i>				
Service cost	\$ —	\$ 24	\$ —	\$ 48
Interest cost	50	53	100	106
Amortization of actuarial loss	(38)	(36)	(76)	(72)
<b>Net periodic benefit cost</b>	<b>\$ 12</b>	<b>\$ 41</b>	<b>\$ 24</b>	<b>\$ 82</b>

The Company also established several deferred compensation plans for vice-presidents that provide defined benefit payments to participants based on the deferral of current compensation subject to vesting and retirement or termination provisions. The components of net periodic benefit cost are as follows:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
<i>Components of net periodic benefit costs:</i>				
Service cost	\$ 786	\$ 661	\$1,572	\$1,322
Interest cost	813	778	1,626	1,566
Amortization of actuarial gain	100	185	200	370
<b>Net periodic benefit cost</b>	<b>\$ 1,699</b>	<b>\$ 1,624</b>	<b>\$3,398</b>	<b>\$3,258</b>

In January 2004, the Company implemented the Executive Capital Accumulation Plan ("ECAP"). ECAP 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 a \$4.0 million ECAP contribution in the three and six months ended October 31, 2004 that vests over a 3 year period. The Company's fiscal year 2006 ECAP contribution is discretionary and is based on the Company's profitability and results of operations.

**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**  
(in thousands, except per share amounts)

**5. Restructuring Charges**

Based on deteriorating economic conditions in fiscal 2002, the Company began a series of restructuring initiatives to address its cost structure and to reposition the enterprise to gain market share and take advantage of any potential economic up-trend. These business realignment initiatives reduced the Company's work force by nearly 30%, or over 850 employees.

Operating results include restructuring charges related to the following business segments in the six months ended October 31, 2003:

	Restructuring		
	Severance	Facilities	Total
<b>Executive recruitment</b>			
North America	\$ 455	\$ (191)	\$ 264
Europe	4,405	505	4,910
Asia Pacific	160	—	160
South America	58	—	58
<b>Total executive recruitment</b>	<b>5,078</b>	<b>314</b>	<b>5,392</b>
Futurestep	1,474	1,508	2,982
Corporate	152	—	152
<b>Total</b>	<b>\$ 6,704</b>	<b>\$ 1,822</b>	<b>\$ 8,526</b>

Executive recruitment severance of \$5.1 million included 112 employees terminated. The \$0.3 million of facilities restructuring charge is net of a \$0.8 million favorable adjustment related to previously reported restructured properties as a result of subleases signed at better terms than originally anticipated. The facilities restructuring charge primarily relates to lease termination costs, net of estimated sublease income, for excess space in three executive recruitment offices and included \$0.2 million related to the write-down of fixed assets and \$0.3 million of other restructuring charges.

Futurestep severance of \$1.5 million included 43 employees terminated. Facilities restructuring costs of \$1.5 million relates to five Futurestep Europe offices that were closed as employees co-located with executive recruitment offices and included \$0.2 million related to the write-down of related fixed assets and \$0.2 million of other restructuring charges.

Corporate severance of \$0.1 million included 7 employees terminated.

A roll-forward of the restructuring liability at October 31, 2004 is as follows:

	Restructuring		
	Severance	Facilities	Total
Liability as of April 30, 2004	\$ 847	\$ 9,891	\$ 10,738
Payments	(237)	(1,646)	(1,883)
<b>Liability as of October 31, 2004</b>	<b>\$ 610</b>	<b>\$ 8,245</b>	<b>\$ 8,855</b>

The severance accrual includes amounts paid monthly and are expected to be paid in full by December 2004. The accrued liability for facilities costs relates to commitments under operating leases, net of estimated sublease income, of which \$5.9 million is included in other long-term liabilities, paid over the next seven years.

**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**  
(in thousands, except per share amounts)

**6. Mandatorily Redeemable Convertible Securities**

In June 2002, the Company issued 7.5% Convertible Subordinated Notes in an aggregate principal amount of \$40.0 million and 10,000 shares of 7.5% Convertible Series A Preferred Stock at an aggregate purchase price of \$10.0 million. The notes and preferred stock have priority over common stockholders. The notes and preferred stock are convertible into shares of the Company's common stock at \$10.19 per share, as amended in December 2003. The Company also issued warrants to purchase 274,207 shares, as amended, of its common stock at an exercise price of \$11.94, as amended. The warrants expire in 2012. The warrants were recorded at fair value resulting in discounts on the Notes and Preferred Stock (together "the securities") of \$1.2 million and \$0.3 million, respectively, and are amortized over the life of the securities. In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity," effective at the beginning of the first interim period after June 15, 2003. This Statement requires that mandatorily redeemable instruments be classified as liabilities. The Company adopted this Statement in the first quarter of fiscal 2004 and classified its preferred stock as a liability.

The securities may be redeemed at the option of the purchasers after June 13, 2008, the sixth anniversary of the closing date, at a price equal to 101% of the issuance price plus all accrued interest and dividends. The securities are mandatorily redeemable if still outstanding on June 13, 2010, at a price equal to 101% of the issuance price plus accrued interest and dividends. From the third to the sixth year, the securities are subject to optional redemption by the Company at 200% to 250% of the then outstanding principal balance provided certain minimum price targets for the Company's common stock are not achieved.

Interest and dividends are payable semi-annually with 1% payable in cash and 6.5% payable in additional Notes and Preferred Stock for the first two year period from the date of issuance. Thereafter, interest and dividends are payable in either additional securities or cash at the option of the Company. The Company also incurred issuance costs of \$4.3 million that have been deferred and are being amortized over the life of the securities as interest expense with respect to \$3.4 million allocated to the Notes and \$0.9 million allocated to the Preferred Stock.

**7. Business Segments**

The Company operates in two global business segments in the retained recruitment industry, executive recruitment and Futurestep. These segments are distinguished primarily by the candidates' level of compensation. The executive recruitment business segment is managed by geographic regional leaders. Revenue from leadership development solutions and other consulting engagements is included in executive recruitment. Futurestep's worldwide operations are managed by the Chief Executive Officer of Futurestep. The geographic regional leaders and the Chief Executive Officer of Futurestep report directly to the Chief Executive Officer of the Company.

A summary of the Company's results of operations for the three and six months ended October 31, 2004 and 2003 by business segment are as follows:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
<b>Fee revenue:</b>				
<b>Executive recruitment:</b>				
North America	\$ 55,657	\$ 40,615	\$ 107,313	\$ 77,022
Europe	23,837	17,860	48,655	36,015
Asia Pacific	13,554	8,314	26,056	16,321
South America	2,497	2,380	4,604	4,301
<b>Total executive recruitment</b>	<b>95,545</b>	<b>69,169</b>	<b>186,628</b>	<b>133,659</b>
<b>Futurestep</b>	<b>12,960</b>	<b>7,481</b>	<b>24,685</b>	<b>15,578</b>
<b>Total fee revenue</b>	<b>\$ 108,505</b>	<b>\$ 76,650</b>	<b>\$ 211,313</b>	<b>\$ 149,237</b>

[Table of Contents](#)

**KORN/FERRY INTERNATIONAL AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**  
(in thousands, except per share amounts)

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
<b>Total revenue:</b>				
North America	\$ 58,493	\$43,802	\$ 113,438	\$ 83,610
Europe	24,798	18,638	50,395	37,810
Asia Pacific	13,871	8,593	26,694	16,954
South America	2,628	2,503	4,827	4,519
<b>Total executive recruitment</b>	<b>99,790</b>	<b>73,536</b>	<b>195,354</b>	<b>142,893</b>
<b>Futurestep</b>	<b>13,751</b>	<b>8,429</b>	<b>26,370</b>	<b>17,405</b>
<b>Total revenue</b>	<b>\$ 113,541</b>	<b>\$81,965</b>	<b>\$ 221,724</b>	<b>\$ 160,298</b>
	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
<b>Operating income (loss) before restructuring charges</b>				
<b>Executive recruitment:</b>				
North America	\$ 11,956	\$ 8,260	\$ 24,056	\$ 14,338
Europe	4,022	324	8,583	347
Asia Pacific	3,064	217	5,262	976
South America	272	350	552	400
<b>Total executive recruitment</b>	<b>19,314</b>	<b>9,151</b>	<b>38,453</b>	<b>16,061</b>
<b>Futurestep</b>	<b>2,383</b>	<b>479</b>	<b>4,293</b>	<b>(70)</b>
<b>Corporate</b>	<b>(6,227)</b>	<b>(4,472)</b>	<b>(12,693)</b>	<b>(9,211)</b>
<b>Operating income before restructuring charges</b>	<b>15,470</b>	<b>5,158</b>	<b>30,053</b>	<b>6,780</b>
<b>Restructuring charges (Note 5)</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>(8,526)</b>
<b>Total operating income (loss)</b>	<b>\$ 15,470</b>	<b>\$ 5,158</b>	<b>\$ 30,053</b>	<b>\$ (1,746)</b>

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## [Table of Contents](#)

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **Forward-looking Statements**

*This quarterly report on Form 10-Q may contain certain statements that we believe are, or may be considered to be, "forward-looking" statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally can be identified by use of statements that include phrases such as "believe", "expect", "anticipate", "intend", "plan", "foresee", "may", "will", "estimates", "potential", "continue" or other similar words or phrases. Similarly, statements that describe our objectives, plans or goals also are forward-looking statements. All of these forward-looking statements are subject to risks and uncertainties that could cause our actual results to differ materially from those contemplated by the relevant forward-looking statement. The principal risk factors that could cause actual performance and future actions to differ materially from the forward-looking statements include, but are not limited to, dependence on attracting and retaining qualified and experienced consultants, portability of client relationships, local political or economic developments in or affecting countries where we have operations, ability to manage growth, restrictions imposed by off-limits agreements, competition, risks related to the growth and results of Futurestep, reliance on information processing systems, and employment liability risk. Readers are urged to consider these factors carefully in evaluating the forward-looking statements. The forward-looking statements included in this Form 10-Q are made only as of the date of this report and we undertake no obligation to publicly update these forward-looking statements to reflect subsequent events or circumstances.*

*The following presentation of management's discussion and analysis of our financial condition and results of operations should be read together with our consolidated financial statements included in this Form 10-Q.*

#### **Executive Summary**

We are a leading provider of recruitment and leadership development services with the broadest global presence in the recruitment industry. Our services include executive recruitment, middle-management recruitment (through Futurestep), leadership development solutions and executive coaching. Over half of the executive recruitment searches we performed in fiscal 2004 were for board level, chief executive and other senior executive positions and our 3,608 clients included approximately 42% of the Fortune 500 companies. We have established strong client loyalty; more than 79% of the executive recruitment assignments we performed in fiscal 2004 were on behalf of clients for whom we had conducted previous assignments over the last three fiscal years.

To reach our objective of expanding our position as a leading provider of recruitment and leadership development services, our strategic objectives include broadening our product and service offering, improving coordination in global recruiting and increasing operational efficiencies, expanding our market reach and presence through technology and assessment solutions and leveraging our leadership and brand name in executive recruitment. We will continue to develop new products and services, refine our technology and aggressively market our proven global recruitment expertise.

In our second quarter of fiscal 2005, fee revenue increased 42% over last year to \$108.5 million with increases across all regions. Operating income improved \$10.3 million to \$15.5 million in the current quarter. Futurestep revenues increased 73% to \$13.0 million from \$7.5 million in the prior year with increases across all regions. Futurestep's operating income increased to \$2.4 million from \$0.5 million in the prior year.

#### **Critical Accounting Policies**

The following discussion and analysis of our financial condition and operating results are based on our unaudited condensed consolidated financial statements. Preparation of this Form 10-Q requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results may differ from those estimates and assumptions. In preparing our financial statements and accounting for the underlying transactions and balances, we apply our accounting policies as disclosed in our Notes to Unaudited Condensed Consolidated Financial Statements. We consider the policies related to revenue recognition,

[Table of Contents](#)

deferred compensation and the carrying values of goodwill and deferred income taxes as critical to an understanding of our financial statements because their application places the most significant demands on management's judgment. Specific risks for these critical accounting policies are described in our Fiscal 2004 Annual Report on Form 10-K.

**Results of Operations**

The following table summarizes the results of our operations for the three and six months ended October 31, 2004 and 2003 as a percentage of fee revenue:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2004	2003	2004	2003
Fee revenue	100%	100%	100%	100%
Reimbursed out-of-pocket engagement expenses	5	7	5	7
<b>Total revenue</b>	<b>105%</b>	<b>107%</b>	<b>105%</b>	<b>107%</b>
Compensation and benefits	64	67	63	69
General and administrative expenses	20	23	20	23
Out-of-pocket engagement expenses	5	7	5	7
Depreciation and amortization	2	3	2	3
Restructuring charges	0	0	0	6
Operating income (loss)	14	7	14	(1)
Net income (loss)	8	3	8	(5)

The following tables summarize the results of our operations by business segment. Operating income (loss) is calculated as a percentage of fee revenue.

	Three Months Ended October 31,				Six Months Ended October 31,			
	2004		2003		2004		2003	
	Dollars	%	Dollars	%	Dollars	%	Dollars	%
<b>Fee revenue</b>								
<b>Executive recruitment:</b>								
North America	\$ 55,657	51%	\$40,615	53%	\$107,313	51%	\$ 77,022	52%
Europe	23,837	22	17,860	23	48,655	23	36,015	24
Asia Pacific	13,554	13	8,314	11	26,056	12	16,321	11
South America	2,497	2	2,380	3	4,604	2	4,301	3
<b>Total executive recruitment</b>	<b>95,545</b>	<b>88</b>	<b>69,169</b>	<b>90</b>	<b>186,628</b>	<b>88</b>	<b>133,659</b>	<b>90</b>
<b>Futurestep</b>	<b>12,960</b>	<b>12</b>	<b>7,481</b>	<b>10</b>	<b>24,685</b>	<b>12</b>	<b>15,578</b>	<b>10</b>
<b>Total fee revenue</b>	<b>108,505</b>	<b>100%</b>	<b>76,650</b>	<b>100%</b>	<b>211,313</b>	<b>100%</b>	<b>149,237</b>	<b>100%</b>
Reimbursed out-of-pocket engagement expenses	5,036		5,315		10,411		11,061	
<b>Total revenue</b>	<b>\$113,541</b>		<b>\$81,965</b>		<b>\$221,724</b>		<b>\$160,298</b>	

	Three Months Ended October 31,				Six Months Ended October 31,			
	2004		2003		2004		2003	
	Dollars	%	Dollars	%	Dollars	%	Dollars	%
<b>Operating income (loss)</b>								
<b>Executive recruitment:</b>								
North America	\$ 11,956	21%	\$ 8,260	20%	\$ 24,056	22%	\$ 14,074	18%
Europe	4,022	17	324	2	8,583	18	(4,563)	(13)
Asia Pacific	3,064	23	217	3	5,262	20	816	5
South America	272	11	350	15	552	12	342	8
<b>Total executive recruitment</b>	<b>19,314</b>	<b>20</b>	<b>9,151</b>	<b>13</b>	<b>38,453</b>	<b>21</b>	<b>10,669</b>	<b>8</b>
<b>Futurestep</b>	<b>2,383</b>	<b>18</b>	<b>479</b>	<b>6</b>	<b>4,293</b>	<b>17</b>	<b>(3,052)</b>	<b>(20)</b>
<b>Corporate</b>	<b>(6,227)</b>		<b>(4,472)</b>		<b>(12,693)</b>		<b>(9,363)</b>	
<b>Total operating income (loss)</b>	<b>\$ 15,470</b>	<b>14%</b>	<b>\$ 5,158</b>	<b>7%</b>	<b>\$ 30,053</b>	<b>14%</b>	<b>\$ (1,746)</b>	<b>(1)%</b>

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## [Table of Contents](#)

### **Three Months Ended October 31, 2004 Compared to Three Months Ended October 31, 2003**

*Fee Revenue.* Fee revenue increased \$31.9 million, or 42%, to \$108.5 million in the three months ended October 31, 2004 compared to \$76.7 million in the three months ended October 31, 2003. The increase in fee revenue is attributable to an increase in the number of new engagements opened and increased average fees. Exchange rates favorably impacted fee revenues by \$3.0 million in the current quarter.

*Executive Recruitment* – Executive Recruitment fee revenue increased \$26.4 million, or 38%, due to an increase in the number of new engagements opened as well as an increase in average fees. North America fee revenue increased \$15.0 million, or 37% in the current quarter primarily due to an increase of 26% in the number of billed engagements. Europe reported fee revenue of \$23.8 million, an increase of \$6.0 million, or 33%, compared to the same period last year. The increase in fee revenue was driven by an increase of 8% in the number of billed engagements and an increase in average fees. Exchange rates favorably impacted Europe fee revenue by \$2.1 million in the current quarter. Asia Pacific fee revenue increased \$5.2 million, or 63%, to \$13.6 million compared to the same period last year due to an increase of 26% in the number of new engagements opened, an increase of 32% in the number of billed engagements, as well as an increase in average fees. South America reported fee revenue of \$2.5 million, an increase of \$0.1 million, or 5%, compared to the same period last year.

*Futurestep* - Fee revenue increased \$5.5 million, or 73%, to \$13.0 million in the three months ended October 31, 2004 compared to \$7.5 million in the three months ended October 31, 2003. The increase in fee revenue, reflected across all regions, is due to our continued strategic emphasis on outsourced recruiting solutions. Exchange rates favorably impacted Futurestep fee revenue by \$0.6 million in the current quarter.

*Compensation and Benefits.* Compensation and benefits expense increased \$17.7 million, or 34%, to \$69.0 million in the three months ended October 31, 2004 compared to \$51.4 million in the three months ended October 31, 2003. The increase in compensation and benefits expense reflects an increase in bonus expense as a result of increased profitability, an increase in existing employees' salary base as well as an increase due to new consultants hired. Exchange rates impacted compensation and benefits unfavorably by \$1.7 million. Executive recruitment compensation and benefits costs of \$57.4 million increased \$13.4 million, or 30%, compared to last year due to an increase in the number of consultants and bonus expense. Exchange rates impacted executive recruitment compensation and benefits expense unfavorably by \$1.4 million in the current quarter. Executive recruitment compensation and benefits expense, as a percentage of fee revenue, decreased to 60% from 64% in the prior year, as a result of increased productivity by our consultants. Futurestep compensation and benefits expense increased \$3.0 million, or 59%, to \$8.2 million from \$5.2 million in the prior year due to increases in execution resources and bonus expense. Futurestep compensation and benefits expense, as a percentage of fee revenue, decreased to 63% from 69% in the prior year. Corporate compensation and benefits expense increased \$1.2 million, or 55%, to \$3.4 million in the current quarter, reflecting an increase in bonus expense as well as decreased returns on investments related to our Company Owned Life Insurance ("COLI") policies.

*General and Administrative Expenses.* General and administrative expenses increased \$3.9 million, or 22%, to \$21.4 million in the three months ended October 31, 2004 compared to \$17.5 million in the same period last year. Exchange rates unfavorably impacted general and administrative expenses by \$0.5 million in the current quarter. In executive recruitment, general and administrative expenses increased \$2.7 million, or 19%, due to increases in bad debt expenses, professional fees and costs associated with the global partner meeting that occurred in October 2004. Executive recruitment general and administrative expenses, as a percentage of fee revenue, decreased to 17% from 20% in the prior year, as a result of our efforts in controlling costs. Futurestep general and administrative expenses, as a percentage of fee revenue, decreased to 16% from 19% in the prior year. Corporate general and administrative expenses increased \$0.6 million, or 27%, to \$2.7 million in the current quarter primarily due to increased professional fees.

*Out-of-Pocket Engagement Expenses.* Out-of-pocket engagement expenses are comprised of expenses incurred by candidates and our consultants that are generally billed to clients. Out-of-pocket engagement expenses of \$5.5 million remained fairly consistent with the prior year. As a percentage of fee revenue, out-of-pocket engagement expenses decreased to 5% from 7% in the prior year.

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## Table of Contents

*Depreciation and Amortization Expenses.* Depreciation and amortization expense of \$2.1 million in the three months ended October 31, 2004 decreased \$0.4 million, or 14%, from the prior year as fixed assets became fully depreciated in the latter half of fiscal 2004.

*Operating Income (Loss.)* Operating income increased \$10.2 million to \$15.5 million in the current quarter compared to \$5.2 million in the prior year.

Executive recruitment operating income increased \$10.2 million to \$19.3 million in the three months ended October 31, 2004 compared to \$9.2 million in the three months ended October 31, 2003. The increase in executive recruitment operating income is a result of the increase in revenue offset by increases in compensation and bonus expense, bad debt expenses, professional fees and costs associated with our global partner meeting. Executive recruitment operating income, as a percentage of fee revenue, increased to 20% in the current quarter from 13% in the same period last year.

Futurestep operating income improved \$1.9 million to \$2.4 million in the three months ended October 31, 2004 from \$0.5 million in the three months ended October 31, 2003. The improvement in Futurestep operating income reflects the increase in revenue in the current quarter offset by an increase in compensation and bonus expense.

*Interest Income and Other Income, Net.* Interest income and other income, net includes interest income of \$0.4 and \$0.2 million in the three months ended October 31, 2004 and 2003, respectively.

*Interest Expense.* Interest expense, primarily related to the borrowings under COLI policies and our convertible securities, was \$2.7 million in the current quarter, consistent with prior year.

*Provision for Income Taxes.* The provision for income taxes was \$4.9 million in the three months ended October 31, 2004 compared to \$0.5 million in the same period last year. The provision for income taxes in the current year reflects a 37.4% effective tax rate. The provision for income taxes in the prior year reflects foreign income tax expense as a result of pretax income in certain foreign subsidiaries.

*Equity in Earnings of Unconsolidated Subsidiaries.* Equity in earnings of unconsolidated subsidiaries is comprised of our less than 50% shareholder interest in our Mexican subsidiaries. We report our interest in earnings or loss of the Mexican subsidiaries on the equity basis as a one line adjustment to net income (loss). Equity in earnings was \$0.5 million in the current quarter compared to \$0.2 million the same period last year.

### **Six Months Ended October 31, 2004 Compared to Six Months Ended October 31, 2003**

*Fee Revenue.* Fee revenue increased \$62.1 million, or 42%, to \$211.3 million in the six months ended October 31, 2004 compared to \$149.2 million in the six months ended October 31, 2003. The increase in fee revenue is attributable to an increase in the number of new engagements opened across all regions. Exchange rates favorably impacted fee revenues by \$7.2 million.

*Executive Recruitment* – Executive recruitment fee revenue increased \$53.0 million, or 40%, due to an increase in the number of new engagements opened as well as an increase in average fees. North America fee revenue increased \$30.3 million, or 39%, to \$107.3 million due to a 25% increase in the number of new engagements opened. Europe reported fee revenue of \$48.7 million, an increase of \$12.6 million, or 35%, compared to the same period last year driven by an increase of 10% in the number of new engagements opened as well as an increase in average fees. Exchange rates favorably impacted Europe fee revenue by \$3.8 million. Asia Pacific fee revenue increased \$9.7 million, or 60%, to \$26.1 million compared to the same period last year due to an increase of 22% in the number of new engagements opened as well as an increase in average fees. South America reported fee revenue of \$4.6 million, an increase of \$0.3 million, or 7%, compared to the same period last year.

*Futurestep* - Fee revenue increased \$9.1 million, or 58%, to \$24.7 million in the six months ended October 31, 2004 compared to \$15.6 million in the six months ended October 31, 2003. The increase in fee revenue is due primarily to our continued strategic emphasis on outsourced recruiting solutions. Exchange rates favorably affected Futurestep revenue by \$2.7 million.



## Table of Contents

*Compensation and Benefits.* Compensation and benefits expense increased \$31.2 million, or 30%, to \$133.9 million in the six months ended October 31, 2004 compared to \$102.7 million in the six months ended October 31, 2003. The increase in compensation and benefits expense reflects an increase in bonus expense as a result of increased profitability, an increase in existing employees' salary base as well as an increase due to new consultants hired. Exchange rates impacted compensation and benefits unfavorably by \$3.3 million. Executive recruitment compensation and benefits costs of \$111.2 million increased \$24.4 million, or 28%, compared to last year due to an increase in the number of consultants and bonus expense. Exchange rates impacted executive recruitment compensation and benefits expense unfavorably by \$2.7 million. Executive recruitment compensation and benefits expense, as a percentage of fee revenue, decreased to 60% from 65% in the prior year, as a result of an increase in productivity by our consultants. Futurestep compensation and benefits expense increased \$4.3 million, or 39%, to \$15.3 million from \$11.0 million in the prior year due to increases in execution resources and bonus expense. Exchange rates impacted Futurestep compensation and benefits expense unfavorably by \$0.6 million. Futurestep compensation and benefits expense, as a percentage of fee revenue, decreased to 62% from 71% in the prior year. Corporate compensation and benefits expense increased \$2.5 million, or 52%, to \$7.4 million, reflecting an increase in bonus expense and compensation associated with executive benefits.

*General and Administrative Expenses.* General and administrative expenses increased \$7.9 million, or 23%, to \$42.2 million for the six months ended October 31, 2004 compared to \$34.3 million in the same period last year. Exchange rates unfavorably impacted general and administrative expenses by \$2.4 million. In executive recruitment, general and administrative expenses increased \$6.2 million, or 23%, due to increases in bad debt expenses, professional fees and costs associated with the global partner meeting that occurred in October 2004. Executive recruitment general and administrative expenses, as a percentage of fee revenue, decreased to 18% from 20% in the prior year, as a result of our efforts in controlling costs. Futurestep general and administrative expenses increased by \$0.7 million, or 20%, to \$4.2 million. Futurestep general and administrative expenses, as a percentage of fee revenue, decreased to 17% from 23% in the prior year. Corporate general and administrative expenses increased \$1.0 million, or 26%, to \$5.1 million primarily due to increased professional fees.

*Out-of-Pocket Engagement Expenses.* Out-of-pocket engagement expenses are comprised of expenses incurred by candidates and our consultants that are generally billed to clients. Out-of-pocket engagement expenses of \$11.2 remained fairly constant with the prior year. As a percentage of fee revenue, out-of-pocket engagement expenses decreased to 5% from 7% in the prior year.

*Depreciation and Amortization Expenses.* Depreciation and amortization expense of \$4.4 million in the six months ended October 31, 2004 decreased \$0.9 million, or 17%, from the prior year as fixed assets became fully depreciated in fiscal 2004.

*Operating Income (Loss).* Operating income increased \$23.3 million to \$30.1 million in the current quarter compared to \$6.8 million in the prior year. Prior year operating profit includes \$8.5 million of restructuring expenses.

Executive recruitment operating income increased \$22.4 million to \$38.5 million in the six months ended October 31, 2004 compared to \$16.1 million in the six months ended October 31, 2003. Prior year operating income includes \$5.4 million of restructuring expense. The increase in executive recruitment operating income is a result of the increase in revenue offset by increases in compensation and bonus expense, bad debt expenses, professional fees and costs associated with our global partner meeting. Executive recruitment operating income, as a percentage of fee revenue, increased to 21% in the current quarter from 12% in the same period last year.

Futurestep operating income improved \$4.4 million to \$4.3 million in the six months ended October 31, 2004 from an operating loss of \$0.1 million in the six months ended October 31, 2003. Prior year operating loss included \$3.0 million of restructuring charges. The improvement in Futurestep operating income is due to the increase in revenues offset by an increase in compensation and bonus expense.

*Interest Income and Other Income, Net.* Interest income and other income, net includes interest income of \$0.7 and \$0.5 million in the six months ended October 31, 2004 and 2003, respectively.

*Interest Expense.* Interest expense, primarily related to the borrowings under COLI policies and our convertible securities, was \$5.3 million, a slight decrease from the prior year.

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## Table of Contents

*Provision for Income Taxes.* The provision for income taxes was \$9.4 million in the six months ended October 31, 2004 compared to \$0.9 million in the same period last year. The provision for income taxes in the current year reflects a 36.7% effective tax rate. Although we reported a pretax loss in the prior year, certain foreign subsidiaries reported pretax income resulting in foreign income tax expenses.

*Equity in Earnings of Unconsolidated Subsidiaries.* Equity in earnings of unconsolidated subsidiaries is comprised of our less than 50% shareholder interest in our Mexican subsidiaries. We report our interest in earnings or loss of the Mexican subsidiaries on the equity basis as a one line adjustment to net income (loss). Equity in earnings was \$0.9 million compared to \$0.4 million the same period last year.

### **Liquidity and Capital Resources**

Cash provided by operating activities was \$6.2 million for the six months ended October 31, 2004 compared to cash used in operating activities of \$11.3 million for the same period last year. The increase in operating cash in the current period compared to the same period last year is primarily due to the increase in net income and taxes payable partially offset with the increase in receivables.

Cash used in investing activities was \$9.7 million for the six months ended October 31, 2004 and \$0.7 million in the same period last year. In the six months ended October 31, 2004 we invested \$6.1 million in marketable securities in conjunction with our ECAP program. Capital expenditures for the six months ended October 31, 2004 and 2003 were \$2.8 million and \$0.9 million, respectively. Capital expenditures primarily consist of systems hardware and software costs and leasehold improvements.

Cash provided by financing activities was \$7.9 million for the six months ended October 31, 2004 compared to cash used in financing activities of \$5.5 million in the six months ended October 31, 2003. In the current period, we received \$1.6 million from borrowings under our COLI policies and issued \$8.7 million of common stock, which is offset by \$2.3 million in purchases of common stock. In the same period last year, we made payments of \$5.1 million on acquisition notes.

Total outstanding borrowings under our COLI policies was \$58.9 million and \$65.7 million as of October 31, 2004 and 2003, respectively. Generally, we borrow under our COLI policies to pay related premiums. Such borrowings do not require principal payments, bear interest at primarily variable rates and are secured by the cash surrender value of the life insurance policies of \$119.4 million and \$119.7 million as of October 31, 2004 and 2003, respectively.

In the six months ended October 31, 2004, we issued an additional \$1.5 million of 7.5% Convertible Subordinated Notes in lieu of cash interest and \$0.4 million of 7.5% Convertible Series A Preferred Stock in lieu of cash dividends. As of October 31, 2004, we had approximately \$46.7 million outstanding in aggregate principal amount of 7.5% Convertible Subordinated Notes due in June 2010 and 7.5% Convertible Series A Preferred Stock with an aggregate liquidation preference of \$11.7 million.

We have a \$30.0 million Senior Secured Revolving Credit Facility. The total amount available for borrowing is limited based on certain accounts receivable balances. The credit facility is secured by substantially all of our assets including certain accounts receivable balances and guarantees by and pledges a portion of the capital stock of our significant subsidiaries. We are required to meet certain financial condition covenants on a quarterly basis. As of October 31, 2004, we had no outstanding borrowings on our credit facility.

We believe that cash on hand, borrowings available under our credit facility and funds from operations will be sufficient to meet our anticipated working capital, debt service requirements, capital expenditures and general corporate requirements. However, adverse changes in our revenue could require us to further cut costs or obtain financing to meet our cash needs.

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## Table of Contents

### *Off-Balance Sheet Arrangements*

We have no off-balance sheet arrangements and have not entered into any transactions involving unconsolidated, limited purpose entities.

### **Recently Issued Accounting Standards**

In December 2003, the FASB issued FASB Interpretation No. 46(R), "Consolidation of Variable Interest Entities", effective as of the first reporting period beginning after March 15, 2004. The impact upon adoption of this standard did not have a material impact on the results of our operations or financial position.

In March 2004, the FASB issued an Exposure Draft, "Share-Based Payment - An Amendment of FASB Statements No. 123 and 95" ("Proposed SFAS 123R.") The Proposed SFAS 123R may be effective for interim or annual periods beginning after June 15, 2005 and would eliminate the ability to account for share-based compensation transactions using APB 25. We would be required to recognize compensation expense, using a fair-value based method, for stock options and employee stock purchase plans.

### **Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

As a result of our global operating activities, we are exposed to certain market risks, including foreign currency exchange fluctuations, fluctuations in interest rates and variability in interest rate spread relationships. We manage our exposure to these risks in the normal course of our business as described below. We have not utilized financial instruments for trading or other speculative purposes, nor do we trade in derivative financial instruments.

#### *Foreign Currency Risk*

Substantially all our foreign subsidiaries are measured in their local currencies. Assets and liabilities are translated into U.S. dollars at the rates of exchange in effect at the end of each year and revenue and expenses are translated at average rates of exchange during the year. Resulting translation adjustments are reported as a component of comprehensive income on our Statement of Stockholders' Equity. We recognized \$0.2 million and \$0.7 million of transaction adjustments in the three and six months ended October 31, 2004, respectively.

Historically, we have not realized significant foreign currency gains or losses on transactions denominated in foreign currencies. In the three and six months ended October 31, 2004, we recognized foreign currency losses, after income taxes, of \$0.1 million and \$0.5 million, respectively, primarily related to our Europe operations on our Statement of Operations.

Our primary exposure to exchange losses is based on outstanding inter-company loan balances denominated in U.S. dollars. If the U.S. dollar strengthened 15%, 25% and 35% against Pounds Sterling and the Euro, the Company would recognize an exchange loss of \$1.0 million, \$1.7 million and \$2.4 million, respectively, based on outstanding balances at October 31, 2004.

#### *Interest Rate Risk*

We primarily manage our exposure to fluctuations in interest rates in part through our regular financing activities, which generally are short term and provide for variable market rates. As of October 31, 2004, we had no outstanding balance on our credit facility. We have \$58.9 million of borrowings against the cash surrender value of COLI contracts as of October 31, 2004 bearing interest primarily at variable rates. The risk of fluctuations in these variable rates is minimized by a corresponding adjustment to our borrowed funds crediting rate on the cash surrender value on our COLI contracts.

In June 2002, we issued \$40.0 million of 7.5% Convertible Debt and \$10.0 million of 7.5% Convertible Preferred Stock that is mandatorily redeemable by us if still outstanding on June 13, 2010.

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[Table of Contents](#)

**Item 4. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures.

Based on their evaluation of our disclosure controls and procedures conducted as of the end of the period covered by this quarterly report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act) are effective.

(b) Changes in Internal Control over Financial Reporting.

There were no changes in our internal control over financial reporting or that have materially affected or are reasonably likely to materially affect our internal control over financial reporting, including any corrective actions with regard to significant deficiencies and material weaknesses.

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[Table of Contents](#)

**PART II. OTHER INFORMATION**

**Item 6. Exhibits**

<u>Exhibit Number</u>	<u>Description of Exhibit</u>
3.1	Certificate of Incorporation of the Company, filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q, dated December 15, 1999, and incorporated herein by reference.
3.2	Certificate of Designations of 7.5% Convertible Preferred Stock, filed as Exhibit 3.1 to the Company's Current Report on Form 8-K, dated June 18, 2002, and incorporated herein by reference.
3.3	Amended and Restated Bylaws of the Company, filed as Exhibit 3.3 to the Company's Annual Report on Form 10-K, dated July 29, 2002, and incorporated herein by reference.
31.1	Chief Executive Officer Certification pursuant to Rule 13a-14(a) under the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Chief Financial Officer Certification pursuant to Rule 13a-14(a) under the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Chief Executive Officer and Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350.

**SIGNATURE**

Pursuant to the requirements of the Securities Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

KORN/FERRY INTERNATIONAL

Date: December 10, 2004

By: /s/ GARY D. BURNISON

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Gary D. Burnison  
Chief Operating Officer and  
Chief Financial Officer

**CERTIFICATIONS PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Paul C. Reilly, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Korn/Ferry International (the "Registrant");
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By:           /s/ PAUL C. REILLY          

Name: Paul C. Reilly  
Title: Chairman and Chief  
Executive Officer

Date: December 10, 2004

**CERTIFICATIONS PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Gary D. Burnison, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Korn/Ferry International (the "Registrant");
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ GARY D. BURNISON

Name: Gary D. Burnison  
Title: Chief Operating Officer,  
Chief Financial Officer and  
Executive Vice President

Date: December 10, 2004



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), each of the undersigned officers of Korn/Ferry International, a Delaware corporation (the "Company"), hereby certifies that, to his best knowledge:

(a) the Quarterly Report on Form 10-Q for the quarter ended October 31, 2004 (the "Report") of the Company fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(b) information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: December 10, 2004

By: /s/ PAUL C. REILLY

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Name: Paul C. Reilly  
Title: Chairman and Chief Executive Officer

By: /s/ GARY D. BURNISON

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Name: Gary D. Burnison  
Title: Chief Operating Officer,  
Chief Financial Officer and  
Executive Vice President