SEPTEMBER 2021

Korn Ferry

Secular Transformation To Drive Re-Rating Amidst Cyclical Upturn

KORN FERRY (KFY)

A Secular Rerating Amidst A Cyclical Upturn

		FY	2020	2021	2022E	2023E
Share Price as of 09/03/21	**71.79**					
Diluted Shares	56	Revenue	1,929	1,977	2,160	2,359
Market Capitalization	**3,995**	Adj. EBITDA	280	272	393	447
Plus: Total debt	601	Adj. EBIT	215	176	316	360
Less: Cash and equivalents	(905)	Net Income	149	137	229	263
Enterprise Value	**3,691**	EPS	2.74	2.51	4.36	5.10

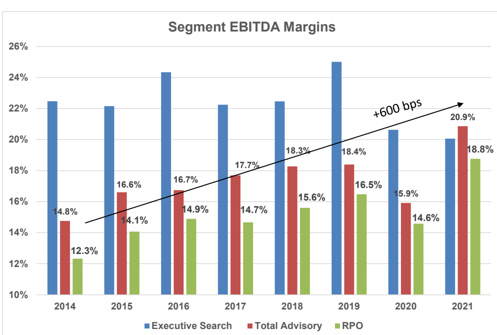
In the 18 months since our original report on Korn Ferry, available at kerr.co/kfy, we've gained further conviction that the company's combination of strong revenue growth, attractive incremental margins, and higher subscription revenue mix will continue to drive estimates and multiples higher.

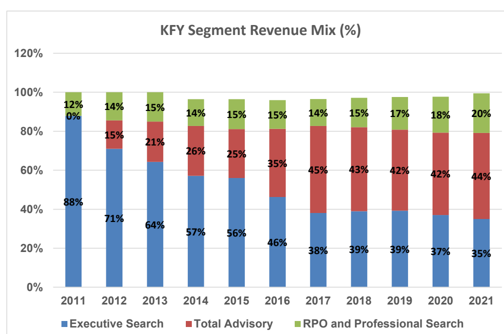
Korn Ferry is the dominant executive search firm and is successfully transforming into a digital-first global consulting organization with a leading technology platform. The company brings an increasingly diversified revenue mix that's lowered cyclicality in the business, and a scale advantage that is not reflected in its current valuation when comparing KFY to its sub-scale private competitors or firms competing down-market. The company's recent proxy suggests management wants us to comp the business to commercial real-estate companies like Jones Lang Lasalle Inc. and asset-light dominant franchises like Nielson Holdings plc, and we agree. Korn Ferry's business model shares many similarities to the commercial real-estate market, including share gains in a fragmented market providing consolidation opportunities, with a growing demand for outsourcing of services benefiting large established incumbents with diversified business segments like KFY. We think shares re-rate from current 8.5x EV/EBITDA multiple to 12 -14x, driving upside for the stock to the $100 – 110 range.

Marquee Customer Strategy and Cross-Selling/Referral Go-To-Market Strategy to Drive Higher Incremental Margins We believe Korn Ferry's improving EBITDA margins reflect a focus in business strategy to drive incremental revenue from the largest accounts through leveraging higher cross-sell/referral opportunities amongst those marquee accounts. Similar to other transactional fee-driven businesses, value in the past historically accrued to star consultants/brokers who had built an extensive relationship rolodex, as seen by KFY's historical lack of operating leverage and lower operating margins that remained in the ~10% range for a number of years. Today, the company is consciously moving away from individual "star" operators and becoming more of an integrated talent solutions company which provides a common unified framework for all of its client development activities. This strategy has seen considerable success, with marquee accounts comprising approximately one third of overall fee revenue currently. Further, with referral revenue approaching 30% (vs. 15% in 2018) and cross-sell revenue contribution in the mid-20% range vs. 19-20% in 2016, we see Korn Ferry successfully leveraging its cross-selling go-to-market strategy to drive higher growth rates and margins to the overall business.

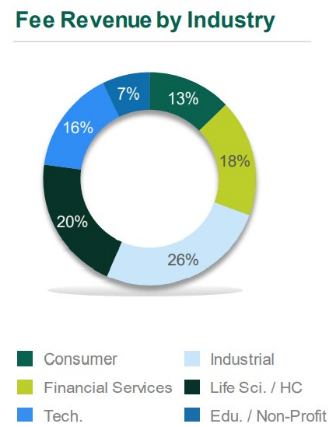
Diversified Revenue Mix and Increasing EBITDA Margins From a largely executive search focused firm in 2011, Korn Ferry has now successfully diversified into Advisory (both consulting and digital engagements) and RPO segments, with these segments comprising almost two-thirds of overall revenue today. With Executive Search the most cyclical segment, this growing revenue diversification also comes with the benefit of lowering overall company cyclicality, as growth is now being driven by the increasingly secular segments of Digital and RPO.

With a professional search TAM of $25B, 5x larger than that of executive search, we expect a long runway of growth with high single-digit to low-double digit growth in professional search, well above the historical mid-single digit CAGR in Executive Search. KFY's more diversified revenue mix should also drive higher organic growth, led by Digital and RPO segments' growth of low-double digits and mid-to-high teens respectively.



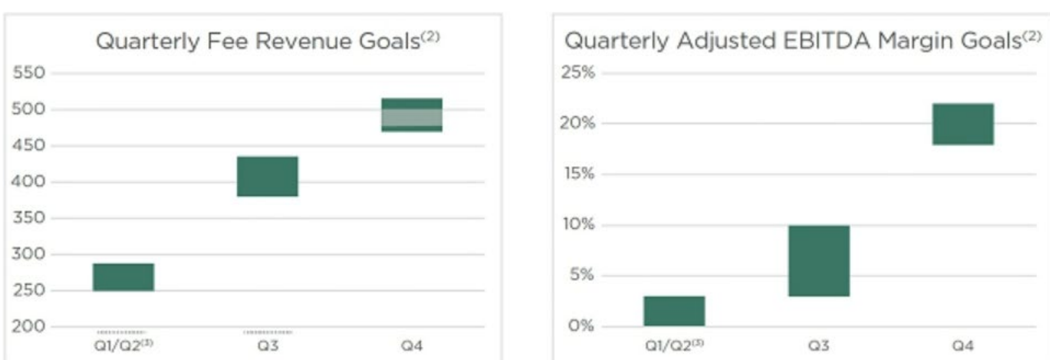


KFY's diversified revenue exposure can be seen from an end-market perspective as well, where we highlight technology gaining ~100 bps of annual share due to its higher overall growth rates.



KFY has succesfully expanded EBITDA margins by approximately an annual 100 bps CAGR in both its Advisory and RPO segments since 2014, with EBITDA margins expanding more than 600 bps over the past five years. While management recently updated its longer-term EBITDA margin outlook to 18%, we see no reason why long-term EBITDA margins cannot exceed well north of 20%+. Management updated 4Q21 EBITDA margin targets for FY21 with long-term incentive compensation to exceed 20% – therefore, internally Korn Ferry management is incentivising compensation via structurally higher EBITDA margin targets above what it has communicated externally to investors. Finally, with historical EBITDA-to-FCF conversion in the 70-75% range, we expect higher incremental EBITDA margins to benefit the company via higher FCF growth as well.

/ Increasing Difficulty of Quarterly Performance Goals(1)

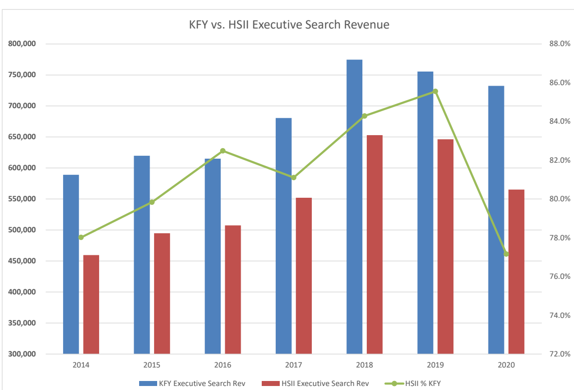


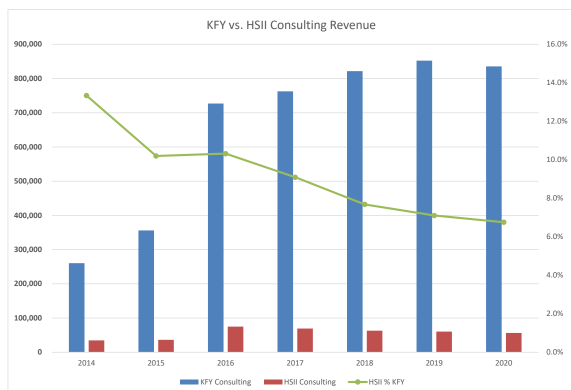
<u>Accelerating Share Gains Against HSII</u> As the only public competitor in the "Big Five" (KFY, Spencer Stuart, Egon Zehnder, Heidrick & Struggles, and Russell Reynolds) Executive Search space, Heidrick & Struggles International (HSII) provides important insights into overall industry market share trends. KFY has consistently gained share in consulting revenue, especially after the acquisition of Hay Group in 2015. HSII's recent acquisition of Business Talent Group to provide an online marketplace for independent talent on demand likely further dilutes HSII's "premium" brand messaging for the CXO marketplace. While Heidrick & Struggles gained relative share from 2014-2019, we highlight the recent share loss trajectory with HSII management sounding hesitant on market-share gain opportunities.

7/26/21 2Q21 Earnings Call. *Q: Are you taking share, keeping share or losing share based on your growth rates? A: In terms of market share, it's always very difficult for us to measure. As you know, there's only one other public company, and the rest is private. And some of the industry data we get is survey-based, and I don't put a lot of weight on it. Overall, based on the growth that we're seeing, based on what we can benchmark ourselves to, I definitely know we're holding our own. I highly suspect that we're doing better in terms of some market trends.*

2/22/21 4Q20 Earnings Call. *While near-term economic visibility remains limited, we are committed to capturing additional market share by going to market as one firm with an integrated value proposition.*

10/26/20 3Q20 Earnings Call. *Our team continues to perform well, and we believe we are gaining share in the market.*





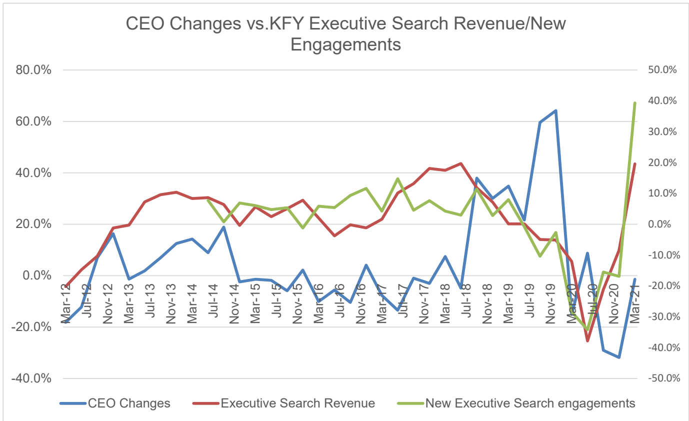
<u>New Peer Group Disclosure Highlights Size and Revenue Mismatch</u> By highlighting a new peer group in the recent proxy consisting of commercial real-estate companies, we believe KFY management is trying to highlight these asset light, higher quality business models which better represent KFY versus the current view of Korn Ferry as cyclical and fragile. Part of the reason behind KFY's cheap valuation has been the market comparing it to niche, sub-scale private competitors and to temp staffing firms with a fundamentally different business model and unit economics.

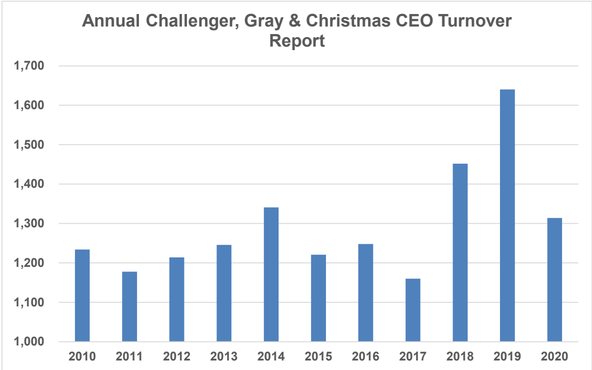
Korn Ferry's business model shares many similarities to the commercial real-estate market, including share gains in a fragmented market providing consolidation opportunities, with growing demand for outsourcing of services benefiting large established incumbents with diversified business segments. As management described it: *The selection of commercial real estate companies was predicated on business model and strategy alignment. As professional services firms, real estate companies face very similar business model, colleague, and go-to-market issues. We consider the business strategy of such companies as similar to our business strategy because commercial real estate brokers are analogous to our Executive Search partners: they have strong client relationships which the firms are leveraging by building a business with a number of closely related adjacent services that can be sold into clients through those relationships.*

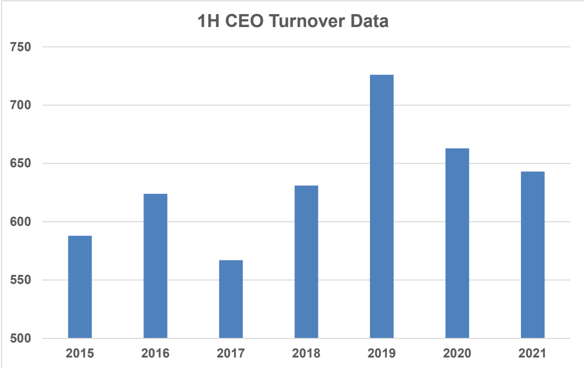
As can be seen in the relative valuation section below, KFY trades 4 to 10 turns cheaper from an EV/EBITDA multiple perspective and 2 to 4 turns cheaper from a P/E ratio perspective (without giving KFY the benefit of net cash on the balance sheet) when compared to a relative comp set in temp staffing (RHI, MAN, ASGN, KFRC) and human consulting (HURN, FCN, LTG) firms.

		Share					EV / Sales	EV / Sales		EV / EBITDA		P / E		FCF/Mkt Cap		Revenue Growth	
Ticker	Company	Price	Mkt Cap	Debt	EV	2020A	LTM	2021E	2022E	2021E	2022E	2021E	2022E	2021E	2021E	2021E	2022E
HSII	Heidrick & Struggle	41.96	819	104	685	1.1x	0.9x	0.7x	0.7x	5.5x	5.5x	11.8x	12.4x	9.6%	11.1%	54.0%	2.4%
HURN	Huron Consulting G	50.11	1,063	338	1,388	1.6x	1.7x	1.6x	1.4x	14.1x	12.4x	19.3x	17.1x	6.9%	10.2%	5.9%	7.6%
FCN	FTI Consulting, Inc.	143.12	4,759	657	5,159	2.1x	1.9x	1.9x	1.8x	14.6x	12.8x	22.3x	19.2x	5.1%	6.2%	11.1%	4.6%
LTG	Learning Technolog	3.05	2,395	39	2,313	12.9x	17.5x	9.6x	9.0x	28.6x	25.1x	44.5x	39.0x	2.7%	3.0%	34.5%	6.5%
Average Human Consulting						**5.6x**	**7.0x**	**4.3x**	**4.1x**	**19.1x**	**16.8x**	**28.7x**	**25.1x**	**4.9%**	**6.5%**	**17.2%**	**6.2%**
Temp Staffing																	
RHI	Robert Half Internat	103.39	11,395	281	11,133	2.2x	2.0x	1.8x	1.6x	13.4x	12.9x	20.6x	19.7x	4.2%	4.4%	24.7%	7.6%
MAN	ManpowerGroup In	121.68	6,599	1,476	6,623	0.4x	0.3x	0.3x	0.3x	9.8x	8.6x	17.2x	14.3x	6.9%	8.2%	18.6%	5.2%
ASGN	ASGN Incorporated	110.60	5,851	1,100	6,576	1.7x	1.6x	1.7x	1.5x	14.4x	13.0x	22.0x	19.8x	6.5%	6.8%	1.2%	8.3%
KFRC	Kforce Inc.	57.67	1,181	121	1,185	0.9x	0.8x	0.8x	0.8x	10.4x	10.0x	17.5x	16.4x	6.2%	7.9%	9.8%	3.3%
Average Temp Staffing						**3.2x**	**3.8x**	**2.5x**	**2.4x**	**14.4x**	**13.0x**	**22.7x**	**20.3x**	**5.9%**	**7.1%**	**19.7%**	**5.7%**
New Peer Group																	
ASGN	ASGN Incorporated	110.60	5,851	1,100	6,576	1.7x	1.6x	1.7x	1.5x	14.4x	13.0x	22.0x	19.8x	6.5%	6.8%	1.2%	8.3%
CWK	Cushman & Wakefi	17.95	4,007	3,769	6,704	0.9x	0.8x	0.8x	0.7x	9.4x	8.6x	12.5x	10.7x	5.2%	8.3%	13.2%	5.2%
JLL	Jones Lang LaSalle	241.35	12,237	2,690	14,531	1.7x	1.5x	1.4x	1.3x	11.4x	11.0x	15.4x	15.2x	4.6%	4.1%	19.5%	5.1%
NLSN	Nielsen Holdings pl	21.94	7,872	6,115	13,771	2.2x	2.2x	3.9x	3.8x	9.3x	8.8x	13.8x	12.5x	8.0%	8.9%	(44.1%)	3.6%
New Peer Group						**2.0x**	**2.2x**	**1.9x**	**1.8x**	**12.6x**	**11.6x**	**19.2x**	**17.4x**	**5.9%**	**6.9%**	**8.1%**	**5.9%**
KFY	**Korn Ferry**	**69.59**	**3,723**	**601**	**3,419**	**2.1x**	**1.9x**	**1.6x**	**1.5x**	**8.5x**	**8.5x**	**16.9x**	**16.9x**	**4.6%**	**4.9%**	**30.3%**	**4.3%**

<u>Challenger, Gray & Christmas CEO Turnover Data Suggests Cyclical Recovery Is Still Ahead.</u> As can be seen in the figure below, the Challenger, Gray & Christmas CEO Turnover data tracks Korn Ferry's executive search revenue and new engagement trends closely. Since the 2008 recession, annual CEO turnover remained in the 1,200 to 1,300 range for several years, reflecting the general lack of employment growth seen typically in a post-recession recovery. Led by strong growth in the technology sector, a desire to hire younger external CEOs, and a growing demand for CEO accountability, 2018 and 2019 saw strong growth in CEO turnover, with annual figures exceeding 1,400 and 1,600 respectively. We are still early in terms of post-COVID recovery, as highlighted by flat Y/Y 1H CEO turnover data. Notwithstanding KFY revenue exceeding pre-COVID levels, we believe we are still early in the ongoing cyclical upturn, with the current labor market mismatch suggesting strong demand for Korn Ferry's suite of consulting and recruiting services.

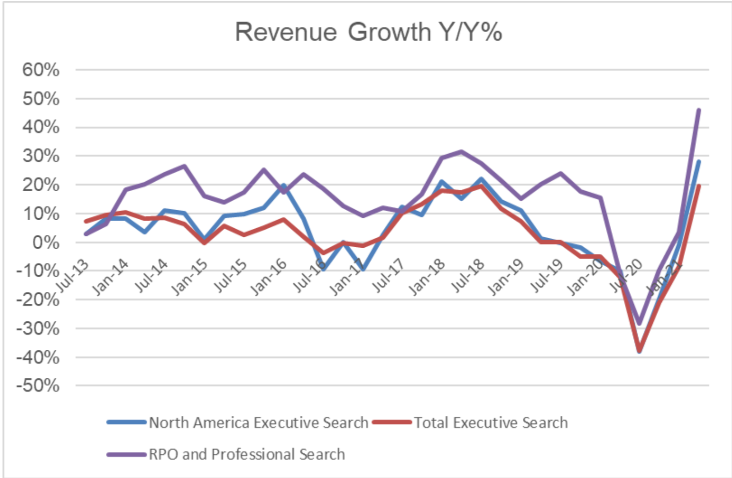






<u>Revenue Exceeding Pre-COVID As Strong Sequential Growth Continues Through CY21.</u>

We expect the company to continue to benefit from a cyclical recovery with better-than-expected incremental margins. With a double-digit sequential growth rate post-COVID, easy comps over the next 6 to 9 months, and HSII's recent results and guidance with revenue accelerating 30% Q/Q, we expect KFY to easily outperform its -2% Q/Q guided revenue outlook and current consensus modeling flat revenue trajectory through FY22.



And while KFY shares have outperformed post-COVID, we expect a combination of higher revenue growth, higher incremental margins, a growing mix of KF Digital and RPO revenue, and higher subscription revenue mix to eventually drive higher multiples. The company features an undemanding valuation with a clean balance sheet, new disclosures that re-categorize KFY from a niche staffing firm to a digital-led services business, and a diversified revenue mix that continues to lower cyclicality in the business. Assuming 12-14x EV / EBITDA multiple (vs. current 8.5x), we see continued upside to KFY shares to the $100-110 range.