

# 2018 SECOND QUARTER CONFERENCE CALL SCRIPT

July 30, 2018

## Julie Creed, Vice President Investor Relations & Real Estate

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Good afternoon everyone, and thank you for participating in Heidrick & Struggles 2018 second quarter conference call. Joining me on today's call is our President and CEO, Krishnan Rajagopalan, and our Chief Financial Officer, Mark Harris. We have posted our second quarter slides on the IR home page of our website at [heidrick.com](http://heidrick.com) and we encourage you to print them for additional context, but we won't be referring to specific page numbers during our opening comments.

In our opening remarks or in our quarterly slides we refer to Adjusted EBITDA, Adjusted EBITDA Margin, Adjusted operating income and operating margin, and Adjusted net income and EPS. These are non-GAAP financial measures that we believe better explain some of our results. A reconciliation between GAAP and non-GAAP financial measures can be found in a schedule at the end of the release, and in our supporting slides. Also in our remarks, we will be making forward-looking statements and ask that you please refer to the Safe Harbor language contained in our news release and on SLIDE 1 of our presentation.

Krishnan, I'll turn the call over to you.

## Krishnan Rajagopalan, President & Chief Executive Officer:

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Good afternoon and thank you for joining our call. As you have seen from our press release, we reported another strong quarter-- our **12<sup>th</sup>** quarter in a row of year-over-year revenue growth. Moreover, we are beginning to see the positive impact on profitability as a result of the changes we have been making over the last year.

Some of the financial highlights in the second quarter were:

- A company record for quarterly net revenue of \$183.1 million, up 20% year over year and up 14% sequentially.
- Growth in Executive Search revenue of 24%, with a year-over-year increase in all three regions of at least 23%.
- A company record for Executive Search productivity per consultant of \$1.9 million dollars.
- Sixteen percent sequential growth in revenue from Heidrick Consulting, a comparison we believe is more relevant given the significant reorganization and restructuring in this business last year.
- A reduction in quarterly G&A expenses resulting in the lowest run rate in almost two years.
- Operating margin of 10.1% -- the highest quarterly operating margin since third quarter of 2008.

- And diluted earnings per share of 59 cents compared to adjusted diluted earnings per share of 33 cents in last year's second quarter.

These financial results are being driven by improvements that we are achieving in the business. I'll give you a few examples.

- In Heidrick Consulting, we are pleased with the continuous improvements we have seen each month, since the official launch in January. We added three new partners in the second quarter and have more in the pipeline. We solidified our three Centers of Excellence and go-to-market offerings. Our cross collaboration initiatives with Search have already resulted in some very impactful engagements with our clients, which helped drive the sequential revenue growth in 2Q, and are setting up future opportunities. One large win that I am very excited about is the work we are going to be doing for an international integrated industrial company that includes organizational design, top team assessment, a leadership definition and development model, and five c-suite searches.
- In Executive Search, we are winning a record number of searches, completing more of these searches, executing them more efficiently, getting more upticks, and achieving higher average fees. We believe our growth rate is outpacing the market. We are hiring strategically as well. And we are continuously working to stay ahead of our clients' needs. For example, we launched a new specialty practice in Artificial Intelligence as well as a Disruptive Innovators Team to advise emerging companies who are at the cusp of rapid growth, breakthrough innovation and market disruption.

I'd like to thank our employees around the world for driving these strong second quarter and year-to-date results.

We continue to execute on our strategic, operational and financial initiatives. I am quite proud of what we achieved in the first half and I am excited about our momentum and potential going forward.

Now let me turn the call over to Mark to further discuss the financial results.

## Mark Harris, Chief Financial Officer:

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Thank you Krishnan and good afternoon to everyone on the call. Our excellent quarterly performance was the result of continued strength in Search, good progress in Heidrick Consulting, and prudent expense initiatives that we started at the end of last year.

Let me start with our consolidated net revenue. In the second quarter of 2018 we reached net revenue of \$183.1 million, up \$31 million or 20% year over year, and up 14% sequentially from the first quarter this year. This quarterly net revenue was a record for Heidrick & Struggles, and a great achievement from our entire Heidrick & Struggles team.

Turning to Executive Search. Executive Search revenue increased 24% year over year or \$32 million, and was up 14% sequentially. All of the key Search metrics improved, as did every region. For example: Search confirmations increased 23% year over year and 11% sequentially; productivity was a record \$1.9 million per consultant compared to \$1.5 million in last year's second quarter; and average revenue per search was over \$119,000 compared to about \$118,000 in last year's second quarter. In addition to generally firing on all cylinders, we saw an unusual increase in upticks for searches in the quarter which also contributed significantly to our second quarter historical achievement. Upticks are inherently difficult to predict, and were a significant reason we were ahead of the guidance we provided when reporting first quarter results.

Now turning to Heidrick Consulting. Heidrick Consulting revenue increased sequentially by 16% compared to the first quarter of this year. Although there was a year-over-year decline in revenue, it should be noted that much of this was attributable to the new revenue recognition methodology. Given the first and second quarter results were both impacted by this methodology, we are encouraged by the sequential improvement as a proxy for the growth of this business and pleased with the integration.

Salaries and Employee benefits increased \$24.3 million, or 23.5%, from the second quarter 2017. \$18.1 million of the increase was related to variable compensation associated with the strong performance in Search. And \$6.2 million was an increase in fixed compensation, primarily related to higher costs for talent acquisition and retention as we continue to invest in our future.

For the third quarter in a row, General and Administrative expenses declined year over year. G&A was \$36.9 million, down 3.1% or \$1.2 million. We are pleased with savings

that were achieved in a number of areas, but two contributors to the decline included the use of fewer external consultants and lower intangible amortization.

Operating Income in the quarter increased to \$18.5 million with an operating margin of 10.1%, the highest since the third quarter 2008, and nearly 200 bps higher than the first quarter. The year-over-year comparisons to last year's GAAP results aren't as relevant given the impairment charge in last year's second quarter, but even on an adjusted basis, as shown on SLIDES 9 and 10 of our quarterly slides, you will see that we are driving improved operating profitability. Further, we added a SLIDE 11 in the deck that shows our trailing 12 month operating margin as this is a primary metric that we focus on to ensure that we are leveraging our platform to its maximum value. The operating margin is adjusted for restructurings and impairments, but shows the progress we are making on a trailing 12-month basis moving from 5.8% margins in mid-2016 to the 8.0% we achieved at the end of this quarter. While there is always variability on a quarterly basis, it is a trend we intend to keep.

Net income in the second quarter grew to \$11.5 million and diluted earnings was \$0.59 per share with an effective tax rate of 37.7%. With a continued focus to drive our effective tax rate down, we believe our annual effective tax rate will be in the mid-30% range by the end of this year, a reduction from an adjusted 48.9% tax rate in 2017.

Now let me turn to our Balance Sheet. Reflecting the payment of bonuses in the second quarter, and the repayment of \$12 million that was outstanding on our credit facility, we ended the second quarter with cash and cash equivalents of \$85.8 million compared to \$58.2 million at the end of the 2017 second quarter. Further, of the \$86 million in cash and cash equivalents, \$78 million is available for operational use, while \$8 million has more limited availability due to currency, tax, and other factors that make it less efficient to use at this time.

Now let me give you the guidance for the third quarter. Our Executive Search backlog remains strong. Given monthly Search confirmation trends and other factors on which we base our forecast, including 1.) anticipated fees; 2.) the expectations for our Heidrick Consulting assignments; 3.) the number of consultants and their productivity; 4.) the seasonality of the business; 5.) the anticipated economic climate; and 6.) foreign currency exchange rates, we are forecasting 2018 third quarter net revenue between

\$170 million and \$180 million. This compares to \$159.8 million in net revenue in last year's third quarter.

In summary, we delivered another outstanding quarter and continued our pace of growth from the first quarter. Our business continues to benefit from the overall market strength and we believe we are capturing this very well, as our financial performance indicates. This positions us well for future growth assuming no change in the macro environment, but irrespective, we continue to focus on strong execution, prudent long-term planning and adding value to our clients. With that, I'll turn the call back over to Krishnan who will give an update on our strategic priorities.

## Krishnan Rajagopalan, President & Chief Executive Officer:

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Thank you, Mark.

Our second quarter results showcase the power of Heidrick & Struggles globally. Every region contributed to our achievements. I couldn't be more proud of what we accomplished as a team.

In the last two calls, I have discussed our results and our initiatives in the context of the four priorities we have. I'll do the same this quarter.

The first priority is **GROWTH—increasing the scale and impact of both our business segments.**

I think it is safe to say that we are executing well on this initiative in Executive Search, and we have no intentions of letting up. We are still looking to hire new consultants, strategically, while maintaining a significant focus on developing our talent from within and driving expansion into markets and practices where we see good opportunities for growth.

In Heidrick Consulting, we are focusing on scaling the business that we launched on January 1. We continue to cross train consultants on our service offering, and are pleased to report that we have several engagements that reflect cross-selling between the former Culture and Leadership Consulting organizations. We added net three consultants in the second quarter and will continue to add more expertise, new service offerings, and scalable tools and methodologies. We are pleased with the growing pipeline of client engagements.

Our second priority has been to accelerate our **cross-enterprise collaboration**. When we bring the full power of our people and services from both Search and Consulting to our clients, we can achieve the greatest impact for them and drive profitable growth for the firm.

As part of the creation of Heidrick Consulting in January, we made a very concerted effort to develop joint training programs for Executive Search and Heidrick Consulting. We also held three regional consultant conferences in the second quarter where a large focus was on training and cross-collaboration opportunities. The increased partnership that we are seeing as a result of this training has been very encouraging. There are many joint teams pursuing a meaningful number of opportunities, and some good wins as well, like the one I referenced earlier for the large energy company.

Our third priority is on driving a **premium service experience** for our clients that will further distinguish Heidrick from its competitors. I am very excited about the progress we are making on this initiative and the feedback is outstanding. Recall that in 2017 we launched the Heidrick Way. The Heidrick Way has been the foundation of our initiative to provide this premium service experience for our clients. The Heidrick Way has standardized how we assess candidates, capture data, and communicate with our clients globally. We were recently with a client in Asia who had nine searches and was planning to use three different search firms. But when the client saw how we would deliver the searches, using such an insightful and consistent methodology and our proprietary client portal – Heidrick Connect-- they immediately awarded all nine searches to us. There have been a number of follow-on benefits as adoption rates of our standardized assessment methodology continue to grow. We are collecting better, more consistent data that gives us more valuable insights to share with clients and we see increased efficiencies in completing searches as well.

And, finally, our fourth priority is to further **improve our cost structure**. We are pleased with the first half improvements in operating income, margin and EPS, but we are not satisfied. A return to double-digit operating margin felt great in the second quarter, but we believe we can do better and remain focused on improving our margin and our operating model.

I want to again thank our employees around the globe for their hard work this year. Now we would be happy to take your questions.