

HEIDRICK & STRUGGLES INTERNATIONAL INC

Form 10-Q

October 28, 2014

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2014

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 0-25837

HEIDRICK & STRUGGLES INTERNATIONAL, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

36-2681268
(I.R.S. Employer
Identification Number)

233 South Wacker Drive-Suite 4200

Chicago, Illinois

60606-6303

(Address of Principal Executive Offices)

(312) 496-1200

(Registrant's Telephone Number, Including Area Code)

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 (or for such shorter period of time that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-Accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of October 23, 2014, there were 18,244,337 shares of the Company's common stock outstanding.

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HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except share amounts)**

| | September 30, 2014 (Unaudited) | December 31, 2013 |
|--|---|------------------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 159,537 | \$ 181,646 |
| Accounts receivable, net | 94,130 | 71,666 |
| Other receivables | 9,762 | 6,906 |
| Prepaid expenses | 15,153 | 14,786 |
| Other current assets | 1,757 | 1,937 |
| Income taxes recoverable | 7,098 | 5,772 |
| Deferred income taxes | 6,949 | 8,061 |
| Total current assets | 294,386 | 290,774 |
| Non-current assets: | | |
| Property and equipment, net | 30,070 | 34,961 |
| Restricted cash | 7,998 | 7,878 |
| Assets designated for retirement and pension plans | 20,850 | 22,685 |
| Investments | 14,276 | 13,848 |
| Other non-current assets | 6,649 | 5,693 |
| Goodwill | 122,657 | 123,274 |
| Other intangible assets, net | 22,432 | 26,637 |
| Deferred income taxes | 22,258 | 27,474 |
| Total non-current assets | 247,190 | 262,450 |
| Total assets | \$ 541,576 | \$ 553,224 |
| Current liabilities: | | |
| Current portion of debt | \$ 6,000 | \$ 6,000 |
| Accounts payable | 5,532 | 7,791 |
| Accrued salaries and employee benefits | 104,803 | 109,943 |
| Deferred revenue, net | 31,848 | 27,714 |
| Other current liabilities | 24,797 | 18,938 |
| Income taxes payable | 4,655 | 5,401 |
| Total current liabilities | 177,635 | 175,787 |

| | | |
|---|-------------------|-------------------|
| Non-current liabilities: | | |
| Non-current debt, less current maturities | 25,000 | 29,500 |
| Retirement and pension plans | 37,044 | 38,735 |
| Other non-current liabilities | 53,341 | 61,329 |
| Total non-current liabilities | 115,385 | 129,564 |
| Total liabilities | 293,020 | 305,351 |
| Commitments and contingencies (Note 18) | | |
| Stockholders equity: | | |
| Preferred stock, \$0.01 par value, 10,000,000 shares authorized, no shares issued at September 30, 2014 and December 31, 2013 | | |
| Common stock, \$0.01 par value, 100,000,000 shares authorized, 19,585,777 shares issued, 18,240,995 and 18,134,129 shares outstanding at September 30, 2014 and December 31, 2013, respectively | 196 | 196 |
| Treasury stock at cost, 1,344,782 and 1,451,648 shares at September 30, 2014 and December 31, 2013, respectively | (44,261) | (47,811) |
| Additional paid in capital | 231,382 | 232,008 |
| Retained earnings | 47,169 | 48,511 |
| Accumulated other comprehensive income | 14,070 | 14,969 |
| Total stockholders equity | 248,556 | 247,873 |
| Total liabilities and stockholders equity | \$ 541,576 | \$ 553,224 |

The accompanying notes to Condensed Consolidated Financial Statements are an integral part of these statements.

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HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands, except per share amounts)

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------|------------------------------------|------------|
| | 2014 | 2013 | 2014 | 2013 |
| Revenue: | | | | |
| Revenue before reimbursements (net revenue) | \$ 125,829 | \$ 118,981 | \$ 373,030 | \$ 343,992 |
| Reimbursements | 4,432 | 4,523 | 13,721 | 14,148 |
| Total revenue | 130,261 | 123,504 | 386,751 | 358,140 |
| Operating expenses: | | | | |
| Salaries and employee benefits | 84,046 | 81,671 | 252,089 | 236,216 |
| General and administrative expenses | 32,226 | 28,957 | 98,092 | 93,292 |
| Reimbursed expenses | 4,432 | 4,523 | 13,721 | 14,148 |
| Total operating expenses | 120,704 | 115,151 | 363,902 | 343,656 |
| Operating income | 9,557 | 8,353 | 22,849 | 14,484 |
| Non-operating expense: | | | | |
| Interest, net | (152) | (91) | (232) | (120) |
| Other, net | (488) | (709) | (444) | (1,675) |
| Net non-operating expense | (640) | (800) | (676) | (1,795) |
| Income before income taxes | 8,917 | 7,553 | 22,173 | 12,689 |
| Provision for income taxes | 5,925 | 3,429 | 16,138 | 7,844 |
| Net income | 2,992 | 4,124 | 6,035 | 4,845 |
| Other comprehensive (loss) income, net of tax: | | | | |
| Foreign currency translation adjustment | (2,315) | 232 | (1,067) | (1,769) |
| Net unrealized (loss) gain on available-for-sale investments | (349) | 436 | 160 | 783 |
| Unrealized (loss) gain on cash flow hedge | 77 | (74) | 8 | 76 |
| Other comprehensive (loss) income, net of tax | (2,587) | 594 | (899) | (910) |
| Comprehensive income | \$ 405 | \$ 4,718 | \$ 5,136 | \$ 3,935 |
| Basic weighted average common shares outstanding | 18,233 | 18,104 | 18,200 | 18,064 |
| Dilutive common shares | 233 | 119 | 197 | 143 |

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| | | | | |
|--|---------|---------|---------|---------|
| Diluted weighted average common shares outstanding | 18,466 | 18,223 | 18,397 | 18,207 |
| Basic net income per common share | \$ 0.16 | \$ 0.23 | \$ 0.33 | \$ 0.27 |
| Diluted net income per common share | \$ 0.16 | \$ 0.23 | \$ 0.33 | \$ 0.27 |
| Cash dividends paid per share | \$ 0.13 | \$ 0.13 | \$ 0.39 | \$ 0.26 |

The accompanying notes to Condensed Consolidated Financial Statements are an integral part of these statements.

Table of Contents**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY**

(In thousands)

(Unaudited)

| | Common Stock | | Treasury Stock | | Additional Paid in Capital | Retained Earnings | Accumulated | |
|---|--------------|--------|----------------|------------|----------------------------------|----------------------|---------------------------------------|------------|
| | Shares | Amount | Shares | Amount | | | Other Compre- hensive Income | Total |
| Balance at December 31, 2013 | 19,586 | \$ 196 | 1,452 | \$(47,811) | \$ 232,008 | \$ 48,511 | \$ 14,969 | \$ 247,873 |
| Net income | | | | | | 6,035 | | 6,035 |
| Other comprehensive loss, net of tax | | | | | | | (899) | (899) |
| Treasury and common stock transactions: | | | | | | | | |
| Stock-based compensation | | | | | 2,885 | | | 2,885 |
| Vesting of equity, net of tax withholdings | | | (84) | 2,737 | (3,141) | | | (404) |
| Re-issuance of treasury stock | | | (23) | 813 | (363) | | | 450 |
| Cash dividends declared (\$0.39) per share) | | | | | | (7,108) | | (7,108) |
| Dividend equivalents on restricted stock units | | | | | | (269) | | (269) |
| Tax deficit related to stock-based compensation | | | | | (7) | | | (7) |
| Balance at September 30, 2014 | 19,586 | \$ 196 | 1,345 | \$(44,261) | \$ 231,382 | \$ 47,169 | \$ 14,070 | \$ 248,556 |

The accompanying notes to Condensed Consolidated Financial Statements are an integral part of these statements.

Table of Contents**HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

| | Nine Months Ended September 30, | |
|---|--|-------------|
| | 2014 | 2013 |
| Cash flows operating activities: | | |
| Net income | \$ 6,035 | \$ 4,845 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation and amortization | 11,359 | 12,046 |
| Deferred income taxes | 5,633 | (500) |
| Stock-based compensation expense | 2,885 | 2,775 |
| Accretion expense related to earnout payments | 1,308 | 1,551 |
| Cash paid for restructuring charges | (108) | (918) |
| Changes in assets and liabilities, net of effects of acquisitions: | | |
| Accounts and other receivables | (27,196) | (21,607) |
| Accounts payable | (2,177) | (2,381) |
| Accrued expenses | (1,774) | (12,073) |
| Deferred revenue | 4,486 | 1,964 |
| Income taxes payable, net | (2,220) | 4,826 |
| Retirement and pension plan assets and liabilities | 100 | 574 |
| Prepaid expenses | (557) | (3,207) |
| Other assets and liabilities, net | 178 | 240 |
| Net cash used in operating activities | (2,048) | (11,865) |
| Cash flows investing activities: | | |
| Restricted cash | (103) | (50) |
| Capital expenditures | (2,609) | (1,920) |
| Purchases of available for sale investments | (896) | (661) |
| Proceeds from sales of available for sale investments | 966 | 155 |
| Net cash used in investing activities | (2,642) | (2,476) |
| Cash flows financing activities: | | |
| Proceeds from debt issuance | | 40,000 |
| Debt repayment | (4,500) | (3,000) |
| Cash dividends paid | (7,364) | (4,875) |
| Payment of employee tax withholdings on equity transactions | (406) | (647) |
| Acquisition earnout payments | (3,390) | (357) |

| | | |
|---|------------|------------|
| Net cash (used in) provided by financing activities | (15,660) | 31,121 |
| Effect of exchange rates fluctuations on cash and cash equivalents | (1,759) | (1,595) |
| Net (decrease) increase in cash and cash equivalents | (22,109) | 15,185 |
| Cash and cash equivalents at beginning of period | 181,646 | 117,605 |
| Cash and cash equivalents at end of period | \$ 159,537 | \$ 132,790 |

The accompanying notes to Condensed Consolidated Financial Statements are an integral part of these statements.

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HEIDRICK & STRUGGLES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(All tables in thousands, except share and per share figures)

(Unaudited)

1. Basis of Presentation of Interim Financial Information

The accompanying unaudited Condensed Consolidated Financial Statements of Heidrick & Struggles International, Inc. and subsidiaries (the Company) have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC). The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Significant items subject to estimates and assumptions include revenue recognition, allowance for doubtful accounts, interim effective tax rate, allowances for deferred tax assets, assessment of goodwill and other intangible assets for impairment, compensation accruals, stock-based compensation and contingent liabilities. Estimates are subject to a degree of uncertainty and actual results could differ from these estimates. These financial statements and notes are to be read in conjunction with the Company's Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on March 13, 2014.

2. Summary of Significant Accounting Policies

A complete listing of the Company's significant accounting policies is discussed in Note 2, *Summary of Significant Accounting Policies*, in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Recent Financial Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*. The ASU requires that an entity recognizes revenue to depict the transfer of promised goods or services to customer in an amount that reflects the consideration to which the Company expects to be entitled in exchange for these goods or services. The standard is effective for annual reporting periods beginning after December 15, 2016, including interim periods, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients or (ii) a retrospective approach with the cumulative effect upon initial adoption recognized at the date of adoption. The Company is currently evaluating the effect that this pronouncement will have on its financial statements and related disclosures. The effect is not known or reasonably estimable at this time.

3. Allowance for Doubtful Accounts

The activity of the allowance for doubtful accounts for the nine months ended September 30, 2014 is as follows:

| | |
|-------------------------------|----------|
| Balance at December 31, 2013 | \$ 4,709 |
| Provision charged to income | 740 |
| Write-offs | (612) |
| Currency | (124) |
| Balance at September 30, 2014 | \$ 4,713 |

4. Property and Equipment, net

The components of the Company's property and equipment are as follows:

| | September 30, 2014 | December 31, 2013 |
|--|-----------------------|----------------------|
| Leasehold improvements | \$ 43,552 | \$ 44,242 |
| Office furniture, fixtures and equipment | 18,554 | 24,301 |
| Computer equipment and software | 29,854 | 38,039 |
| Property and equipment, gross | 91,960 | 106,582 |
| Accumulated depreciation | (61,890) | (71,621) |
| Property and equipment, net | \$ 30,070 | \$ 34,961 |

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Depreciation expense was \$2.3 million and \$2.6 million for the three months ended September 30, 2014 and 2013, respectively. Depreciation expense for the nine months ended September 30, 2014 and 2013 was \$7.2 million and \$7.7 million, respectively.

5. Restricted Cash

The components of the Company's restricted cash are as follows:

| | September 30, 2014 | December 31, 2013 |
|--|-----------------------|----------------------|
| Non-current restricted cash: | | |
| Retention escrow | \$ 6,500 | \$ 6,501 |
| Lease guarantees | 1,399 | 1,377 |
| Business licenses | 99 | |
| Total non-current restricted cash | \$ 7,998 | \$ 7,878 |

The retention escrow is associated with the Senn Delaney acquisition and will be paid to certain key executives of Senn Delaney if they remain with the Company for three years subsequent to the acquisition (See Note 8, *Acquisitions*). The Company has certain business licenses and lease agreements with terms that require the Company to restrict cash through the termination dates of the agreements, which extend through 2017 and 2018, respectively.

6. Investments

The components of the Company's investments are as follows:

| | September 30, 2014 | December 31, 2013 |
|---|-----------------------|----------------------|
| U.S. non-qualified deferred compensation plan | \$ 13,592 | \$ 13,232 |
| Warrants and equity securities | 684 | 616 |
| Total | \$ 14,276 | \$ 13,848 |

The Company's U.S. non-qualified deferred compensation plan consists primarily of U.S. marketable securities and mutual funds, all of which are valued using Level 1 inputs (See Note 7, *Fair Value Measurements*). The aggregate cost basis for these investments was \$10.1 million and \$9.9 million as of September 30, 2014 and December 31, 2013, respectively.

7. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three-level fair value hierarchy prioritizes the inputs used to measure fair value. The hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1 Quoted prices in active markets for identical assets and liabilities.

Level 2 Quoted prices in active markets for similar assets and liabilities, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

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| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|--|---|--|--|--------------|
| At September 30, 2014 | | | | |
| U.S. non-qualified deferred compensation plan | \$ 13,592 | \$ | \$ | \$ 13,592 |
| Assets designated for retirement and pension plans | | 22,344 | | 22,344 |
| Derivatives designated as cash flow hedge | | 198 | | 198 |
| Warrants and equity securities | | | 684 | 684 |
| Acquisition earnout accruals | | | (11,897) | (11,897) |
| | \$ 13,592 | \$ 22,542 | \$ (11,213) | \$ 24,921 |

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|--|---|--|--|--------------|
| At December 31, 2013 | | | | |
| U.S. non-qualified deferred compensation plan | \$ 13,232 | \$ | \$ | \$ 13,232 |
| Assets designated for retirement and pension plans | | 24,312 | | 24,312 |
| Derivatives designated as cash flow hedge | | 180 | | 180 |
| Warrants and equity securities | | | 616 | 616 |
| Acquisition earnout accruals | | | (14,053) | (14,053) |
| | \$ 13,232 | \$ 24,492 | \$ (13,437) | \$ 24,287 |

The following table provides a reconciliation of the beginning and ending balance of Level 3 assets and liabilities for the nine months ended September 30, 2014.

| | Warrants and Equity Securities | Acquisition Earnout Accruals | Total |
|------------------------------|---|---|--------------|
| Balance at December 31, 2013 | \$ 616 | \$ (14,053) | \$ (13,437) |
| Realized / unrealized gains | 68 | | 68 |

| | | |
|-------------------------------|---------|-------------|
| Earnout accretion | (1,308) | (1,308) |
| Earnout payments | 3,390 | 3,390 |
| Foreign currency translation | 74 | 74 |
| Balance at September 30, 2014 | \$ 684 | \$ (11,897) |
| | | \$ (11,213) |

The Level 2 assets above are fair valued using a market approach. The Level 3 liabilities are: (i) accruals for future earnout payments related to prior acquisitions, the values of which are determined based on discounted cash flow models; and (ii) warrant and equity securities, the values of which are determined using a valuation model. The Company considers the recorded value of its financial assets and liabilities, which consist primarily of cash and cash equivalents, accounts receivable, and accounts payable, to approximate the fair value of the respective assets and liabilities at September 30, 2014 and December 31, 2013 based upon the short-term nature of the assets and liabilities.

8. Acquisitions

Scambler MacGregor Executive Search Pty Limited

In November 2013, the Company acquired Scambler MacGregor, an Australian-based retained Executive Search boutique in the financial services industry for 1.1 million Australian dollars (equivalent to \$1.0 million at September 30, 2014 and December 31, 2013, respectively) of initial consideration, pursuant to a stock purchase, which was funded from existing cash. In December 2013, the Company paid an additional \$0.1 million related to the final working capital settlement. The Company

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also recorded \$0.4 million of intangible assets and \$2.7 million of goodwill. The goodwill is primarily related to the acquired workforce and strategic fit. The former owners of Scambler MacGregor are eligible to receive earnout payments of up to 2.8 million Australian dollars based on the achievement of certain revenue metrics over the period November 2013 through December 2018. As a result, the Company accrued 2.3 million Australian dollars (equivalent to \$2.0 million at September 30, 2014 and December 31, 2013), representing the estimated fair value of future earnout payments as of the acquisition date.

Senn-Delaney Leadership Consulting Group, LLC

In December 2012, the Company acquired Senn-Delaney Leadership Consulting Group, LLC, a global leader of corporate culture shaping. Under the terms of the purchase agreement, the Company paid \$53.5 million at closing for 100 percent of the equity of Senn Delaney. The agreement also included additional cash consideration up to \$15.0 million based on the realization of specific earnings milestones achieved over the period December 2012 through December 2015, of which \$3.4 million was paid during the second quarter of 2014. The Company has accrued \$9.9 million and \$12.1 million at September 30, 2014 and December 31, 2013, respectively, for the remaining cash consideration. The Company has recognized \$0.3 million and \$0.5 million of accretion expense included in *General and administrative expenses* in the three months ended September 30, 2014 and 2013, respectively, and \$1.2 million and \$1.6 million of accretion expense in the nine months ended September 30, 2014 and 2013, respectively. The Company also holds \$6.5 million in a retention escrow that will be paid to certain key executives of Senn Delaney if they remain with the Company for three years subsequent to the acquisition. The Company recognized \$0.3 million and \$0.5 million of compensation expense included in *Salaries and employee benefits* in the three months ended September 30, 2014 and September 30, 2013, respectively, related to the retention awards. The Company recognized \$1.5 million and \$1.8 million of compensation expense included in *Salaries and employee benefits* in the nine months ended September 30, 2014 and 2013, respectively, related to the retention awards.

9. Goodwill and Other Intangible Assets, Net*Goodwill*

Changes in the carrying amount of goodwill by segment for the nine months ended September 30, 2014 are as follows:

| | Executive Search and Leadership Consulting- Americas | Executive Search and Leadership Consulting Asia Pacific | Culture Shaping | Total |
|--------------------------------------|---|---|--------------------|------------|
| Balance at December 31, 2013 | \$ 82,640 | \$ 10,854 | \$ 29,780 | \$ 123,274 |
| Exchange rate fluctuations | (221) | (351) | (45) | (617) |
| Balance at September 30, 2014 | \$ 82,419 | \$ 10,503 | \$ 29,735 | \$ 122,657 |

Other Intangible Assets, Net

The Company's other intangible assets, net by segment, are as follows:

| | September 30, 2014 | December 31, 2013 |
|---|-------------------------------|------------------------------|
| Executive Search and Leadership Consulting | | |
| Americas | \$ 1,114 | \$ 1,340 |
| Asia Pacific | 449 | 591 |
| | | |
| Total Executive Search and Leadership Consulting | 1,563 | 1,931 |
| Culture Shaping | 20,869 | 24,706 |
| | | |
| Total Other intangible assets, net | \$ 22,432 | \$ 26,637 |

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The carrying amount of amortizable intangible assets and the related accumulated amortization are as follows:

| | Weighted Average Life (in years) | September 30, 2014 | | | December 31, 2013 | | |
|--------------------------------|--|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
| | | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Customer relationships | 8.7 | \$ 23,454 | \$ (14,254) | \$ 9,200 | \$ 23,541 | \$ (11,834) | \$ 11,707 |
| Trade name | 15.0 | 9,397 | (2,085) | 7,312 | 9,430 | (1,223) | 8,207 |
| Software | 7.0 | 7,200 | (1,800) | 5,400 | 7,200 | (1,029) | 6,171 |
| Non-compete | 5.0 | 600 | (80) | 520 | 603 | (51) | 552 |
| Total intangible assets | 10.2 | \$ 40,651 | \$ (18,219) | \$ 22,432 | \$ 40,774 | \$ (14,137) | \$ 26,637 |

Intangible asset amortization expense for the three months ended September 30, 2014 and 2013 was \$1.3 million and \$1.5 million, respectively. Intangible asset amortization expense for the nine months ended September 30, 2014 and 2013 was \$4.1 million and \$4.3 million, respectively. The estimated intangible amortization expense is \$5.5 million for fiscal year 2014, \$4.7 million for fiscal year 2015, \$4.5 million for fiscal year 2016, \$3.6 million for fiscal year 2017, and \$2.8 million for fiscal year 2018. These amounts are based on intangible assets recorded as of September 30, 2014, and actual amortization expense could differ from these estimates as a result of future acquisitions and other factors.

10. Derivative Financial Instruments

The Company uses derivative instruments to manage exposures to interest rate risk. The Company's primary objective in holding derivatives is to reduce the volatility of earnings and cash flows associated with changes in interest rates. The Company's derivatives expose it to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. The Company does, however, seek to mitigate such risks by limiting its counterparties to financial institutions that meet certain criteria. In addition, the potential risk of loss with any one counterparty resulting from this type of credit risk is monitored. Management does not expect material losses as a result of defaults by counterparties.

The Company pays short-term variable interest rates, plus a spread which is dependent on the Company's leverage ratio, calculated as defined within the Amendment and Restatement Agreement (Restated Credit Agreement). The term loan exposes the Company to the variability in interest payments and therefore fluctuations in interest expense and cash flows due to changes in interest rates.

On February 28, 2013, the Company entered into an interest rate swap to hedge the variable interest rate exposure from the underlying term facility (See Note 12, *Line of Credit and Term Loan*). The interest rate swap was entered into to manage fluctuations in cash flows resulting from interest rate risk attributable to changes in the short-term variable interest rate. This interest rate swap involves the exchange of variable-rate interest payments for fixed-rate interest payments based on the contractual underlying notional amount. Gains or losses on the interest rate swap that are linked to the term loan being hedged are expected to perfectly offset the losses or gains on the underlying term loan from the short-term variable interest rate. The effective portion of changes in the fair value of a derivative that is

designated and that qualifies as a cash flow hedge is recorded in *Accumulated other comprehensive income* and is subsequently reclassified into earnings in the period when the hedged forecasted transaction affects earnings. If a derivative is deemed to be ineffective, the ineffective portion of the change in fair value of the derivative is recognized directly in earnings. During the quarter ended September 30, 2014, the Company's interest rate swap entered into for purposes of managing fluctuations in cash flows resulting from the variable rate term loan was deemed effective and the Company expects it will be effective for the next twelve months. The notional amount of the interest rate swap was \$31.0 million and \$35.5 million as of September 30, 2014 and December 31, 2013, respectively.

The summary of information with respect to the interest rate swap is as follows:

| | September 30, 2014 | | December 31, 2013 | |
|--|-----------------------|---------|----------------------|---------|
| | Fair Value (1) | Gain(2) | Fair Value (1) | Gain(2) |
| Interest Rate Swap Contract | | | | |
| Derivative designed as cash flow hedge | \$ 198 | \$ 198 | \$ 180 | \$ 180 |

(1) Included in the Condensed Consolidated Balance Sheets within *Other current assets*.

(2) Included in *Accumulated other comprehensive income, net* is \$75 and \$65 thousand of tax as of September 30, 2014 and December 31, 2013, respectively.

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The Company reclassified from *Accumulated other comprehensive income* into *Interest, net* \$0.1 million during the three months ended September 30, 2014 and 2013 and \$0.2 million during the nine months ended September 30, 2014 and 2013.

11. Other Non-Current Liabilities

The components of other non-current liabilities are as follows:

| | September 30, 2014 | December 31, 2013 |
|--|-----------------------|----------------------|
| Accrued salaries and employee benefits | \$ 29,564 | \$ 30,879 |
| Premise related costs | 15,318 | 16,562 |
| Accrued earnout payments | 7,759 | 11,628 |
| Other | 700 | 2,260 |
| Total other non-current liabilities | \$ 53,341 | \$ 61,329 |

12. Line of Credit and Term Loan

On June 22, 2011, the Company and certain foreign subsidiary borrowers of the Company entered into a Credit Agreement (the *Agreement*) with its lenders. The Agreement provides the terms under which the lenders will make available to the Company a committed unsecured revolving credit facility in an aggregate amount of up to \$75 million (the *Revolving Facility*). The Agreement includes an expansion feature that allows the Company to seek to increase the aggregate commitment under the Revolving Facility by up to \$25 million provided that the Company is in compliance with certain conditions set forth in the Agreement. The Agreement also provides for the issuance of letters of credit. The Revolving Facility matures on June 22, 2016. Under the Agreement, the Company may borrow U.S. dollars, euros, British pounds sterling, Australian dollars or other major traded currencies as agreed by the lenders. Borrowings under the Agreement bear interest, at the Company's election, at the existing Alternate Base Rate (as defined in the Agreement) or Adjusted LIBOR Rate (as defined in the Agreement) plus a spread as determined by the Company's leverage ratio.

On January 31, 2013, the Company and certain foreign subsidiary borrowers of the Company entered into a Restated Credit Agreement which amended the Agreement to add a committed term loan facility in an aggregate amount of up to \$40 million (the *Term Facility*). There was no other material term change in the Agreement.

On January 31, 2013 the Company borrowed \$40 million under the Term Facility. The Term Facility is being repaid over a five-year period pursuant to which the Company will make quarterly payments of \$1.5 million through 2016 and quarterly payments of \$2.0 million during 2017. The remaining outstanding balance of the Term Facility will be paid on January 31, 2018. The interest rate on the debt is Adjusted LIBOR plus a spread which is dependent on the Company's leverage ratio. The Company entered into an interest rate swap to address the risk related to the fluctuation in Adjusted LIBOR (See Note 10, *Derivative Financial Instruments*). As of September 30, 2014 the Company's interest rate, including the impact of the interest rate swap, was 2.54%.

As of September 30, 2014 and December 31, 2013 there was \$31.0 million and \$35.5 million, respectively, outstanding under the Term Facility. There were no borrowings made under the Revolving Facility during the nine months ended September 30, 2014 and for the year ended December 31, 2013. The Company was in compliance with the financial and other covenants under the Restated Credit Agreement and no event of default existed as of September 30, 2014 and for the year ended December 31, 2013, respectively.

13. Stock-based Compensation

The Company's 2012 Heidrick & Struggles GlobalShare Program (the "2012 Program") provides for grants of stock options, stock appreciation rights, and other stock-based awards that are valued based upon the grant date fair value of shares. The 2012 Program originally authorized 1,300,000 shares of Common Stock for issuance pursuant to awards under the plan. These awards may be granted to directors, selected employees and independent contractors. On May 22, 2014, the stockholders of the Company approved an amendment to the 2012 Program to increase the number of shares of Common Stock reserved for issuance under the 2012 Program by 700,000 shares. As of September 30, 2014, 772,665 awards have been issued under the 2012 Program and 1,573,375 shares remain available for future awards, which includes 346,040 forfeited awards. The 2012 Program provides that no awards can be granted after May 24, 2022.

The Company measures its stock-based compensation costs based on the grant date fair value of the awards and recognizes these costs in the financial statements over the requisite service period.

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A summary of information with respect to stock-based compensation is as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|--------|-------------------|----------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Salaries and employee benefits | \$ 1,044 | \$ 302 | \$ 2,434 | \$ 2,475 |
| General and administrative expenses | | | \$ 451 | \$ 300 |
| Income tax benefit related to stock-based compensation included in net income | \$ 465 | \$ 118 | \$ 1,286 | \$ 1,087 |

Restricted Stock Units

Restricted stock unit activity for the nine months ended September 30, 2014:

| | Number of Restricted Stock Units | Weighted-Average Grant-date Fair Value |
|--------------------------------------|----------------------------------|--|
| Outstanding on December 31, 2013 | 270,455 | \$ 18.64 |
| Granted | 295,733 | 18.02 |
| Vested and converted to common stock | (93,159) | 19.65 |
| Forfeited | (10,312) | 17.45 |
| Outstanding on September 30, 2014 | 462,717 | 18.07 |

As of September 30, 2014, there was \$4.2 million of pre-tax unrecognized compensation expense related to unvested restricted stock units, which is expected to be recognized over a weighted average of 2.8 years.

Performance Stock Units

The Company grants performance stock units to certain of its senior executives. The performance stock units are generally subject to a cliff vesting at the end of a three year period. The vesting will vary between 0% - 200% based on the attainment of operating income goals over the 3 year vesting period. The performance stock units are expensed on a straight-line basis over the 3 year vesting period.

In the first quarter of 2014, the Company granted market-based performance stock units to the Chief Executive Officer as part of his initial compensation package. The market-based awards vest after a two-year service period and if the price of the Company's common stock exceeds specified targets. The fair value of the market-based awards was determined using the Monte-Carlo simulation model. A Monte Carlo simulation model uses stock price volatility and other variables to estimate the probability of satisfying the market conditions and the resulting fair value of the award. Compensation costs related to the market-based awards are recognized regardless of whether the market condition is satisfied, as long as the requisite service has been provided.

Performance stock unit activity for the nine months ended September 30, 2014:

| | Number of Performance Stock Units | Weighted- Average Grant-date Fair Value |
|--------------------------------------|--|--|
| Outstanding on December 31, 2013 | 61,321 | \$ 19.77 |
| Granted | 186,705 | 17.19 |
| Vested and converted to common stock | (9,429) | 27.18 |
| Forfeited | (9,427) | 27.18 |
| Outstanding on September 30, 2014 | 229,170 | 17.06 |

As of September 30, 2014, there was \$2.2 million of pre-tax unrecognized compensation expense related to unvested performance stock units, which is expected to be recognized over a weighted average of 2.0 years.

Table of Contents**14. Income Taxes**

The Company reported income before taxes of \$8.9 million and \$7.6 million and recorded an income tax provision of \$5.9 million and \$3.4 million for the three months ended September 30, 2014 and 2013, respectively. The increase in income tax provision from the third quarter of 2013 includes a discrete item for the establishment of a \$2.3 million valuation allowance in the Asia Pacific segment as well as a change in the forecasted mix of income.

The Company reported income before taxes of \$22.2 million and \$12.7 million and recorded an income tax provision of \$16.1 million and \$7.8 million for the nine months ended September 30, 2014 and 2013, respectively. The increase in the income tax provision from the prior year includes a discrete item for the establishment of valuation allowances of \$4.8 million in the Asia Pacific segment. The Company's effective income tax rate reflects an adjusted full-year expected annualized tax rate of approximately 75 percent.

15. Changes in Accumulated Other Comprehensive Income

The changes in *Accumulated other comprehensive income* (AOCI) by component for the nine months ended September, 2014 is summarized below:

| | Cash Flow Hedge | Available- for- Sale Securities | Foreign Currency Translation | Pension | AOCI |
|---|-----------------------|--|------------------------------------|---------|-----------|
| Balance at December 31, 2013 | \$ 115 | \$ 2,921 | \$ 11,607 | \$ 326 | \$ 14,969 |
| Other comprehensive income (loss) before reclassification, net of tax | (94) | 448 | (1,067) | | (713) |
| Amount reclassified from AOCI (1) | 102 | (288) | | | (186) |
| Net current period other comprehensive income (loss) | 8 | 160 | (1,067) | | (899) |
| Balance at September 30, 2014 | \$ 123 | \$ 3,081 | \$ 10,540 | \$ 326 | \$ 14,070 |

(1) Cash Flow Hedge and Available-for-Sale Securities reclassifications from AOCI are included in *Interest, net* and *Other, net*, respectively, in the Condensed Consolidated Statement of Comprehensive Income.

16. Segment Information

The Company operates its executive search and leadership consulting services in the Americas; Europe (which includes Africa); and Asia Pacific (which includes the Middle East) and operates its culture shaping business as a separate segment.

For segment purposes, reimbursements of out-of-pocket expenses classified as revenue and other operating income are reported separately and, therefore, are not included in the results of each segment. The Company believes that analyzing trends in revenue before reimbursements (net revenue), analyzing operating expenses as a percentage of net revenue, and analyzing operating income (loss) more appropriately reflects its core operations.

During 2014, consistent with the Company's practice to periodically review its reporting structure and segments, the Company evaluated its allocation of corporate and support costs to each of its regions. In conjunction with that review, to better align the Company's cost and reporting structure, additional costs were allocated to the regions reflecting management's current view of the costs necessary to support the regional operations. The prior period results have been recast to reflect these changes and present comparative year-over-year results.

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The revenue and operating income (loss) by segment are as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Revenue: | | | | |
| Executive Search and Leadership Consulting | | | | |
| Americas | \$ 64,982 | \$ 65,522 | \$ 193,034 | \$ 192,906 |
| Europe | 27,207 | 23,366 | 84,632 | 65,042 |
| Asia Pacific | 23,305 | 23,528 | 69,162 | 68,464 |
| Total Executive Search and Leadership Consulting | 115,494 | 112,416 | 346,828 | 326,412 |
| Culture Shaping | 10,335 | 6,565 | 26,202 | 17,580 |
| Revenue before reimbursements (net revenue) | 125,829 | 118,981 | 373,030 | 343,992 |
| Reimbursements | 4,432 | 4,523 | 13,721 | 14,148 |
| Total | \$ 130,261 | \$ 123,504 | \$ 386,751 | \$ 358,140 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Operating income (loss): | | | | |
| Executive Search and Leadership Consulting | | | | |
| Americas | \$ 14,257 | \$ 17,604 | \$ 43,266 | \$ 47,028 |
| Europe | 1,946 | 342 | 4,373 | (4,740) |
| Asia Pacific | 2,228 | 1,737 | 4,790 | 4,797 |
| Total Executive Search and Leadership Consulting | 18,431 | 19,683 | 52,429 | 47,085 |
| Culture Shaping | 2,866 | (708) | 3,643 | (3,691) |
| Total segments | 21,297 | 18,975 | 56,072 | 43,394 |
| Global Operations Support | (11,740) | (10,622) | (33,223) | (28,910) |
| Total | \$ 9,557 | \$ 8,353 | \$ 22,849 | \$ 14,484 |

17. Guarantees

The Company has issued cash collateralized bank guarantees and letter of credit backed bank guarantees supporting certain obligations, primarily the payment of office lease obligations and business license requirements for certain of its international subsidiaries. The bank guarantees were made to secure the respective agreements and are for the terms of the agreements, which extend through 2018. For each bank guarantee issued, the Company would have to perform under the guarantee if the subsidiary defaults on a lease payment. The maximum amount of undiscounted payments

the Company would be required to make in the event of default on all outstanding bank guarantees is approximately \$2.2 million as of September 30, 2014. The Company has not accrued for these arrangements as no event of default exists or is expected to exist.

18. Commitments and Contingencies

Litigation

The Company has contingent liabilities from various pending claims and litigation matters arising in the ordinary course of the Company's business, some of which involve claims for damages that are substantial in amount, and some of which are covered by insurance. In accordance with ASC 450, *Contingencies*, the Company records a reserve for estimated losses when the loss is probable and the amount can be reasonably estimated. Based upon information currently available, the Company believes the ultimate resolution of any pending claims or litigation will not have a material adverse effect on its financial condition, results of operations or liquidity.

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UK Employee Benefits Trust

On January 27, 2010, HM Revenue & Customs (HMRC) in the United Kingdom notified the Company that it was challenging the tax treatment of certain of the Company s contributions in the United Kingdom to an Employee Benefits Trust between 2002 and 2008. HMRC alleges that these contributions should have been subject to Pay As You Earn tax and Class 1 National Insurance Contributions in the United Kingdom; and HMRC is proposing an adjustment to the Company s payroll tax liability for the affected years. The aggregate amount of HMRC s proposed adjustment is approximately £3.9 million (equivalent to \$6.3 million at September 30, 2014). The Company has appealed the proposed adjustment. At this time, the Company believes that the likelihood of an unfavorable outcome with respect to the proposed adjustment is not probable and the potential amount of any loss cannot be reasonably estimated. The Company also believes that the amount of any final adjustment would not be material to the Company s financial condition.

19. Subsequent Event

On October 1, 2014, the Company amended the terms of its current lease agreement to extend the term of the lease in Chicago, Illinois from October 1, 2015 through September 30, 2026. The impact of new lease on the Company s Condensed Consolidated Financial Statements is not material.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations as well as other sections of this report on Form 10-Q contain forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Forward-looking statements are not historical facts, but instead represent only our beliefs, assumptions, expectations, estimates, forecasts and projections regarding future events, many of which, by their nature, are inherently uncertain and outside our control. These statements include statements other than historical information or statements of current condition and may relate to our future plans and objectives and results. By identifying these statements for you in this manner, we are alerting you to the possibility that our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements.

Factors that may affect the outcome of the forward-looking statements include, among other things, leadership changes, our ability to attract, integrate, manage and retain qualified consultants and senior leaders; our ability to develop and maintain strong, long-term relationships with our clients; fluctuations in the global economy and our ability to execute successfully our leadership advisory strategy through business cycles; the timing, speed or robustness of any future economic recovery; social or political instability in markets where we operate, the impact of foreign currency exchange rate fluctuations; unfavorable tax law changes and tax authority rulings; price competition; the ability to forecast, on a quarterly basis, variable compensation accruals that ultimately are determined based on the achievement of annual results; our ability to realize our tax losses; the timing of the establishment or reversal of valuation allowance on deferred tax assets; the mix of profit and loss by country; our reliance on information management systems; any impairment of our goodwill and other intangible assets; and the ability to align our cost structure and headcount with net revenue. For more information on the factors that could affect the outcome of forward-looking statements, refer to our Annual Report on Form 10-K for the year ended December 31, 2013, under Risk Factors in Item 1A. We caution the reader that the list of factors may not be exhaustive. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Executive Overview

Our Business

We are a leadership advisory firm providing executive search, leadership consulting and culture shaping services. We help our clients build leadership teams by facilitating the recruitment, management and development of senior executives. We believe focusing on top-level services offers us several advantages that include access to and influence with key decision makers, increased potential for recurring search consulting engagements, higher fees per search, enhanced brand visibility, and a leveraged global footprint, which create added barriers to entry for potential competitors. Working at the top of client organizations also allows us to attract and retain high-caliber consultants.

In addition to executive search, we provide culture shaping services and leadership consulting expertise including executive assessment, leadership development, board and top team effectiveness, and succession planning.

We provide our services to a broad range of clients through the expertise of consultants located in major cities around the world. Our executive search services are provided on a retained basis. Revenue before reimbursements of out-of-pocket expenses (net revenue) consists of retainers and indirect expenses billed to clients. Typically, we are paid a retainer for our executive search services equal to approximately one-third of the estimated first year compensation for the position to be filled. In addition, if the actual compensation of a placed candidate exceeds the

estimated compensation, we often are authorized to bill the client for one-third of the excess. Indirect expenses are calculated as a percentage of the retainer with certain dollar limits per search. Net revenue associated with culture shaping consulting is recognized proportionally as services are performed. Net revenue associated with licenses to use culture shaping proprietary materials is typically recognized over the term of the license. Net revenue from leadership consulting is recognized in accordance with the completion of the engagement deliverables.

Key Performance Indicators

We manage and assess Heidrick & Struggles' overall performance through various means, with the primary financial and operational measures including net revenue, operating income, operating margin, Adjusted EBITDA (Non-GAAP), and Adjusted EBITDA margin (Non-GAAP). Executive Search and Leadership Consulting performance is also measured using consultant headcount and consultant productivity. Specific to Executive Search, confirmation trends and average revenue per search or project are used to measure performance.

Revenue is driven by market conditions and a combination of the number of executive search engagements and leadership consulting and culture shaping projects and the average revenue per search or project. With the exception of compensation expense, incremental increases in revenue do not necessarily result in proportionate increases in costs, particularly operating and administrative expenses, thus potentially improving operating margins.

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The number of consultants, confirmation trends, number of searches or projects completed, productivity levels and the average revenue per search or project will vary from quarter to quarter, affecting net revenue and operating margin.

Our Compensation Model

At the Executive Search consultant level there are fixed and variable components of compensation. Individuals are rewarded for their performance based on a system that directly ties a portion of their compensation to the amount of net revenue for which they are responsible. A portion of the reward may be based upon individual performance against a series of non-financial measures. Credit towards the variable portion of an executive search consultant's compensation is earned by generating net revenue for winning and executing work. Each quarter, we review and update the expected annual performance of all Executive Search consultants and accrue variable compensation accordingly. The amount of variable compensation that is accrued for each Executive Search consultant is based on a tiered payout model. Overall Company performance determines the amount available for total variable compensation. The more net revenue that is generated by the consultant, the higher the percentage credited towards the consultant's variable compensation and thus accrued by our Company as expense. The mix of individual consultants who generate the revenue can significantly affect the total amount of compensation expense recorded, which directly impacts operating margin. As a result, the variable portion of the compensation expense may fluctuate significantly from quarter to quarter. The total variable compensation is discretionary and is based on Company-wide financial targets approved by the Human Resources and Compensation Committee of the Board of Directors.

A portion of our Executive Search consultants' and management cash bonuses is deferred and paid over a three-year vesting period. The compensation expense related to the amounts being deferred is recognized on a graded vesting attribution method over the requisite service period. This service period begins on January 1 of the respective fiscal year and continues through the deferral date, which coincides with our bonus payments in the first quarter of the following year, and for an additional three year vesting period. The deferrals are recorded in *Accrued salaries and employee benefits* and *Other non-current liabilities* in the Condensed Consolidated Balance Sheets.

Fourth Quarter 2014 Outlook

We are currently forecasting 2014 fourth quarter net revenue of between \$112 million and \$123 million. Our 2014 fourth quarter guidance is based upon, among other things, management's assumptions for the anticipated volume of new Executive Search confirmations and Leadership Consulting and Culture Shaping projects, the current backlog, consultant productivity, consultant retention, the seasonality of our business and no change in future currency rates.

Our 2014 guidance is subject to a number of risks and uncertainties, including those discussed under Item 1A *Risk Factors* in our 2013 Annual Report on Form 10-K. As such, actual results could vary from these projections.

Table of Contents**Results of Operations**

The following table summarizes, for the periods indicated, our results of operations as a percentage of revenue before reimbursements (net revenue):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Revenue: | | | | |
| Revenue before reimbursements (net revenue) | 100.0 % | 100.0% | 100.0% | 100.0% |
| Reimbursements | 3.5 | 3.8 | 3.7 | 4.1 |
| Total revenue | 103.5 | 103.8 | 103.7 | 104.1 |
| Operating expenses: | | | | |
| Salaries and employee benefits | 66.8 | 68.6 | 67.6 | 68.7 |
| General and administrative expenses | 25.6 | 24.3 | 26.3 | 27.1 |
| Reimbursed expenses | 3.5 | 3.8 | 3.7 | 4.1 |
| Total operating expenses | 95.9 | 96.8 | 97.6 | 99.9 |
| Operating income | 7.6 | 7.0 | 6.1 | 4.2 |
| Non-operating expense | | | | |
| Interest, net | (0.1) | (0.1) | (0.1) | |
| Other, net | (0.4) | (0.6) | (0.1) | (0.5) |
| Net non-operating expense | (0.5) | (0.7) | (0.2) | (0.5) |
| Income before income taxes | 7.1 | 6.3 | 5.9 | 3.7 |
| Provision for income taxes | 4.7 | 2.9 | 4.3 | 2.3 |
| Net income | 2.4 % | 3.5% | 1.6% | 1.4% |

Note: Totals and sub-totals may not equal the sum of individual line items due to rounding.

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We operate our executive search and leadership consulting services in the Americas; Europe (which includes Africa); and Asia Pacific (which includes the Middle East) and operate our culture shaping business as a separate segment (See Note 16, *Segment Information*).

During 2014, consistent with our practice to periodically review our reporting structure and segments, we evaluated our allocation of corporate and support costs to each of our regions. In conjunction with that review, to better align our cost and reporting structure, additional costs were allocated to the regions reflecting our current view of the costs necessary to support the regional operations. The prior period results have been recast to reflect these changes and present comparative year-over-year results.

The following table sets forth, for the periods indicated, our revenue and operating income (loss) by segment (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Revenue: | | | | |
| Executive Search and Leadership Consulting | | | | |
| Americas | \$ 64,982 | \$ 65,522 | \$ 193,034 | \$ 192,906 |
| Europe | 27,207 | 23,366 | 84,632 | 65,042 |
| Asia Pacific | 23,305 | 23,528 | 69,162 | 68,464 |
| Total Executive Search and Leadership Consulting | 115,494 | 112,416 | 346,828 | 326,412 |
| Culture Shaping | 10,335 | 6,565 | 26,202 | 17,580 |
| Revenue before reimbursements (net revenue) | 125,829 | 118,981 | 373,030 | 343,992 |
| Reimbursements | 4,432 | 4,523 | 13,721 | 14,148 |
| Total | \$ 130,261 | \$ 123,504 | \$ 386,751 | \$ 358,140 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Operating income (loss): | | | | |
| Executive Search and Leadership Consulting | | | | |
| Americas | \$ 14,257 | \$ 17,604 | \$ 43,266 | \$ 47,028 |
| Europe | 1,946 | 342 | 4,373 | (4,740) |
| Asia Pacific | 2,228 | 1,737 | 4,790 | 4,797 |
| Total Executive Search and Leadership Consulting | 18,431 | 19,683 | 52,429 | 47,085 |
| Culture Shaping | 2,866 | (708) | 3,643 | (3,691) |
| Total segments | 21,297 | 18,975 | 56,072 | 43,394 |
| Global Operations Support | (11,740) | (10,622) | (33,223) | (28,910) |

| | | | | |
|-------|----------|----------|-----------|-----------|
| Total | \$ 9,557 | \$ 8,353 | \$ 22,849 | \$ 14,484 |
|-------|----------|----------|-----------|-----------|

Three Months Ended September 30, 2014 Compared to the Three Months Ended September 30, 2013

Total revenue. Consolidated total revenue increased \$6.8 million, or 5.5%, to \$130.3 million in 2014 from \$123.5 million in 2013. The increase in total revenue was due primarily to the increase in revenue before reimbursements (net revenue).

Revenue before reimbursements (net revenue). Consolidated net revenue increased \$6.8 million, or 5.8%, to \$125.8 million for the three months ended September 30, 2014 from \$119.0 million for the three months ended September 30, 2013. The positive impact of exchange rate fluctuations resulted in one percentage point of the increase. Executive Search and Leadership Consulting net revenue was \$115.5 million, an increase of \$3.1 million compared to the three months ended September 30, 2013. Increases in the Financial Services, Global Technology & Services, and Industrial search practices were the primary drivers of the increase in consolidated net revenue; however, these increases were partially offset by declines in net revenue from the Consumer Markets and Healthcare & Life Sciences practices. Culture Shaping net revenue was \$10.3 million for the three months ended September 30, 2014 an increase of \$3.8 million compared to the three months ended September 30, 2013. The impact of exchange rate fluctuations in the Culture Shaping segment resulted in approximately one percentage point of the

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increase in the third quarter of 2014. The number of Executive Search and Leadership Consulting consultants was 311 as of September 30, 2014 compared to 308 as of September 30, 2013. Productivity, as measured by annualized net Executive Search and Leadership Consulting revenue per consultant was \$1.5 million in the third quarter of 2014 compared to \$1.4 million in the third quarter of 2013. Specific to Executive Search, our primary business, the number of confirmed searches increased 8% compared to the third quarter of 2013 and the average revenue per executive search was \$122,200 in the third quarter of 2014 compared to \$124,500 in the third quarter of 2013.

For Executive Search and Leadership Consulting, net revenue in the Americas segment was \$65.0 million for the three months ended September 30, 2014, a decrease of \$0.5 million, or less than one percentage point, from \$65.5 million in the third quarter of 2013. Net revenue in the Europe segment was \$27.2 million for the three months ended September 30, 2014, an increase of \$3.8 million, or 16.4%, from \$23.4 million in the third quarter of 2013. The impact of exchange rate fluctuations in the Europe segment resulted in approximately five percentage points of the increase in the third quarter of 2014. Net revenue in the Asia Pacific segment was \$23.3 million for the three months ended September 30, 2014, a decrease of \$0.2 million, or 1.0%, from \$23.5 million in the third quarter of 2013. The decrease in net revenue in the Asia Pacific segment in the third quarter of 2014 includes a one percentage point benefit for exchange rate fluctuations.

Salaries and employee benefits. Consolidated salaries and employee benefits expense increased \$2.4 million, or 2.9%, to \$84.0 million for the three months ended September 30, 2014 from \$81.7 million for the three months ended September 30, 2013. This increase is due to higher performance related compensation of \$3.1 million resulting from an increase in net revenue. The increase in variable compensation expense was partially offset by a decrease in fixed compensation of \$0.7 million. The decrease in fixed compensation is primarily due to \$3.3 million of lower severance expense related to an executive departure in the prior year, partially offset by higher base salaries and employee benefits costs. In the 2014 third quarter we had on average 1,463 employees, compared to an average of 1,465 employees in the 2013 third quarter.

Exchange rate fluctuations increased salaries and employee benefits expense by \$0.8 million or approximately one percent.

As a percentage of net revenue, salaries and employee benefits expense was 66.8% in the third quarter of 2014, compared to 68.6% in the third quarter of 2013.

General and administrative expenses. Consolidated general and administrative expenses increased \$3.3 million, or 11.3%, to \$32.2 million for the three months ended September 30, 2014 from \$29.0 million for the three months ended September 30, 2013. The increase is primarily due to \$1.8 million for a global partner meeting held during the quarter, \$0.5 million for professional fees and \$0.5 million for hiring and staffing fees.

Exchange rate fluctuations increased general and administrative expense by \$0.2 million or less than one percentage point.

As a percentage of net revenue, general and administrative expenses were 25.6% in the third quarter of 2014 compared to 24.3% in the third quarter of 2013.

Operating income. Consolidated operating income was \$9.6 million for the three months ended September 30, 2014 compared to \$8.4 million for the three months ended September 30, 2013.

Net non-operating expense. Net non-operating expense was \$0.6 million for the three months ended September 30, 2014 compared to non-operating expense of \$0.8 million for the three months ended September 30, 2013.

Net interest expense was \$0.1 million in the third quarter of 2014 and 2013. Interest income of \$0.1 million for the three months ended September 30, 2014, was offset by \$0.2 million of interest expense associated with the Term Loan. For the three months ended September 30, 2013, interest income was \$0.2 million, offset by \$0.3 million of interest expense associated with the Term Loan.

Net other non-operating expense was \$0.5 million for the three months ended September 30, 2014, compared to net other non-operating expense of \$0.7 million for the three months ended September 30, 2013. Net other non-operating expense consists of exchange gains and losses from balances which are denominated in currencies other than the functional currency and are not considered permanent in nature.

Income taxes. See Note 14, *Income Taxes*.

Executive Search and Leadership Consulting

Americas

The Americas segment reported operating income of \$14.3 million for the three months ended September 30, 2014, a decrease of \$3.3 million compared to \$17.6 million for the three months ended September 30, 2013. The decrease in operating income was due to increases in salaries and employee benefits of \$2.1 million and general and administrative expenses of \$0.8 million and a decrease in net revenue of \$0.5 million. The increase in salaries and employee benefits expense was due to a \$1.3 million increase in performance-related compensation and a \$0.8 million increase in fixed compensation. Performance-related compensation increased due primarily to higher global net revenue. Fixed compensation increased primarily due to severance costs. The increase in general and administrative expense was primarily due to hiring and staffing fees.

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The decrease in net revenue was due to decreases in the Consumer Markets, Healthcare & Life Sciences, and Industrial practice groups, partially offset by increases in the Global Technology & Services and Financial Services practice groups. The number of consultants was 139 and 137 as of September 30, 2014 and 2013, respectively.

Europe

The Europe segment reported operating income of \$1.9 million for the three months ended September 30, 2014, an improvement of \$1.6 million compared to \$0.3 million for the three months ended September 30, 2013. The increase in operating income was primarily due to an increase in net revenue of \$3.8 million, partially offset by increases in salaries and employee benefits expense of \$1.6 million and in general and administrative expense of \$0.6 million. The increase in net revenue was due to increases in the Financial Services and Industrial practice groups, partially offset by decreases in the Global Technology & Services and Education, Nonprofit & Social Enterprise practice groups. The number of consultants was 91 and 87 as of September 30, 2014 and 2013, respectively.

The increase in salaries and employee benefits expense was due to a \$1.2 million increase in performance-related compensation associated with the increase in net revenue and a \$0.4 million increase in fixed compensation. Exchange rate fluctuations negatively impacted base salaries expense. The increase in general and administrative expense is primarily due to higher travel and entertainment and professional services.

Asia Pacific

The Asia Pacific segment reported operating income of \$2.2 million for the three months ended September 30, 2014, an improvement of \$0.5 million compared to \$1.7 million for the three months ended September 30, 2013. Decreases in salaries and employee benefits of \$0.6 million and general and administrative expenses of \$0.1 million were partially offset by a decrease in net revenue of \$0.2 million. The decrease in salaries and employee benefits reflects lower performance-related compensation of \$0.8 million, partially offset by an increase in fixed compensation of \$0.2 million.

The decrease in net revenue was due to decreases in the Consumer Markets, Global Technology & Services, and Healthcare & Life Sciences practice groups, partially offset by increases in the Education, Nonprofit & Social Enterprise and Financial Services practice groups. The number of consultants was 81 and 84 as of September 30, 2014 and 2013, respectively.

Culture Shaping

The Culture Shaping segment reported operating income of \$2.9 million for the three months ended September 30, 2014, an improvement of \$3.6 million compared to an operating loss of \$0.7 million for the three months ended September 30, 2013. The improvement was due to an increase in net revenue of \$3.8 million and a decrease in general and administrative expenses of \$0.4 million, partially offset by an increase in salaries and benefits of \$0.6 million.

Net revenue increased due to the stage of the project execution for several large clients. Net revenue in the prior year excluded \$0.3 million of pre-acquisition deferred revenue that we were unable to recognize as a result of purchase accounting. The decrease in general and administrative costs was due to lower amortization and accretion expense. The increase in salary and benefit expenses was due to higher consultant costs for additional staffing related to increased projects.

Global Operations Support

Global Operations Support expenses for the three months ended September 30, 2014 increased \$1.1 million, to \$11.7 million from \$10.6 million for the three months ended September 30, 2013. General and administrative expense increased \$2.4 million and salaries and employee benefits expense decreased \$1.3 million.

The increase in general and administrative expense was primarily due to \$1.8 million for a global partners meeting. The decrease in salaries and employee benefits expense reflects a decrease in fixed compensation of \$2.3 million due to an executive severance of \$3.3 million in the prior year, partially offset by an increase in support staff headcount and stock-based compensation and an increase in performance-related compensation of \$1.0 million related to higher net revenue and an increase of participants in the bonus plan.

Nine Months Ended September 30, 2014 Compared to the Nine Months Ended September 30, 2013

Total revenue. Consolidated total revenue increased \$28.7 million, or 8.0%, to \$386.8 million in 2014 from \$358.1 million in 2013. The increase in total revenue was due to the increase in revenue before reimbursements (net revenue).

Revenue before reimbursements (net revenue). Consolidated net revenue increased \$29.0 million, or 8.4%, to \$373.0 million for the nine months ended September 30, 2014 from \$344.0 million for the nine months ended September 30, 2013. The negative impact of exchange rate fluctuations resulted in less than one percentage point of the increase.
Executive Search and

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Leadership Consulting net revenue was \$346.8 million for the nine months ended September 30, 2014, an increase of \$20.4 million compared to the nine months ended September 30, 2013. Increases in the Global Technology & Services, Financial Services, and Consumer Markets search practices were the primary drivers of the increase in consolidated net revenue; however, these increases were partially offset by declines in net revenue from the Healthcare & Life Sciences and Industrial practices. Culture Shaping net revenue was \$26.2 million for the nine months ended September 30, 2014, an increase of \$8.6 million compared to the nine months ended September 30, 2013. The number of Executive Search and Leadership Consulting consultants was 311 as of September 30, 2014 compared to 308 as of September 30, 2013. Productivity, as measured by annualized net Executive Search and Leadership Consulting revenue per consultant was \$1.5 million in the first nine months of 2014 compared to \$1.4 million in the first nine months of 2013. Specific to Executive Search, our primary business, the number of confirmed searches increased 7% compared to the first nine months of 2013, and average revenue per executive search was \$113,400 in the first nine months ended September 30, 2014 compared to \$111,700 for the nine months ended September 30, 2013.

For Executive Search and Leadership Consulting, net revenue in the Americas segment was \$193.0 million for the nine months ended September 30, 2014, essentially flat with the prior year. Net revenue in the Europe segment was \$84.6 million for the nine months ended September 30, 2014, an increase of \$19.6 million, or 30.2%, from \$65.0 million for the nine months ended September 30, 2013. Exchange rate fluctuations contributed seven percentage points of the Europe segment net revenue increase for the first nine months of 2014. Net revenue in the Asia Pacific segment was \$69.2 million for the nine months ended September 30, 2014, an increase of \$0.7 million, or 1.0%, from \$68.5 million for the nine months ended September 30, 2013. The increase in net revenue in the Asia Pacific segment for the nine months ended September 30, 2014 includes a two percentage point detriment for exchange rate fluctuations.

Salaries and employee benefits. Consolidated salaries and employee benefits expense increased \$15.9 million, or 6.7%, to \$252.1 million for the nine months ended September 30, 2014 from \$236.2 million for the nine months ended September 30, 2013. The increase reflects higher performance related compensation of \$19.8 million resulting from an increase in net revenue, partially offset by a decrease in fixed compensation of \$3.9 million due to lower severance expense primarily from an executive departure in the prior year. In the first nine months ended September 30, 2014 we had on average 1,457 employees, compared to an average of 1,489 employees as of September 30, 2013. The decrease in headcount is due to the timing of new hires.

Exchange rate fluctuations increased salaries and employee benefits expense by \$1.1 million or less than one percentage point.

As a percentage of net revenue, salaries and employee benefits expense was 67.6% in the first nine months of 2014, compared to 68.7% in the first nine months of 2013.

General and administrative expenses. Consolidated general and administrative expenses increased \$4.8 million, or 5.1%, to \$98.1 million for the nine months ended September 30, 2014 from \$93.3 million for the nine months ended September 30, 2013. The increase was primarily due to \$1.8 million for a global partner meeting, \$1.5 million for hiring and staffing fees, \$1.5 million for new information technology system contracts, and \$1.0 million for a state franchise tax matter. The increase was partially offset by a \$0.6 million reduction in legal, strategy, and other professional consulting fees.

Exchange rate fluctuations increased general and administrative expense by \$0.2 million or less than one percentage point.

As a percentage of net revenue, general and administrative expenses were 26.3% in the first nine months of 2014, compared to 27.1% in the first nine months of 2013.

Operating income. Our consolidated operating income was \$22.8 million for the nine months ended September 30, 2014 and \$14.5 million for the nine months ended September 30, 2013.

Net non-operating expense. Net non-operating expense was \$0.7 million for the nine months ended September 30, 2014 compared to \$1.8 million for the nine months ended September 30, 2013.

Net interest expense was \$0.2 million and \$0.1 million for the nine months ended September 30, 2014 and September 30, 2013, respectively. Interest income was \$0.4 million for the nine months ended September 30, 2014 offset by \$0.6 million of interest expense associated with the Term Loan. For the nine months ended September 30, 2013, interest income was \$0.5 million, offset by \$0.6 million of interest expense associated with the Term Loan.

Net other non-operating expense was \$0.4 million for the nine months ended September 30, 2014, compared to \$1.7 million for the nine months ended September 30, 2013. Net other non-operating expense consists of exchange gains and losses from balances which are denominated in currencies other than the functional currency and are not considered permanent in nature.

Income taxes. See Note 14, *Income Taxes*.

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Executive Search and Leadership Consulting

Americas

The Americas segment reported operating income of \$43.3 million for the nine months ended September 30, 2014, a decrease of \$3.7 million compared to \$47.0 million for the nine months ended September 30, 2013. The decrease in operating income was due to an increase in salaries and employee benefits of \$4.4 million, which was partially offset by a decrease in general and administrative expense of \$0.6 million and an increase in net revenue of \$0.1 million.

The increase in salaries and employee benefits expense was due to an \$8.5 million increase in performance-related compensation due primarily to higher global net revenue, partially offset by a \$4.1 million decrease in fixed compensation related to lower headcount. The decrease in general and administrative costs was primarily due to the regional partner meeting in the prior year, partially offset by increased hiring and staffing fees. The number of consultants was 139 and 137 as of September 30, 2014 and 2013, respectively.

Europe

The Europe segment reported operating income of \$4.4 million for the nine months ended September 30, 2014, an increase of \$9.1 million compared to a \$4.7 million operating loss for the nine months ended September 30, 2013. The increase in operating income was due to an increase in net revenue of \$19.6 million, partially offset by increases in salaries and employee benefits expense of \$8.3 million and general and administrative expense of \$2.2 million. The increase in net revenue was across all industry practices, except the Education, Nonprofit & Social Enterprise practice. The number of consultants was 91 and 87 as of September 30, 2014 and 2013, respectively.

The increase in salaries and employee benefits expense was due to a \$7.7 million increase in performance-related compensation associated with the increase in net revenue and a \$0.6 million increase in fixed compensation. The increase in fixed costs was due to impacts of exchange rate fluctuations and higher costs related to sign-on bonuses which were offset by \$1.1 million of lower severance costs. The increase in general and administrative expense of \$2.2 million was due to \$0.5 million of hiring and staffing fees, a \$0.5 million bad debt charge, \$0.4 million related to a value added tax charge and professional services.

Asia Pacific

The Asia Pacific segment reported operating income of \$4.8 million for the nine months ended September 30, 2014. The increase in net revenue of \$0.7 million was fully offset by an increase in general and administrative expenses. The increase in net revenue was due to increases in the Global Technology & Services, Financial Services, and Healthcare & Life Sciences search practices, partially offset by declines in net revenue from the Industrial practice. The number of consultants was 81 and 84 as of September 30, 2014 and 2013, respectively. The increase in general and administrative expenses was due to increased internal travel and entertainment costs and professional services.

Culture Shaping

The Culture Shaping segment reported operating income of \$3.6 million for the nine months ended September 30, 2014, an improvement of \$7.3 million compared to an operating loss of \$3.7 million for the nine months ended September 30, 2013. The improvement was due to an increase in net revenue of \$8.6 million and a decrease in general and administrative expense of \$0.5 million, partially offset by an increase in salary and employee benefits of \$1.8 million.

Net revenue increased due to the stage of the project execution for several large clients. Net revenue excluded \$0.3 million and \$3.9 million for the nine months ended September 30, 2014 and 2013, respectively, of pre-acquisition deferred revenue that we were unable to recognize as a result of purchase accounting. The decrease in general and administrative expenses is due to lower amortization and accretion expense. The increase in salary and benefit expenses is due to higher consultant costs for additional staffing related to increased projects and other compensation costs.

Global Operations Support

Global Operations Support expenses for the nine months ended September 30, 2014 increased \$4.3 million or 14.9% to \$33.2 million from \$28.9 million for the nine months ended September 30, 2013. General and administrative expense increased \$2.9 million and salaries and employee benefits expense increased \$1.4 million.

The increase in general and administrative expense was primarily due to \$1.8 million related to a global partners meeting, a state franchise tax matter of \$1.0 million and higher IT systems contracts, partially offset by lower professional legal fees. The increase in salaries and employee benefits expense was due to a \$2.1 million increase in performance-related compensation associated with higher net revenue and more participants in the bonus plan and a \$0.7 million decrease in fixed compensation. The decrease in fixed compensation is due to \$3.3 million for an executive severance in the prior year, partially offset by an increase in support staff headcount and stock-based compensation.

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Liquidity and Capital Resources

General. We continually evaluate our liquidity requirements, capital needs and availability of capital resources based on our operating needs. We believe that our available cash balances together with the funds expected to be generated from operations and funds available under our committed revolving credit facility and our term loan facility will be sufficient to finance our operations for the foreseeable future, as well as to finance the cash payments associated with our cash dividends and stock repurchase program.

We pay the non-deferred portion of annual bonuses in the first quarter following the year in which they are earned. Employee bonuses are accrued throughout the year and are based on our performance and the performance of the individual employee.

Lines of credit and Term Loan. On January 31, 2013, the Company and certain foreign subsidiary borrowers of the Company entered into an Amendment and Restatement Agreement (Restated Credit Agreement), pursuant to which the Company, the Lenders and the Administrative Agent amended and restated the Credit Agreement (Agreement) dated as of June 22, 2011 (See Note 12, *Line of Credit and Term Loan* in the Notes to Condensed Consolidated Financial Statements). Pursuant to the Restated Credit Agreement, the Agreement was amended to add a committed term loan facility in an aggregate amount of up to \$40 million (the Term Facility). On January 31, 2013, the Company borrowed \$40 million under the Term Facility and \$31.0 million was outstanding as of September 30, 2014. The Term Facility is being amortized over a five-year period pursuant to which the Company will make quarterly payments of \$1.5 million through 2016 and quarterly payments of \$2.0 million during 2017. The remaining outstanding balance of the Term Facility will be paid on January 31, 2018. The other material terms of the Agreement were not amended by the Restated Credit Agreement.

There were no other borrowings made under these agreements for the nine months ended September 30, 2014 and 2013, respectively. We were in compliance with the financial and other covenants under the Restated Credit Agreement and no event of default existed as of September 30, 2014 and 2013, respectively.

Cash and cash equivalents. Cash and cash equivalents at September 30, 2014, December 31, 2013 and September 30, 2013 were \$159.5 million, \$181.6 million and \$132.8 million, respectively. The \$159.5 million of cash and cash equivalents at September 30, 2014, includes \$48.2 million held by our foreign subsidiaries. A portion of the \$48.2 million is considered permanently reinvested in these foreign subsidiaries. If these funds were required to satisfy obligations in the U.S., the repatriation of these funds could cause us to incur additional U.S. income taxes or foreign withholding taxes. Any additional taxes could be offset, in part or in whole, by foreign tax credits. The amount of such taxes and application of tax credits would be dependent on the income tax laws and other circumstances at the time these amounts are repatriated. Based on these variables, it is not practicable to determine the income tax liability that might be incurred if these earnings were to be repatriated.

Cash flows used in operating activities. For the nine months ended September 30, 2014, cash used in operating activities was \$2.0 million, principally reflecting a decrease in accrued expenses primarily due to cash bonus payments of approximately \$86 million with the 2014 variable compensation accruals of \$81 million partially offsetting these payments and an increase in accounts and other receivables of \$27.2 million, offset by the higher net income.

Cash used in operating activities for the nine months ended September 30, 2013, was \$11.9 million, principally reflecting a decrease in accrued expenses primarily due to cash bonus payments of approximately \$87 million with the 2013 bonus accruals partially offsetting these payments and a \$21.6 million increase in accounts and other receivables, partially offset by \$15.0 million of non-cash expenses.

Cash flows used in investing activities. Cash used in investing activities was \$2.6 million for the nine months ended September 30, 2014 primarily due to capital expenditures of \$2.6 million.

Cash used in investing activities was \$2.5 million for the nine months ended September 30, 2013 primarily due to capital expenditures of \$1.9 million and purchases of available for sale investments of \$0.7 million.

Cash flows (used in) provided by financing activities. Cash used in financing activities for the nine months ended September 30, 2014 was \$15.7 million primarily due to \$7.4 million of quarterly cash dividends to shareholders, \$3.4 million earnout payment related to the Senn Delaney acquisition, \$4.5 million debt repayment, and \$0.4 million of payments for employee tax withholdings on equity transactions.

Cash provided by financing activities for the nine months ended September 30, 2013 was \$31.1 million primarily due to \$40.0 million of proceeds from the issuance of debt, partially offset by \$4.9 million of quarterly cash dividends to shareholders, \$3.0 million debt repayment, \$0.6 million of payments for employee tax withholdings on equity transactions, and \$0.4 million earnout payment related to the Bell McCaw Bampflyde acquisition.

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Off-Balance Sheet Arrangements. We do not have material off-balance sheet arrangements, special purpose entities, trading activities of non-exchange traded contracts or transactions with related parties.

Application of Critical Accounting Policies and Estimates

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our Condensed Consolidated Financial Statements, which have been prepared using accounting principles generally accepted in the United States of America. Our significant accounting policies are discussed in Note 2, *Summary of Significant Accounting Policies*, in the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the U.S. Securities and Exchange Commission (SEC) on March 13, 2014, and in Note 2, *Summary of Significant Accounting Policies*, in the Notes to Condensed Consolidated Financial Statements included in Item 1. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. If actual amounts are ultimately different from previous estimates, the revisions are included in our results of operations for the period in which the actual amounts become known.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or if changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the financial statements. Management believes its critical accounting policies that reflect its more significant estimates and assumptions relate to revenue recognition, allowance for doubtful accounts, interim effective tax rate, allowances for deferred taxes, assessment of goodwill and other intangible assets for impairment, compensation accruals, stock-based compensation and contingent liabilities. See Application of Critical Accounting Policies and Estimates in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on March 13, 2014.

Recent Financial Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers. The ASU requires that an entity recognizes revenue to depict the transfer of promised goods or services to customer in an amount that reflects the consideration to which the Company expects to be entitled in exchange for these goods or services. The standard is effective for annual reporting periods beginning after December 15, 2016, including interim periods, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients or (ii) a retrospective approach with the cumulative effect upon initial adoption recognized at the date of adoption. The Company is currently evaluating the effect that this pronouncement will have on its financial statements and related disclosures. The effect is not known or reasonably estimable at this time.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Currency market risk. With our operations in the Americas, Europe and Asia Pacific we conduct business using various currencies. Revenue earned in each country is generally matched with the associated expenses incurred,

thereby reducing currency risk to earnings. However, because certain assets and liabilities are denominated in currencies other than the U.S. dollar, changes in currency rates may cause fluctuations in the valuation of such assets and liabilities. As the local currency of our subsidiaries has generally been designated as the functional currency, we are affected by the translation of foreign currency financial statements into U.S. dollars. A 10% change in the average exchange rate for currencies of all foreign countries in which we operate would have increased or decreased our net income for the nine months ended September 30, 2014 by \$0.8 million. For financial information by geographic segment, see Note 16, *Segment Information*, in the Notes to Condensed Consolidated Financial Statements.

Interest Rate Risk. We are exposed to interest rate risk related to our debt. We mitigate this risk through the use of an interest rate swap; see Note 10, *Derivative Financial Instruments* and Note 12, *Line of Credit and Term Loan*, in the Notes to Condensed Consolidated Financial Statements, for more information on our debt and interest rate swaps. A 10% change in interest rates would not have a material impact on the fair value of the outstanding interest rate swap agreement for the nine months ended September 30, 2014.

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ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures as defined in the Securities Exchange Act of 1934, as amended (the Exchange Act), Rule 13a-15(e) and 15d-15(e), that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Any system of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Management of the Company, with the participation of the principal executive officer and the principal financial officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2014. Based on the evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were effective as of September 30, 2014.

(b) Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information presented in Note 18, *Commitments and Contingencies*, to our Condensed Consolidated Financial Statements within this Quarterly Report on Form 10-Q is incorporated herein by reference.

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Item 6. Exhibits

| Exhibit No. | Description |
|--------------------|--|
| *31.1 | Certification of the Company's Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| *31.2 | Certification of the Company's Executive Vice President and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| *32.1 | Certification of the Company's Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| *32.2 | Certification of the Company's Executive Vice President and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| *101.INS | XBRL Instance Document |
| *101.SCH | XBRL Taxonomy Extension Schema Document |
| *101.CAL | XBRL Taxonomy Calculation Linkbase Document |
| *101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| *101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| *101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

* Filed herewith.

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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.

Date: October 28, 2014

Heidrick & Struggles International, Inc.

(Registrant)

By: /s/ Karen K. Pepping

Karen K. Pepping

Senior Vice President, Chief Accounting Officer and

Controller