KFORCE

Q4 2020
CONFERENCE CALL

Prepared remarks from:
David L. Dunkel, Chairman and CEO
Joseph J. Liberatore, President
David M. Kelly, CFO

FOURTH QUARTER 2020 FINANCIAL RESULTS
CONFERENCE CALL, FEBRUARY 8, 2021
PREPARED REMARKS

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DAVID L. DUNKEL, CHAIRMAN AND CEO

Good afternoon. I would like to remind you that this call may contain certain statements that are forward-looking, including statements regarding the impact, opportunities and benefits from actions taken related to the COVID-19 economic and health crisis. These statements are based upon current assumptions and expectations and are subject to risks and uncertainties. Actual results may vary materially from the factors listed in Kforce's public filings and other reports and filings with the Securities and Exchange Commission. We cannot undertake any duty to update any forward-looking statements. You can find additional information about this quarter's results in our Earnings Release and our SEC filings. In addition, we have published our prepared remarks within the Investor Relations portion of our website.

Let me start with some commentary about 2020. Reflecting back and considering all of the significant challenges our nation and world endured, it is remarkable to see how we have persevered, adapted, survived and in some cases, prospered. We began the year with great optimism for continued prosperity. The suddenness of the COVID pandemic and its dramatic effect on businesses, communities and families cannot be overstated. Followed by civil unrest and other social issues, disruption to our daily lives has been very significant. We now face a change in administration that brings with it new questions and concerns about regulatory and fiscal policies. The uncertainty of 2020 has carried over into 2021.

Through it all, the heroes are those who have stepped up through incredible personal sacrifice to serve others experiencing crisis. I am most proud of the leaders of Kforce and our wonderful people who not only adapted to dramatic change in their own lives, but also found it in their hearts to serve others in their communities through our Corporate Social Responsibilities initiatives. Against this backdrop, our talented team also delivered extraordinary financial results and we are grateful and proud of their exceptional efforts.

Years of preparation at Kforce, had us strategically situated as we entered the pandemic in early 2020, because of the decisions we made to principally focus our efforts on helping world class companies solve their strategic objectives by providing critical technology talent and solutions. The pandemic heightened the urgency to rapidly digitize operating models to meet competitive threats from existing and emerging disruptors. Financially, on a billing day basis, we achieved year-over-year revenue and earnings per share growth of approximately 3% and 14% respectively. Full year revenues in our technology business were only down approximately 1% year-over-year despite a very difficult economic landscape. In the fourth quarter we continued to take market share and our results exceeded our expectations across each of our lines of business. Most notably, our technology business grew 6% sequentially.

During the year, we also continued to adapt operationally as the situation required. We seamlessly transitioned our entire workforce to work remote within 24 hours, advanced our Kforce Reimagined initiative as we look to define a more flexible future operating model and work environment, and made significant progress implementing our talent relationship management system.

From a governance standpoint, we continued with our Board refreshment activities and are pleased to welcome Catherine Cloudman as the newest member of our outstanding Board of Directors.

As we look to 2021, we are very excited about our strategic position and ability to execute within what we believe will be a continued strong demand environment for our services. It's our belief that the pandemic has exponentially elevated the imperative for companies to rapidly digitize their businesses, transform business models and drive productivity gains through technology investment.

We believe the macro and secular trends play to the heart of the position of Kforce as a technology and professional services and solutions firm. We will continue to place a priority on improving associate productivity while allocating capital to grow our technology business, especially in our managed teams and managed solutions practice where we have continued to experience tremendous market receptivity and success. The strength of our performance and financial position allows us great flexibility in how we deploy capital in the future.

We are migrating our FA business toward higher-end skillsets for decision support and analytics which are more closely aligned to certain technology disciplines. We are also positioning our Firm to have a more flexible work environment post-pandemic by leveraging many of our ongoing internal technology investments and utilizing available tools, such that our employees will have a blend of in-office and remote work. We expect that this shift will result in fewer offices and a smaller physical footprint per office. Though it will take a few years to transition fully, we have made good progress during 2020. We expect that these decisions will result in a more profitable and higher-quality revenue stream.

We expect to continue to manage our business in a disciplined manner, as we always have, based upon operating trends. Through these uncertain and trying times we will continue to put the health and safety of our associates first. They are the key to our future success, and we know that their resilience and determination will drive increasing success as we move through and beyond the current situation.

I will now turn the call over to Joe Liberatore, President, who will give greater insights into our performance, recent operating trends, and other insights into our operating environment. Dave Kelly, CFO, will then give greater detail on our financial results and position as well as our financial expectations and guidance for the first quarter.

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JOSEPH LIBERATORE, PRESIDENT

I want to first echo Dave's comments and give a sincere thanks to every Kforcer for the personal sacrifices they've made in elevating their game and delivering tremendous results in 2020 against a very challenging backdrop.

As to the fourth quarter, total revenues grew 5.3% on a year-over-year basis and exceeded our expectations across each of our lines of business, especially in our technology business where revenues resumed growth on a year-over-year basis. Let me give you a little more color in each line of business.

With respect to our technology business, the nearly 6% sequential increase in revenues is a meaningful acceleration from the roughly 2% sequential increase we experienced in the third quarter and, as Dave noted, resulted in year-over-year growth of almost 1%. These increases are primarily volume-driven as we have grown our consultants on assignment by 15% since early June 2020. Encouragingly, the pace at which we were growing our consultants on assignment meaningfully accelerated in the fourth quarter. We are benefiting from a combination of solid new assignment activity as well as continued lower levels of assignment ends. These trends have continued into the first quarter and we experienced the lowest level of assignment ends at year end that we have on record.

Job order flow and new assignment activity have continued to increase. In fact, new assignment activity increased 16% sequentially in the fourth quarter. While job orders remain at levels lower than pre-pandemic, they continue to increase. We are also continuing to see significantly higher fill ratios due to improved job order quality as clients are executing against an overall higher mix of critical technology initiatives. We also believe the trends we are experiencing are reflective of the growing confidence in restarting projects that may have been deferred or delayed, the scarcity of higher-end IT resources, and securing resources for new transformative initiatives.

There remains broad strength in demand across multiple industries. We experienced growth sequentially in the Professional Services, Insurance and Retail industries, while other key industry sectors experienced stability. Financial Services, Insurance and Professional Services have shown relative resilience throughout the pandemic and have shown growth on a year-over-year basis.

We continue to see the acceleration of critical technology initiatives within our clients in areas such as cloud, mobile, data analytics and cyber, with a strong focus geared towards improving the consumer's digital experience. The investments we have made in frontend technology and process over the last three years have matured our capabilities to efficiently provide these clients with highly diverse top talent, at scale, in a boundaryless environment across the US.

Over the last three years, we have also significantly invested in our managed teams and solutions capabilities in order to provide a higher value, differentiated offering to our clients. We have been experiencing tremendous success in bringing this offering to our clients due to the strong long-standing partnerships we have built and our reputation for delivering quality services. We intend on making further investments in this capability in 2021. I thought it would help if I provided a relevant client engagement to help solidify the type of business we are driving in this offering. The first engagement with a telecommunications client related to their legacy infrastructure that was compromising their service offerings to their end customers. Our client needed a partner with proven cloud strategy and implementation expertise to deliver a holistic solution from architecture to implementation in AWS. As a strategic partner, we were responsible for defining the cloud strategy including a future state cloud architecture and implementation roadmap. We were also responsible for cloud native development and implementation including data security, compliance, and reporting. Our client is now able to focus on new pursuits and data monetization strategies with a flexible solution complete with multi-tenant capacity. The second engagement was with a healthcare client that was embarking to build a new custom greenfield application as part of its digital transformation strategy. Kforce delivered a scalable outcome-based solution initially deploying four scrum teams to take over the legacy application support and enhancements. We were able to ramp quickly and exceed the performance targets and delivery schedule. Due to our successful partnership, this client has now engaged us to support the application integration related to a recent business acquisition.

Revenues in this offering are accelerating at a significantly greater pace than our overall technology business. We feel extremely confident in the positioning of our technology business and the ability to continue expanding our market share.

As to early first quarter trends, consultants on assignment are up 2% on a year-over-year basis and new assignment starts have continued to be strong. Thus, we expect that first quarter revenues in our technology business could increase in the mid-single digits on a year-over-year basis.

Moving to our FA business. Flex revenues were up nearly 26% year-over-year in the fourth quarter, primarily as a result of the contribution of approximately 28 million dollars of revenue from our support of government-sponsored initiatives tied to the economic fallout from the COVID-19 pandemic. These opportunities have continued to provide an important level of support to our overall FA Flex business. The COVID revenue stream remains fluid and we expect that revenues could be in a range of $22.5 million to $27.5 million in the first quarter and a range of $10 to $15 million in the second quarter, based on current information.

Our non-COVID FA Flex business grew 13% on a sequential basis and declined approximately 17% year-over-year. We have collectively grown our consultants on assignment by 33% since early June 2020. As Dave mentioned, we are intensifying efforts to migrate our FA business towards more highly skilled assignments such as analytics and decision-support roles that are less susceptible to technological change and automation and more synergistic with our Technology footprint. To that end, we expect to experience natural assignment ends of lower skilled FA roles in 2021 where strategic client relationships do not exist. We expect our non-COVID FA revenues to be down in the mid-single digits sequentially and down on a year-over-year basis consistent with fourth quarter levels. When combined with the mid-point of the range of COVID revenue, total FA Flex may be down sequentially in the high single digits and up YoY in the low to mid 20% range.

Direct Hire revenues in the fourth quarter increased approximately 8% sequentially and declined 13% year-over-year. Direct Hire remains an important part of our service offering to clients though we have not allocated significant investment here due primarily to its sensitivity to economic cycles. We expect Direct Hire revenues may be roughly flat on a year-over-year basis in the first quarter.

We are continuing to invest in strategic initiatives to better position our Firm for long term, sustainable profitable growth. These investments include our CRM and TRM systems, both of which are cloud-based and seamlessly integrate with other Microsoft product offerings; thus, providing us significant efficiencies. Our team has also significantly advanced efforts in the evolution of a fully integrated hybrid operating model to enhance the online experience of our internal team and the interaction with our clients, candidates, and consultants. These and many other efforts will position us with maximum flexibility regardless of what lies ahead.

We are continuing to manage the productivity of our associates. In the fourth quarter, we began making selective investments to increase the number of associates in our technology business so that we are able to take advantage of the expected economic acceleration in 2021. Overall capacity remains sufficient to support above market growth rates and should improve due to our continued investments in technology and greater enablement of communication and collaboration tools and processes that have been so successful for us during this transition to remote work.

Our experience has been that recessionary cycles result in competitive advantages for the strongest companies and we believe we are ideally situated to take advantage of the market as conditions continue to recover in what we believe could be an accelerated digitally led expansion in 2021 and beyond.

We have supported and retained our best people, structurally reduced our fixed costs, and are refining a more leverageable model that we expect will result in positive leverage as growth accelerates as we reimagine the future. Our customer and employee satisfaction levels are at an all-time high. We carry the highest Glassdoor rating among our peers, achieved a world class net promoter score from our clients and consultants and are the most recognized firm by technology consultants per SIA.

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I greatly appreciate the trust our clients, consultants and candidates have placed in Kforce and I couldn't be prouder of our teams' attitude and efforts executing in a fully remote capacity while managing through these remarkable times. I will now turn the call over to Dave Kelly, Kforce's Chief Financial Officer.

DAVID M. KELLY, CHIEF FINANCIAL OFFICER

The ability of our team to execute extremely well in our core business during this very difficult year and the critical decisions made to pursue business outside of our core allowed us to not only maintain valuable infrastructure, but to also deliver exceptional results for our shareholders. Full year revenues of $1.4 billion and earnings per share of $2.62 represent year over year increases of 3.3% on a billing day basis and 14.4%, respectively.

Driven by our strong tech performance, fourth quarter revenues of $354.0 million significantly exceeded our expectations and reflect a continued strengthening of performance in each quarter since the beginning of the pandemic. Earnings per share of 86 cents grew 30.3% year-over-year.

Our gross profit percentage in the quarter of 28.4% was stable sequentially and decreased 80 basis points year-over-year as a result of a lower direct hire revenue mix and a decrease in overall flex gross profit margins.

Our flex gross profit percentage of 26.5% declined 20 basis points sequentially due to usual holiday impacts, and 40 basis points year-over-year. The primary driver to the flex margin decline was the impact of the lower margin COVID-19 revenue on our FA business. Flex margins in FA declined 100 basis points year over year. Flex margins in our technology business declined 30 basis points year over year, due primarily to slight spread compression and slightly higher healthcare costs.

Average bill rates in technology of nearly $80 per hour have increased nearly 4% over the past year. As we have previously stated, our clients have generally retained the more highly skilled and highly compensated consultants since the onset of the pandemic given the scarcity of talent, which has positively influenced both overall bill rate and overall length of assignment. Average bill rates in our FA business, exclusive of Covid-19 revenues, were generally stable at $37 per hour.

As we look forward to Q1, we expect bill rates and bill/pay spreads in both our technology and FA businesses to be relatively stable. We are seeing continued growth in our managed teams and solutions business, which carries an overall higher average bill rate. These higher rate, higher margin projects should help bring rate and spread stability in a competitive environment and over the longer term create leverage to increase margins and overall profitability.

While we expect stability in overall spreads, flex margins will be negatively impacted in the first quarter by approximately 110 basis points relative to Q4 due to seasonal payroll tax resets.

Overall SG&A expenses decreased as a percentage of revenue by 170 basis points year-over-year due to improved associate productivity, solid expense management and lower costs in areas such as travel and office expenses. These positive trends will continue into Q1, as we embrace the remote work environment brought on by the pandemic. SG&A expenses in Q1 will be up slightly from Q4 in terms of percentage due primarily to payroll tax resets but will be lower than the first quarter last year in terms of both percentage and dollars, despite significantly higher revenues.

Our fourth quarter operating margin was 6.8%, which once again exceeded previously communicated operating margin targets. We believe the improving quality of our revenue stream, continued productivity improvements and ongoing lower operating costs will collectively drive improved profitability. As a result, we are raising our operating margin targets by approximately 20 basis points from prior expectations. This increase is reflected in our full year 2021 expectation of operating margins of between 6.0% and 6.3%.

Our effective tax rate in the third quarter was 20.1%, which was lower than we anticipated due to a greater tax benefit realized upon the vesting of our long-term incentive awards as a result of an increase in Kforce's stock price. The majority of our long-term incentive awards vest annually in the fourth quarter.

Next, I'll spend a few minutes discussing our operating cash flows and liquidity position.

Operating cash flows were $15 million in the fourth quarter and slightly greater than $109 million for the full year. We continued to benefit from the deferral of approximately $13 million in payroll taxes under the CARES Act in the fourth quarter, bringing the total deferral for the year to nearly $39 million. Our strong operating cash flows resulted in us ending 2020 with $3.5 million of net cash versus net debt of $45.2 million at the end of 2019. In addition to retiring all of our outstanding debt, we returned approximately $46 million in capital to our shareholders in 2020 through $29.4 million in share repurchases and $16.8 million in dividends.

We generated roughly $97 million in EBITDA in 2020. Our strong cash flows, debt-free balance sheet and $300 million revolving credit facility, provide ample liquidity to operate the business, even in extreme conditions, and flexibility to opportunistically allocate resources to areas such as acquisitions and returning capital to our shareholders while also making continued investments to organically grow the business.

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As a signal of our belief in the strength of our operating trends going into 2021, our Board of Directors approved a 15% increase to our quarterly dividend effective in the first quarter. This increase will bring our dividend yield to roughly 2% at current stock price levels.

The continued macro-economic uncertainty and the unpredictability of our current COVID-19 revenue stream leads us to continue providing a broader range in our guidance. Our billing days are 63 days in the first quarter, which is one more day than Q4 2020 and one fewer day than Q1 2020. We expect Q1 revenues to be in the range of $354 million to $364 million and earnings per share to be between 57 and 65 cents. Gross margins are expected to be between 27.4% and 27.6%, while Flex margins are expected to be between 25.4% and 25.6%. SG&A as a percent of revenue is expected to be between 21.6% and 21.8% and operating margins should be between 5.2% and 5.6%. Weighted average diluted shares outstanding are expected to be approximately 21.5 million for Q1, and the anticipated effective tax rate is 28.0%.

As a reminder, first quarter operating margins are typically impacted by approximately 150 basis points due to seasonal impacts of annual payroll tax resets. This also impacts earnings per share by approximately 20 cents. This guidance does not consider the potential negative impact on the demand environment from a significant increase in COVID-19 cases, the effect, if any, of charges related to any one-time costs, costs or charges related to any pending tax or legal matters, the impact on revenues of any disruption in government funding, or the Firm's response towards regulatory, legal or future tax law changes.

To better assist in understanding how our business may change over the course of 2021, we have provided some detail on our full year revenue and profitability expectations in our press release. This information reflects an expectation of full year revenue growth in our technology business of between 8%-12%. Ranges provided for our FA unit reflect the net impact of revenue declines from business that we are no longer pursuing due to our strategic migration to higher end skill sets. We have also provided our most up-to-date expectations for our COVID-19 revenues, which we currently believe may end in the first half of the year. In terms of profitability, we have reflected the improved operating margins I mentioned earlier and resulting earnings per share.

We are very pleased with our performance in 2020 and believe that demand for technology resources in 2021 will continue to strengthen. As our revenue mix evolves, we expect to enter 2022 with 85% our revenues focused in technology, which permeates every aspect of business and society, and an FA business that is directly focused on complimenting those technology efforts. We have built an exceptional team and armed them with a technology-enabled operating model that, we believe, will allow us to outperform the market on a sustained basis. Our strong financial position and bias for ongoing investment will further enable the team to excel in providing resources and solutions critical to the success of every company in every industry. On behalf of our entire management team, I'd like to extend a sincere thank you to our teams for their efforts in overcoming the challenges of the past year and making it a resounding success.

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DAVID L. DUNKEL, CHAIRMAN AND CEO

Thank you for your interest in and support of Kforce. As we continue to persevere during these unprecedented times, I would like to say thank you to each and every member of our field and corporate teams for the incredible efforts, and to our consultants and our clients, for your trust in Kforce in partnering with you and allowing us the privilege of serving you. We delivered another quarter of exceptional results and are excited about how we are beginning 2021. We look forward to talking with you again after the first quarter.