KFORCE

Q2 2019
CONFERENCE CALL

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

Great results through strategic partnerships and knowledge sharing.®

SECOND QUARTER 2019 FINANCIAL RESULTS
CONFERENCE CALL, JULY 31, 2019
PREPARED REMARKS

DAVID L. DUNKEL, CHAIRMAN AND CEO

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.

The second quarter marked the completion of a multi-year strategy to position the Firm as a dedicated domestic provider of technical and professional staffing and solutions where we, as a top 5 provider in both Tech and FA, can focus on solving the most critical talent needs in our information and technology driven society. As we finalized the divestitures of our prime federal contracting businesses this quarter, we also delivered continued above market growth in our Tech Flex business and strong earnings per share. Over the course of this strategy, we have divested over $320 million in revenue and, now, nearly 80% of our revenues are derived from our domestic Technology segment. We firmly believe that the technology staffing and solutions market provides extremely deep and sustainable growth prospects.

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We continue to experience strong secular drivers in the technology space. Every industry and organization is being confronted with the imperative to invest and rapidly adapt to changing business models and new competitors and to improve its customer experience.

Virtually every Fortune 500 company now understands the value of utilizing flexible technology resources. Many of these companies that we speak to indicate to us that they are targeting a greater percentage of their overall workforce for flexible resources. These are our target clients, and they make up a significant majority of our revenues. These companies are looking to partner with firms with the necessary scale and compliance infrastructure with the breadth of services, such as Kforce, to both provide the resources necessary to execute on critical projects and to also assume a greater role in more complex engagements that require managed services and solutions. Our clients have increasingly expressed their desire to engage with us to serve as a viable alternative or complement to the larger scale integrators. While the size of this business for us is still relatively small, it continues to grow and is an important part of our strategy. We believe significant opportunity exists to expand our capabilities and provide a differentiated service to our clients. In addition, we are executing a disciplined acquisition strategy for niche solutions providers that fit our technology offerings.

With respect to Kforce's internal technology, we have clearly stated our strategy is to embrace enabling technologies and focus on relationships by delivering exceptional service to our customers. We believe that the speed of innovation and change necessitate an open architecture as new tools are rapidly introduced.

In addition to our service capabilities, our financial position, which includes strong cash flows and no net debt, gives us maximum flexibility to deploy our available capital in ways that best serve our shareholders. Our priorities are to sustain our dividend yield, pursue acquisitions within the technology solutions space, and return capital to shareholders through share repurchases. During the quarter, we were able to deploy $37 million of the $102 million in net cash generated from our divestitures on share repurchases and expect to continue being aggressive until these proceeds have been exhausted. We are able to comfortably undertake these actions without reducing our flexibility to make acquisitions that improve our capabilities and offerings and make other strategic investments that may arise.

The steps we have taken have positioned Kforce to be able to dedicate our focus on an important and growing market. We are well positioned to invest in becoming an even more valued partner to our clients and I'm excited about our future growth prospects.

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I will now turn the call over to Joe Liberatore, President, who will give greater detail into our operating results and trends and then Dave Kelly, CFO, will add further color on second quarter results, our intentions with use of cash proceeds and provide guidance on Q3.

JOSEPH LIBERATORE, PRESIDENT

Overall revenue from continuing operations in the second quarter fell within our range of guidance as Tech Flex continued to gain market share and our FA Flex revenues stabilized at Q1 levels.

Tech Flex grew 6.2% year-over-year. The majority of this growth is being driven by an increase in billable consultants on assignment as bill rates modestly improved by 2.4% over last year. The above-market growth is reflective of our efforts to align our service offerings and operating model to best fit with how our clients purchase services. We have made a concerted effort to align our teams by industry and size of relationship to drive enhanced customer intimacy. Consequently, our strongest growth continues to come from clients that are significant users of the services we provide and where we have established long-standing relationships. Further, the demand we are experiencing from these clients has been relatively consistent and reliable. Conversely, growth rates of clients where we don't have as fully established relationships were slower in the quarter. We believe the continued focus on deepening our relationships with existing clients is the right path, given our stellar client portfolio, while also selectively establishing relationships with prospects possessing the attributes aligning to our value and capabilities to continue expanding our client portfolio.

Our strong relationships and scarcity of quality and skilled technology talent to execute the numerous technology initiatives of our clients have also driven an increase in the average duration of our consultant assignments to almost 9 months. We believe this trend may continue, especially as we expand our capabilities and offerings to provide a higher value-add service to our clients.

Fortune 500 companies continue to be the largest consumers of flexible technology talent in which we have established relationships with many and do business with 70 percent of the Fortune 100. We are able to leverage our deep understanding of their needs and craft solutions through both traditional staff augmentation, and also by providing a greater level of managed service and solution offerings.

We have experienced growth across virtually every significant industry vertical in which we do business with particular strength in business and professional services as well as health services. Our weakest industry vertical was telecommunications, however the business dynamics and depth of client relationships within this vertical lead us to be optimistic about our long-term prospects for the services and solutions we provide.

We expect continued above market growth in our Tech Flex business in the third quarter. Year-over-year growth rates in the third quarter should remain in the mid-single digits and sequential growth should be in the low single digits.

Our FA Flex business declined 9.4% year-over-year and was essentially flat sequentially. We continue to make progress repositioning this business in more highly skilled positions that are less susceptible to being disrupted by technology advancements though it is taking longer than anticipated and the volume of new assignment starts has been below our expectations. With this transition, average bill rates within FA Flex were up 4.7% year-over-year. The market for our FA Flex business continues to be healthy and we believe our efforts in this area should lead to improving performance in the second half of the year. Current trends suggest that FA Flex revenues will be stable in Q3 from Q2 levels and year over year declines may improve to mid-single digits.

Direct Hire revenue increased 7.7% year-over-year and has been a solid performing business. Our Direct Hire business continues to be an important capability in ensuring that we can meet the talent needs of our clients through whatever means they prefer, which is paying dividends. We expect a seasonal sequential decrease in the third quarter and for year over year growth rates in this business to be consistent with second quarter levels. Over the long term, we have built our model with the belief that Direct Hire will continue to decline as a percentage of overall revenue due to higher growth expectations in our other lines of business.

With respect to our revenue-generating talent, we continue to make significant technology and process investments in order to continue improving associate productivity. We are particularly focused on our new talent relationship management system along with continued efforts to leverage technology in areas such as sourcing, talent assessments, automated intelligent matching capabilities and consultant engagement. The number of sales and delivery associates has been relatively stable this year. We don’t expect to make material additions beyond those areas where productivity levels warrant as we believe significant capacity exists to accelerate and sustain revenue growth through at least the remainder of the year.

Our simplified business model, client portfolio and focused service offering has us well positioned for long- term growth. Our narrowed focus is yielding brand recognition and reputational results as demonstrated by Staffing Industry Analysts number one ranking of Kforce as the most recognized brand by IT consultants, a world class Net Promoter score from our Clients and Glassdoor’s highest rating among our competitors. I appreciate the trust our clients and candidates have placed in Kforce and our team's efforts in driving our Firm forward. I will now turn the call over to Dave Kelly, Kforce's Chief Financial Officer, who will provide additional insights on operating trends and expectations.

DAVID M. KELLY, CHIEF FINANCIAL OFFICER

As previously noted, during the second quarter, Kforce completed the sale of our KGS and TraumaFX businesses. The operating results from these businesses through the effective date of the transactions and the gains on sale resulted in earnings per share from discontinued operations in the second quarter of 2 dollars and 40 cents. Further commentary will focus exclusively on results from continuing operations, unless otherwise noted.

Revenues of $338.9 million in the quarter grew 2.8% year-over-year and earnings per share were 66 cents, an increase of 10% year-over-year.

Our gross profit percentage in the quarter of 29.8% declined 60 basis points year-over-year primarily as a result of a decline in our Flex gross profit percentage.

Tech Flex margins of 26.4% declined 80 basis points year-over-year. Tech Flex spreads were stable sequentially. Year-over-year, spreads have compressed primarily as a result of our success in growing revenue with our larger clients, which have a slightly lower margin profile than the overall average for Tech Flex. As we look to the future, we expect to continue to more deeply penetrate our existing clients. This will likely create slight declines in overall flex margins since our pricing structures typically include tiered discounts for greater volume at our largest clients. However, we believe this strategy will benefit operating margins, as greater scale at individual clients allows our associates and support infrastructure to be more efficient and drive profitability that is accretive to current operating margins even at slightly lower flex margins. Our portfolio is well diversified. No single client represents more than 4.3% of total revenues and our 25 largest clients represent only 39% of total revenues. Significant growth of a single client will not unduly create risk to the enterprise overall.

SG&A expenses declined as a percent of revenue by 30 basis points year-over-year. We continue to make progress in generating SG&A leverage as revenues expand. This leverage has been achieved while also significantly increasing our technology investments. We are also aggressively pursuing opportunities to partner with leading technology firms to embrace applications that enhance our client and candidate experiences and further improve productivity and strengthen client and consultant relationships.

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Our second quarter operating margin of 6.3%, was in line with our expectations at these revenue levels. During this economic cycle, our gross margin percentage has declined by approximately 200 basis points due to a decline in the percentage of direct hire business and compression in our Flex spreads. Despite this compression, operating margins have improved by approximately 400 basis points, which reflects the success of our efforts to deepen relationships in our existing client base while aligning our infrastructure to optimize efficiency in serving these larger more complex clients.

Our effective tax rate in the second quarter from continuing operations was 23.4%, which was slightly lower than expected due to a change in the treatment of foreign taxes attributable to our Philippine operations, which was sold in 2017.

Our business continues to drive significant operating cash flows. These cash flows coupled with the $102 million of net proceeds from the sale of KGS and TraumaFX allowed us to repurchase approximately one million shares of stock in the quarter and exit the quarter with zero net debt. The repurchase activity in the quarter was substantially better than we had anticipated, and we now expect to deploy the remaining proceeds by the end of the year.

The strength of our balance sheet, healthy operating cash flows, and $300 million Credit Facility provide us maximum flexibility to execute quickly on strategic or tuck-in acquisitions or other ventures and strategic partnerships, even while aggressively repurchasing stock.

I wanted to provide you a sense of how our weighted average shares outstanding could trend for the remainder of 2019 given current repurchase expectations. Based upon expected Q3 and Q4 activity, we would expect weighted average diluted share outstanding of approximately 23.4 million in Q3 and 22.5 million in Q4. This assumes the repurchase of approximately 1.1 million shares in Q3 at current price levels. Actual results of course could vary significantly depending upon stock price and volume.

Our billing days are 64 days in the third quarter, which is the same as Q2 and is one day more than the third quarter of 2018. With respect to guidance for continuing operations, we expect Q3 revenues to be in the range of $337 million to $341 million and for earnings per share to be between 65 and 67 cents. Gross margins are expected to be between 29.3% and 29.5%, while Flex margins are expected to be between 26.8% and 27.0%. SG&A as a percent of revenue is expected to be between 22.5% and 22.7% and operating margins should be between 6.2% and 6.4%. Weighted average diluted shares outstanding, as I mentioned, are expected to be approximately 23.4 million for Q3. Included in our guidance is an anticipated increase in the Other Expense line of the Income Statement of between 1 cent and 2 cents per share related to our share of quarterly losses of a joint venture we entered into late in the second quarter. This impact is essentially offset by a lower than previously anticipated effective tax rate of 24.5%.

This guidance does not consider the effect, if any, of charges related 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.

We are excited about our prospects and pleased with the successful execution by our teams to focus our business in the areas of greatest need in our economy and to improve our processes and technology. We remain committed to our operating margin objectives. While we still have work to do, we are poised to take advantage of a strong market and our exceptional foundation to sustain above market revenue growth rates while improving profitability.