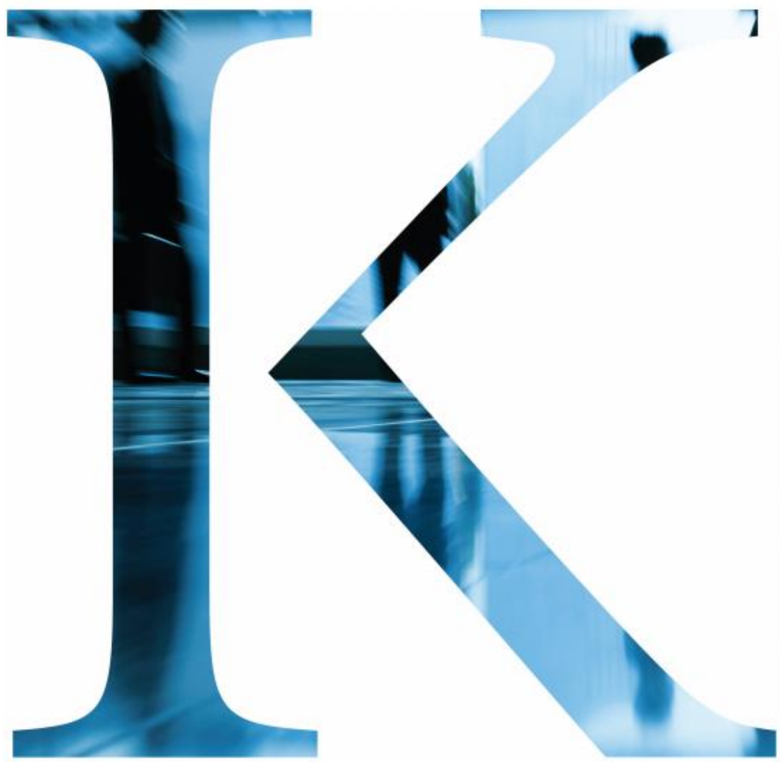
KFORCE

Q2 2017
CONFERENCE CALL

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



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SECOND QUARTER 2017 FINANCIAL RESULTS
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DAVID L. DUNKEL, CHAIRMAN AND CEO

You can find additional information about Kforce in our 10-K, 10-Q and 8-K filings with the SEC. We also provide substantial disclosure in our earnings release to assist in better understanding our performance and to improve the quality of this call. In addition, we have published our prepared remarks within the Investor Relations portion of our website.

We are now nine years into a cycle where flexible staffing revenues have continued to capture an increasing proportion of the total workforce as the temp penetration rate recently hit an all-time high at 2.07%. The specialty staffing market growth rate continues to significantly outpace total flexible staffing growth. Domestic IT staffing specifically has grown from $15.8 in 2009 to an estimated $30 billion at the end of 2017. This does not include technology services and solutions. We have taken significant steps to position our Firm to take advantage of the long term growth prospects of this vibrant market. Though second quarter revenues of $340.3 million and Earnings Per Share of 44 cents fell short of our expectations, the underlying improvements we have made in our business model provide an excellent foundation for growth.

Over the last 18 months, we have been executing a strategic plan to refine our operating structure, rebalance our revenue generating talent, and make prudent and necessary investments to improve our sales efforts and enable our associates with new technology, including a new CRM system. These efforts are not yet complete, and with regard to our sales transformation investments, the anticipated return on investment is taking longer than we had originally anticipated. However, the improvements we are beginning to see in activity levels and the quality of client conversations provide confidence that those returns are forthcoming. Joe will comment further later in the call.

From a gross margin perspective, we have reinforced to our associates the value of the services we provide our clients, and as a result have stabilized flex margins through improved pricing in Q2 relative to the first quarter. We are also pleased with the ongoing progress we have made to improve our operating leverage. Earnings per share increased 3 cents on a year-over-year basis. One of the drivers to this increase is an improvement in the productivity within our revenue generating talent. Productivity remains significantly below peak levels, which we believe we should be able to return to as a result of our investments, and we have ample capacity to meaningfully grow our Firm at current talent levels.

The strength in the demand environment has not changed. We believe the secular drivers of demand remain intact as companies increasingly look to technology to provide internal operating efficiencies, enhance competitive position and enable sustained market relevance in today's rapidly evolving marketplace. Also, competitive pressures and the need to innovate continues to intensify and technology investments in areas such as big data, artificial intelligence and machine learning remain a critical component. The areas of highest demand include mobility, cloud computing, cyber security, e-commerce, machine learning, and digital marketing. The shorter-term project nature of technology requires specific skill sets, which are increasingly driving companies to a greater use of flexible resources. Though already strong, an improvement in economic conditions could accelerate demand for flexible resources as technology investments typically increase in more robust periods of growth.

Recent job growth statistics provide additional confidence in sustained economic growth and a positive environment for flexible staffing. The second quarter brought very little clarity on key political policy initiatives, including corporate tax reform, immigration reform, healthcare reform, and financial de-regulation. While there is still great uncertainty as to the details and impact of any potential reform, we believe the balance of any changes should be a net positive for our industry.

We remain confident that our ongoing investments will enhance our business model and improve our growth prospects. The fundamental necessity of technological investment in every business, in every geography and every industry, along with the project nature of these investments, will continue to drive demand for flexible resources. We still have much work to do, but remain confident in our long term success and the operating objectives we have established.

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I will now turn the call over to Joe Liberatore, President, who will provide further details on our Q2 operating results. Dave Kelly, Chief Financial Officer, will then add further color on our Q2 operating trends and financial results as well as provide guidance on Q3.

JOSEPH LIBERATORE, PRESIDENT

Thank you Dave and thanks to all of you for your interest in Kforce.

Our top line results for the quarter reflect growth on a sequential and year-over-year basis of 1.9% and 1.6%, respectively, but fell short of our expectations.

Tech Flex, our largest segment, which accounts for roughly 65% of total revenues, increased 2.7% sequentially and 1.5% year-over-year. The momentum in new starts activity that we generated in the first quarter and carried through April plateaued in May and June. We also experienced slightly higher than anticipated assignment ends and higher conversions during the quarter.

Critical to the long-term success of our Tech Flex business is the ability to deliver at scale to larger consumers of flexible technology talent, and further deepening our expertise within growing industry verticals to allow us to expand the breadth of our service offerings to these larger, sophisticated buyers. Larger customers continue to concentrate spend with firms, such as Kforce, that can meet their needs nationally as well as ensure compliance with internal and external policies and regulations. We are one of the few providers that can meet these client needs on a national basis. We continue to focus efforts to optimize driving efficiency in sales, delivery and our back office within this segment. Our mature platform within Centralized Delivery remains a significant element in our efforts to reduce overall servicing cost, allowing us to maintain bottom line contribution within this important segment within our overall portfolio. Our 25 largest Tech Flex customers comprise nearly 50% of Tech Flex revenues. Our largest customer represents 8% and our top 5 represent 23%.

We believe we are well positioned to gain further client share in this portfolio while further diversifying within other significant consumers of flexible resources where we already have relationships.

We are also investing to differentiate ourselves from competition and deepen and expand our service offerings to the more sophisticated buyers where we have strong relationships and a platform for growth. During the quarter, we experienced year-over-year growth in 6 of our top 10 industry verticals. Communications, manufacturing, retail and energy were particular strengths year-over-year.

For the third quarter, we expect Tech Flex revenues to improve sequentially and year-over-year growth to accelerate slightly from Q2 levels on a billing day basis.

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Our FA Flex business, which represents 24% of our total revenues, increased 4.3% year-over-year. From an industry perspective, 8 out of our top 10 verticals experienced year-over-year growth, including financial services, business services, retail and energy. We experienced sequential declines in the second quarter, as expected, following some slowdown in activities associated with bulk staffing engagements late in the first quarter. We expect year-over-year growth rates to improve from Q2 and to be in the mid-single digit on a billing day basis.

Revenues for Kforce Government Solutions decreased 4.0% sequentially and 6.4% year-over-year. KGS was negatively impacted in the quarter by delays in the commencement of services work and delays in the delivery of product within our highly profitable product-based business as a result of the timing of funding associated with recent contract awards by the Federal Government. Our team is executing well against the backdrop of a challenging procurement environment. Much like the commercial space, Technology and Finance & Accounting resources are in short supply. We expect revenues for KGS to increase sequentially and be stable on a year-over-year billing day basis.

Direct Hire revenues from placements and conversions improved 20% sequentially and 2% year over year and is currently 4.1% of total Firm revenues, which is flat compared to the year ago period. We believe this growth speaks to our clients' confidence in both the economy and their future growth prospects. Our Direct Hire capabilities remain an important element of our strategy and our objective is to meet the talent needs of our clients through whatever means they prefer, leveraging our 50+ years of experience servicing clients. The second quarter of the year is our typical peak Direct Hire quarter historically, so we expect some seasonal sequential decline. Year-over-year Direct Hire revenues are expected to improve slightly.

As Dave mentioned earlier, we are focused on making investments that provide our revenue generating talent with the necessary training, methodologies and digitally enabled tools to engage in more strategic conversations and allow us to elevate the value we are bringing to our clients and consultants. We rolled out our new customer relationship management system to a number of offices throughout the second quarter and expect to complete the deployment in the third quarter. We believe these investments, among others, will generate a significant return by improving how we consistently engage with and deliver services to our clients, candidates and enhance the effectiveness and efficiency by which we conduct business. We are beginning to see positive momentum in front end indicators such as quality of proposals, case studies, client visits along with YOY and sequential productivity improvements.

Our revenue-generating talent was down 8.5% in the second quarter on a year-over-year basis, which principally relates to intentional reductions in our delivery talent to ensure optimal ratios exist to maximize productivity. We believe capacity exists within our revenue generating talent to accelerate revenue growth rates. We expect associate headcount levels to be stable for the remainder of the year with second quarter levels and resume modest investments after further adoption of our new sales methodology and our customer relationship management systems positioning us for improvement in productivity.

Our success is tied to our ability to consistently improve associate productivity by ensuring they are engaging with the right customers, leveraging the investments we have made in our new sales methodology, as well as the technology-related investments we are making, inclusive of our new CRM. We are confident in our ability to realize the benefits of these investments.

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

Thank you Joe.

Total revenue for the quarter of $340.3 million represents growth of 1.6% on a year-over-year basis. All of our staffing businesses grew year-over-year and our government business declined slightly.

Earnings per share of 44 cents in the quarter improved 3 cents, or 7.3%, over the second quarter a year ago, reflecting continued progress towards our longer-term profitability objectives.

Our gross profit percentage in the quarter of 30.5% increased 140 basis points sequentially, which slightly exceeded expectations, due to a greater mix of Direct Hire revenue than anticipated. The 120 basis point year-over-year decline is the result of a decline in Flex gross profit margins.

Our Flex gross profit percentage of 27.6% in the second quarter improved 100 basis points sequentially. On a sequential basis, we have seen improving spreads between bill and pay rates on new assignments primarily in our Tech Flex business, while FA Flex spreads have been stable. We have reinforced our internal messaging to ensure that, during pricing discussions, our associates appropriately consider the value of services that we provide to our clients. The recent improvements have allowed overall spreads to remain essentially stable, as the higher spreads this quarter are helping offset some of the lower spread business booked previously. As anticipated, we also experienced a 100 basis point sequential improvement from the reduction in seasonal payroll taxes.

Year-over-year, bill/pay spreads are down and we expect pay rates will continue to rise as tight labor supply in our candidate population persists. We will work to pass through these increases in the form of bill rate increases. However, if the current economic landscape continues, where our customers still lack pricing power, spreads may continue to be under pressure. However, as we look to Q3, early quarter data suggests that Tech Flex and FA Flex spreads may be stable sequentially.

We continue to make progress in improving our operating leverage as SG&A as a percentage of revenue was down 130 basis points to 24.2% in the second quarter of 2017 year over year. This leverage is primarily a result of the realization of the benefits from the realignment activities completed over the last 18 months, improved productivity within our revenue-generating talent, and greater expense control in other areas of spend. We will continue to make additional investments in enabling technologies to further increase our efficiency in delivering service to our clients and candidates.

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Q2 2017 operating margins were 5.7% compared to 5.5% in Q2 2016. The SG&A reductions and operating margin improvements we have seen are anticipated to continue as we grow and associate productivity continues to improve.

During the quarter, we announced the completion of a new $300 million cash flow-based revolving credit facility, which replaced our previous $170 million asset-based revolving credit facility and provides significantly flexibility and support for our future growth.

With respect to our balance sheet and cash flows, operating cash flows in the second quarter were $16.1 million, an increase from $12.6 million in the year ago period. Long-term debt at the end of the quarter was $127.4 million, a decrease of $8.3 million from Q1 2017 and reflects leverage of 1.6 times trailing twelve months EBITDA. Capital expenditures for Q2 were approximately $2.1 million.

We returned approximately $3 million in dividends to our shareholders in Q2 2017. We did not repurchase any stock during the quarter. Since the beginning of 2015, we have spent approximately $80.7 million on repurchases and returned $31.1 through dividend payments over the same period. In total, cash returned to shareholders has exceeded operating cash flows over that period. We will continue to appropriately balance the utilization of available capital between investing in the long-term growth of our business through both technology investments and potential tuck-in acquisitions, reducing debt levels and returning capital to our shareholders.

With respect to guidance, the third quarter of 2017 has 63 billing days, which is one day less than both Q2 2017 and Q3 2016. As a reference point, we generate approximately $5.3 million in revenue per each billing day. We expect Q3 revenues to be in the range of $338 million to $343 million, and for earnings per share to be between 44 and 47 cents.

Gross margins are expected to be between 30.5% and 30.7%, while flex margins are expected to be between 27.8% and 28.0%. SG&A as a percent of revenue is expected to be between 24.1% and 24.3%. Operating margins are expected to be between 5.7% and 6.0%. This guidance assumes an effective tax rate of 38.3%. Weighted average diluted shares outstanding are expected to be approximately 25.5 million for Q3.

This guidance does not consider the effect, if any, of charges related to the impairment of intangible assets, any one-time costs, costs 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 tax law changes.

Our activity levels and feedback from our revenue generating talent suggest strength in demand in Technology and Finance & Accounting professional staffing services. This provides us confidence in our ability to reaccelerate revenue growth, even though it is taking longer than we had originally anticipated. We remain on track to achieve operating margins of 6.3% at $1.4 billion in annualized revenue and 7.5% at $1.6 billion in annualized revenue and remain confident in our long-term success.

Operator, we would now like to open up the call for questions.

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DAVID L. DUNKEL, CHAIRMAN AND CEO

Thank you for your interest in and support of Kforce. I would like to say thank you to each and every member of our field and corporate teams, and to our consultants and our clients, for allowing us the privilege of serving you.