KFORCE®

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Q1 2021 CONFERENCE CALL

Prepared remarks from:
David L. Dunkel, Chairman and CEO
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FIRST QUARTER 2021 FINANCIAL RESULTS
CONFERENCE CALL, MAY 3, 2021
PREPARED REMARKS

Disclaimer

All statements in this press release, other than those of a historical nature, are forward-looking statements including, but not limited to, statements regarding the performance of technology-focused businesses, the secular drivers of technology, the pace of digital transformation, the Firm's opportunity to continue investing in its future growth, returning capital to its shareholders including the intent and ability to declare and pay quarterly dividends, the expected close and proceeds of the sale of our corporate headquarters, and the Firm's guidance for the second quarter of 2021. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Factors that could cause actual results to differ materially include the following: business conditions, growth rate in temporary staffing and the general economy; competitive factors; risks due to shifts in the market demand; a reduction in the supply of consultants and candidates or the Firm's ability to attract and retain such individuals; the success of the Firm in attracting and retaining its management team and key operating employees; the impacts (direct and indirect) of COVID-19 on our business, our consultants and employees, and the overall economy; changes in the service mix; ability of the Firm to repurchase shares; the occurrence of unanticipated expenses; the effect of adverse weather conditions; changes in our effective tax rate; changes in government regulations, laws and policies that impact our business and our ability to comply with the same; risk of contract performance, delays or termination or the failure to obtain new assignments or contracts, or funding under contracts; changes in client demand and our ability to adapt to such changes; our ability to continue to perform under the government-sponsored COVID-19 related initiatives; continued performance of and improvements to our enterprise information systems; impacts of outstanding litigation or other legal matters, including the risk factors and matters listed from time to time in the Firm's reports filed with the Securities and Exchange Commission, including, but not limited to, the Firm's Form 10-K for the fiscal year ending December 31, 2020, as well as assumptions regarding the foregoing. The terms "should," "believe," "estimate," "expect," "intend," "anticipate," "foresee," "plan" and similar expressions and variations thereof contained in this press release identify certain of such forward-looking statements, which speak only as of the date of this press release. As a result, such forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Future events and actual results may differ materially from those indicated in the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements and the Firm undertakes no obligation to update any forward-looking statements.

KFORCE

FIRST QUARTER 2021 FINANCIAL RESULTS
CONFERENCE CALL, MAY 3, 2021
PREPARED REMARKS

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. 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.

I am incredibly proud of the continued outstanding execution by the entire Kforce team in delivering first quarter results that were at the high end of our elevated expectations and that improved as the quarter progressed. This extraordinary execution follows on the heels of a great 2020 where our largest business, Technology, demonstrated remarkable resilience against the backdrop of an unprecedented macro environment. The momentum we have built and increasing expectations of demand for technology resources have significantly raised our expectations for the second quarter and our ongoing performance, which Dave Kelly will cover in some detail in a moment.

As I reflect on our strategic decision to focus our business on domestic technology staffing and solutions, it is important to remember that prior to the Great Recession the domestic technology staffing market was roughly $20 billion in size and the third largest staffing market segment behind industrial and clerical staffing. The most recent update from Staffing Industry Analysts noted that the domestic technology staffing market became the largest market segment in 2020, with spend of nearly $31 billion. Over the same period, our technology business grew in excess of two times the market rate. Additionally, the technology professional services market exceeds $100 billion. Companies have significantly increased their technology spend over the past decade and the rate of growth in this market is accelerating. In fact, SIA currently anticipates the domestic technology staffing market will grow by 9% in 2021. This confirms the wisdom of our strategic decision to focus our energy in technology and complimentary functional skills in FA and related skillsets. As we look to the future, there is no other single market segment where we would want to be focused and we are incredibly excited about Kforce's future prospects.

The strength in the secular drivers of demand, coupled with improving corporate prospects across virtually every industry, allowed our talented team to deliver services to our blue-chip client portfolio at a level above our expectations, with technology in the first quarter growing more than 3% sequentially and 6% year-over-year on a billing day basis. Additionally, we made nice progress in our objective of migrating our FA business toward higher-end skillsets for decision support and analytics in the quarter. Our FA results, excluding COVID revenues, also exceeded our expectations. This strategic shift, we believe, will provide an important compliment to the technology services we provide our clients, which Joe will elaborate on during his remarks.

We also continue to make great progress in positioning our Firm to have a more flexible work environment post-pandemic through our Reimagine initiative 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. This vision includes both the revenue-generating and revenue-enabling components of our workforce. As per our release last week, we have entered into an agreement to sell our corporate HQ and are actively seeking a new facility in Tampa Bay.

Our business continues to generate significant operating cash flows and we were active in repurchasing approximately $16 million in stock in the first quarter. The strength in our balance sheet and availability under our Credit Facility allows us to be opportunistic with respect to deploying capital. While we will continue to evaluate potential acquisitions, we will apply our stringent cultural and financial criteria to any potential transaction. In addition to the proceeds from the sale of our building, we expect to continue generating solid operating cash flows in the second quarter. Given the strength in our balance sheet and our belief in our future growth prospects, we expect to remain active in repurchasing our stock at current levels.

From a governance perspective, four years ago, we began, in earnest, a mission to refresh our Board with individuals possessing necessary skillsets and backgrounds to lead Kforce into the future. Earlier in the quarter, we provided detail on two additions to our Board. Ms. Catherine Cloudman joined our Board of Directors in the fourth quarter of 2020, and Mr. Derrick Brooks joined the Board in the first quarter of 2021. Each of these extraordinarily accomplished individuals, both professionally and personally, bring diverse and valuable perspectives to our Board.

As we look ahead, 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.

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 second quarter.

KFORCE

FIRST QUARTER 2021 FINANCIAL RESULTS
CONFERENCE CALL, MAY 3, 2021
PREPARED REMARKS

JOSEPH LIBERATORE, PRESIDENT

Thanks to all of you for your interest in Kforce.

The momentum across our business is accelerating. Total revenues for the first quarter grew 10.1% on a year-over-year billing day basis as the improvements we are seeing in our technology business and strategic areas in FA are being complemented by the COVID business.

I am extremely pleased with the 3.1% sequential and 6.3% year-over-year billing day growth in our Technology business. This is the best sequential growth in a first quarter we have on record and perhaps the best March performance we have ever experienced at Kforce. More typically, we experience a sequential revenue decline on a billing day basis in the first quarter given seasonal year-end assignment ends. However, we had remarkably low assignment ends at the end of 2020 and a very strong first quarter with respect to new assignment starts. In fact, we returned to pre-holiday levels of consultants on assignment by the end of January. Typically, it takes until the end of the quarter to return to these levels. For additional perspective, going back to the Great Recession, the range of sequential billing day declines in our Technology business was about 1% to nearly 6% so this result is tremendously encouraging relative to that range. We believe that this speaks volumes as to the vital, non-discretionary mission critical work that we are performing across our client portfolio, which I will further elaborate on shortly.

Enhancing our growth rate is an improving bill rate trend. Bill rates have increased 4.4% year-over-year in technology to $80 per hour. Volume, however, is the most significant driver to our growth. Billable consultants on assignment began increasing shortly after the inception of the pandemic and have grown sequentially for three consecutive quarters. Consultants on assignment are now at levels 21% greater than in June 2020. We are benefiting from a combination of solid new assignment activity as well as continued lower levels of assignment ends. Both strong bill rates and volume increases have continued into the second quarter and provide us a solid foundation to meaningfully accelerate our sequential growth from first quarter levels.

Job order flow has recently returned to pre-pandemic levels and new assignment activity in the months of March and thus far in April has significantly surpassed levels seen prior to the pandemic. We are also continuing to see 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.

FIRST QUARTER 2021 FINANCIAL RESULTS
CONFERENCE CALL, MAY 3, 2021
PREPARED REMARKS

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

A significant accelerant to our overall Technology growth has been the investments we've made in our managed teams and solutions capabilities in order to provide a higher value, differentiated offering to our clients. This offering provides a strong complement to our traditional staffing business. 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 throughout 2021 and in the foreseeable future. We feel extremely confident in the positioning of our technology business and the ability to continue expanding our market share.

There remains broad strength in demand across virtually every industry. We experienced growth sequentially in the Professional Services, Insurance and Retail industries, while nearly all other key industry sectors experienced modest growth or stability. Financial Services, Insurance and Professional Services have shown relative resilience throughout the pandemic and have been significant contributors to our growth on a year-over-year basis.

Given the momentum we have carried into the second quarter we expect revenues in our Technology business could increase in the mid to high teens on a year-over-year basis. This well-above market growth is compounding our success, as Technology revenues significantly outperformed the market in the depths of the pandemic, only declining 3% in the second quarter last year. We are clearly continuing to take market share which we would attribute to our team's execution against the backdrop of an acceleration of overall technology spend.

Our FA flex revenues were up 26.4% year-over-year on a billing day basis in the first quarter, primarily as a result of the contribution of approximately $24 million of revenue from our support of government-sponsored initiatives tied to the economic fallout and recovery efforts from the COVID-19 pandemic. The COVID revenue stream remains fluid and we expect that revenues could be in a range of $28 million to $33 million in the second quarter.

Our non-COVID FA Flex business was stable sequentially and declined 12% year-over-year on a billing day basis. As we mentioned previously, we began to intensify our 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. We will continue to support lower end skill sets for certain clients where we have long-standing relationships and are strategically important to Kforce's ongoing success in our Technology business. We have seen natural assignment ends of lower skilled FA roles in the first quarter of 2021 where strategic client relationships do not exist and expect that to continue in the second quarter. We expect our non-COVID FA revenues to be up on a year-over-year basis as our repositioning gains traction. When combined with the mid-point of the range of COVID revenue, total FA Flex may be up sequentially in the mid-single digits, but down slightly year-over-year on a billing day basis due to the expected decline of COVID revenue.

Direct Hire revenues in the first quarter increased nearly 1% sequentially and 5% year-over-year on a billing day basis. 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 see slight growth sequentially and increase approximately 50% year-over-year in the second quarter as clients demonstrate a high degree of confidence in the recovery through the addition of full-time staff.

We are continuing to invest in strategic initiatives to better position our Firm for long term, sustainable profitable growth. Our most recent significant investment is in our Talent Relationship Management system, which went fully live in the first quarter. Both our CRM and TRM systems 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. The sale of our Corporate Headquarters building announced last week positions us to build out a state of the art facility with a smaller real-estate footprint aligned with how work will be performed in the future deploying a high tech, high touch hybrid operating model. These and many other efforts, will position us for the continued evolution of an operating model that provides maximum flexibility regardless of what lies ahead.

Productivity metrics continue to improve across our experienced associate base. We are very bullish in our long term prospects and also began making selective investments to increase the number of associates in our technology business late last year so that we are able to take advantage of what we believe will be sustained strong growth in the technology staffing market for years to come. Overall capacity currently 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. This allows us the opportunity to continue to invest in growing our resources to address growth beyond 2021.

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 continue to carry the highest Glassdoor rating among our peers and maintain a world class net promoter score from our clients and consultants and are the most recognized firm by technology consultants per SIA.

KFORCE

FIRST QUARTER 2021 FINANCIAL RESULTS
CONFERENCE CALL, MAY 3, 2021
PREPARED REMARKS

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 operating under the circumstances of the past year. I will now turn the call over to Dave Kelly, Kforce's Chief Financial Officer.

DAVID M. KELLY, CHIEF FINANCIAL OFFICER

First quarter revenues of $363.2 million were near the high end of our guidance and the positive trends we are seeing across our business, especially in our technology business, lead us to provide second quarter guidance that significantly exceeds our previous expectations.

Earnings per share of 62 cents in the first quarter grew 47.6% year-over-year. We are also significantly increasing our EPS expectations for the second quarter due to the strength of our revenue growth.

Our gross profit percentage in the quarter of 27.2% decreased 100 basis points year-over-year primarily as a result of a decrease in overall Flex gross profit margins, which also declined by 100 basis points, to 25.2%.

Specific to Technology flex margins, we experienced a 70-basis point decline year-over-year. This decline is partially related to spread compression, which is driven by year-over-year growth in some of our largest clients with a margin profile slightly lower than the average of our tech business as a whole. I should note that as we grow our business with these lower gross margin clients, we are able to continue to expand operating margins as the benefits of scale more than offset the lower gross margins. We also experienced higher payroll taxes in Q1, as states began to raise rates, and also slightly higher healthcare costs versus the first quarter last year.

Sequentially, spreads in our Technology business expanded from Q4 as we continue to have success growing our higher end managed solutions offering.

Flex margins in FA declined 200 basis points year-over-year, with our lower margin COVID project portfolio being the primary contributor to this decline.

As we look forward to Q2, we expect spreads in both our technology and FA businesses to be relatively stable. Should we begin seeing wage inflation within our consultant population, we are confident in our ability to work with our clients to appropriately align bill rates so that they can retain these valuable resources. We believe rising wages is a sign of strengthening demand for technology resources and is a long-term net positive for our business. We also continue to experience success in growing our managed teams and solutions business, which carries roughly 400 basis point higher margins than our technology staffing business. We expect this offering to help stabilize overall Technology spreads and over the longer term create leverage to increase margins and overall profitability.

Flex margins should improve by approximately 150 basis points relative to Q1, principally due to the seasonal alleviation of payroll tax resets that occurred in Q1.

Overall SG&A expenses decreased as a percentage of revenue by 210 basis points year-over-year due to operating leverage provided by our revenue growth, significantly improved associate productivity, lower costs in areas such as travel and office expenses and improving credit trends. These reductions are offsetting higher performance-based pay due to our strong results. SG&A expenses as a percentage of revenue in the second quarter will decline from first quarter levels due primarily to the alleviation of payroll tax costs in Q2 and the $2 million gain on the sale of our headquarters.

Our first quarter operating margin was 5.4%. We believe the improving quality of our revenue stream, continued productivity improvements and ongoing lower structural operating costs will collectively drive continued improvement in profitability levels.

Our effective tax rate in the first quarter was 27.0%.

EBITDA in Q1 was $24.1 million, which represents a 32.1% increase from the first quarter last year. Operating cash flows were $22.4 million in the first quarter. We returned approximately $21 million in capital to our shareholders in the first quarter through $16.2 million in share repurchases and $4.8 million in dividends. We ended the first quarter with $1.3 million in net cash.

As we look forward to the second quarter, there are two items I'd like to discuss in some detail that are assumed in our guidance.

First, as announced last week, we entered into an agreement to sell our corporate headquarters facility for $24 million. This transaction is expected to close in mid-May and generate a roughly $2 million pre-tax gain that will be recorded in SG&A in the second quarter. The agreement includes a leaseback of the building for a period of 18 months. This transaction monetizes an under-utilized asset on our balance sheet. While we expect a negative impact to SG&A of roughly $300,000 per quarter during the brief leaseback period due to increased occupancy costs as a tenant, it is expected to provide $1.5 to $2 million in annual savings thereafter, as we identify a smaller, more technology-enabled footprint in the Tampa Bay area.

The second discrete item impacting second quarter results is an approximately $2 million charge resulting from the termination of our Supplemental Executive Retirement Plan, which is expected to be recorded in Other expense. Our Compensation Committee and Board of Directors made the decision to terminate this plan and eliminate a component of executive compensation not directly linked to performance. The termination will also reduce P&L volatility and eliminate unnecessary expense, given its cost to maintain. In addition to the $2 million charge, our expected effective tax rate for the second quarter of 29.5% reflects the loss of a previously anticipated $750,000 tax benefit related to the SERP. Excluding the tax impact, the SERP charge and gain on sale of the building largely offset each other. Our expected normalized tax rate in Q2 excluding the SERP impact would have been 26.7%.

The higher levels of revenue we are generating and the unpredictability of our COVID revenue stream leads us to continue providing a broader range in our guidance. Our billing days are 64 days in the second quarter, which is one more day than the first quarter and the same number of days as the second quarter of 2020. We expect Q2 revenues to be in the range of $387 million to $397 million and earnings per share to be between $0.87 and $0.95 cents. Gross margins are expected to be between 28.4% and 28.6%, while Flex margins are expected to be between 26.6% and 26.8%. SG&A as a percent of revenue is expected to be between 20.2% and 20.4% and operating margins should be between 7.7% and 8.1%. Weighted average diluted shares outstanding are expected to be approximately 21.4 million for Q2, and, as noted, the anticipated effective tax rate is expected to be 29.5%.

Our guidance does not consider the potential negative impact on the demand environment from a significant increase in COVID-19 variant 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.

Overall, we believe we are in an exceptional place. The strategic decision to focus our business in domestic technology, which is expected to grow organically in Q2 at 15% or greater, positions us for very strong overall revenue growth in Q2 and the foreseeable future. As our revenue mix evolves, we expect COVID-related revenues to decline through Q3 and Q4 and to reach minimal levels by the end of the year. 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. Our shareholders continue to benefit from strong performance and efficient capital allocation, as exhibited by a return on invested capital in excess of 30%. Our predictable cash flows, supplemented by the proceeds from our building sale, provide significant future flexibility to continue making investments in our business and remain active repurchasing our stock at current levels.

FIRST QUARTER 2021 FINANCIAL RESULTS
CONFERENCE CALL, MAY 3, 2021
PREPARED REMARKS

On behalf of our entire management team, I'd like to extend a sincere thank you to our teams for their efforts in outperforming market expectations through the adversity of 2020 and continuing to build on that success in 2021.

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.