KFORCE®

Q3 2018
CONFERENCE CALL

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

Great People = Great Results®

KFORCE

THIRD QUARTER 2018 FINANCIAL RESULTS
CONFERENCE CALL, OCTOBER 31, 2018
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.

I will provide some high-level opening remarks on our third quarter results and the operating environment and will then turn it over to Joe Liberatore, President, who will give greater detail into our operating results and trends and then Dave Kelly, CFO, who will add further color on third quarter results and provide guidance on Q4.

Third quarter revenues of $355.5 million grew 4.2% year-over-year. Growth in our largest business, Tech Flex, continues at above-market levels and grew at 10.3%. Overall revenues, however, fell short of our expectations due primarily to weaker than expected results in our FA Flex and KGS services businesses. We continue to evolve our FA Flex model, as we did with Tech, which Joe will comment on further later in this call. Recent significant KGS awards should accelerate growth beginning in Q1 of 19.

Despite the lower than expected revenues, the Firm continues to generate operating earnings consistent with our previously stated expectations and generate strong cash flows.

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Despite the recent volatility in the market, economic data and client activity suggests that growth in the US economy is strong and business spending is robust and accelerating. The digital transformation of every industry is forcing every organization to increase and sustain their technology investment as competition and the speed of change intensifies. Nontraditional competitors are also entering new end markets; thus, putting increased pressure on companies to invest in innovation and the evolution of their business models. We firmly believe these secular drivers will transcend traditional cyclical patterns as these business models are transformed. Big data, artificial intelligence and machine learning continue to be in high demand, as well as cloud computing, cybersecurity, mobility and digital marketing.

These rapidly changing technologies are also impacting staffing as new tools become available and non-traditional competitors enter the industry. At Kforce, our strategy is to embrace technologies that will enable our associates to focus on serving our customers with trusted relationships. We believe that technology will facilitate enhanced productivity and improved customer service in the sophisticated and complex world of professional and technical staffing. We have already deployed many new tools that are contributing to the improved productivity we are experiencing. There are limited providers with the infrastructure to not only provide quality and timely talent, but to also meet increasingly stringent compliance requirements. These represent significant competitive advantages in today's war for talent. It is people serving people.

While there remains work to do to reaccelerate growth in FA Flex, we are well positioned, with over 70% of our revenues in Tech Flex and with the recent significant awards at KGS.

JOSEPH LIBERATORE, PRESIDENT

The third quarter saw a continuation of strength in our largest business, Tech Flex, which saw an improvement to 10.3% growth on a year-over-year basis. The investments we have made and continue to make in technology and training and the continued refinement of our sales and delivery model have driven above-market revenue growth rates in this business.

We continue to refine the alignment of our sales and delivery talent within our client portfolio and tailoring incentives to the growth that we expect to occur. Fortune 1000 companies continue to be the largest consumers of flexible technology talent. Our revenue growth over the last several quarters has been largely a result of our broader diversification efforts beyond our largest clients and deeper into other Fortune 1000 customers where we have established relationships. This focus on significant users of flexible staffing services has better enabled us to understand the technology issues these more sophisticated and substantial consumers of the services we provide are facing and to craft solutions.

From an industry standpoint, we experienced broad-based growth in 7 of our top 10 industries, including Technology, Financial Services, Professional Services and Retail.

As we look forward to the fourth quarter, weaker than anticipated starts activity and higher conversions during the third quarter will have an impact on near term growth rates. We expect Tech Flex revenues to be relatively flat sequentially, and for year-over-year growth rates to be in the mid to high single digit range on a billing day basis.

Our FA Flex business, which represents roughly 20% of overall revenues, declined 11.8% year-over-year. We have experienced softness in this business as we place greater emphasis on higher bill rate opportunities as we position the business within the skill sets less susceptible to being disrupted long term by technology advancements. Bill rates within FA

Flex have increased 6.4% on a year-over-year basis, which reflects our pursuit of a more balanced mix of higher skilled roles in FA as larger projects end.

We are positioning this business for future growth against a solid demand environment. We expect fourth quarter revenues to be up sequentially on a billing day basis in the low to mid-single digit range as we take advantage of seasonal fluctuations in this business and the ramp of a large project. We expect the year-over-year percentage decline to approximate third quarter levels.

KGS services revenues declined 0.6% year-over-year. KGS' management team has done a solid job building a strong qualified pipeline of new business pursuits. During the quarter, KGS was awarded business having an aggregate contract value of $32.5 million that is expected to be recognized over a period of 5 years. Additionally, late last week, KGS received another sizable award of approximately $150 million, the largest in its history, which is also expected to be recognized over a period of 5 years. Revenues from these new business opportunities were expected to positively impact the third and fourth quarter, however, the awards were delayed, but are expected to accelerate growth in 2019. In the third quarter we also experienced attrition in assignments on existing low margin contracts that, by design, were not backfilled. The combination of award delays and selective attrition resulted in KGS services revenues falling short of our expectations in the third quarter.

KGS product revenues, which are inherently more volatile than its services business, accelerated 95.9% year-over-year. For the fourth quarter, we expect KGS product revenues to be flat with Q3 levels and for total KGS revenues to be up sequentially and flat to slightly down on a year-over-year billing day basis.

Direct Hire revenues, which represent roughly 3% of overall revenues, declined 13.7% year-over-year. 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. This is particularly true in Tech, where hiring managers are increasingly looking for a model that allows them to add flexible consultants that they ultimately convert to full time employees, which may be contributing to both our declines in Tech direct hire and supporting the strong demand for Tech Flex. We have been selective in our investments in this line of business to meet this evolving model. We expect a typical seasonal decrease in the fourth quarter, and year-over-year to be down in the high single to low double digits. Over the long term, we have built our model with the belief that direct hire will continue to decline as a percentage of our entire business.

Our technology and process investments have led to improved productivity of our revenue-generating talent. We have made slight additions to our associate population in the quarter, though we expect headcount levels to remain relatively constant near term. As we refine our model, we continue to identify opportunities for improving productivity, and therefore have not made material additions to associate headcount beyond those areas where productivity levels warrant additions as we believe significant capacity exists to continue to grow revenue at our targeted levels.

Our success is tied to our ability to consistently improve associate productivity by ensuring they are engaging with the right customers and arming them with the best tools and leadership.

I appreciate our team's efforts as we continue to move 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.

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DAVID M. KELLY, CHIEF FINANCIAL OFFICER

Revenues of $355.5 million in the quarter grew 4.2% year-over-year and earnings per share of 64 cents improved 60% year-over-year on a GAAP basis and 42% on a non-GAAP basis. For comparison purposes, we have provided a reconciliation between GAAP and non-GAAP results for the third quarter of 2017, in our press release.

Our gross profit percentage in the quarter of 29.4% declined 120 basis points year-over-year, primarily related to a decline in the mix of Direct Hire and a 110 basis point year-over-year decline in our Flex gross profit percentage to 26.7%. Staffing bill/pay spreads have held up well, though increased healthcare costs and competitive pricing pressures in our KGS services business have driven down Flex margins overall.

Tech Flex margins of 26.5% declined 50 basis points year-over-year and FA Flex margins of 29.0% were flat on a year-over-year basis. Contributing to the decline in Tech were elevated healthcare costs in the quarter. Additionally, after experiencing slight spread improvement throughout the year due to success in our account diversification efforts, we saw a slight compression in spread this quarter. This was driven due to higher revenue growth in several of our largest accounts, which have a slightly lower margin profile, as well as an acceleration in pay rates overall. Pay rates in Tech have increased 5.1% year over year, which is a bit faster than the 4.6% increase we have seen in bill rates. Both pay and bill rate increases have accelerated slightly from Q2 levels. Looking forward to the fourth quarter, we may see further compression in spreads as a result of the continued strong growth in the large accounts I mentioned. In Q4, overall spreads will also be negatively impacted by seasonal paid time off.

SG&A expenses as a percent of revenue declined 160 basis points year-over-year to 22.4% in the third quarter of 2018, which is a historic low for our Firm. We continue to make significant progress in generating SG&A leverage by improving the productivity of our associates and exercising solid control over discretionary expenses. These actions have allowed us to increase our investments in technology while also improving operating margins. Looking forward to Q4, we expect SG&A dollar expense to be flat sequentially and continue to be down on a year-over-year basis. SG&A expenses in Q4 contemplate continued increased investments in technology, with a focus on improving the candidate and consultant experience and further expanding our business intelligence capabilities.

Third quarter 2018 operating margins of 6.4% improved 40 basis points year-over-year and is where we would expect at these revenue levels. During this economic cycle, our gross margin percentage has declined by 230 basis points. Despite this compression, operating margins have improved by 450 basis points. We are very pleased with the progress we have made and are firmly on track to reach our next milestone of 7.5% operating margins when quarterly revenues exceed $400 million.

Our effective tax rate in the third quarter was 25.2%. As it relates to our effective income tax rate in Q4, we expect this will track close to levels seen in the first half of 2018, excluding the impact of any excess tax benefits that may be recorded and any impact from the anticipated changes in tax regulations related to the deductibility of executive compensation.

With respect to our balance sheet and cash flows, operating cash flows in the third quarter of $26.4 million were very strong. Capital expenditures in the third quarter were $900,000. We decreased outstanding borrowings under our Credit Facility by

$21.3 million in the quarter. Long term debt under our Credit Facility at the end of September was $79.3 million and less than 0.9 times trailing twelve-months EBITDA.

Our healthy cash flows, strong balance sheet and $300 million Credit Facility collectively provide significant flexibility if we were to identify strategic or tuck-in acquisitions or partnerships.

Additionally, our Board of Directors recently approved an increase to our share buyback authorization to $100 million which, along with the 50% increase in our dividend last quarter, allows us to continue returning cash to our shareholders and maintaining flexibility to take action if there are dislocations between our stock price and performance. Based upon our current stock price, our dividend yield of 2% represents significant value for our shareholders.

Looking forward, there are 62 billing days in Q4, which is one day less than Q3 2018 and one day more than Q4 2017. Revenue per billing day in the third quarter of 2018 was $5.6 million. With respect to guidance, we expect Q4 revenues to be in the range of $349 million to $354 million and for earnings per share to be between 56 and 58 cents. Gross margins are expected to be between 28.8% and 29.0%, while Flex margins are expected to be between 26.4% and 26.6%. SG&A as a percent of revenue is expected to be between 22.6% and 22.8% and operating margins should be between 5.6% and 5.8%. Guidance assumes an effective tax rate of 25.5%. Weighted average diluted shares outstanding are expected to be approximately 25.2 million for Q4.

This guidance does not consider the effect, if any, of charges related to the impairment of intangible assets, 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 pleased with the above-market performance in our Tech Flex business and are optimistic about our KGS services business as a result of their recent wins. We believe we are on the right path to addressing the challenges in our FA business. The market for our services remains strong and we remain confident that we have built a solid foundation for sustained revenue growth and continued improvements in profitability which will lead to operating margins of at least 7.5% in a quarter, without seasonality impacts, where revenues reach $400 million.