

KFORCE INC  
Form 10-Q  
July 31, 2013  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2013

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-26058

**Kforce Inc.**

(Exact name of registrant as specified in its charter)

Edgar Filing: KFORCE INC - Form 10-Q

**FLORIDA**  
(State or other jurisdiction of  
incorporation or organization)

**59-3264661**  
(I.R.S. Employer  
Identification No.)

**1001 East Palm Avenue**

**TAMPA, FLORIDA**  
(Address of principal executive offices)

**33605**  
(Zip-Code)

**Registrant's telephone number, including area code: (813) 552-5000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

The number of shares outstanding of the registrant's common stock as of July 29, 2013, was 33,531,653.

**Table of Contents****KFORCE INC.****QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED JUNE 30, 2013****TABLE OF CONTENTS****PART I FINANCIAL INFORMATION**

Item 1.	<u>Financial Statements.</u>	3
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	16
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk.</u>	27
Item 4.	<u>Controls and Procedures.</u>	27

**PART II OTHER INFORMATION**

Item 1.	<u>Legal Proceedings.</u>	28
Item 1A.	<u>Risk Factors.</u>	28
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>	28
Item 3.	<u>Defaults Upon Senior Securities.</u>	28
Item 4.	<u>Mine Safety Disclosures.</u>	28
Item 5.	<u>Other Information.</u>	28
Item 6.	<u>Exhibits.</u>	29

**SIGNATURES**

30

**SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS**

References in this document to the Registrant, Kforce, we, the Firm, our or us refer to Kforce Inc. and its subsidiaries, except where the context otherwise requires or indicates.

This report, particularly Part I. Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) and Part II. Item 1A. Risk Factors, and the documents we incorporate into this report contain certain statements that are, or may be deemed to be, forward-looking statements 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 (the Exchange Act ), and are made in reliance upon the protections provided by such acts for forward-looking statements. Such statements may include, but may not be limited to, projections of revenue, income, losses, cash flows, capital expenditures, future prospects, anticipated costs and benefits of proposed (or future) acquisitions, integration of acquisitions, transition of divestitures, plans for future operations, capabilities of business operations, effects of interest rate variations, our ability to obtain financing and favorable terms, financing needs or plans, plans relating to services of Kforce, estimates concerning the effects of litigation or other disputes, estimates concerning our ability to collect on our accounts receivable, expectations of the economic environment, developments within the staffing sector including, but not limited to, the penetration rate and growth in temporary staffing, estimates concerning goodwill impairment, as well as assumptions as to any of the foregoing and all statements that are not based on historical fact but rather reflect our current expectations concerning future results and events. For a further list and description of various risks, relevant factors and uncertainties that could cause future results or events to differ materially from those expressed or implied in our forward-looking statements, see the Risk Factors and MD&A sections. In addition, when used in this discussion, the terms anticipates, estimates, expects, intends, plans, believes, will, may, could, variations thereof and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted. Future events and actual results could differ materially from those set forth in or underlying the forward-looking statements. Readers are cautioned not to place undue reliance on any forward-looking statements contained in this report, which speak only as of the date of this report. Kforce undertakes no obligation to publicly publish the results of any adjustments to these forward-looking statements that may be made to reflect events on or after the date of this report or to reflect the occurrence of unexpected events.

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****KFORCE INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****AND COMPREHENSIVE INCOME (LOSS)***(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)*

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2013</b>	<b>June 30, 2012</b>	<b>June 30, 2013</b>	<b>June 30, 2012</b>
Net service revenues	\$ 283,689	\$ 274,129	\$ 549,316	\$ 542,479
Direct costs of services	190,842	184,363	373,133	371,888
Gross profit	92,847	89,766	176,183	170,591
Selling, general and administrative expenses	78,503	71,414	154,196	179,529
Goodwill impairment		65,300		65,300
Depreciation and amortization	2,462	2,877	4,859	5,759
Income (loss) from operations	11,882	(49,825)	17,128	(79,997)
Other expense, net	205	265	461	657
Income (loss) from continuing operations before income taxes	11,677	(50,090)	16,667	(80,654)
Income tax expense (benefit)	4,729	(16,908)	6,625	(29,745)
Income (loss) from continuing operations	6,948	(33,182)	10,042	(50,909)
Income from discontinued operations, net of taxes		15		21,818
Net income (loss)	6,948	(33,167)	10,042	(29,091)
Other comprehensive income:				
Defined benefit pension and postretirement plans, net of tax	34	53	68	127
Comprehensive income (loss)	\$ 6,982	\$ (33,114)	\$ 10,110	\$ (28,964)
Earnings (loss) per share basic:				
From continuing operations	\$ 0.21	\$ (0.90)	\$ 0.29	\$ (1.43)
From discontinued operations		0.00		0.61
Earnings (loss) per share basic	\$ 0.21	\$ (0.90)	\$ 0.29	\$ (0.82)
Earnings (loss) per share diluted:				
From continuing operations	\$ 0.21	\$ (0.90)	\$ 0.29	\$ (1.43)
From discontinued operations		0.00		0.61
Earnings (loss) per share diluted	\$ 0.21	\$ (0.90)	\$ 0.29	\$ (0.82)

Edgar Filing: KFORCE INC - Form 10-Q

Weighted average shares outstanding	basic	33,754	36,712	34,073	35,665
Weighted average shares outstanding	diluted	33,859	36,712	34,172	35,665

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE UNAUDITED  
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

**Table of Contents****KFORCE INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS***(IN THOUSANDS)*

	June 30, 2013	December 31, 2012
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 1,064	\$ 1,381
Trade receivables, net of allowances of \$2,266 and \$2,153, respectively	164,713	151,570
Income tax refund receivable	5,197	1,750
Deferred tax assets, net	7,985	9,494
Prepaid expenses and other current assets	11,145	7,364
<b>Total current assets</b>	<b>190,104</b>	<b>171,559</b>
Fixed assets, net	36,061	34,883
Other assets, net	29,571	28,038
Deferred tax assets, net	20,668	21,523
Intangible assets, net	5,355	5,736
Goodwill	63,410	63,410
<b>Total assets</b>	<b>\$ 345,169</b>	<b>\$ 325,149</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities:		
Accounts payable and other accrued liabilities	\$ 31,074	\$ 36,205
Accrued payroll costs	52,565	50,063
Other current liabilities	11,678	11,564
Income taxes payable	173	1,042
<b>Total current liabilities</b>	<b>95,490</b>	<b>98,874</b>
Long-term debt – credit facility	50,113	21,000
Long-term debt – other	1,595	1,144
Other long-term liabilities	37,545	34,285
<b>Total liabilities</b>	<b>184,743</b>	<b>155,303</b>
Commitments and contingencies		
Stockholders' Equity:		
Preferred stock, \$0.01 par; 15,000 shares authorized, none issued and outstanding		
Common stock, \$0.01 par; 250,000 shares authorized, 68,908 and 68,531 issued, respectively	689	685
Additional paid-in capital	401,709	400,688
Accumulated other comprehensive loss	(2,645)	(2,713)
Retained earnings	50,245	40,203
Treasury stock, at cost; 35,388 and 33,980 shares, respectively	(289,572)	(269,017)
<b>Total stockholders' equity</b>	<b>160,426</b>	<b>169,846</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 345,169</b>	<b>\$ 325,149</b>

Edgar Filing: KFORCE INC - Form 10-Q

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE UNAUDITED  
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

**Table of Contents**

**KFORCE INC. AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENT**  
**OF CHANGES IN STOCKHOLDERS' EQUITY**  
*(IN THOUSANDS)*

	<b>Six Months Ended June 30, 2013</b>
<b>Common stock – shares:</b>	
Shares at beginning of period	68,531
Issuance of restricted stock, net of forfeitures	349
Exercise of stock options	28
<b>Shares at end of period</b>	<b>68,908</b>
<b>Common stock – par value:</b>	
Balance at beginning of period	\$ 685
Issuance of restricted stock, net of forfeitures	4
Exercise of stock options	
<b>Balance at end of period</b>	<b>\$ 689</b>
<b>Additional paid-in capital:</b>	
Balance at beginning of period	\$ 400,688
Issuance of restricted stock, net of forfeitures	(4)
Exercise of stock options	237
Income tax benefit from stock-based compensation	48
Employee stock purchase plan	139
Stock-based compensation expense	601
<b>Balance at end of period</b>	<b>\$ 401,709</b>
<b>Accumulated other comprehensive loss:</b>	
Balance at beginning of period	\$ (2,713)
Pension and postretirement plans, net of tax	68
<b>Balance at end of period</b>	<b>\$ (2,645)</b>
<b>Retained earnings:</b>	
Balance at beginning of period	\$ 40,203
Net income	10,042
<b>Balance at end of period</b>	<b>\$ 50,245</b>
<b>Treasury stock – shares:</b>	
Shares at beginning of period	33,980
Repurchases of common stock	1,429
Employee stock purchase plan	(21)
<b>Shares at end of period</b>	<b>35,388</b>



Edgar Filing: KFORCE INC - Form 10-Q

Treasury stock cost:		
Balance at beginning of period	\$	(269,017)
Repurchases of common stock		(20,722)
Employee stock purchase plan		167
Balance at end of period	\$	(289,572)

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE UNAUDITED  
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

**Table of Contents****KFORCE INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS***(IN THOUSANDS)*

	<b>Six Months Ended</b>	
	<b>June 30, 2013</b>	<b>June 30, 2012</b>
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 10,042	\$ (29,091)
Adjustments to reconcile net income (loss) to cash (used in) provided by operating activities:		
Gain on sale of discontinued operations		(36,624)
Goodwill impairment		65,300
Deferred income tax provision, net	2,321	(17,349)
Depreciation and amortization	4,859	5,832
Stock-based compensation	601	25,649
Provision for bad debts on accounts receivable and other accounts receivable reserves	535	2,124
Pension and postretirement benefit plans expense	1,878	2,266
Deferred compensation liability increase, net	1,445	1,126
Tax benefit attributable to stock-based compensation	48	1,809
Excess tax benefit attributable to stock-based compensation	(25)	(1,789)
Gain on cash surrender value of Company-owned life insurance policies	(1,482)	(690)
Other	82	86
(Increase) decrease in operating assets:		
Trade receivables, net	(13,678)	(23,804)
Income tax receivable	(3,447)	145
Prepaid expenses and other current assets	(3,781)	(4,532)
Other assets, net	86	49
Increase (decrease) in operating liabilities:		
Accounts payable and other current liabilities	(2,718)	15,708
Accrued payroll costs	2,807	2,362
Income taxes payable	(870)	622
Other long-term liabilities	51	(1,493)
 Cash (used in) provided by operating activities	 (1,246)	 7,706
 <b>Cash flows from investing activities:</b>		
Capital expenditures	(4,215)	(2,868)
Proceeds from disposition of business		48,326
Proceeds from the sale of assets held within the Rabbi Trust	1,596	734
Purchase of assets held within the Rabbi Trust	(1,864)	(1,088)
 Cash (used in) provided by investing activities	 (4,483)	 45,104
 <b>Cash flows from financing activities:</b>		
Proceeds from bank line of credit	282,485	216,864
Payments on bank line of credit	(253,372)	(255,398)
Short-term vendor financing	39	908
Proceeds from exercise of stock options, net of shares tendered in payment of the exercise price of stock options	237	148
Excess tax benefit attributable to stock-based compensation	25	1,789
Repurchases of common stock	(23,219)	(16,300)
Payments of capital expenditure financing	(783)	(948)

Edgar Filing: KFORCE INC - Form 10-Q

Cash provided by (used in) financing activities	5,412	(52,937)
Decrease in cash and cash equivalents	(317)	(127)
Cash and cash equivalents at beginning of period	1,381	939
Cash and cash equivalents at end of period	\$ 1,064	\$ 812
<b>Supplemental Cash Flow Information:</b>		
Cash paid (received) during the period for:		
Income taxes, net	\$ 8,648	\$ 2,698
Interest, net	\$ 323	\$ 263
<b>Non-Cash Transaction Information:</b>		
Employee stock purchase plan	\$ 306	\$ 379
Equipment acquired under capital leases	\$ 1,396	\$ 265
Capital expenditures not yet paid	\$	\$ 345
Shares tendered in payment of the exercise price of stock options	\$	\$ 161

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE UNAUDITED

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

---

**Table of Contents**

**KFORCE INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

*(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)*

**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Organization and Nature of Operations***

Kforce Inc. and subsidiaries (collectively, Kforce) provide professional staffing services and solutions to customers in the following segments: Technology (Tech), Finance and Accounting (FA), Health Information Management (HIM) and Government Solutions (GS). Kforce provides flexible staffing services and solutions on both a temporary and full-time basis. Kforce operates through its corporate headquarters in Tampa, Florida and 61 field offices located throughout the United States (the U.S.). Additionally, one of our subsidiaries, Kforce Global Solutions, Inc. (Global), provides information technology outsourcing services internationally through an office in Manila, Philippines. Our international operations constituted approximately 2% of net service revenues for both the six months ended June 30, 2013 and 2012 and are included in our Tech segment.

Kforce serves clients from the Fortune 1000, the Federal Government, state and local governments, local and regional companies and small to mid-sized companies.

***Basis of Presentation***

The unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) regarding interim financial reporting. Accordingly, certain information and footnotes normally required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements have been condensed or omitted pursuant to those rules and regulations, although Kforce believes that the disclosures made are adequate to make the information not misleading. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012. In management's opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments) considered necessary for a fair presentation of our financial condition as of June 30, 2013, our results of operations for the three and six months ended June 30, 2013 and our cash flows for the six months ended June 30, 2013. The condensed consolidated balance sheet as of December 31, 2012 was derived from our audited consolidated balance sheet as of December 31, 2012, as presented in our 2012 Annual Report on Form 10-K.

Our quarterly operating results are affected by the number of billing days in a quarter and the seasonality of our customers' businesses. In addition, we experience an increase in direct costs of services and a corresponding decrease in gross profit in the first fiscal quarter of each year as a result of certain U.S. state and federal employment tax resets. Thus, the results of operations for any interim period are not necessarily indicative of, nor comparable to, the results of operations for a full year.

***Principles of Consolidation***

The condensed consolidated financial statements include the accounts of Kforce Inc. and its wholly-owned subsidiaries. References in this document to Kforce, the Company, we, the Firm, our or us refer to Kforce Inc. and its subsidiaries, except where the context indicates otherwise. All intercompany transactions and balances have been eliminated in consolidation.

***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most important of these estimates and assumptions relate to the following: accounting for goodwill and identifiable intangible assets and any related impairment; stock-based compensation; obligations for pension and postretirement benefit plans; expected annual commission rates; self-insured liabilities for workers' compensation and health insurance; allowance for doubtful accounts, fallouts and other accounts receivable reserves and accounting for income taxes. Although these and other estimates and assumptions are based on the best available information, actual results could be materially different from these estimates.



**Table of Contents****Earnings per Share**

Basic earnings per share is computed as earnings divided by the weighted average number of common shares outstanding during the period. Basic weighted average shares outstanding exclude unvested shares of restricted stock ( RS ) and performance-accelerated restricted stock ( PARS ). Diluted earnings per common share is computed by dividing the earnings attributable to common shareholders for the period by the weighted average number of common shares outstanding during the period plus the dilutive effect of stock options and other potentially dilutive securities such as unvested shares of RS and PARS using the treasury stock method, except where the effect of including potential common shares would be anti-dilutive.

The following table sets forth the computation of basic and diluted earnings (loss) per share for the three and six months ended June 30:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Numerator:</b>				
Income (loss) from continuing operations	\$ 6,948	\$ (33,182)	\$ 10,042	\$ (50,909)
Income from discontinued operations, net of tax		15		21,818
Net income (loss)	\$ 6,948	\$ (33,167)	\$ 10,042	\$ (29,091)
<b>Denominator:</b>				
Weighted average shares outstanding basic	33,754	36,712	34,073	35,665
Common stock equivalents	105		99	
Weighted average shares outstanding diluted	33,859	36,712	34,172	35,665
<b>Earnings (loss) per share basic:</b>				
From continuing operations	\$ 0.21	\$ (0.90)	\$ 0.29	\$ (1.43)
From discontinued operations		0.00		0.61
Earnings (loss) per share basic	\$ 0.21	\$ (0.90)	\$ 0.29	\$ (0.82)
<b>Earnings (loss) per share diluted:</b>				
From continuing operations	\$ 0.21	\$ (0.90)	\$ 0.29	\$ (1.43)
From discontinued operations		0.00		0.61
Earnings (loss) per share diluted	\$ 0.21	\$ (0.90)	\$ 0.29	\$ (0.82)

For both the three months and six months ended June 30, 2013, there were no shares of common stock excluded from the computation of dilutive earnings (loss) per share because their inclusion would have had an anti-dilutive effect on earnings per share. Given that Kforce had a loss from continuing operations for the three and six months ended June 30, 2012, the calculations of diluted earnings (loss) per share from continuing operations, discontinued operations and net (loss) income is computed using basic weighted average common shares outstanding.

**Table of Contents****Note B Discontinued Operations**

On March 17, 2012, Kforce entered into a Stock Purchase Agreement (the SPA) to sell all of the issued and outstanding stock of Kforce Clinical Research, Inc. (KCR) to inVentiv Health, Inc. (Purchaser). On March 31, 2012 (Closing Date), the Firm closed the sale of KCR to the Purchaser for a total cash purchase price of \$57,335, after giving effect to a \$7,335 post-closing working capital adjustment.

In connection with the closing of the sale, Kforce entered into a Transition Services Agreement (TSA) with the Purchaser to provide certain post-closing transitional services for a period not to exceed 18 months from the Closing Date. Services provided by Kforce under the TSA had ceased during the three months ended June 30, 2013. The fees for a significant majority of the services under the TSA were generally equivalent to Kforce's cost.

In accordance with the SPA, Kforce is obligated to indemnify the Purchaser for certain losses, as defined, in excess of \$375 although this deductible does not apply to certain losses. Kforce's obligations under the indemnification provisions of the SPA, with the exception of certain items, cease 18 months from the Closing Date and are limited to an aggregate of \$5,000 although this cap does not apply to certain losses. While it cannot be certain, Kforce believes any exposure under the indemnification provisions is remote and, as a result, has not recorded a liability as of June 30, 2013.

The financial results of KCR have been presented as discontinued operations in the accompanying unaudited condensed consolidated statements of operations and comprehensive income (loss). The following summarizes the results from discontinued operations for the three and six months ended June 30, 2012:

	Three Months Ended June 30, 2012	Six Months Ended June 30, 2012
Net service revenues	\$	\$ 29,649
Direct costs of services and operating expenses	(36)	26,408
	36	3,241
Gain on sale of discontinued operations		36,624
Income from discontinued operations, before income taxes	36	39,865
Income tax expense	21	18,047
Income from discontinued operations, net of income taxes	\$ 15	\$ 21,818

Additionally, in connection with the servicing of the TSA, as of December 31, 2012, approximately \$2,658 was due to the Purchaser from Kforce and is classified within accounts payable and other accrued liabilities in the unaudited condensed consolidated balance sheet. Services under the TSA had ceased during the three months ended June 30, 2013.

*Acceleration of Equity Awards*

In connection with the disposition of KCR as described above, the Board exercised its discretion, as permitted within the Kforce Inc. 2006 Stock Incentive Plan, to accelerate the vesting for tax planning purposes of substantially all of the outstanding and unvested RS, PARS and alternative long-term incentive awards (ALTI) effective March 31, 2012. Kforce recognized a tax benefit from the acceleration of the vesting of RS, PARS and ALTI. The acceleration resulted in the recognition of previously unrecognized compensation expense during the quarter ended March 31, 2012 of \$31,297, which includes \$784 of payroll taxes. This expense has been classified in selling, general and administrative expenses in the accompanying unaudited condensed consolidated statements of operations and comprehensive income (loss).

---

**Table of Contents****Note C Commitments and Contingencies*****Litigation***

As disclosed in our previous filings with the SEC, Kforce was a defendant in a California class action lawsuit alleging misclassification of California Account Managers and seeking unspecified damages. The tentative settlement referred to in our Annual Report on Form 10-K for the year ended December 31, 2010 was approved by the California court during the three months ended June 30, 2011 in the amount of \$2,526, which was recorded within accounts payable and other accrued liabilities in the accompanying consolidated balance sheet as of December 31, 2012. The full settlement was paid by Kforce to the independent third-party settlement administrator during the three months ended June 30, 2013.

On June 18, 2013, Kforce, along with other staffing firms, was named as a defendant in a class action lawsuit filed in the Orange County Superior Court of the State of California. The complaint alleges that a class of current and former Kforce employees working in California was denied compensation for the time they spent interviewing with current and potential clients of Kforce, over a period covering four years prior to the filing of the complaint. The plaintiff seeks recovery in an unspecified amount for this alleged unpaid compensation, the alleged failure of Kforce to provide them with accurate wage statements, the alleged improper use of debit cards as an employee payment mechanism in certain circumstances, alleged unfair competition, and statutory penalties, attorney's fees and other damages. At this stage of the litigation, it is not feasible to predict the outcome or a range of loss, should a loss occur. Accordingly, no amounts have been provided for in Kforce's Financial Statements. Kforce believes it has meritorious defenses to the allegations and intends to vigorously defend the matter.

In the ordinary course of its business, Kforce is from time to time threatened with litigation or named as a defendant in various lawsuits and administrative proceedings. While management does not expect any of these other matters to have a material adverse effect on the Company's results of operations, financial position or cash flows, litigation is subject to certain inherent uncertainties. Kforce maintains liability insurance in such amounts and with such coverage and deductibles as management believes is reasonable. The principal liability risks that Kforce insures against are workers' compensation, personal injury, bodily injury, property damage, directors' and officers' liability, errors and omissions, employment practices liability and fidelity losses. There can be no assurance that Kforce's liability insurance will cover all events or that the limits of coverage will be sufficient to fully cover all liabilities.

Kforce is not aware of any litigation that would reasonably be expected to have a material effect on its unaudited results of operations, its cash flows or its financial condition.

***Employment Agreements***

Kforce has entered into employment agreements with certain executives that provide for minimum compensation, salary and continuation of certain benefits for a six-month to a three-year period under certain circumstances. Certain of the agreements also provide for a severance payment of one to three times annual salary and one half to three times average annual bonus if such an agreement is terminated without good cause by the employer or for good reason by the employee. These agreements contain certain post-employment restrictive covenants. Kforce's liability at June 30, 2013 would be approximately \$41,725 if all of the employees under contract were terminated without good cause by the employer or if the employees resigned for good reason following a change in control. Kforce's liability at June 30, 2013 would be approximately \$11,832 if all of the employees under contract were terminated by Kforce without good cause or if the employees resigned for good reason in the absence of a change of control.

Kforce has not recorded any liability related to the employment agreements as no events have occurred that would require payment under the agreements.

**Note D Employee Benefit Plans*****Alternative Long-Term Incentive***

On January 3, 2012, Kforce granted to certain executive officers an ALTI as the result of certain performance criteria established in 2011 being met, which was to be initially measured over three tranches having periods of 12, 24, and 36 months. The terms of the grants specified that the ultimate annual payouts will be based on: (a) Kforce's common stock price changes each year relative to its peer group, or (b) based upon the achievement of other market conditions contained in the terms of the award.

As discussed within Note B Discontinued Operations, the Board approved the acceleration of all outstanding and unvested long-term incentives, including the ALTI, effective March 31, 2012. During the three and six months ended June 30, 2012, Kforce recognized total compensation



## Edgar Filing: KFORCE INC - Form 10-Q

expense related to the ALTI of \$0 and \$9,805, respectively, which approximated the grant date fair value. There was no compensation expense related to the ALTI recognized during the three or six months ended June 30, 2013.

### ***Foreign Pension Plan***

Kforce maintains a foreign defined benefit pension plan for eligible employees of the Philippine branch of Global that is required by Philippine labor law. The plan defines retirement as those employees who have attained the age of 60 and have completed at least five years of credited service. Benefits payable under the plan equate to one-half month's salary for each year of credited service. Benefits under the plan are paid out as a lump sum to eligible employees at retirement.

**Table of Contents**

The net periodic benefit cost recognized for the three and six months ended June 30, 2013 and 2012 was based upon the actuarial valuation at the beginning of the respective fiscal year. The significant assumptions used by Kforce in the actuarial valuation include the discount rate, the estimated rate of future annual compensation increases and the estimated turnover rate. As of December 31, 2012 and 2011, the discount rate used to determine the actuarial present value of the projected benefit obligation and pension expense was 6.0% and 7.4%, respectively. The discount rate was determined based on long-term Philippine government securities yields commensurate with the expected payout of the benefit obligation. The estimated rate of future annual compensation increases as of both December 31, 2012 and 2011 was 3.0 % and 5.0%, respectively, and was based on historical compensation increases as well as future expectations. Kforce applies a turnover rate to the specific age of each group of employees, which ranges from 20 to 64 years of age. For the three and six months ended June 30, 2013, net periodic benefit cost was \$34 and \$70, respectively. For the three and six months ended June 30, 2012, net periodic benefit cost was \$96 and \$190, respectively.

As of June 30, 2013 and December 31, 2012, the projected benefit obligation associated with our foreign defined benefit pension plan was \$1,217 and \$1,187, respectively, which is classified in other long-term liabilities.

**Supplemental Executive Retirement Plan**

Kforce maintains a Supplemental Executive Retirement Plan (the SERP ) for the benefit of certain executive officers. The primary goals of the SERP are to create an additional wealth accumulation opportunity, restore lost qualified pension benefits due to government limitations and retain our covered executive officers. The SERP is a non-qualified benefit plan and does not include elective deferrals of covered executive officers' compensation.

Normal retirement age under the SERP is defined as age 65; however, certain conditions allow for early retirement as early as age 55 or upon a change in control. Vesting under the plan is defined as 100% upon a participant's attainment of age 55 and 10 years of service and 0% prior to a participant's attainment of age 55 and 10 years of service. Full vesting also occurs if a participant with five years or more of service is involuntarily terminated by Kforce without cause or upon death, disability or a change in control. The SERP is funded entirely by Kforce, and benefits are taxable to the covered executive officer upon receipt and deductible by Kforce when paid. Benefits payable under the SERP upon the occurrence of a qualifying distribution event, as defined, are targeted at 45% of the covered executive officers' average salary and bonus, as defined, from the three years in which the executive officer earned the highest salary and bonus during the last 10 years of employment, which is subject to adjustment for retirement prior to the normal retirement age and the participant's vesting percentage. The benefits under the SERP are reduced for a participant that has not reached age 62 with 10 years of service or age 55 with 25 years of service with a percentage reduction up to the normal retirement age.

Benefits under the SERP are normally paid based on the lump sum present value but may be paid over the life of the covered executive or 10-year annuity, as elected by the covered executive officer upon commencement of participation in the SERP. None of the benefits earned pursuant to the SERP are attributable to services provided prior to the effective date of the plan. For purposes of the measurement of the benefit obligation, Kforce has assumed that all participants will elect to take the lump sum present value option.

The following represents the components of net periodic benefit cost for the three and six months ended:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Service cost	\$ 545	\$ 521	\$ 1,090	\$ 1,043
Interest cost	117	140	234	280
Amortization of actuarial loss	29	42	58	82
Net periodic benefit cost	\$ 691	\$ 703	\$ 1,382	\$ 1,405

The net periodic benefit cost recognized for the three and six months ended June 30, 2013 was based upon the actuarial valuation at the beginning of the year, which utilized the assumptions noted in our Annual Report on Form 10-K for the year ended December 31, 2012. There is no requirement for Kforce to fund the SERP and, as a result, no contributions were made to the SERP during the six months ended June 30, 2013. Kforce does not currently anticipate funding the SERP during the year ending December 31, 2013.



**Table of Contents**

The Firm previously announced the retirement of a participant in the SERP. The Firm anticipates making a lump-sum payment to the participant on or about December 1, 2013 due to the participant's separation from service on June 1, 2013. Accordingly, the current portion of the present value of the projected benefit obligation of \$10,682 as of June 30, 2013 and December 31, 2012, is recorded in other current liabilities in the accompanying unaudited condensed consolidated balance sheets. The long-term portion of the present value of the projected benefit obligation as of June 30, 2013 and December 31, 2012 is \$10,300 and \$8,976, respectively, and is recorded in other long-term liabilities in the accompanying unaudited condensed consolidated balance sheets. During the six months ended June 30, 2013, there have been no payments made under the SERP.

**Supplemental Executive Retirement Health Plan**

Kforce maintains a Supplemental Executive Retirement Health Plan (SERHP) to provide postretirement health and welfare benefits to certain executives. The vesting and eligibility requirements mirror that of the SERP, and no advance funding is required by Kforce or the participants. Consistent with the SERP, none of the benefits earned are attributable to services provided prior to the effective date of the plan.

The following represents the components of net periodic postretirement benefit cost for the three and six months ended:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Service cost	\$ 173	\$ 230	\$ 345	\$ 460
Interest cost	33	37	67	75
Amortization of actuarial loss	26	69	51	136
Net periodic benefit cost	\$ 232	\$ 336	\$ 463	\$ 671

The net periodic post-retirement benefit cost recognized for the three and six months ended June 30, 2013 was based upon the actuarial valuation at the beginning of the year, which utilized the assumptions noted in our Annual Report on Form 10-K for the year ended December 31, 2012.

The long-term portion of the accumulated postretirement benefit obligation as of June 30, 2013 and December 31, 2012 is \$3,966 and \$3,554, respectively, and is recorded in other long-term liabilities in the accompanying unaudited condensed consolidated balance sheets. During the six months ending June 30, 2013, there have been no payments made under the SERHP.

**Note E Fair Value Measurements**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., an exit price) in an orderly transaction between market participants at the measurement date. It establishes a fair value hierarchy and a framework which requires categorizing assets and liabilities into one of three levels based on the assumptions (inputs) used in valuing the asset or liability. Level 1 provides the most reliable measure of fair value, while Level 3 generally requires significant management judgment. Level 1 inputs are unadjusted, quoted market prices in active markets for identical assets or liabilities. Level 2 inputs are observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in inactive markets. Level 3 inputs include unobservable inputs that are supported by little, infrequent, or no market activity and reflect management's own assumptions about inputs used in pricing the asset or liability. The Company uses the following valuation techniques to measure fair value.

The underlying investments within Kforce's deferred compensation plans have included money market funds and bond mutual funds. The assets previously invested in bond mutual funds as of December 31, 2012 are now held in a money market fund as of June 30, 2013. Assets held within the money market funds and bond mutual funds are measured on a recurring basis and are recorded at fair value based on each fund's quoted market value per share in an active market, which is considered a Level 1 input.

Certain assets, in specific circumstances, are measured at fair value on a non-recurring basis utilizing Level 3 inputs such as goodwill, other intangible assets and other long-lived assets. For these assets, measurement at fair value in periods subsequent to their initial recognition would be applicable if one or more of these assets were determined to be impaired.



**Table of Contents**

There were no transfers into or out of Level 1, 2 or 3 assets during the six months ended June 30, 2013. Kforce's measurements at fair value as of June 30, 2013 and December 31, 2012 were as follows:

Assets/(Liabilities) Measured at Fair Value:	Asset/(Liability)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>As of June 30, 2013:</i>				
Recurring basis:				
Money market funds	\$ 2,549	\$ 2,549	\$	\$
Credit Facility (1)	\$ (50,113)	\$	\$ (50,113)	\$
<i>As of December 31, 2012:</i>				
Recurring basis:				
Bond mutual funds	\$ 4,124	\$ 4,124	\$	\$
Credit Facility (1)	\$ (21,000)	\$	\$ (21,000)	\$

(1) The estimated fair value of our Credit Facility is determined using a discounted cash flow analysis, considered a level 2 input.

**Note F Stock Incentive Plans**

On April 5, 2013, the shareholders approved the 2013 Stock Incentive Plan, which was previously adopted by the Board of Directors on March 1, 2013, subject to shareholder approval. The aggregate number of shares of common stock that are subject to awards under the 2013 Stock Incentive Plan, subject to adjustment upon a change in capitalization, is 4,000. On June 20, 2006, the shareholders approved the 2006 Stock Incentive Plan and, as amended, the aggregate number of shares of common stock that are subject to awards is 7,850.

The 2013 Stock Incentive Plan and 2006 Stock Incentive Plan allow for the issuance of stock options, stock appreciation rights (SARs), PARS and RS, subject to share availability. Vesting of equity instruments is determined on a grant-by-grant basis. Options expire at the end of 10 years from the date of grant, and Kforce issues new shares upon exercise of options.

The 2013 Stock Incentive Plan terminates on April 5, 2023 and the 2006 Stock Incentive Plan terminates on April 28, 2016. The Incentive Stock Option Plan expired in 2005.

**Stock Options**

The following table presents stock option activity during the six months ended June 30, 2013:

	Incentive Stock Option Plan	2006 Stock Incentive Plan	Total	Weighted Average Exercise Price per Share	Total Intrinsic Value of Options Exercised
Outstanding as of December 31, 2012	154	93	247	\$ 10.87	
Exercised	(18)	(10)	(28)	\$ 8.43	\$ 186
Forfeited/Cancelled				\$	
Outstanding and Exercisable as of June 30, 2013	136	83	219	\$ 11.19	

No compensation expense was recorded during the three or six months ended June 30, 2013 or 2012. As of June 30, 2013, there was no unrecognized compensation cost related to non-vested options.



**Table of Contents****Restricted Stock and Performance-Accelerated Restricted Stock**

RS and PARS are periodically granted to certain Kforce executives and are generally based on the extent by which annual long-term incentive performance goals, which are established by Kforce's Compensation Committee during the first quarter of the year of performance, are certified by the Compensation Committee as having been met. RS granted during the six months ended June 30, 2013 will vest over a period of two to five years, with equal vesting annually. There were no PARS outstanding as of June 30, 2013 or December 31, 2012 and there have been no PARS granted subsequent to the acceleration of substantially all equity awards on March 31, 2012, as discussed below.

RS contain voting rights and are included in the number of shares of common stock issued and outstanding. RS contain a non-forfeitable right to dividends or dividend equivalents in the form of additional shares of restricted stock containing the same vesting provisions as the underlying award. The following table presents the RS activity for the six months ended June 30, 2013:

	# of RS	Weighted Average Grant Date Fair Value
Outstanding as of December 31, 2012	38	\$ 12.11
Granted	348	\$ 14.59
Outstanding as of June 30, 2013	386	\$ 14.35

The fair market value of restricted stock is determined based on the closing stock price of Kforce's common stock at the date of grant, and is amortized on a straight-line basis over the service period.

As discussed within Note B Discontinued Operations, the Board approved the vesting acceleration of substantially all of the outstanding and unvested long-term incentives, including the RS, effective March 31, 2012. As a result, Kforce accelerated all of the previously unrecognized compensation expense associated with these awards of \$1,994 during the three months ended March 31, 2012. Kforce recognized total compensation expense related to RS of \$326 and \$601 during the three and six months ended June 30, 2013, respectively. During the three and six months ended June 30, 2012, Kforce recognized total compensation expense related to RS of \$0 and \$2,808, respectively. As of June 30, 2013, total unrecognized compensation expense related to RS was \$4,816, which will be recognized over a weighted average remaining period of 4.1 years.

During the three and six months ended June 30, 2012, Kforce recognized total compensation expense related to PARS of \$0 and \$23,344, respectively.

**Note G Goodwill and Other Intangible Assets**

The following table sets forth the activity in goodwill and other intangible assets during the six months ended June 30, 2013:

	Goodwill	Other Intangible Assets, Net	Total
Balance as of December 31, 2012	\$ 63,410	\$ 5,736	\$ 69,146
Amortization of intangible assets		(386)	(386)
Other		5	5
Balance as of June 30, 2013	\$ 63,410	\$ 5,355	\$ 68,765

As of June 30, 2013 and December 31, 2012, other intangible assets, net in the accompanying unaudited condensed consolidated balance sheets consisted of customer relationships and trademarks. Indefinite-lived intangible assets, which consist of trade names and trademarks, amounted to \$2,240 as of June 30, 2013 and December 31, 2012. All of the other intangible assets, net represented less than 5% of total assets.



## Edgar Filing: KFORCE INC - Form 10-Q

As of June 30, 2013 and December 31, 2012, accumulated amortization for intangible assets was \$24,826 and \$24,440, respectively. The estimated remaining amortization expense is \$361 for 2013, \$634 for 2014, \$634 for 2015, \$457 for 2016 and \$209 for 2017.

Kforce performed an interim goodwill impairment test for its GS reporting unit as of June 30, 2012, which resulted in Kforce recording an estimated impairment charge of \$65,300 and a related tax benefit of \$23,265 during the three months ended June 30, 2012. During the three months ended June 30, 2013, Kforce considered factors, including economic developments and the overall macro-economic environment, and determined that no triggering events necessitated an interim review of the carrying value of our goodwill or that of any of our reporting units. As a result, there were no goodwill impairment charges recorded during the three months ended June 30, 2013. Kforce will perform its annual review of goodwill during the fourth quarter of 2013.

**Table of Contents****Note H Reportable Segments**

Kforce's reportable segments are: (i) Tech; (ii) FA; (iii) HIM and (iv) GS. This determination was supported by, among others: the existence of segment presidents responsible for the operations of each segment and who also report directly to our chief operating decision maker, the nature of the segment's operations and information presented to the Board of Directors. Kforce also reports Flexible billings and Search fees separately by segment, which has been incorporated into the table below.

Historically, and for the three and six months ended June 30, 2013, Kforce has generated only sales and gross profit information on a segment basis. Substantially all operations and long-lived assets are located in the United States.

As described in Note B Discontinued Operations, all revenues and gross profit associated with KCR have been recorded within income from discontinued operations, net of tax, in the unaudited condensed consolidated statement of operations and comprehensive income (loss). The following table provides information concerning the continuing operations of our segments for the three and six months ended June 30, 2013 and 2012:

	Tech	FA	HIM	GS	Total
<i>Three Months Ended June 30:</i>					
2013					
Net service revenues:					
Flexible billings	\$ 175,213	\$ 52,954	\$ 18,921	\$ 23,297	\$ 270,385
Search fees	5,356	7,900	48		13,304
Total net service revenues	\$ 180,569	\$ 60,854	\$ 18,969	\$ 23,297	\$ 283,689
Gross profit	\$ 54,095	\$ 24,251	\$ 6,252	\$ 8,249	\$ 92,847
2012					
Net service revenues:					
Flexible billings	\$ 166,044	\$ 53,562	\$ 19,774	\$ 21,545	\$ 260,925
Search fees	5,695	7,305	204		13,204
Total net service revenues	\$ 171,739	\$ 60,867	\$ 19,978	\$ 21,545	\$ 274,129
Gross profit	\$ 51,944	\$ 23,933	\$ 7,419	\$ 6,470	\$ 89,766
<i>Six Months Ended June 30:</i>					
2013					
Net service revenues:					
Flexible billings	\$ 338,053	\$ 102,815	\$ 37,465	\$ 46,127	\$ 524,460
Search fees	10,151	14,565	140		24,856
Total net service revenues	\$ 348,204	\$ 117,380	\$ 37,605	\$ 46,127	\$ 549,316
Gross profit	\$ 102,894	\$ 45,544	\$ 12,232	\$ 15,513	\$ 176,183
2012					
Net service revenues:					
Flexible billings	\$ 326,438	\$ 108,200	\$ 39,096	\$ 44,533	\$ 518,267
Search fees	10,956	12,923	333		24,212
Total net service revenues	\$ 337,394	\$ 121,123	\$ 39,429	\$ 44,533	\$ 542,479
Gross profit	\$ 97,744	\$ 45,435	\$ 13,913	\$ 13,499	\$ 170,591

---

## **Table of Contents**

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) is intended to help the reader understand Kforce Inc., our operations, and our present business environment. This MD&A should be read in conjunction with Item 1. Financial Statements of this Report on Form 10-Q.

This overview summarizes the MD&A, which includes the following sections:

*Executive Summary* an executive summary of our results of operations for the six months ended June 30, 2013.

*Critical Accounting Estimates* a discussion of the accounting estimates that are most critical to aid in fully understanding and evaluating our reported financial results and that require management's most difficult, subjective or complex judgments.

*Results of Operations* an analysis of Kforce's unaudited condensed consolidated results of operations for each of the six months ended June 30, 2013 and 2012, which have been presented in its unaudited condensed consolidated financial statements. In order to assist the reader in understanding our business as a whole, certain metrics are presented for each of our segments.

*Liquidity and Capital Resources* an analysis of cash flows, off-balance sheet arrangements, stock repurchases and the impact of changes in interest rates on our business.

On March 31, 2012, Kforce sold all of the issued and outstanding stock of KCR. See Note B Discontinued Operations to the Unaudited Condensed Consolidated Financial Statements for a more detailed discussion. The results presented in the accompanying Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for the three and six months ended June 30, 2012 include activity relating to KCR as a discontinued operation. Except as specifically noted, our discussions below exclude any activity related to KCR, which is addressed separately in the discussion of income from discontinued operations, net of income taxes.

## **EXECUTIVE SUMMARY**

The following is an executive summary of what Kforce believes are important results as of and for the six months ended June 30, 2013, which should be considered in the context of the additional discussions herein and in conjunction with its unaudited condensed consolidated financial statements. We believe such highlights are as follows:

Net service revenues for the six months ended June 30, 2013 increased 1.3% to \$549.3 million from \$542.5 million in the comparable period in 2012.

Flex revenues for the six months ended June 30, 2013 increased 1.2% to \$524.5 million from \$518.3 million in the comparable period in 2012.

Search revenues for the six months ended June 30, 2013 increased 2.7% to \$24.9 million from \$24.2 million in the comparable period in 2012.

Flex gross profit margin for the six months ended June 30, 2013 increased 70 basis points to 28.9% from 28.2% in the comparable period in 2012. Flex gross profit margin for the three months ended June 30, 2013 increased 110 basis points to 29.4% on a sequential basis, primarily as a result of lower statutory payroll taxes.

## Edgar Filing: KFORCE INC - Form 10-Q

Selling, general and administrative ( SG&A ) expenses as a percentage of revenues for the six months ended June 30, 2013 decreased to 28.1% from 33.1% in the comparable period in 2012. This decrease was primarily a result of the acceleration of substantially all of the outstanding and unvested RS, PARS and ALTI awards on March 31, 2012, which resulted in the acceleration of \$31.3 million of compensation expense and payroll taxes that was recorded during the first quarter of 2012. The decrease was partially offset by an increase in compensation related expenses related to the significant increase in revenue responsible headcount during the fourth quarter of 2012 and first quarter of 2013.

Net income of \$10.0 million for the six months ended June 30, 2013 increased \$39.1 million from a net loss of \$29.1 million in the comparable period in 2012. The results for the six months ended June 30, 2012, include an after-tax goodwill impairment charge of \$42.0 million.

Earnings per share from continuing operations for the six months ended June 30, 2013 increased to \$0.29 from a loss per share of \$1.43 in the comparable period in 2012, which was primarily driven by the equity and ALTI awards acceleration and goodwill impairment charge referred to above.

During the six months ended June 30, 2013, Kforce repurchased 1.4 million shares of common stock at a total cost of approximately \$20.7 million.

The total amount outstanding under the Credit Facility increased to \$50.1 million as of June 30, 2013 as compared to \$21.0 million as of December 31, 2012, which was primarily related to the repurchase of common stock.

**Table of Contents****CRITICAL ACCOUNTING ESTIMATES**

Our unaudited condensed consolidated financial statements are prepared in accordance with GAAP. In connection with the preparation of our financial statements, we are required to make assumptions and estimates about future events, and apply judgments that affect the reported amount of assets, liabilities, revenues, expenses and the related disclosures. We base our assumptions, estimates and judgments on historical experience, current trends, and other factors that management believes to be relevant at the time our consolidated financial statements are prepared. On a regular basis, management reviews the accounting policies, estimates, assumptions and judgments to ensure that our consolidated financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates, and such differences could be material.

Please refer to Note 1 Summary of Significant Accounting Policies to the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates in our Annual Report on Form 10-K for the year ended December 31, 2012 for a more detailed discussion of our significant accounting policies and critical accounting estimates.

**RESULTS OF OPERATIONS*****Three and Six Months Ended June 30, 2013 and 2012***

Net service revenues for the three and six months ended June 30, 2013 were \$283.7 million and \$549.3 million, respectively, which represents an increase of 3.5% and 1.3%, respectively, over the comparable periods in 2012. These increases were primarily due to our Tech segment (which represents approximately 63% of our total net service revenues) and our GS segment (which represents approximately 8% of our net service revenues), both of which had year-over-year increases in net service revenues for the three months ended June 30, 2013 of 5.1% and 8.1%, respectively, and 3.2% and 3.6% for the six months ended June 30, 2013, respectively. For the three and six months ended June 30, 2013, net service revenues for FA remained flat and decreased 3.1%, respectively, while net service revenues for our HIM segment decreased 5.1% and 4.6%, respectively, over the comparable periods in 2012. Additionally, Search revenues increased 0.8% and 2.7% for the three and six months ended June 30, 2013, respectively, over the compared periods in 2012.

Flex gross profit margin increased 10 basis points to 29.4% for the three months ended June 30, 2013 as compared to 29.3% for the comparable period in 2012, and increased 70 basis points to 28.9% for the six months ended June 30, 2013 as compared to 28.2% for the comparable period in 2012. Flex gross profit margin increased sequentially 110 basis points in the three months ended June 30, 2013. This increase was primarily a result of lower statutory payroll taxes. SG&A expenses as a percentage of net service revenues were 27.7% and 28.1% for the three and six months ended June 30, 2013, respectively, as compared to 26.1% and 33.1% for the three and six months ended June 30, 2012, respectively. The decrease in SG&A expenses as a percentage of net service revenues during the six months ended June 30, 2013 was primarily the result of the acceleration of substantially all of the outstanding and unvested PARS, RS and ALTI awards on March 31, 2012, which resulted in the recognition of incremental compensation expense of \$31.3 million, including payroll taxes. The decrease was partially offset by an increase in compensation related expenses related to the significant increase in revenue responsible headcount during the fourth quarter of 2012 and first quarter of 2013.

From an economic standpoint, temporary employment figures and trends are important indicators of staffing demand, which continued to improve during 2013 on a sequential basis based on data published by the Bureau of Labor Statistics ( BLS ). The penetration rate (the percentage of temporary staffing to total employment) in June 2013 was at 1.97% up slightly from 1.94% in March 2013. Economic forecasters estimate that the penetration rate could surpass the prior peak of 2.03% reached in April 2000 sometime during this economic cycle. While we believe the macro-employment picture continues to be relatively weak with the unemployment rate at 7.6% as of June 2013, non-farm payroll expanded by 195,000 jobs in June 2013, which was materially better than expected by consensus estimates. Also, the college-level unemployment rate, which serves as a proxy for professional employment and is more closely aligned with Kforce's business strategy and candidate profile, was at 3.9% as of June 30, 2013. Kforce believes that uncertainty in the overall U.S. economic outlook related to the political landscape, potential tax changes, geo-political risk and impact of health care reform, will continue to fuel growth in temporary staffing as employers may be reluctant to increase full-time hiring. If the penetration rate of temporary staffing continues to experience growth in the coming years, we believe that our Flex revenues can grow significantly even in a relatively modest growth macro-economic environment. Kforce remains optimistic about the growth prospects of the temporary staffing industry, the penetration rate, and in particular, our revenue portfolio.

**Table of Contents**

Over the last few years, we have undertaken several significant initiatives including: (i) adding revenue responsible headcount to capitalize on targeted growth opportunities; (ii) further developing and optimizing our National Recruiting Center ( NRC ) and Strategic Accounts ( SA ) teams in support of our field operations; (iii) restructuring both our back office and field operations under our Shared Services program, which focuses on process improvement, centralization, technology infrastructure and outsourcing; (iv) divesting KCR in March 2012 (in an attempt to enhance Kforce s focus on our core service offerings); (v) upgrading our corporate systems (primarily our front-end systems) with a focus on AMP!, ICE, job order prioritization and the development of mobile applications and (vi) making other technology investments designed to increase the performance of our corporate and field associates. We believe that these investments have increased our operating efficiency, enabling us to be more responsive to our clients and have provided a better operating platform to support our expected future growth. We believe our field operations model, which allows us to deliver our service offerings in a disciplined and consistent manner across all geographies and business lines, as well as our centralized back office operations, are competitive advantages and keys to our future growth and profitability. We also believe that our diversified portfolio of service offerings, which are primarily in the U.S., will also be a key contributor to our long-term financial stability.

**Net Service Revenues.** The following table sets forth, as a percentage of net service revenues, certain items in our unaudited condensed consolidated statements of operations and comprehensive income (loss) for the three and six months ended June 30:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Net Service Revenues by Segment:</b>				
Tech	63.7%	62.6%	63.4%	62.2%
FA	21.4	22.2	21.4	22.3
HIM	6.7	7.3	6.8	7.3
GS	8.2	7.9	8.4	8.2
Net service revenues	100.0%	100.0%	100.0%	100.0%
<b>Revenue by Type:</b>				
Flex	95.3%	95.2%	95.5%	95.5%
Search	4.7	4.8	4.5	4.5
Net service revenues	100.0%	100.0%	100.0%	100.0%
Gross profit	32.7%	32.7%	32.1%	31.4%
Selling, general and administrative expenses	27.7%	26.1%	28.1%	33.1%
Goodwill impairment		23.8%		12.0%
Depreciation and amortization	0.9%	1.0%	0.9%	1.1%
Income (loss) from continuing operations before income taxes	4.1%	(18.3)%	3.0%	(14.9)%
Income (loss) from continuing operations	2.4%	(12.1)%	1.8%	(9.4)%

**Table of Contents**

The following table details net service revenues for Flex and Search by segment and changes from the prior period for the three and six months ended June 30:

<i>(in \$000 s)</i>	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	Increase (Decrease)	2012	2013	Increase (Decrease)	2012
<b>Tech</b>						
Flex	\$ 175,213	5.5%	\$ 166,044	\$ 338,053	3.6%	\$ 326,438
Search	5,356	(6.0)%	5,695	10,151	(7.3)%	10,956
Total Tech	\$ 180,569	5.1%	\$ 171,739	\$ 348,204	3.2%	\$ 337,394
<b>FA</b>						
Flex	\$ 52,954	(1.1)%	\$ 53,562	\$ 102,815	(5.0)%	\$ 108,200
Search	7,900	8.1%	7,305	14,565	12.7%	12,923
Total FA	\$ 60,854	0.0%	\$ 60,867	\$ 117,380	(3.1)%	\$ 121,123
<b>HIM</b>						
Flex	\$ 18,921	(4.3)%	\$ 19,774	\$ 37,465	(4.2)%	\$ 39,096
Search	48	(76.5)%	204	140	(58.0)%	333
Total HIM	\$ 18,969	(5.1)%	\$ 19,978	\$ 37,605	(4.6)%	\$ 39,429
<b>GS</b>						
Flex	\$ 23,297	8.1%	\$ 21,545	\$ 46,127	3.6%	\$ 44,533
Search						
Total GS	\$ 23,297	8.1%	\$ 21,545	\$ 46,127	3.6%	\$ 44,533
Total Flex	\$ 270,385	3.6%	\$ 260,925	\$ 524,460	1.2%	\$ 518,267
Total Search	13,304	0.8%	13,204	24,856	2.7%	24,212
Total Revenues	\$ 283,689	3.5%	\$ 274,129	\$ 549,316	1.3%	\$ 542,479

**Flex Revenues.** The primary drivers of Flex revenues are the number of consultant hours worked, the consultant bill rate per hour and, to a limited extent, the amount of billable expenses incurred by Kforce. Our quarterly operating results are affected by the number of billing days in a quarter and the seasonality of our clients' businesses. For both the three months ended June 30, 2013 and 2012, there were 64 billing days.

Flex revenues for our largest segment, Tech, experienced growth during the three and six months ended June 30, 2013 of 5.5% and 3.6%, respectively, as compared to the same periods in 2012. On a sequential basis, Tech experienced an increase in Flex revenues of 7.6%. A report published by Staffing Industry Analysts (SIA) provided an expectation that temporary technology staffing could experience growth of 8% for 2013 due in part to a shift by consumers of technology staffing services away from independent contractors and into temporary staffing primarily due to increased employment compliance risk. In addition to this shift of hiring to a temporary staffing model, there are notable skill shortages in certain technology skill sets, which we believe will result in strong future growth in our Tech segment. We continue to believe that our operating model allows us to deliver our service offerings in a disciplined and consistent manner across all geographies and business lines. Additionally, our revenue responsible Tech headcount is up 24.8% when comparing the second quarter of 2013 to the comparable period in 2012 in an effort to take advantage of this expected growth. Kforce's operating model includes our NRC, which we believe has been highly effective in increasing the quality and speed of delivery of services to our clients, particularly our SA. We expect to see continued growth in 2013 within our Tech segment.

Our FA segment experienced a decrease in Flex revenues of 1.1% and 5.0% during the three and six months ended June 30, 2013, respectively, as compared to the same periods in 2012. In its April 2013 update, SIA revised its finance and accounting 2013 growth projections from 7% to

## Edgar Filing: KFORCE INC - Form 10-Q

5%. Management believes that the investments made in revenue responsible headcount within FA staffing in the third and fourth quarters of 2012 will positively impact revenues in the second half of 2013 due to improvements in associate productivity that typically come with tenure.



**Table of Contents**

Flex revenues for HIM decreased 4.3% and 4.2% for the three and six months ended June 30, 2013, respectively, as compared to the same periods in 2012. The decrease is partially attributable to a few large projects that were ongoing during the first half of 2012 that were completed in the second half of 2012. The declines were partially offset by revenues generated from requirements and deadlines related to International Statistical Classification of Diseases and Related Health Problems, 10<sup>th</sup> edition ( ICD-10 ). The required implementation date for ICD-10 is October 1, 2014. Management expects Flex revenues in HIM to be stable to improving for the remainder of 2013.

Our GS segment experienced an increase of 8.1% and 3.6% in Flex revenues for the three and six months ended June 30, 2013, respectively, as compared to the comparable periods in 2012. The increases primarily relate to the expansion of revenues under a contract with GS' s largest customer, which was awarded during the first quarter of 2012. While we cannot predict the outcome of the widening federal deficits and past, current and future efforts to reduce federal spending, including through sequestration cuts that went into effect on March 1, 2013, and whether these efforts will materially impact the budgets of federal agencies that are clients of our GS segment, we still expect to see growth within our GS segment for the remainder of 2013.

The following table details total Flex hours for each segment and percentage changes over the prior period for the three and six months ended June 30:

<i>(in 000 s)</i>	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	Increase (Decrease)	2012	2013	Increase (Decrease)	2012
Tech	2,688	6.2%	2,532	5,205	4.3%	4,991
FA	1,628	2.7	1,585	3,126	(2.3)	3,201
HIM	282	(4.1)	294	555	(5.6)	588
Total hours	4,598	4.2%	4,411	8,886	1.2%	8,780

The changes in billable expenses, which are included as a component of net services revenues, are primarily attributable to increases or decreases in project work. The following table details total Flex billable expenses for each segment and percentage changes over the prior period for the three and six months ended June 30:

<i>(in \$000 s)</i>	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	Increase (Decrease)	2012	2013	Increase (Decrease)	2012
Tech	\$ 1,543	(28.2)%	\$ 2,149	\$ 3,063	(16.9)%	\$ 3,688
FA	100	(31.5)	146	242	(13.9)	281
HIM	1,340	(16.3)	1,601	2,796	(17.2)	3,378
GS	59	(71.1)	204	167	(34.8)	256
Total billable expenses	\$ 3,042	(25.8)%	\$ 4,100	\$ 6,268	(17.6)%	\$ 7,603

**Search Fees.** The primary drivers of Search fees are the number of placements and the average placement fee. Search fees also include conversion revenues (conversions occur when consultants initially assigned to a client on a temporary basis are later converted to a permanent placement). Our GS segment does not make permanent placements.

Search revenues increased 0.8% and 2.7% for the three and six months ended June 30, 2013, respectively, as compared to the same periods in 2012 and increased 15.2% sequentially. We expect Search revenues to remain flat for the remainder of 2013 when compared to the same period in 2012.

**Table of Contents**

Total placements for each segment and percentage changes over the prior period were as follows for the three and six months ended June 30:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	Increase (Decrease)	2012	2013	Increase (Decrease)	2012
Tech	336	(5.1)%	354	646	(6.5)%	691
FA	600	1.2	593	1,149	11.1	1,034
HIM	4	(55.6)	9	10	(66.7)	30
Total placements	940	(1.7)%	956	1,805	2.8%	1,755

The average placement fee for each segment and percentage changes over the prior period were as follows for the three and six months ended June 30:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	Increase (Decrease)	2012	2013	Increase (Decrease)	2012
Tech	\$ 15,955	(0.8)%	\$ 16,076	\$ 15,723	(0.8)%	\$ 15,856
FA	13,156	6.7	12,330	12,668	1.3	12,503
HIM	12,126	(46.7)	22,739	14,068	26.7	11,106
Total average placement fee	\$ 14,151	2.4%	\$ 13,817	\$ 13,768	(0.2)%	\$ 13,799

**Gross Profit.** Gross profit on Flex billings is determined by deducting the direct cost of services (primarily flexible personnel payroll wages, payroll taxes, payroll-related insurance, and subcontractor costs) from net Flex service revenues. In addition, consistent with industry practices, gross profit dollars from Search fees are equal to revenues, because there are generally no direct costs associated with such revenues.

The gross profit percentage for each segment and percentage changes over the prior period were as follows for the three and six months ended June 30:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	Increase (Decrease)	2012	2013	Increase (Decrease)	2012
Tech	30.0%	(0.7)%	30.2%	29.5%	1.7%	29.0%
FA	39.9%	1.5	39.3%	38.8%	3.5	37.5%
HIM	33.0%	(11.1)	37.1%	32.5%	(7.9)	35.3%
GS	35.4%	18.0	30.0%	33.6%	10.9	30.3%
Total gross profit percentage	32.7%	0.0%	32.7%	32.1%	2.2%	31.4%

Kforce also monitors the gross profit percentage as a percentage of Flex revenues, which is referred to as the Flex gross profit percentage. This provides management with the necessary insight into the other drivers of total gross profit percentage such as changes in volume evidenced by changes in hours billed for Flex and changes in the spread between bill rate and pay rate for Flex.

The increase in Search gross profit for the three months ended June 30, 2013, compared to the same period in 2012, was \$0.1 million, composed of a \$0.2 million decrease in volume and a \$0.3 million increase in rate. The increase in Search gross profit for the six months ended June 30, 2013, compared to the same period in 2012, was \$0.6 million, composed of a \$0.7 million increase in volume and a \$0.1 million decrease in rate. The sequential net increase in Search gross profit was \$1.8 million, composed of a \$1.1 million increase in volume and a \$0.7 million increase in rate.



**Table of Contents**

The following table presents, for each segment, the Flex gross profit percentage and percentage change over the prior period for the three and six months ended June 30:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	Increase (Decrease)	2012	2013	Increase (Decrease)	2012
Tech	27.8%	(0.4)%	27.9%	27.4%	3.0%	26.6%
FA	30.9%	(0.3)	31.0%	30.1%	0.3	30.0%
HIM	32.8%	(10.1)	36.5%	32.3%	(6.9)	34.7%
GS	35.4%	18.0	30.0%	33.6%	10.9	30.3%
Total Flex gross profit percentage	29.4%	0.3%	29.3%	28.9%	2.5%	28.2%

The increase in Flex gross profit for the three months ended June 30, 2013, compared to the same period in 2012, was \$3.0 million, composed of a \$2.8 million increase in volume and a \$0.2 million increase in rate. The net increase in Flex gross profit for the six months ended June 30, 2013, compared to the same period in 2012, was \$4.9 million, composed of a \$1.7 million increase in volume and a \$3.2 million increase in rate. The sequential net increase in Flex gross profit was \$7.8 million, composed of a \$4.6 million increase in volume and a \$3.2 million increase in rate.

During the three and six months ended June 30, 2013, Flex gross profit percentage experienced an increase of 10 basis points and 70 basis points, respectively, as compared to the same periods in 2012. The increase during the six months ended June 30, 2013, was primarily driven by the improvement in the spread between our bill rates and pay rates predominately within our Tech and GS segments. A continued focus for Kforce is optimizing the spread between bill rates and pay rates by providing our associates with tools, economic knowledge and defined programs to drive improvement in the effectiveness of our pricing strategy around the staffing services we provide. We believe this strategy will serve to balance the desire for optimal volume, rate, effort and duration of assignment, while ultimately maximizing the benefit for our clients, our consultants and Kforce. We anticipate that Flex gross profit margins will be stable for the remainder of 2013 as compared to 2012 as we balance improvement in the spread between our bill rates and pay rates with capturing market demand.

**Selling, General and Administrative Expenses ( SG&A ).** For both the three and six months ended June 30, 2013, total commissions, compensation, payroll taxes, and benefit costs as a percentage of SG&A was 84.3% as compared to 84.4% and 87.4% for the three and six months ended June 30, 2012, respectively. Commissions and related payroll taxes and benefit costs are variable costs driven primarily by revenue and gross profit levels, and associated performance. Therefore, as gross profit levels change, these expenses would also generally be anticipated to change but remain relatively consistent as a percentage of revenues.

The following table presents these components of SG&A along with an other caption, which includes bad debt expense, lease expense, professional fees, travel, telephone, computer and certain other expenses, as an absolute amount and as a percentage of total net service revenues for the three and six months ended June 30:

(in \$000 s)	2013	% of Revenues	2012	% of Revenues
<i>Three Months Ended June 30:</i>				
Compensation, commissions, payroll taxes and benefits costs	\$ 66,217	23.3%	\$ 60,253	22.0%
Other	12,286	4.4	11,161	4.1
Total SG&A	\$ 78,503	27.7%	\$ 71,414	26.1%
<i>Six Months Ended June 30:</i>				
Compensation, commissions, payroll taxes and benefits costs	\$ 130,000	23.7%	\$ 156,819	28.9%
Other	24,196	4.4	22,710	4.2
Total SG&A	\$ 154,196	28.1%	\$ 179,529	33.1%



**Table of Contents**

SG&A as a percentage of net service revenues increased 160 and decreased 500 basis points for the three and six months ended June 30, 2013, respectively, as compared to the same periods in 2012.

For the three months ended June 30, 2013, the net increase was primarily attributable to the following:

Increase in compensation and benefits of 0.8% of net service revenues and increase in commission expense of 0.6% of net service revenues, both of which were primarily attributable to the costs of hiring, developing and mentoring the significant revenue responsible headcount additions in the fourth quarter of 2012 and first quarter of 2013.

For the six months ended June 30, 2013, the net decrease was primarily attributable to the following:

Decrease in compensation and benefits cost of 5.9% of net service revenues, which was primarily related to the discretionary acceleration of substantially all of the outstanding and unvested RS, PARS and ALTI awards on March 31, 2012. This resulted in incremental compensation expense of \$31.3 million, including payroll taxes, that was recorded during the first quarter of 2012. This decrease was partially offset by the impact of the revenue responsible headcount additions in the fourth quarter of 2012 and first quarter of 2013.

Decrease in bad debt expense of 0.3% of net service revenues, which was primarily attributable to a decreased level of write-offs during 2013 as compared to 2012 combined with a continued positive trend in collections.

A partial offset due to an increase in commission expense of 0.7% of net service revenues, which was primarily attributable to the costs of hiring, developing and mentoring the significant revenue responsible headcount additions in the fourth quarter of 2012 and first quarter of 2013.

**Depreciation and Amortization.** The following table presents depreciation and amortization expense and percentage changes over the prior period by major category for the three and six months ended June 30:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	Increase (Decrease)	2012	2013	Increase (Decrease)	2012
Fixed asset depreciation	\$ 1,056	20.3%	\$ 878	\$ 2,049	16.7%	\$ 1,756
Capital lease asset depreciation	428	0.5	426	848	0.7	842
Capitalized software amortization	785	(40.9)	1,328	1,576	(41.2)	2,678
Intangible asset amortization	193	(21.2)	245	386	(20.1)	483
<b>Total depreciation and amortization</b>	<b>\$ 2,462</b>	<b>(14.4)%</b>	<b>\$ 2,877</b>	<b>\$ 4,859</b>	<b>(15.6)%</b>	<b>\$ 5,759</b>

The \$0.5 million and \$1.1 million decrease in capitalized software amortization during the three and six months ended June 30, 2013 compared to the same periods in 2012 is the result of certain software becoming fully depreciated during the second half of 2012.

**Other Expense, Net.** Other expense, net was \$0.2 million and \$0.3 million for the three months ended June 30, 2013 and 2012, respectively, and \$0.5 million and \$0.7 million for the six months ended June 30, 2013 and 2012, respectively. Other expense, net consisted primarily of interest expense related to outstanding borrowings under our Credit Facility.

**Income Tax Expense (Benefit).** Income tax expense (benefit) as a percentage of income (loss) from continuing operations before income taxes (our effective rate) for the six months ended June 30, 2013 and 2012 was 39.7% and (36.9)%, respectively. The change in Kforce's effective rate for the six months ended June 30, 2013 compared to the six months ended June 30, 2012 was primarily a result of the partially non-deductible goodwill impairment charge recognized in the quarter ended June 30, 2012.



**Table of Contents**

**Income from Discontinued Operations, Net of Income Taxes.** Discontinued operations includes the consolidated income and expenses of KCR. During the three months ended March 31, 2012, Kforce completed the sale of KCR resulting in a pre-tax gain of \$36.6 million. Included in the determination of the pre-tax gain is approximately \$5.5 million of goodwill for KCR and transaction expenses totaling approximately \$2.2 million, which primarily included commissions, legal fees and transaction bonuses. Income tax expense as a percentage of income from discontinued operations, before income taxes, for the six months ended June 30, 2012 was 45.3%.

**Adjusted EBITDA.** Adjusted EBITDA, a non-GAAP financial measure, is defined by Kforce as net income before discontinued operations, non-cash goodwill impairment charges, interest, income taxes, depreciation and amortization and acceleration and amortization of stock-based compensation expense. Adjusted EBITDA should not be considered a measure of financial performance under GAAP. Items excluded from Adjusted EBITDA are significant components in understanding and assessing our past and future financial performance, and this presentation should not be construed as an inference by us that our future results will be unaffected by those items excluded from Adjusted EBITDA. Adjusted EBITDA is a key measure used by management to evaluate its operations including its ability to generate cash flows and, consequently, management believes this is useful information to investors. The measure should not be considered in isolation or as an alternative to net income, cash flows or other financial statement information presented in the unaudited condensed consolidated financial statements as indicators of financial performance or liquidity. The measure is not determined in accordance with GAAP and is thus susceptible to varying calculations. Also, Adjusted EBITDA, as presented, may not be comparable to similarly titled measures of other companies.

Some of the items that are excluded also impacted certain balance sheet assets, resulting in all or a portion of an asset being written off without a corresponding recovery of cash we may have previously spent with respect to the asset. In addition, although we excluded stock-based compensation expense (which we expect to continue to incur in the future) because it is a non-cash expense, the associated stock issued may result in an increase in our outstanding shares of stock, which may result in the dilution of our stockholder ownership interest. We encourage you to evaluate these items and the potential risks of excluding such items when analyzing our financial position.

The following table presents Adjusted EBITDA results and includes a reconciliation of Adjusted EBITDA to net income for the three and six months ended June 30, 2013 and 2012:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013	Per Share	2012	Per Share	2013	Per Share	2012	Per Share
Net income (loss)	\$ 6,948	\$ 0.21	\$ (33,167)	\$ (0.90)	\$ 10,042	\$ 0.29	\$ (29,091)	\$ (0.82)
Income from discontinued operations, net of taxes			15	0.00			21,818	0.61
Income (loss) from continuing operations	6,948	0.21	(33,182)	(0.90)	10,042	0.29	(50,909)	(1.43)
Depreciation and amortization	2,462	0.07	2,877	0.08	4,859	0.14	5,759	0.16
Goodwill impairment			65,300	1.77			65,300	1.83
Acceleration of RS and PARS							22,158	0.62
Amortization of RS and PARS	326	0.01			601	0.02	3,439	0.09
Interest expense and other	290	0.01	238	0.01	533	0.02	576	0.01
Income tax (benefit) expense	4,729	0.14	(16,908)	(0.46)	6,625	0.19	(29,745)	(0.83)
Adjusted EBITDA	\$ 14,755	\$ 0.44	\$ 18,325	\$ 0.50	\$ 22,660	\$ 0.66	\$ 16,578	\$ 0.45



**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES**

To meet our capital and liquidity requirements, we primarily rely on operating cash flow as well as borrowings under our existing Credit Facility. At June 30, 2013, Kforce had \$94.6 million in working capital compared to \$72.7 million at December 31, 2012. Kforce's current ratio (current assets divided by current liabilities) was 2.0 at June 30, 2013 compared to 1.7 at December 31, 2012.

The accompanying Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012 provide a more detailed description of our cash flows. Currently, Kforce is principally focused on achieving the appropriate balance in the following areas of cash flow: (i) achieving positive cash flow from operating activities; (ii) repurchasing our common stock; (iii) making strategic acquisitions; and (iv) investing in our infrastructure to allow sustainable growth via capital expenditures.

We believe that existing cash and cash equivalents, cash flow from operations, and available borrowings under our Credit Facility will be adequate to meet the capital expenditure and working capital requirements of our operations for at least the next 12 months. However, significant deterioration in the economic environment or market conditions, among other things, could negatively impact operating results and liquidity as well as the ability of our lenders to fund borrowings. There is no assurance that: (i) our lenders will be able to fund our borrowings or (ii) if operations were to deteriorate and additional financing were to become necessary, we would be able to obtain financing in amounts sufficient to meet operating requirements or at terms which are satisfactory and which would allow us to remain competitive.

Actual results could also differ materially from those indicated as a result of a number of factors, including the use of currently available resources for possible acquisitions and possible additional stock repurchases.

The following table presents a summary of our net cash flows from operating, investing and financing activities for the six months ended June 30:

	<b>2013</b>	<b>2012</b>
Cash provided by (used in):		
Operating activities	\$ (1,246)	\$ 7,706
Investing activities	(4,483)	45,104
Financing activities	5,412	(52,937)
Decrease in cash and cash equivalents	\$ (317)	\$ (127)

***Discontinued Operations***

As was previously discussed, Kforce sold KCR on March 31, 2012. The accompanying unaudited condensed consolidated statements of cash flows have been presented on a combined basis (continuing operations and discontinued operations). Cash flows provided by discontinued operations for all prior periods, including the six months ended June 30, 2012, were provided by operating activities and were not material to the capital resources of Kforce. In addition, the absence of cash flows from discontinued operations is not expected to have a significant effect on the future liquidity, financial position, or capital resources of Kforce.

**Operating Activities**

The significant variations in cash provided by operating activities and net income are principally related to adjustments to net income for certain non-cash charges such as depreciation and amortization expense and stock-based compensation as well as the gain on the sale of discontinued operations and the goodwill impairment charge. These adjustments are more fully detailed in our Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012. Our largest source of operating cash flows is the collection of trade receivables and our largest use of operating cash flows is the payment of our employee and consultant populations' compensation, which includes base salary, commissions and bonuses.

**Investing Activities**

Capital expenditures for the six months ended June 30, 2013 and 2012 were \$4.2 and 2.9 million, respectively, which exclude equipment acquired under capital leases. Additionally, proceeds from the divestiture of KCR of \$48.3 million, net of transaction costs, were included in

## Edgar Filing: KFORCE INC - Form 10-Q

investing activities during the six months ended June 30, 2012.

We expect to continue to selectively invest in our infrastructure in order to support the expected future growth in our business. Kforce believes it has sufficient cash and availability under its Credit Facility to make any expected necessary capital expenditures in the foreseeable future. In addition, we continually review our portfolio of businesses and their operations in comparison to our internal strategic and performance objectives. As part of this review, we may acquire other businesses and further invest in, fully divest and/or sell parts of our current businesses.

---

## **Table of Contents**

### **Financing Activities**

During the six months ended June 30, 2013, open market repurchases of common stock were approximately \$23.2 million, which was comprised of approximately \$20.7 million in common stock repurchases during the six months ended June 30, 2013 and the settlement of approximately \$2.5 million of common stock repurchases from the fourth quarter of 2012.

#### *Credit Facility*

The maximum borrowings available to Kforce under the Credit Facility are limited to: (a) a revolving credit facility of up to \$100 million (the Revolving Loan Amount ) and (b) a \$15 million sub-limit included in the Credit Facility for letters of credit.

Borrowing availability under the Credit Facility is limited to the remainder of (a) the lesser of (i) \$100.0 million minus the four week average aggregate weekly payroll of employees assigned to work for customers, or (ii) 85% of the net amount of eligible accounts receivable, plus 80% of the net amount of eligible unbilled accounts receivable, plus 80% of the net amount of eligible employee placement accounts, minus certain minimum availability reserves, and in either case, minus (b) the aggregate outstanding amount under the Credit Facility. Outstanding borrowings under the Revolving Loan Amount bear interest at a rate of (a) LIBOR plus an applicable margin based on various factors or (b) the higher of: (i) the prime rate, (ii) the federal funds rate plus 0.50% or (iii) LIBOR plus 1.00%. Fluctuations in the ratio of unbilled to billed receivables could result in material changes to availability from time to time. Letters of credit issued under the Credit Facility require Kforce to pay a fronting fee equal to 0.125% of the amount of each letter of credit issued, plus a per annum fee equal to the applicable margin for LIBOR loans based on the total letters of credit outstanding. To the extent that Kforce has unused availability under the Credit Facility, an unused line fee is required to be paid equal to the applicable margin times the amount by which the maximum revolver amount exceeded the sum of the average daily outstanding amount of the revolving loans and the average daily undrawn face amount of outstanding letters of credit during the immediate preceding month. Borrowings under the Credit Facility are secured by substantially all of the assets of Kforce and its subsidiaries, excluding the real estate located at the Kforce s corporate headquarters in Tampa, Florida. Under the Credit Facility, Kforce is subject to certain affirmative and negative covenants including (but not limited to) the maintenance of a fixed charge coverage ratio if the Firm s availability under the Credit Facility is less than the greater of 10% of the aggregate amount of the commitment of all of the lenders under the Credit Facility and \$11.0 million. As of June 30, 2013, Kforce had availability under the Credit Facility in excess of the minimum requirement; therefore, the minimum fixed charge coverage ratio of 1.00 to 1.00 was not applicable. Kforce believes that it will be able to maintain the minimum availability requirement; however, in the event that Kforce is unable to do so, Kforce could fail the fixed charge coverage ratio covenant, which would constitute an event of default. The Credit Facility expires September 20, 2016.

As of June 30, 2013, there was \$50.1 million outstanding and \$36.3 million was available under the Credit Facility. During the three months ended June 30, 2013, maximum outstanding borrowings under the Credit Facility were \$52.3 million. As of July 29, 2013, there was \$43.4 million outstanding and \$43.5 million was available under the Credit Facility.

### **Off-Balance Sheet Arrangements**

Kforce provides letters of credit to certain vendors in lieu of cash deposits. At June 30, 2013, Kforce had letters of credit outstanding for workers compensation and other insurance coverage totaling \$2.4 million and for facility lease deposits totaling \$0.3 million. Kforce does not have any additional off-balance sheet arrangements that have had, or are expected to have, a material effect on our unaudited condensed consolidated financial statements.

### **Stock Repurchases**

As of December 31, 2012, \$39.9 million of the Board-authorized common stock repurchase program remained available for future repurchases. On February 1, 2013, our Board of Directors approved an increase to the existing authorization for repurchases of common stock by \$50.0 million (exclusive of any previously unused authorizations). As a result, \$89.9 million remained available for future repurchases as of February 1, 2013. During the six months ended June 30, 2013, Kforce repurchased approximately 1.4 million shares of common stock at a total cost of approximately \$20.7 million. As of June 30, 2013, \$69.1 million remains available for future repurchases.

## **Table of Contents**

### **Item 3. *Quantitative and Qualitative Disclosures About Market Risk.***

In addition to the risks inherent in its operations, Kforce is exposed to certain market risks, primarily changes in interest rates. The sensitivity analysis presented below for our Credit Facility is based on a hypothetical 10% change in interest rates. This change is a hypothetical scenario and is used to calibrate potential risk and does not necessarily represent our view of future market changes.

As of June 30, 2013, we had \$50.1 million outstanding under our Credit Facility. Our weighted average effective interest rate on our Credit Facility was 1.7% at June 30, 2013. A hypothetical 10% increase in interest rates in effect at June 30, 2013 would have the effect of increasing annualized interest expense on borrowings outstanding as of June 30, 2013 by \$0.1 million.

We do not believe that we have a material exposure to fluctuations in foreign currencies because our international operations represented approximately 2% of net service revenues for the six months ended June 30, 2013, and because our international operations functional currency is the U.S. Dollar. However, we will continue to assess the impact that currency fluctuations could have on our operations going forward.

### **Item 4. *Controls and Procedures.***

#### **Evaluation of Disclosure Controls and Procedures**

As of June 30, 2013, we carried out an evaluation required by Rules 13a-15 and 15d-15 under the Exchange Act (the Evaluation ), under the supervision and with the participation of our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15 and 15d-15 under the Exchange Act ( Disclosure Controls ). Based on the Evaluation, our CEO and CFO concluded that our Disclosure Controls are effective in timely alerting them to material information required to be included in our periodic SEC reports.

#### **Changes in Internal Control over Financial Reporting**

Management has evaluated, with the participation of our CEO and CFO, whether any changes in our internal control over financial reporting that occurred during our last fiscal quarter have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on the evaluation we conducted, management has concluded that no such changes have occurred.

#### **Inherent Limitations of Internal Control over Financial Reporting**

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

#### **CEO and CFO Certifications**

Exhibits 31.1 and 31.2 are the Certifications of the CEO and the CFO, respectively. The Certifications are required in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 (the Section 302 Certifications ). This Item of this report, which you are currently reading, is the information concerning the Evaluation referred to in the Section 302 Certifications and this information should be read in conjunction with the Section 302 Certifications for a more complete understanding of the topics presented.

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings.**

As disclosed in our previous filings with the SEC, Kforce was a defendant in a California class action lawsuit alleging misclassification of California Account Managers and seeking unspecified damages. The tentative settlement referred to in our Annual Report on Form 10-K for the year ended December 31, 2010 was approved by the California court during the three months ended June 30, 2011 in the amount of \$2.5 million, which was recorded within accounts payable and other accrued liabilities in the accompanying consolidated balance sheet as of December 31, 2012. The full settlement was paid by Kforce to the independent third-party settlement administrator during the three months ended June 30, 2013.

On June 18, 2013, Kforce, along with other staffing firms, was named as a defendant in a class action lawsuit filed in the Orange County Superior Court of the State of California. The complaint alleges that a class of current and former Kforce employees working in California was denied compensation for the time they spent interviewing with current and potential clients of Kforce, over a period covering four years prior to the filing of the complaint. The plaintiff seeks recovery in an unspecified amount for this alleged unpaid compensation, the alleged failure of Kforce to provide them with accurate wage statements, the alleged improper use of debit cards as an employee payment mechanism in certain circumstances, alleged unfair competition, and statutory penalties, attorney's fees and other damages. At this stage of the litigation, it is not feasible to predict the outcome or a range of loss, should a loss occur. Accordingly, no amounts have been provided for in Kforce's Financial Statements. Kforce believes it has meritorious defenses to the allegations and intends to vigorously defend the matter.

We are not aware of any new legal proceedings that are likely to have a material adverse impact on Kforce, or other material developments with respect to existing legal proceedings, that occurred during the six months ended June 30, 2013.

**Item 1A. Risk Factors.**

There have been no material changes in the risk factors previously disclosed in our Annual Report on Form 10-K for our year ended December 31, 2012.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

The following table presents information with respect to our repurchases of Kforce common stock during the three months ended June 30, 2013:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
April 1, 2013 to April 30, 2013		\$		\$ 83,912,120
May 1, 2013 to May 31, 2013	348,890	\$ 13.80	348,890	\$ 79,096,215
June 1, 2013 to June 30, 2013	670,184	\$ 14.86	670,184	\$ 69,140,348
Total	1,019,074	\$ 14.50	1,019,074	\$ 69,140,348

(1) All of the shares reported above as purchased are attributable to shares repurchased in the open market.

**Item 3.** *Defaults Upon Senior Securities.*  
None.

**Item 4.** *Mine Safety Disclosures.*  
None.

**Item 5.** *Other Information.*  
None.

**Table of Contents****Item 6. Exhibits.**

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation. (1)
3.1a	Articles of Amendment to Articles of Incorporation. (2)
3.1b	Articles of Amendment to Articles of Incorporation. (2)
3.1c	Articles of Amendment to Articles of Incorporation. (2)
3.1d	Articles of Amendment to Articles of Incorporation. (3)
3.1e	Articles of Amendment to Articles of Incorporation. (4)
3.2	Amended & Restated Bylaws. (5)
31.1	Certification by the Chief Executive Officer of Kforce Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by the Chief Financial Officer of Kforce Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by the Chief Executive Officer of Kforce Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by the Chief Financial Officer of Kforce Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.1	Part I, Item 1 of this Form 10-Q formatted in XBRL. (6)

- (1) Incorporated by reference to the Registrant's Registration Statement on Form S-1 (File 33-91738) filed April 28, 1995.
- (2) Incorporated by reference to the Registrant's Form S-4/A (File No. 333-111566) filed February 9, 2004, as amended.
- (3) Incorporated by reference to the Registrant's Form 8-K (File No. 000-26058) filed May 17, 2000.
- (4) Incorporated by reference to the Registrant's Annual Report on Form 10-K (File No. 000-26058) filed March 29, 2002.
- (5) Incorporated by reference to the Registrant's Current Report on Form 8-K (File No. 000-26058) filed April 29, 2013.
- (6) The interactive data files shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Kforce Inc.  
(Registrant)

Date: July 31, 2013

By: */s/* DAVID M. KELLY  
David M. Kelly  
Senior Vice President and Chief Financial Officer  
(Principal Financial Officer)

Date: July 31, 2013

By: */s/* JEFFREY B. HACKMAN  
Jeffrey B. Hackman  
Vice President and Chief Accounting Officer  
(Principal Accounting Officer)