

KFORCE INC  
Form 10-Q  
May 10, 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 March 31, 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 May 7, 2013, was 34,531,368.

**Table of Contents**

**KFORCE INC.**

**QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED MARCH 31, 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>	26
Item 4.	<u>Controls and Procedures.</u>	26

**PART II OTHER INFORMATION**

Item 1.	<u>Legal Proceedings.</u>	27
Item 1A.	<u>Risk Factors.</u>	27
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>	27
Item 3.	<u>Defaults Upon Senior Securities.</u>	27
Item 4.	<u>Mine Safety Disclosures.</u>	27
Item 5.	<u>Other Information.</u>	27
Item 6.	<u>Exhibits.</u>	28

**SIGNATURES**

29

**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***(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)*

	<b>Three Months Ended</b>	
	<b>March 31,</b>	<b>March 31,</b>
	<b>2013</b>	<b>2012</b>
Net service revenues	\$ 265,627	\$ 268,350
Direct costs of services	182,291	187,525
Gross profit	83,336	80,825
Selling, general and administrative expenses	75,693	108,115
Depreciation and amortization	2,397	2,882
Income (loss) from operations	5,246	(30,172)
Other expense, net	256	392
Income (loss) from continuing operations before income taxes	4,990	(30,564)
Income tax expense (benefit)	1,896	(12,837)
Income (loss) from continuing operations	3,094	(17,727)
Income from discontinued operations, net of taxes		21,803
Net income	3,094	4,076
Other comprehensive income:		
Defined benefit pension and postretirement plans, net of tax	34	74
Comprehensive income	\$ 3,128	\$ 4,150
Earnings per share basic:		
From continuing operations	\$ 0.09	\$ (0.51)
From discontinued operations		0.63
Earnings per share basic	\$ 0.09	\$ 0.12
Earnings per share diluted:		
From continuing operations	\$ 0.09	\$ (0.51)
From discontinued operations		0.63
Earnings per share diluted	\$ 0.09	\$ 0.12

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

Weighted average shares outstanding	basic	34,391	34,703
Weighted average shares outstanding	diluted	34,485	34,703

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)*

	<b>March 31, 2013</b>	<b>December 31, 2012</b>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 907	\$ 1,381
Trade receivables, net of allowances of \$2,307 and \$2,153, respectively	164,487	151,570
Income tax refund receivable	2,177	1,750
Deferred tax assets, net	8,828	9,494
Prepaid expenses and other current assets	9,395	7,364
Total current assets	185,794	171,559
Fixed assets, net	35,543	34,883
Other assets, net	29,024	28,038
Deferred tax assets, net	21,665	21,523
Intangible assets, net	5,545	5,736
Goodwill	63,410	63,410
Total assets	\$ 340,981	\$ 325,149
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable and other accrued liabilities	\$ 32,540	\$ 36,205
Accrued payroll costs	50,373	50,063
Other current liabilities	11,565	11,564
Income taxes payable	1,329	1,042
Total current liabilities	95,807	98,874
Long-term debt - credit facility	39,549	21,000
Long-term debt - other	1,429	1,144
Other long-term liabilities	36,550	34,285
Total liabilities	173,335	155,303
Commitments and contingencies (see Note C)		
Stockholders' Equity:		
Preferred stock, \$0.01 par; 15,000 shares authorized, none issued and outstanding		
Common stock, \$0.01 par; 250,000 shares authorized, 68,865 and 68,531 issued, respectively	688	685
Additional paid-in capital	401,224	400,688
Accumulated other comprehensive loss	(2,679)	(2,713)
Retained earnings	43,297	40,203
Treasury stock, at cost; 34,379 and 33,980 shares, respectively	(274,884)	(269,017)
Total stockholders' equity	167,646	169,846
Total liabilities and stockholders' equity	\$ 340,981	\$ 325,149

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE UNAUDITED

Edgar Filing: KFORCE INC - Form 10-Q  
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

**Table of Contents**

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

	Three Months Ended
	March 31, 2013
Common stock – shares:	
Shares at beginning of period	68,531
Issuance of restricted stock, net of forfeitures	314
Exercise of stock options	20
Shares at end of period	68,865
Common stock – par value:	
Balance at beginning of period	\$ 685
Issuance of restricted stock, net of forfeitures	3
Exercise of stock options	0
Balance at end of period	\$ 688
Additional paid-in capital:	
Balance at beginning of period	\$ 400,688
Issuance of restricted stock, net of forfeitures	(3)
Exercise of stock options	181
Income tax benefit from stock-based compensation	25
Employee stock purchase plan	59
Stock-based compensation expense	274
Balance at end of period	\$ 401,224
Accumulated other comprehensive loss:	
Balance at beginning of period	\$ (2,713)
Pension and postretirement plans, net of tax	34
Balance at end of period	\$ (2,679)
Retained earnings:	
Balance at beginning of period	\$ 40,203
Net income	3,094
Balance at end of period	\$ 43,297
Treasury stock – shares:	
Shares at beginning of period	33,980
Repurchases of common stock	409
Employee stock purchase plan	(10)



# Edgar Filing: KFORCE INC - Form 10-Q

Shares at end of period		34,379
Treasury stock cost:		
Balance at beginning of period	\$	(269,017)
Repurchases of common stock		(5,949)
Employee stock purchase plan		82
Balance at end of period	\$	(274,884)

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>Three Months Ended</b>	
	<b>March 31, 2013</b>	<b>March 31, 2012</b>
Cash flows from operating activities:		
Net income	\$ 3,094	\$ 4,076
Adjustments to reconcile net income to cash (used in) provided by operating activities:		
Gain on sale of discontinued operations		(36,624)
Deferred income tax provision, net	503	4,493
Depreciation and amortization	2,397	2,955
Stock-based compensation	274	25,649
Provision for bad debts on accounts receivable and other accounts receivable reserves	294	1,064
Pension and postretirement benefit plans expense	970	1,132
Deferred compensation liability increase, net	1,190	1,729
Tax benefit attributable to stock-based compensation	25	1,804
Excess tax benefit attributable to stock-based compensation	(10)	(1,789)
Gain on cash surrender value of Company-owned life insurance policies	(1,208)	(1,359)
Other	40	50
(Increase) decrease in operating assets:		
Trade receivables, net	(13,212)	(16,462)
Income tax refund receivable	(427)	(3,106)
Prepaid expenses and other current assets	(2,031)	(1,319)
Other assets, net	69	13
(Decrease) increase in operating liabilities:		
Accounts payable and other current liabilities	(1,283)	15,966
Accrued payroll costs	451	3,646
Income taxes payable	287	1,037
Other long-term liabilities	163	(482)
Cash (used in) provided by operating activities	(8,414)	2,473
Cash flows from investing activities:		
Capital expenditures	(1,916)	(959)
Proceeds from disposition of business		48,326
Premiums paid for company-owned life insurance policies, net		(1,069)
Proceeds from the sale of assets held within the Rabbi Trust	1,049	
Purchase of assets held within the Rabbi Trust	(1,203)	
Cash (used in) provided by investing activities	(2,070)	46,298
Cash flows from financing activities:		
Proceeds from bank line of credit	141,121	92,851
Payments on bank line of credit	(122,572)	(142,377)
Short-term vendor financing	115	(8)
Proceeds from exercise of stock options, net of shares tendered in payment of the exercise price of stock options	181	22
Excess tax benefit attributable to stock-based compensation	10	1,789
Repurchases of common stock	(8,448)	(623)
Payments of capital expenditure financing	(397)	(502)
Cash provided by (used in) financing activities	10,010	(48,848)
Decrease in cash and cash equivalents	(474)	(77)

# Edgar Filing: KFORCE INC - Form 10-Q

Cash and cash equivalents at beginning of period	1,381	939
Cash and cash equivalents at end of period	\$ 907	\$ 862
Supplemental Cash Flow Information:		
Cash paid during the period for:		
Income taxes, net	\$ 1,537	\$ 978
Interest, net	\$ 152	\$ 266
Non-Cash Transaction Information:		
Employee stock purchase plan	\$ 141	\$ 166
Equipment acquired under capital leases	\$ 702	\$
Shares tendered in payment of the exercise price of stock options	\$	\$ 161
Unsettled repurchases of common stock	\$	\$ 14,883

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 63 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 comprised approximately 2% of net service revenues for both the three months ended March 31, 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 March 31, 2013, our results of operations and comprehensive income and cash flows for the three months ended March 31, 2013. The data in 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, allowances 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. Weighted average shares outstanding for purposes of computing diluted earnings per common share excludes contingently issuable unvested PARS unless the performance condition has been achieved as of the end of the applicable reporting period.

The following table sets forth the computation of basic and diluted earnings per share for the three months ended March 31:

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Numerator:</b>		
Income (loss) from continuing operations	\$ 3,094	\$ (17,727)
Income from discontinued operations, net of tax		21,803
Net income	\$ 3,094	\$ 4,076
<b>Denominator:</b>		
Weighted average shares outstanding basic	34,391	34,703
Common stock equivalents	94	
Weighted average shares outstanding diluted	34,485	34,703
<b>Earnings per share basic:</b>		
From continuing operations	\$ 0.09	\$ (0.51)
From discontinued operations		0.63
Earnings per share basic	\$ 0.09	\$ 0.12
<b>Earnings per share diluted:</b>		
From continuing operations	\$ 0.09	\$ (0.51)
From discontinued operations		0.63
Earnings per share diluted	\$ 0.09	\$ 0.12

For the three months ended March 31, 2013, there were 0 shares of common stock excluded from the computation of dilutive earnings 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 months ended March 31, 2012, each of the calculations of diluted earnings per share from continuing operations, discontinued operations and net income was 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. The majority of the services provided by Kforce under the TSA had ceased as of March 31, 2013. The fees for a significant majority of these services were generally equivalent to Kforce's cost. The fees for the remaining services to be performed are expected to also be generally equivalent to Kforce's cost although certain of these remaining services may be provided at negotiated rates.

Although the services provided under the TSA generated continuing cash flows between Kforce and the Purchaser, the amounts are not considered to be direct cash flows of the discontinued operation nor are they significant to the ongoing operations of either entity. Kforce has not had contractual ability through the TSA, SPA or any other agreement to significantly influence the operating or financial policies of the Purchaser. As a result, Kforce has not had significant continuing involvement in the operations of KCR and, as such, has classified such operating results as discontinued operations.

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 March 31, 2013.

The financial results of KCR have been presented as discontinued operations in the accompanying unaudited condensed consolidated statements of operations and comprehensive income. The following summarizes the results from discontinued operations for the three months ended March 31, 2012:

Net service revenues	\$ 29,649
Direct costs of services and operating expenses	26,444
	3,205
Gain on sale of discontinued operations	36,624
Income from discontinued operations, before income taxes	39,829
Income tax expense	18,026
Income from discontinued operations, net of income taxes	\$ 21,803

Additionally, in connection with the servicing of the TSA, as of March 31, 2013 and December 31, 2012 approximately \$920 and \$2,658, respectively, is due to the Purchaser, net of amounts due to Kforce from the Purchaser, and is classified within accounts payable and other accrued liabilities in the unaudited condensed consolidated balance sheet.

*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 included \$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.





## **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 is recorded within accounts payable and other accrued liabilities in the accompanying consolidated balance sheet as of March 31, 2013 and December 31, 2012. An appeal of the settlement was dismissed in April 2013, and we now expect the settlement to be consummated during the three months ended June 30, 2013.

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 March 31, 2013 would be approximately \$53,571 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 March 31, 2013 would be approximately \$15,174 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 months ended March 31, 2012, Kforce recognized total compensation expense related to the ALTI of \$9,805, which approximated the grant date fair value. There was no additional compensation expense related to the ALTI recognized during the three months ended March 31, 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 months ended March 31, 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%, 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 months ended March 31, 2013 and 2012, net periodic benefit cost was \$47 and \$94, respectively.

As of March 31, 2013 and December 31, 2012, the projected benefit obligation associated with our foreign defined benefit pension plan was \$1,233 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 months ended:

	Three Months Ended March 31,	
	2013	2012
Service cost	\$ 545	\$ 522
Interest cost	117	140
Amortization of loss	29	40
Net periodic benefit cost	\$ 691	\$ 702

The net periodic benefit cost recognized for the three months ended March 31, 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 three months ended March 31, 2013. Kforce does not currently anticipate funding the SERP during the year ending December 31, 2013.

During October 2012, the Firm announced the expected retirement of a participant in the SERP. The Firm anticipates making a lump-sum payment to the participant on or about December 2, 2013 due to the participant's separation from service, which is expected to be June 1, 2013.

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

Accordingly, the current portion of the present value of the projected benefit obligation of \$10,682 as of March 31, 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 March 31, 2013 and December 31, 2012 is \$9,638 and \$8,976, respectively, and is recorded in other long-term liabilities in the accompanying unaudited condensed consolidated balance sheets. During the three months ended March 31, 2013, there have been no payments made under the SERP.

**Table of Contents*****Supplemental Executive Retirement Health Plan***

Kforce maintains a Supplemental Executive Retirement Health Plan ( SERHP ) to provide postretirement health and welfare benefits to certain officers. 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 months ended:

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
Service cost	\$ 173	\$ 230
Interest cost	33	38
Amortization of loss	26	67
Net periodic benefit cost	\$ 232	\$ 335

The net periodic post-retirement benefit cost recognized for the three months ended March 31, 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 March 31, 2013 and December 31, 2012 is \$3,760 and \$3,554, respectively, and is recorded in other long-term liabilities in the accompanying unaudited condensed consolidated balance sheets. During the three months ending March 31, 2013, there have been no payments made under the SERHP.

***Deferred Compensation Plan***

In March 2012, Kforce surrendered certain of its Company-owned life insurance policies within its deferred compensation plan having a cash surrender value of approximately \$8,037. The proceeds associated with the surrendered policies were reinvested in bond mutual funds and are included in a Rabbi Trust along with the cash surrender value of the Company-owned life insurance policies. Employee distributions are being funded through proceeds from the sale of assets held within the Rabbi Trust. The fair value of the bond mutual funds and the cash surrender value of the Company-owned life insurance policies as of March 31, 2013 are recorded in Other assets, net in the accompanying unaudited condensed consolidated balance sheets. The bond mutual funds are considered to be trading securities. Gains attributable to the investments in bond mutual funds during the three months ended March 31, 2013 were \$21, and are included in selling, general and administrative expenses in the unaudited condensed consolidated statements of operations and comprehensive income. Earnings attributable to the investment in bond mutual funds during the three months ended March 31, 2012 were not significant.

In conjunction with a change in the administrative service provider, life insurance provider and trustee associated with its deferred compensation plans, Kforce surrendered certain of its Company-owned life insurance policies that were not eligible for a Section 1035 tax-free exchange in September 2012, which collectively had a cash surrender value of approximately \$6,250. These proceeds, less the distributions out of the Rabbi Trust, were held in a cash account within the Rabbi Trust as of March 31, 2013.

**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.



## Table of Contents

The underlying investments within Kforce's deferred compensation plans include bond mutual funds. Assets held within the 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.

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

Assets/(Liabilities) Measured at Fair Value:		Quoted Prices in Active Markets for Identical Assets (Level 1)			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Asset/(Liability)						
<i>As of March 31, 2013:</i>						
Recurring basis:						
Bond mutual funds (1)	\$ 3,056	\$ 3,056	\$	\$		
Credit Facility (2)	\$ (39,549)	\$	\$	\$ (39,549)		
<i>As of December 31, 2012:</i>						
Recurring basis:						
Bond mutual funds (1)	\$ 4,124	\$ 4,124	\$	\$		
Credit Facility (2)	\$ (21,000)	\$	\$	\$ (21,000)		

(1) See Employee Benefit Plans within Note D to the unaudited condensed consolidated financial statements for additional discussion.

(2) 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.

**Table of Contents****Stock Options**

The following table presents the activity under the 2006 Stock Incentive Plan and the Incentive Stock Option Plan (the 2013 Stock Incentive Plan was not approved by shareholders until after the end of the first quarter) for the three months ended March 31, 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	(10)	(10)	(20)	\$ 9.05	\$ 128
Forfeited/Cancelled				\$	
Outstanding and Exercisable as of March 31, 2013	144	83	227	\$ 11.03	

No compensation expense was recorded during the three months ended March 31, 2013 or 2012. As of March 31, 2013, there was no unrecognized compensation cost related to non-vested options.

**Restricted Stock and Performance-Accelerated Restricted Stock**

RS and PARS are periodically granted to certain Kforce executives and is 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 three months ended March 31, 2013 will vest over a period of five years with 20% of the awards vesting annually. There were no PARS outstanding as of March 31, 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 three months ended March 31, 2013:

	# of RS	Weighted Average Grant Date Fair Value
Outstanding as of December 31, 2012	38	\$ 12.11
Granted	313	\$ 14.58
Outstanding as of March 31, 2013	351	\$ 14.32

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 all outstanding and unvested long-term incentives, including the RS and PARS, 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 \$274 and \$2,808 during the three months ended March 31, 2013 and 2012, respectively. As of March 31, 2013, total unrecognized compensation expense related to RS was \$4,629, which will be recognized over a weighted average remaining period of 4.6 years.



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

Kforce recognized total compensation expense related to PARS of \$0 and \$23,344 during the three months ended March 31, 2013 and 2012, respectively.

**Table of Contents****Note G Goodwill and Other Intangible Assets**

The following table sets forth the activity in goodwill and other intangible assets during the three months ended March 31, 2013:

	<b>Goodwill</b>	<b>Other Intangible Assets, Net</b>	<b>Total</b>
Balance as of December 31, 2012	\$ 63,410	\$ 5,736	\$ 69,146
Amortization of intangible assets		(193)	(193)
Other		2	2
Balance as of March 31, 2013	\$ 63,410	\$ 5,545	\$ 68,955

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

As of March 31, 2013 and December 31, 2012, accumulated amortization for intangible assets was \$24,633 and \$24,440, respectively. The estimated remaining amortization expense is \$554 for 2013, \$634 for 2014, \$634 for 2015, \$457 for 2016 and \$209 for 2017.

**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 months ended March 31, 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. The following table provides information concerning the continuing operations of our segments for the three months ended March 31, 2013 and 2012:

	<b>Tech</b>	<b>FA</b>	<b>HIM</b>	<b>GS</b>	<b>Total</b>
<i>Three Months Ended March 31:</i>					
2013					
Net service revenues:					
Flexible billings	\$ 162,840	\$ 49,861	\$ 18,544	\$ 22,830	\$ 254,075
Search fees	4,795	6,665	92		11,552
Total net service revenues	\$ 167,635	\$ 56,526	\$ 18,636	\$ 22,830	\$ 265,627
Gross profit	\$ 48,799	\$ 21,293	\$ 5,980	\$ 7,264	\$ 83,336
2012					
Net service revenues:					
Flexible billings	\$ 160,394	\$ 54,638	\$ 19,322	\$ 22,988	\$ 257,342
Search fees	5,261	5,618	129		11,008
Total net service revenues	\$ 165,655	\$ 60,256	\$ 19,451	\$ 22,988	\$ 268,350

Edgar Filing: KFORCE INC - Form 10-Q

Gross profit	\$	45,800	\$	21,501	\$	6,494	\$	7,030	\$	80,825
--------------	----	--------	----	--------	----	-------	----	-------	----	--------

---

## **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 three months ended March 31, 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 three months ended March 31, 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 for the three months ended March 31, 2013 and 2012 include activity relating to KCR as discontinued operations. 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 three months ended March 31, 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 three months ended March 31, 2013 decreased 1.0% to \$265.6 million from \$268.4 million in the comparable period in 2012.

Flex revenues for the three months ended March 31, 2013 decreased 1.3% to \$254.1 million from \$257.3 million in the comparable period in 2012.

Flex gross profit margin for the three months ended March 31, 2013 increased 120 basis points to 28.3% from 27.1% in the comparable period in 2012, primarily as a result of an increase in the spread between our bill and pay rates. Flex gross profit margins increased 170 basis points for Tech, 20 basis points for FA and 120 basis points for GS and decreased 110 basis points for HIM. Also, during the three months ended March 31, 2012, Kforce accrued a liability of \$1.9 million related to audits by state taxing authorities, which negatively impacted Flex gross profit margin by 50 basis points for the three months ended March 31, 2012.

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

Selling, general and administrative ( SG&A ) expenses as a percentage of revenues for the three months ended March 31, 2013 decreased to 28.5% from 40.3% 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 three months ended March 31, 2012.

Net income of \$3.1 million for the three months ended March 31, 2013 declined \$1.0 million from net income of \$4.1 million in the comparable period in 2012.

Earnings per share for the three months ended March 31, 2013 decreased to \$0.09 from \$0.12 in the comparable period in 2012.

During the three months ended March 31, 2013, Kforce repurchased approximately 0.4 million shares of common stock at a total cost of approximately \$5.9 million.

## **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 Months Ended March 31, 2013 and 2012***

Net service revenues for the three months ended March 31, 2013 and 2012 were \$265.6 million and \$268.4 million, respectively, which represents a decrease of 1.0%. The decrease was primarily due to our FA segment (which represents approximately 21% of our net service revenues), which had a year-over-year decrease in net service revenues of 6.2%. This was partially offset by a year-over-year increase in our Tech segment (which represents approximately 63% of our total net service revenues) of 1.2%. Net service revenues for HIM decreased 4.2% and our GS segment experienced a 0.7% decrease in net service revenues during the three months ended March 31, 2013 compared to the three months ended March 31, 2012. Search revenues increased 4.9% on a year-over-year basis.

Flex gross profit margins increased 120 basis points to 28.3% compared to 27.1% for the three months ended March 31, 2013 and 2012, respectively, primarily as a result of an increase in the spread between our bill rates and pay rates and the recording in the quarter ended March 31, 2012 of a contingent liability of \$1.9 million (\$1.4 million impact to gross profit; \$0.5 million impact to SG&A) related to sales, income and gross receipts tax audits in the first quarter of 2012. Kforce experienced year-over-year increases in Flex gross profit margins for the Tech, FA and GS segments of 170 basis points, 20 basis points and 120 basis points, respectively. These increases were partially offset by a year-over-year decrease in HIM Flex gross profit margins of 110 basis points which was partially attributable to a few large projects that were ongoing during the first quarter of 2012 that were completed in the second half of 2012 as well as costs associated with a consultant retention program. SG&A expenses as a percentage of net service revenues were 28.5% and 40.3% for the three months ended March 31, 2013 and 2012, respectively. The decrease in SG&A expenses as a percentage of net service revenues 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, that was recorded during the three months ended March 31, 2012.

From an economic standpoint, temporary employment figures and trends are important indicators of staffing demand, which continue 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 March 2013 was at 1.94% up slightly from 1.90% at the end of 2012. Economic forecasters estimate that the penetration rate could surpass the prior peak of 2.03% reached in April 2000 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 March 2013, non-farm payroll expanded by 88,000 jobs in March 2013. 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 3.8% as of March 31, 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**

Net service revenues for our GS segment decreased 0.7% for the three months ended March 31, 2013 as compared to the three months ended March 31, 2012. In recent years, GS has taken measures to increase its Flex gross profit (in absolute dollars) and Flex gross profit percentage by changing its business strategy and profile. 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 began on March 1, 2013 and the potential impact on GS and the budgets of the federal agencies that are clients of our GS segment, there has not been a material adverse impact on GS operations. With that said, we continue to review the GS reporting unit on an ongoing basis for any potential triggering events that could necessitate an interim goodwill impairment test and an increased risk surrounding federal deficits and sequestration, in addition to those considered in the assumptions used within the annual goodwill impairment test performed as of December 31, 2012, may indicate future impairment in the GS reporting unit, which could be material. Goodwill allocated to the GS reporting unit as of March 31, 2013 and December 31, 2012 was \$33.5 million.

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) 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 (v) 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 highly 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 for the three months ended March 31:

	2013	2012
Net Service Revenues by Segment:		
Tech	63.1%	61.7%
FA	21.3	22.5
HIM	7.0	7.2
GS	8.6	8.6
Net service revenues	100.0%	100.0%
Revenue by Type:		
Flex	95.7%	95.9%
Search	4.3	4.1
Net service revenues	100.0%	100.0%
Gross profit	31.4%	30.1%
Selling, general and administrative expenses	28.5%	40.3%
Depreciation and amortization	0.9%	1.1%
Income (loss) from continuing operations before income taxes	1.9%	(11.4)%
Income (loss) from continuing operations	1.2%	(6.6)%
Net income	1.2%	1.5%

**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 months ended March 31:

<i>(in \$000 s)</i>	2013	Increase (Decrease)	2012
<b>Tech</b>			
Flex	\$ 162,840	1.5%	\$ 160,394
Search	4,795	(8.9)%	5,261
Total Tech	\$ 167,635	1.2%	\$ 165,655
<b>FA</b>			
Flex	\$ 49,861	(8.7)%	\$ 54,638
Search	6,665	18.6%	5,618
Total FA	\$ 56,526	(6.2)%	\$ 60,256
<b>HIM</b>			
Flex	\$ 18,544	(4.0)%	\$ 19,322
Search	92	(28.7)%	129
Total HIM	\$ 18,636	(4.2)%	\$ 19,451
<b>GS</b>			
Flex	\$ 22,830	(0.7)%	\$ 22,988
Search			
Total GS	\$ 22,830	(0.7)%	\$ 22,988
Total Flex	\$ 254,075	(1.3)%	\$ 257,342
Total Search	11,552	4.9%	11,008
Total Revenues	\$ 265,627	(1.0)%	\$ 268,350

**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 the three months ended March 31, 2013 and 2012, there were 63 and 64 billing days, respectively.

Flex revenues for our largest segment, Tech, experienced modest growth during the first quarter of 2013 of 1.5% as compared to the first quarter of 2012 (3.2% on a billing day basis). A recent 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 to take advantage of this expected growth. In order to capture this expected demand, Kforce increased its Tech staffing headcount 5.9% in the first quarter of 2013 on a sequential basis and 26.3% on a year-over-year basis, which we believe will assist our field sales teams in capturing expected market demand. 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 8.7% during the three months ended March 31, 2013 as compared to 2012. In its April 2013 update, SIA revised its finance and accounting 2013 growth projections from 7% to 5%. Management believes that the investments made in revenue responsible headcount within FA staffing in the third and fourth quarters of 2012 will begin to positively impact revenues as 2013 progresses due to improvements in associate productivity that typically come with tenure.





**Table of Contents**

Flex revenues for HIM decreased 4.0% for the three months ended March 31, 2013 as compared to 2012. The decrease is partially attributable to a few large projects that were ongoing during the first quarter 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 in 2013.

Our GS segment experienced a decrease of 0.7% in net service revenues for the three months ended March 31, 2013 as compared to the three months ended March 31, 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 2013.

The following table details total Flex hours for each segment and percentage changes over the prior period for the three months ended March 31:

<i>(in 000 s)</i>	2013	Increase (Decrease)	2012
Tech	2,517	2.4%	2,459
FA	1,498	(7.2)	1,615
HIM	273	(7.5)	295
Total hours	4,288	(1.9)%	4,369

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 months ended March 31:

<i>(in \$000 s)</i>	2013	Increase (Decrease)	2012
Tech	\$ 1,520	(1.2)%	\$ 1,539
FA	142	5.2	135
HIM	1,456	(18.1)	1,777
GS	108	107.7	52
Total billable expenses	\$ 3,226	(7.9)%	\$ 3,503

**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 4.9% for the three months ended March 31, 2013 compared to 2012. We believe the increase over the prior year reflects clients who are continuing to selectively rebuild staff after significant reductions during the most recent economic recession. We expect slight growth in Search revenues for the remainder of 2013.

Total placements for each segment and percentage changes over the prior period were as follows for the three months ended March 31:

	2013	Increase (Decrease)	2012
Tech	310	(8.0)%	337
FA	549	24.5	441
HIM	6	(71.4)	21
Total placements	865	8.3%	799

**Table of Contents**

The average placement fee for each segment and percentage changes over the prior period were as follows for the three months ended March 31:

	2013	Increase (Decrease)	2012
Tech	\$ 15,472	(1.0)%	\$ 15,624
FA	12,135	(4.7)	12,734
HIM	15,363	151.0	6,121
Total average placement fee	\$ 13,352	(3.1)%	\$ 13,778

**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 months ended March 31:

	2013	Increase (Decrease)	2012
Tech	29.1%	5.4%	27.6%
FA	37.7	5.6	35.7
HIM	32.1	(3.9)	33.4
GS	31.8	3.9	30.6
Total gross profit percentage	31.4%	4.3%	30.1%

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 March 31, 2013, compared to the same period in 2012, was \$0.5 million, composed of a \$0.9 million increase in volume and a \$0.4 million decrease in rate.

The following table presents, for each segment, the Flex gross profit percentage and percentage change over the prior period for the three months ended March 31:

	2013	Increase (Decrease)	2012
Tech	27.0%	6.7%	25.3%
FA	29.3	0.7	29.1
HIM	31.8	(3.3)	32.9
GS	31.8	3.9	30.6
Total Flex gross profit percentage	28.3%	4.4%	27.1%

The increase in Flex gross profit for the three months ended March 31, 2013, compared to the same period in 2012, was \$2.0 million, composed of an \$0.9 million decrease in volume and a \$2.9 million increase in rate. The Flex gross profit percentage was negatively impacted during the three months ended March 31, 2012 by the recording of a contingent liability of \$1.4 million related to sales, income and gross receipts tax audits.

A significant 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 continue to expand slightly for the remainder of 2013 as compared to 2012 based on expected improvements in bill and pay spread offsetting expected increases in statutory payroll costs.



**Table of Contents**

**Selling, General and Administrative Expenses ( SG&A ).** For the three months ended March 31, 2013 and 2012, total commissions, compensation, payroll taxes, and benefit costs as a percentage of SG&A represented 84.3% and 89.3%, respectively. Commissions and related payroll taxes and benefit costs are variable costs driven primarily by revenue and gross profit levels, and associated performance. As the performance of our recently added revenue responsible headcount improves, we expect to gain operating leverage. Therefore, SG&A expenses would generally be anticipated to decline as a percentage of revenues in the second half of 2013.

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 months ended March 31:

<i>(in \$000 s)</i>	<b>2013</b>	<b>% of Revenues</b>	<b>2012</b>	<b>% of Revenues</b>
Compensation, commissions, payroll taxes and benefits costs	\$ 63,783	24.0%	\$ 96,566	36.0%
Other	11,910	4.5	11,549	4.3
<b>Total SG&amp;A</b>	<b>\$ 75,693</b>	<b>28.5%</b>	<b>\$ 108,115</b>	<b>40.3%</b>

SG&A as a percentage of net service revenues decreased to 28.5% of net services revenues for the three months ended March 31, 2013 as compared to 40.3% for the comparable period in 2012. This was primarily attributable to the following:

Decrease in compensation and benefits cost of 12.7% of net service revenues, which was primarily related to an increase in stock-based compensation expense and related payroll taxes for 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 three months ended March 31, 2012. Additionally, as disclosed within Kforce's Proxy Statement filed with the SEC on March 8, 2013, Kforce restructured its NEO compensation framework for 2013 to provide better alignment with compensation of the broader market for similarly-sized companies, which reduced overall compensation levels.

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

Increase in commission expense, staffing expense and travel expense of 1.1% of net service revenues in the aggregate. These increases 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.

**Goodwill Impairment.** Net service revenues for our GS segment decreased 0.7% for the three months ended March 31, 2013 as compared to the three months ended March 31, 2012. In recent years, GS has taken measures to increase its Flex gross profit (in absolute dollars) and Flex gross profit percentage by changing its business strategy and profile. 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 began on March 1, 2013 and the potential impact on GS and the budgets of the federal agencies that are clients of our GS segment, there has not been a material adverse impact on GS operations. With that said, we continue to review the GS reporting unit on an ongoing basis for any potential triggering events that could necessitate an interim goodwill impairment test. The increased risk surrounding federal deficits and sequestration, in addition to those considered in the assumptions used within the annual goodwill impairment test performed as of December 31, 2012, may indicate future impairment in the GS reporting unit, which could be material. Goodwill allocated to the GS reporting unit as of March 31, 2013 and December 31, 2012 was \$33.5 million.

**Table of Contents**

**Depreciation and Amortization.** The following table presents depreciation and amortization expense and percentage changes over the prior period by major category for the three months ended March 31:

<i>(in \$000 s)</i>	2013	% Increase (Decrease)	2012
Fixed asset depreciation	\$ 993	13.1%	\$ 878
Capital lease asset depreciation	420	1.0	416
Capitalized software amortization	791	(41.5)	1,351
Intangible asset amortization	193	(18.6)	237
Total depreciation and amortization	\$ 2,397	(16.8)%	\$ 2,882

The \$0.5 million decrease in capitalized software amortization during the three months ended March 31, 2013 compared to 2012 is the result of certain software becoming fully depreciated during the second half of 2012.

**Other Expense, Net.** Other expense, net was \$0.3 million and \$0.4 million for the three months ended March 31, 2013 and 2012, respectively, and 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 three months ended March 31, 2013 and 2012 was 38.0% and (42.0)%, respectively. Kforce's effective rate for the three months ended March 31, 2013 compared to the three months ended March 31, 2012 was primarily a result of a loss from continuing operations during the three months ended March 31, 2012 largely driven by the acceleration of long-term incentives.

**Income from Discontinued Operations, Net of Income Taxes.** Discontinued operations include 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 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 three months ended March 31, 2012 was 45.3%.

**Adjusted EBITDA.** Adjusted EBITDA, a non-GAAP financial measure, is defined by Kforce as net income (loss) before discontinued operations, 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.

**Table of Contents**

The following table presents Adjusted EBITDA results and includes a reconciliation of Adjusted EBITDA to net income for the three months ended March 31, 2013 and 2012:

	2013	Three Months Ended March 31, Per Share	2012	Per Share
Net income	\$ 3,094	\$ 0.09	\$ 4,076	\$ 0.12
Income from discontinued operations, net of taxes			21,803	0.63
Income (loss) from continuing operations	3,094	0.09	(17,727)	(0.51)
Depreciation and amortization	2,397	0.07	2,882	0.08
Acceleration of RS and PARS			22,158	0.64
Amortization of RS and PARS	274	0.00	3,439	0.10
Interest expense and other	243	0.00	338	0.01
Income tax expense (benefit)	1,896	0.07	(12,837)	(0.37)
Adjusted EBITDA	\$ 7,904	\$ 0.23	\$ (1,747)	\$ (0.05)

**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 March 31, 2013, Kforce had \$90.0 million in working capital compared to \$72.7 million at December 31, 2012. Kforce's current ratio (current assets divided by current liabilities) was 1.9 at March 31, 2013 compared to 1.7 at December 31, 2012.

The accompanying Unaudited Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011 provide a more detailed description of our cash flows. 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) reducing the outstanding balance of our Credit Facility; (iii) repurchasing our common stock; (iv) investing in our infrastructure to allow sustainable growth via capital expenditures; and (v) making strategic acquisitions.

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, cash flow, liquidity and 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 and dividends.

The following table presents a summary of our net cash flows from operating, investing and financing activities for the three months ended March 31:

	2013	2012
Cash (used in) provided by:		
Operating activities	\$ (8,414)	\$ 2,473
Investing activities	(2,070)	46,298
Financing activities	10,010	(48,848)
Increase (decrease) in cash and cash equivalents	\$ (474)	\$ (77)

*Discontinued Operations*

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

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 three months ended March 31, 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.



## **Table of Contents**

### **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 deferred compensation. These adjustments are more fully detailed in our Unaudited Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 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 three months ended March 31, 2013 and 2012 were \$1.9 million and \$1.0 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 investing activities during the three months ended March 31, 2012.

We expect to leverage our existing infrastructure that has been built over the last several years and selectively invest at moderate levels 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.

### **Financing Activities**

During the three months ended March 31, 2013, open market repurchases of common stock totaled approximately \$8.4 million, which was comprised of approximately \$5.9 million in common stock repurchases during the first quarter of 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 March 31, 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 March 31, 2013, outstanding borrowings were \$39.5 million and \$47.0 million was available under the Credit Facility. During the three months ended March 31, 2013, maximum outstanding borrowings under the Credit Facility were \$46.9 million. As of May 7, 2013, \$33.6 million was outstanding and \$53.0 million was available under the Credit Facility.



## **Table of Contents**

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

Kforce provides letters of credit to certain vendors in lieu of cash deposits. At March 31, 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 three months ended March 31, 2013, Kforce repurchased approximately 0.4 million shares of common stock at a total cost of approximately \$5.9 million. As of March 31, 2013, \$83.9 million remains available for future repurchases.

### **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 March 31, 2013, there was \$39.5 million outstanding under our Credit Facility. Our weighted average effective interest rate on our Credit Facility was 1.9% at March 31, 2013. A hypothetical 10% increase in interest rates in effect at March 31, 2013 would not have any significant effect on Kforce's annual interest expense.

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 three months ended March 31, 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 March 31, 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 is recorded within accounts payable and other accrued liabilities in the accompanying consolidated balance sheet as of March 31, 2013 and December 31, 2012. An appeal of the settlement was dismissed in April 2013, and we now expect the settlement to be consummated during the three months ended June 30, 2013.

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 three months ended March 31, 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 March 31, 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
January 1, 2013 to January 31, 2013		\$		\$ 39,861,995
February 1, 2013 to February 28, 2013		\$		\$ 89,861,995
March 1, 2013 to March 31, 2013	409,489	\$ 14.53	409,489	\$ 83,912,120
Total	409,489	\$ 14.53	409,489	\$ 83,912,120

(1) All of the shares reported above as purchased are attributable to shares repurchased on 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.**

<b>Exhibit Number</b>	<b>Description</b>
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)
10.1	Amended and Restated Employment Agreement, dated as of January 1, 2013, between Kforce Inc. and David M. Kelly. (6)
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. (7)

- (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 February 7, 2007.
- (6) Incorporated by reference to the Registrant's Current Report on Form 8-K (File No. 000-26058) filed January 3, 2013.
- (7) 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: May 10, 2013

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

Date: May 10, 2013

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