We Love What We Do. We Love Who We Serve.®

Q1 2023
CONFERENCE CALL

Prepared remarks from:
Joseph J. Liberatore, President, and CEO
David M. Kelly, EVP and Chief Financial Officer
Kye Mitchell, EVP and Chief Operations Officer

Disclaimer

All statements in this press release, other than those of a historical nature, are forward-looking statements including, but not limited to, statements regarding the strength of the secular drivers of demand in technology remaining intact, the catalysts for continued long-term, sustainable, above-market performance, the Firm's expected 2023 operating cash flows, the Firm's incremental investments in its business and the benefit of such investments to the Firm's shareholders in the long term, the Firm's commitment to return capital to its shareholders regardless of the economic climate, the intent and ability to declare and pay quarterly dividends, and the Firm's guidance for the second quarter of 2023. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Factors that could cause actual results to differ materially include the following: business conditions; growth rate in temporary staffing and the general economy; competitive factors; risks due to shifts in the market demand; changes in client demand or our ability to adapt to such changes; a constraint in the supply of consultants and candidates or the Firm's ability to attract and retain such individuals; the success of the Firm in attracting and retaining its management team and key operating employees; changes in business or service mix; ability of the Firm to repurchase shares; the occurrence of unanticipated expenses, income, gains or losses; the effect of adverse weather conditions; changes in our effective tax rate; our ability to comply with government regulations, laws, orders, guidelines and policies that impact our business; risk of contract performance, delays or termination or the failure to obtain new assignments or contracts, or funding under contracts; ability to comply with our obligations in a remote work environment; continued performance of and improvements to our enterprise information systems; impacts of actual or potential litigation or other legal or regulatory matters or liabilities, including the risk factors and matters listed from time to time in the Firm's reports filed with the Securities and Exchange Commission, including, but not limited to, the Firm's Form 10-K for the fiscal year ended December 31, 2022, as well as assumptions regarding the foregoing. The terms "should," "believe," "estimate," "expect," "intend," "anticipate," "foresee," "plan," "in our view" and similar expressions and variations thereof contained in this press release identify certain of such forward-looking statements, which speak only as of the date of this press release. As a result, such forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Future events and actual results may differ materially from those indicated in the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements and the Firm undertakes no obligation to update any forward-looking statements.

JOE LIBERATORE, PRESIDENT AND CEO

Good afternoon. This call contains certain statements that are forward-looking. These statements are based upon current assumptions and expectations and are subject to risks and uncertainties. Actual results may vary materially from the factors listed in Kforce's public filings and other reports and filings with the Securities and Exchange Commission. We cannot undertake any duty to update any forward-looking statements. You can find additional information about our results in our earnings release and our SEC filings. In addition, we have published our prepared remarks within the Investor Relations portion of our website.

On this call, we will discuss certain non-GAAP items. The non-GAAP financial measures provided should not be considered as a substitute for or superior to the measures of financial performance prepared in accordance with GAAP. They are included as additional clarifying items to aid investors in further understanding the impact these items and events have on the financial results. Our earnings press release provides the reconciliation of differences between GAAP and non-GAAP financial measures.

Let me start by offering a few comments about the current operating environment, which is informed by our internal metrics, discussions with clients, and other industry data points. There is a heightened degree of uncertainty in the macro-economic environment as we sit here today versus one quarter ago with two 25 basis point Fed interest rate hikes; the collapse of several financial institutions; a recent rise in unemployment claims and other factors that all point to a higher likelihood that the U.S.

economy could fall into a recession. Our clients, broadly speaking, continue to exercise restraint against the backdrop of this uncertainty as it relates to certain technology spend that can be moderated without significant impacts. We have not seen; however, instances of mission critical projects being postponed.

As to our financial performance in the first quarter, revenues were at the low end of our guidance and our Technology staffing and solutions business continued to grow on a year-over-year basis even off of tremendous prior year comps. Earnings per share was at the midpoint of our expectations despite revenues falling at the bottom end of our guidance, which reflects our highly variable and performance-based cost model. The pace of decline as we finished the first quarter moderated significantly in our Technology business as compared to the month following our last earnings call. As to our second quarter expectations, we anticipate the average number of billable consultants on assignment to be relatively stable with current levels.

As we look further into the future, we remain steadfast in our beliefs in two areas.

First, we believe that the long-term secular drivers of demand in technology are very much intact and will persist in the future irrespective of how the short-term environment plays out. The strength of the secular drivers of demand in technology accelerated coming out of both the Great Recession and the Pandemic and it remains clear to us that the broad and strategic uses of technology, including the recent headlines that GenAI technologies have garnered, will continue. Said simply, technology investments are simply not optional in today's competitive and disruptive business climate where the talent necessary to make those advancements remains in short supply. Our core competency is rooted in the ability to identify and provide these critical resources real-time at scale in virtually every industry. While our business is not immune from the impacts of economic turbulence, technology spend is increasingly resilient and less correlated than other areas where companies utilize flexible talent, as was reflected in the two most recent economic downturns. There is simply no other market we would want to be focused in other than the domestic technology talent solutions space.

Second, we expect the sharpening in our focus that has occurred over the last decade to continue to contribute to our market outperformance. We have built a solid foundation at Kforce and are partnering with stable world-class companies to solve complex problems and help them competitively transform their businesses. Our balance sheet is clean, and we expect our strong cash flows to continue providing us great flexibility to return significant capital to our shareholders. We have a solid, highly tenured team in place with the expectation of continuing to capture additional market share. Our Executive Leadership team has been through multiple economic cycles and has the experience to skillfully navigate through whatever may lie ahead.

We have continued to make strategic investments to both enhance internal productivity and meet the needs of our customers in various engagement models. Our team has also continued to meaningfully advance our multi-year effort to transform our back-office operations. In addition, we published our 2022 Sustainability Report in mid-February 2023, which not only memorialized our recent accomplishments but also outlined our opportunities for continued growth and evolution with our 2023 goals that push for even greater progress in each area of ESG. We remain committed to our Office-Occasional work environment, which continues to positively impact the lives of our associates by providing our people with maximum flexibility and choice in designing their workdays that is grounded in our trust in them and supported by technology. This has resulted in improved retention of our associates and positions Kforce as a destination for top talent. Kforce is proud to be certified as a Great Place to Work, which distinguishes Kforce as one of the best companies to work for in the country.

As we look ahead, we expect to continue making the necessary investments in our business to further advance our enterprise priorities to sustain our long-term growth ambitions and attain double digit operating margins while prudently managing our operating costs. Kye Mitchell, our Chief Operations Officer, will now give greater insights into our performance and recent operating trends. Dave Kelly, Kforce's Chief Financial Officer will then provide additional detail on our financial results as well as our future financial expectations.

KYE MITCHELL, EVP AND CHIEF OPERATIONS OFFICER

Revenues in our technology staffing and solutions business grew 1.4% on a year-over-year basis. Overall revenues declined 2.6% year-over-year.

On our prior earnings call, we indicated the sales cycle had been longer than usual because of the uncertainty in the macroeconomic environment and select clients had begun pruning resources. We typically see a gradual increase in consultants on assignment throughout Q1, but that was not the case this year. Clients are telling us that they are committed to starting new projects that are mission critical to them and we have seen many recent wins across multiple industries. Overall average bill rates in our technology business remain near record levels at approximately $89 per hour and were up 4.7% year-over-year. The slight decline sequentially is primarily due to a change in business mix, and we expect average bill rates in the near term to be relatively stable given the continued scarcity of highly skilled technology talent. Our longer-term view continues to be that average bill rates should help our business, especially as the mix of higher value service offerings increases. Most of our consultants are in higher skill set areas which are not as sensitive to the changes in the economy. We do very little business in lower bill rate areas which are most affected by the economy. This mix is expected to provide significant revenue and margin stability.

Our clients remain focused on critical technology initiatives in the areas of cloud, digital, UI/UX, data analytics, project, and program management. Clients are telling us that they want to keep investing in technology to stay competitive, even if the economy is uncertain. While clients are currently being more careful about which projects they choose to invest in, our historical experience is that companies quickly shift their priorities and invest more in technology once the macro-economic landscape becomes clearer.

Our clients want us to continue to expand our service offerings from traditional staffing to managed teams and project solutions. Our integrated strategy leverages the relationships we have with world-class companies and all our existing sales, recruiters, and consultants to bring higher value teams and project solutions to solve our clients' challenges.

We have a broad client portfolio which includes large, market-leading customers, leading to our sustained above market growth rates. We believe this customer base will be a positive catalyst for continued long-term, sustainable, above-market growth. Our largest industry vertical, Financial Services, comprises less than 17% of technology revenues and is concentrated in what we believe are large, stable financial institutions. Layoffs within technology companies have continued to dominate the headlines in 2023. To offer you some perspective, only 5 of our top 25 clients are in the technology services or technology manufacturing space. Total revenues for those 5 companies were down approximately 4% year-over-year as compared to our overall growth of approximately 2% in the first quarter. Even though we might be susceptible to short-term disruption with certain clients or industries, we expect our diverse client base of world-class companies will benefit our shareholders in the long term.

We expect second-quarter revenues in our Technology business to decline sequentially in the low-single digits and decline in the mid-single digits year-over-year off very strong comps in the second quarter of 2022.

Our overall FA business declined approximately 28% year-over-year, which reflects the year-over-year impact of business we no longer support due to our repositioning efforts as well as a more challenging macro environment. Sequentially, our FA business experienced a 17% decline largely due to the expected wind-down of a short-term project supporting Hurricane Ian recovery efforts. We expect revenues to be down in the mid-20% range on a year-over-year basis in the second quarter, which reflects a sequential decline of near double-digit levels as the short-term project concludes. We continue to support our FA business and improve its alignment with our Technology business. Evidence of this progress is that our average bill rate in FA, excluding the Hurricane Ian project, in the first quarter of 2023 is $52 compared to $38 in the first quarter of 2020.

As usual, we are managing associates' productivity and are focused on retaining our most productive associates so that we are positioned to take advantage of the market when it reaccelerates. We also continue to make targeted investments to improve our managed teams and project solutions capabilities. We're happy to announce that we recently received the highest rating for corporate culture from Glassdoor, as well as the highest ranking in our industry.

We're thankful for the trust our clients, consultants, and candidates have in us, and we could not have achieved our first quarter results without our incredible team. Our people are the reason for our success, and we are grateful for their hard work and dedication. I will now turn the call over to Dave Kelly, Kforce's Chief Financial Officer.

DAVID M. KELLY, EVP AND CHIEF FINANCIAL OFFICER

First quarter revenues of $406.0 million declined 2.6% year-over-year and earnings per share were 82 cents.

Overall gross margins decreased 40 basis points sequentially and 160 basis points year-over-year to 28.1% in the first quarter due to a combination of a lower mix of direct hire revenue and a decline in Flex margins.

Flex margins of 25.9% in our Technology business declined 20 basis points sequentially and 90 basis points year-over-year due to higher healthcare costs and modest declines in bill-pay spreads due to heightened price sensitivities and changes in business mix. The year-over-year decline in Technology Flex margins is fairly typical of what we have seen in prior slowdowns; and we typically see margins recover as the macroeconomic environment stabilizes. Our ability to maintain reasonably consistent margins, even during times of economic slowdown is reflective of the supply/demand imbalance for highly skilled technology talent. As additional reference, margins in our Technology business in 2022 were consistent with 2021 and 2020 levels. Technology talent has been scarce for more than a decade and we expect to see continued wage increases over the longer term and relative margin stability.

Flex margins in our FA business increased 10 basis points sequentially and have improved nearly 200 basis points over the last three years as our mix of business has improved.

As we look forward to Q2, we expect spreads in our Technology business to be relatively stable with first quarter levels, though overall Technology Flex margins will be higher in Q2 due to seasonal payroll tax resets that occurred in Q1. We expect clients to be more price sensitive in the current macro environment. However, as clients increasingly engage us for projects critical to their ongoing success, including managed teams and project solutions engagements that are typically higher margin opportunities, this also supports overall margin stability.

Overall SG&A expenses, as a percentage of revenue decreased by 80 basis points year-over-year. Given our exceptional growth in 2021 and 2022, our compensation plan structure rewarded our top performing associates with very significant bonuses and commissions. With growth coming off those historically very high levels, we are generating leverage in our SG&A costs through lower overall compensation costs. We have also been successful at driving greater cost efficiencies from our real estate portfolio given our Office-Occasional model, which has allowed us to reduce overall square footage by approximately 40%. As we continue to transition our remaining office leases over the next three years, we expect to generate additional savings from further reductions in overall square footage. It is also important to note that we are closely monitoring the landscape and maintaining significant diligence in every area of discretionary spend. This allows us to generate additional SG&A leverage while also maintaining investments in critical strategic initiatives. We expect SG&A expenses as a percentage of revenue to decrease slightly sequentially in Q2.

Our first quarter operating margin was 5.8%, which was at the top end of our expectations. Our effective tax rate in the first quarter was 27.5%.

Operating cash flows were $19 million and our return on invested capital was approximately 45% in the first quarter.

We have a balance sheet with very little debt and expect to continue generating close to $120 million of operating cash flows in 2023, regardless of the operating environment. We have had a long history of returning capital to our shareholders. Since we initiated our dividend in 2014, we have increased it 360%. In addition, since 2007, we have reduced our weighted average shares outstanding from 42.3 million to 19.7 million, or more than 50%. All in, we have returned approximately $850 million in capital to our shareholders since 2007, which has represented approximately 75% of the cash we generated, while significantly growing our business and improving profitability levels. During the last two years, we have returned over 100% of cash flows through repurchases and dividends. Our plans going forward are no different as we remain committed to returning capital to our shareholders regardless of the economic climate.

With respect to guidance, the second quarter has 64 billing days, which is the same as the first quarter of 2023 and the same as the second quarter of 2022. We expect Q2 revenues to be in the range of $392 million to $400 million and earnings per share to be between 94 cents and $1.02. Second quarter earnings per share will be positively impacted by approximately 12 cents due to seasonal impacts of annual payroll tax resets.

Our guidance does not consider the potential impact of unusual or nonrecurring items that may occur.

While the current operating climate is certainly challenging, we remain excited about our strategic position and prospects for continuing to deliver above-market growth while continuing to make the necessary investments in our integrated strategy and back-office transformation efforts that will help drive long term growth and the attainment of double-digit operating margins in the future.

On behalf of our entire management team, I’d like to extend a sincere thank you to our teams for their efforts.