

KFORCE INC
Form 10-Q
August 02, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended June 30, 2017

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)

FLORIDA 59-3264661
(State or other jurisdiction of (IRS Employer
incorporation or organization) Identification No.)
1001 EAST PALM AVENUE, TAMPA, FLORIDA 33605
(Address of principal executive offices) (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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares outstanding of the registrant's common stock as of July 28, 2017 was 26,727,540.

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KFORCE INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED JUNE 30, 2017

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

References in this document to “the Registrant,” “Kforce,” “the Company,” “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, our beliefs regarding potential government actions, the impact of changes in laws and regulations, 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 overall economic outlook, developments within the staffing sector including, but not limited to, the penetration rate (the percentage of temporary staffing to total employment) and growth in temporary staffing, a reduction in the supply of candidates for temporary employment or the Firm’s ability to attract such candidates, the success of the Firm in attracting and retaining revenue-generating talent, estimates concerning goodwill impairment, risk of contract non-performance, delays or termination or the failure to obtain awards, task orders or funding under contracts, changes in client demand for our services such as the resulting impact of any significant organizational changes within our largest clients, 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 “anticipate,” “assume,” “estimate,” “expect,” “intend,” “plan,” “believe,” “will,” “may,” “could,” “should,” “suggest” and 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.

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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)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------|------------------|-----------|
| | June 30, | June 30, | June 30, | June 30, |
| | 2017 | 2016 | 2017 | 2016 |
| Net service revenues | \$340,309 | \$335,047 | \$674,301 | \$657,248 |
| Direct costs of services | 236,390 | 228,765 | 473,247 | 453,777 |
| Gross profit | 103,919 | 106,282 | 201,054 | 203,471 |
| Selling, general and administrative expenses | 82,506 | 85,474 | 167,184 | 170,929 |
| Depreciation and amortization | 2,053 | 2,252 | 4,103 | 4,579 |
| Income from operations | 19,360 | 18,556 | 29,767 | 27,963 |
| Other expense, net | 1,357 | 831 | 2,542 | 1,499 |
| Income before income taxes | 18,003 | 17,725 | 27,225 | 26,464 |
| Income tax expense | 6,859 | 6,861 | 10,179 | 11,950 |
| Net income | 11,144 | 10,864 | 17,046 | 14,514 |
| Other comprehensive (loss) income: | | | | |
| Defined benefit pension plans, net of tax | (4) | (2) | (9) | (5) |
| Change in fair value of interest rate swap, net of tax | (112) | — | (112) | — |
| Comprehensive income | \$11,028 | \$10,862 | \$16,925 | \$14,509 |
| Earnings per share – basic | \$0.44 | \$0.41 | \$0.68 | \$0.55 |
| Earnings per share – diluted | \$0.44 | \$0.41 | \$0.67 | \$0.55 |
| Weighted average shares outstanding – basic | 25,273 | 26,180 | 25,248 | 26,436 |
| Weighted average shares outstanding – diluted | 25,482 | 26,335 | 25,542 | 26,587 |
| Dividends declared per share | \$0.12 | \$0.12 | \$0.24 | \$0.24 |

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

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KFORCE INC. AND SUBSIDIARIES
 UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
 (IN THOUSANDS)

| | June 30, 2017 | December 31, 2016 |
|---|------------------|----------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$3,532 | \$ 1,482 |
| Trade receivables, net of allowances of \$2,226 and \$2,066, respectively | 225,408 | 206,361 |
| Income tax refund receivable | 1,717 | 172 |
| Prepaid expenses and other current assets | 10,920 | 10,691 |
| Total current assets | 241,577 | 218,706 |
| Fixed assets, net | 41,892 | 43,145 |
| Other assets, net | 35,872 | 30,511 |
| Deferred tax assets, net | 21,081 | 23,449 |
| Intangible assets, net | 3,470 | 3,642 |
| Goodwill | 45,968 | 45,968 |
| Total assets | \$389,860 | \$ 365,421 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable and other accrued liabilities | \$32,228 | \$ 37,230 |
| Accrued payroll costs | 46,428 | 44,137 |
| Other current liabilities | 1,888 | 1,765 |
| Income taxes payable | 486 | 221 |
| Total current liabilities | 81,030 | 83,353 |
| Long-term debt – credit facility | 124,128 | 111,547 |
| Long-term debt – other | 3,256 | 3,984 |
| Other long-term liabilities | 46,359 | 44,801 |
| Total liabilities | 254,773 | 243,685 |
| Commitments and contingencies (see Note B) | | |
| Stockholders' Equity: | | |
| Preferred stock, \$0.01 par; 15,000 shares authorized, none issued and outstanding | — | — |
| Common stock, \$0.01 par; 250,000 shares authorized, 71,263 and 71,268 issued, respectively | 713 | 713 |
| Additional paid-in capital | 433,310 | 428,212 |
| Accumulated other comprehensive income | 63 | 184 |
| Retained earnings | 185,221 | 174,967 |
| Treasury stock, at cost; 44,542 and 44,469 shares, respectively | (484,220) | (482,340) |
| Total stockholders' equity | 135,087 | 121,736 |
| Total liabilities and stockholders' equity | \$389,860 | \$ 365,421 |

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

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

| | Six Months Ended June 30, 2017 |
|--|--------------------------------------|
| Common stock – shares: | |
| Shares at beginning of period | 71,268 |
| Issuance for stock-based compensation and dividends, net of forfeitures | (10) |
| Exercise of stock options | 5 |
| Shares at end of period | 71,263 |
| Common stock – par value: | |
| Balance at beginning of period | \$713 |
| Issuance for stock-based compensation and dividends, net of forfeitures | 0 |
| Exercise of stock options | 0 |
| Balance at end of period | \$713 |
| Additional paid-in capital: | |
| Balance at beginning of period | \$428,212 |
| Cumulative effect upon adoption of new accounting standard (Note A) | 769 |
| Issuance for stock-based compensation and dividends, net of forfeitures | 244 |
| Exercise of stock options | 72 |
| Stock-based compensation expense | 3,869 |
| Employee stock purchase plan | 144 |
| Balance at end of period | \$433,310 |
| Accumulated other comprehensive income: | |
| Balance at beginning of period | \$184 |
| Defined benefit pension plans, net of tax of \$5 | (9) |
| Change in fair value of interest rate swap, net of tax of \$70 | (112) |
| Balance at end of period | \$63 |
| Retained earnings: | |
| Balance at beginning of period | \$174,967 |
| Cumulative effect upon adoption of new accounting standard (Note A), net of tax of \$300 | (469) |
| Net income | 17,046 |
| Dividends, net of forfeitures (\$0.24 per share) | (6,323) |
| Balance at end of period | \$185,221 |
| Treasury stock – shares: | |
| Shares at beginning of period | 44,469 |
| Repurchases of common stock | 86 |
| Employee stock purchase plan | (13) |
| Shares at end of period | 44,542 |
| Treasury stock – cost: | |
| Balance at beginning of period | \$(482,340) |
| Repurchases of common stock | (2,017) |
| Employee stock purchase plan | 137 |
| Balance at end of period | \$(484,220) |

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

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

| | Six Months Ended | |
|---|------------------|------------------|
| | June 30, 2017 | June 30, 2016 |
| Cash flows from operating activities: | | |
| Net income | \$ 17,046 | \$ 14,514 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Deferred income tax provision, net | 2,738 | 2,199 |
| Provision for bad debts on accounts receivable | 356 | 774 |
| Depreciation and amortization | 4,208 | 4,600 |
| Stock-based compensation expense | 3,869 | 3,706 |
| Defined benefit pension plans expense | 479 | 954 |
| Loss on deferred compensation plan investments, net | 206 | 303 |
| Other | 595 | 124 |
| (Increase) decrease in operating assets | | |
| Trade receivables, net | (19,403) | (17,498) |
| Income tax refund receivable | (1,545) | (440) |
| Prepaid expenses and other current assets | (229) | (3,694) |
| Other assets, net | (116) | 83 |
| (Decrease) increase in operating liabilities | | |
| Accounts payable and other current liabilities | (4,126) | 1,097 |
| Accrued payroll costs | 2,572 | 8,620 |
| Income taxes payable | 265 | 1,125 |
| Other long-term liabilities | (1,376) | (516) |
| Cash provided by operating activities | 5,539 | 15,951 |
| Cash flows from investing activities: | | |
| Capital expenditures | (4,344) | (3,182) |
| Cash used in investing activities | (4,344) | (3,182) |
| Cash flows from financing activities: | | |
| Proceeds from credit facility | 611,193 | 455,028 |
| Payments on credit facility | (598,611) | (439,715) |
| Proceeds from other financing arrangements | — | 856 |
| Payments on other financing arrangements | (1,079) | (937) |
| Proceeds from exercise of stock options | 72 | 172 |
| Payments of loan financing fees | (1,688) | (144) |
| Repurchases of common stock | (2,952) | (22,185) |
| Cash dividend | (6,080) | (6,298) |
| Cash provided by (used in) financing activities | 855 | (13,223) |
| Change in cash and cash equivalents | 2,050 | (454) |
| Cash and cash equivalents at beginning of period | 1,482 | 1,497 |
| Cash and cash equivalents at end of period | \$ 3,532 | \$ 1,043 |

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

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KFORCE INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note A - Summary of Significant Accounting Policies

Unless otherwise noted below, there have been no material changes to the accounting policies presented in Note 1 - "Summary of Significant Accounting Policies" of the Notes to Consolidated Financial Statements, included in Item 8. Financial Statements and Supplementary Data of the 2016 Annual Report on Form 10-K.

Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of 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 2016 Annual Report on Form 10-K. 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. The Unaudited Condensed Consolidated Balance Sheet as of December 31, 2016 was derived from our audited Consolidated Balance Sheet as of December 31, 2016, as presented in our 2016 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 may be impacted by these factors and are not necessarily indicative of, nor comparable to, the results of operations for a full year.

Principles of Consolidation

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

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: allowance for doubtful accounts, fallouts and other accounts receivable reserves; accounting for goodwill and identifiable intangible assets; self-insured liabilities for workers' compensation and health insurance; obligations for pension plans 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.

Derivative Instrument

Kforce's interest rate swap derivative instrument is recorded at fair value on the Unaudited Condensed Consolidated Balance Sheets. The derivative instrument has been designated as a cash flow hedge; the effective portion of the gain or loss on the derivative instrument is recorded as a component of accumulated other comprehensive income, net of tax, and reclassified into earnings when the hedged item affects earnings and into the line item of the hedged item. Any ineffective portion of the gain or loss is recognized immediately into Other expense, net on the Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income. Cash flows from the derivative instrument is classified in the Unaudited Condensed Consolidated Statements of Cash Flows in the same category as the hedged item.

Stock-Based Compensation

Kforce accounts for stock-based compensation by measuring the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The cost is recognized over the requisite service period. Effective January 1, 2017, as a result of our adoption of a recently issued accounting standard, the Firm changed its accounting policy regarding forfeitures and elected to recognize them as they occur.

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Income Taxes

Effective January 1, 2017, as a result of our adoption of a recently issued accounting standard, excess tax benefits or deficiencies of deductions attributable to employees' vesting of restricted stock are reflected in Income tax expense in the accompanying Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income.

Health Insurance

Except for certain fully insured health insurance lines of coverage, Kforce retains the risk of loss for each health insurance plan participant up to \$350 thousand in claims annually. Additionally, for all claim amounts exceeding \$350 thousand, Kforce retains the risk of loss up to an aggregate annual loss of those claims of \$700 thousand. For its partially self-insured lines of coverage, health insurance costs are accrued using estimates to approximate the liability for reported claims and incurred but not reported claims, which are primarily based upon an evaluation of historical claims experience, actuarially-determined completion factors and a qualitative review of our health insurance exposure including the extent of outstanding claims and expected changes in health insurance costs.

Earnings per Share

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

For the three and six months ended June 30, 2017, there were 209 thousand and 294 thousand common stock equivalents included in the diluted WASO, respectively. For the three and six months ended June 30, 2016, there were 155 thousand and 151 thousand common stock equivalents included in the diluted WASO, respectively. For the three and six months ended June 30, 2017 and 2016, there was an insignificant amount of anti-dilutive common stock equivalents.

New Accounting Standards

Recently Adopted Accounting Standards

In March 2017, the FASB issued authoritative guidance requiring that an employer disaggregate the service cost component from the other components of net periodic benefit cost for defined benefit pension plans. The amendments also provide explicit guidance on how to present the service cost component and the other components of net periodic benefit cost in the income statement. The guidance is to be applied for annual periods beginning after December 15, 2017, including interim periods within those annual periods, and early adoption is permitted. The guidance should be applied retrospectively for the presentation of the service cost component and the other components of net periodic benefit cost in the income statements. We elected to early adopt this guidance as of January 1, 2017 due to the ease of implementation. The impact of early adoption resulted in a retrospective adjustment to the Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income to reclass the interest cost component of net periodic benefit cost from Selling, general and administrative expenses to Other expense, net. The amount of the reclassification was approximately \$0.1 million for the three months ended June 30, 2017 and June 30, 2016, respectively. The amount of the reclassification was approximately \$0.3 million and \$0.2 million for the six months ended June 30, 2017 and June 30, 2016, respectively.

In January 2017, the FASB issued authoritative guidance simplifying the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Under this guidance, an entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The guidance is to be applied for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019 and early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The guidance requires companies to apply the requirements prospectively. We elected to early adopt this guidance as of January 1, 2017 in order to simplify our processes. The adoption of this guidance did not have an impact on the Firm's consolidated financial statements.

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In March 2016, the FASB issued authoritative guidance regarding the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liability, and classification in the statement of cash flows. This guidance was effective for us on January 1, 2017. The impact of this guidance resulted in the following:

- All excess tax benefits and deficiencies will be recognized as income tax benefit or expense in the income statement. Prior to the effective date, they were recognized as a change to additional paid-in capital. The Firm will apply this amendment prospectively. For the three months ended June 30, 2017, there was an insignificant amount of excess tax benefits recorded in the accompanying Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income. For the six months ended June 30, 2017, the Firm recorded approximately \$0.2 million of excess tax benefits as a reduction to Income tax expense in the accompanying Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income. This resulted in a reduction to our effective tax rate of 0.9% and an increase to our diluted earnings per share of \$0.01 for the six months ended June 30, 2017. This accounting standard guidance is likely to create volatility in the Firm's effective tax rate in the future, though the impact is uncertain and based upon stock price changes.
- Excess tax benefits and deficiencies will be classified as an operating activity in the statement of cash flows. Prior to the effective date, they were included in financing activities in the statement of cash flows. The Firm elected to apply this amendment retrospectively. This change increased our net cash provided by operating activities by \$0.2 million and \$0.3 million for the six months ended June 30, 2017 and June 30, 2016, respectively, in the accompanying Unaudited Condensed Consolidated Statements of Cash Flows.
- An entity is allowed to make a policy election as to whether it will include an estimate for awards expected to be forfeited or whether it will account for forfeitures as they occur. The Firm elected to change its policy on accounting for forfeitures and to account for them as they occur in order to simplify our processes. This policy election is to be applied using a modified retrospective approach with a cumulative-effect adjustment to retained earnings as of the effective date. The impact to the beginning balance of retained earnings was \$0.5 million, which is net of taxes of \$0.3 million.

In November 2015, the FASB issued authoritative guidance requiring that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. This guidance was effective for us on January 1, 2017. The Firm elected to apply this guidance retrospectively. As a result, \$4.8 million of current deferred tax assets, net was reclassified to noncurrent deferred tax assets, net as of December 31, 2016.

Accounting Standards Not Yet Adopted

In June 2016, the FASB issued authoritative guidance on accounting for credit losses on financial instruments, including trade receivables. The guidance requires the application of a current expected credit loss model, which measures credit losses based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts. The guidance is to be applied for annual periods beginning after December 15, 2019, and interim periods within those annual periods, and early adoption is permitted no sooner than annual periods beginning after December 15, 2018. The guidance requires companies to apply the requirements using a modified retrospective approach. Kforce is currently evaluating the potential impact on the consolidated financial statements.

In February 2016, the FASB issued authoritative guidance regarding the accounting for leases. The guidance is to be applied for annual periods beginning after December 15, 2018, and interim periods within those annual periods, and early adoption is permitted. The guidance requires companies to apply the requirements retrospectively to all prior periods presented, including interim periods. Kforce elected not to adopt this standard early. The Firm has made progress with assessing contractual arrangements that may be impacted by the new standard. Kforce anticipates that the adoption of this standard will have a significant impact to its consolidated balance sheet as it will result in recording substantially all operating leases as a right-to-use asset and lease obligation. Kforce continues to assess all potential impacts of the standard, especially with respect to our disclosures.

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In May 2014, the FASB issued authoritative guidance regarding revenue from contracts with customers, which specifies that revenue should be recognized when promised goods or services are transferred to customers in an amount that reflects the consideration which the company expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued authoritative guidance deferring the effective date of the new revenue standard by one year for all entities. The one-year deferral results in the guidance being effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017 and entities are not permitted to adopt the standard earlier than the original effective date. Since May 2014, the FASB has issued additional and amended authoritative guidance regarding revenue from contracts with customers in order to clarify and improve the understanding of the implementation guidance. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment. We have selected the modified retrospective transition method. Based on our preliminary assessment, we believe that the timing of our revenue recognition will not be impacted for at least 95% of our revenues. The remainder of our revenues are derived from Government Solutions (“GS”) fixed-price contracts. We are reviewing these contracts in order to determine if there may be any change to the timing. We are continuing to evaluate various items that may impact our revenue transaction prices. Furthermore, we do anticipate an increase in the level of disclosure around our arrangements and resulting revenue recognition.

Note B - Commitments and Contingencies

Litigation

We are involved in legal proceedings, claims, and administrative matters that arise in the ordinary course of our business. We have made accruals with respect to certain of these matters, where appropriate, that are reflected in our unaudited condensed consolidated financial statements but are not, individually or in the aggregate, considered material. For other matters for which an accrual has not been made, we have not yet determined that a loss is probable or the amount of loss cannot be reasonably estimated. While the ultimate outcome of the matters cannot be determined, we currently do not expect that these proceedings and claims, individually or in the aggregate, will have a material effect on our financial position, results of operations, or cash flows. The outcome of any litigation is inherently uncertain, however, and if decided adversely to us, or if we determine that settlement of particular litigation is appropriate, we may be subject to liability that could have a material adverse effect on our financial position, results of operations, or cash flows. Kforce maintains liability insurance in 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, cyber liability, 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.

Accordingly, we disclose matters below for which a material loss is reasonably possible.

On August 25, 2016, Kforce Flexible Solutions LLC (along with co-defendant BMO Harris Bank) was served with a complaint brought in the Northern District of Illinois, U.S. District Court, Eastern District of Illinois; Shepard v. BMO Harris Bank N.A. et al., Case No.: 1:16-cv-08288. The plaintiff purports to bring claims on her own behalf and on behalf of a putative class of telephone-dedicated workers for alleged violations of the Fair Labor Standards Act, the Illinois Minimum Wage Law, and the Illinois Wage Payment and Collection Act based upon the defendants’ purported failure to pay her and other class members all earned regular and overtime pay for all time worked. More specifically, the plaintiff alleges that class employees were required to perform unpaid work before and after the start and end times of their shifts. She seeks unpaid back regular and overtime wages, liquidated damages, statutory penalties, and attorney fees and costs. We are vigorously defending each of the plaintiff’s claims. At this stage in the litigation it is not feasible to predict the outcome of this matter or reasonably estimate a range of loss, should a loss occur, from this proceeding. We believe, based on our current knowledge, that the final outcome of this matter is unlikely to have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows.

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 after their employment ends 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 Kforce or for good reason by the executive. These agreements contain certain post-employment restrictive covenants. Kforce's liability at June 30, 2017 would be approximately \$40.8 million if, following a change in control, all of the executives under contract were terminated without good cause by the employer or if the executives resigned for good reason and \$16.3 million if, in the absence of a change in control, all of the executives under contract were terminated by Kforce without good cause or if the executives resigned for good reason.

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Note C - Accounts Payable and Other Accrued Liabilities

Accounts payable and other accrued liabilities consisted of the following (in thousands):

| | June 30, December 31, | |
|---------------------|-----------------------|-----------|
| | 2017 | 2016 |
| Accounts payable | \$ 18,628 | \$ 20,321 |
| Accrued liabilities | 13,600 | 16,909 |
| | \$ 32,228 | \$ 37,230 |

Our accounts payable balance includes trade creditor and independent contractor payables. Our accrued liabilities balance includes the current portion of our deferred compensation plans liability, accrued customer rebates and other accrued liabilities.

Note D - Accrued Payroll Costs

Accrued payroll costs consisted of the following (in thousands):

| | June 30, December 31, | |
|-----------------------------------|-----------------------|-----------|
| | 2017 | 2016 |
| Payroll and benefits | \$ 39,342 | \$ 37,409 |
| Health insurance liabilities | 3,420 | 2,790 |
| Payroll taxes | 2,434 | 2,640 |
| Workers' compensation liabilities | 1,232 | 1,298 |
| | \$ 46,428 | \$ 44,137 |

Note E - Credit Facility

On May 25, 2017, the Firm entered into a credit agreement with Wells Fargo Bank, National Association, as administrative agent, Wells Fargo Securities, LLC, as lead arranger and bookrunner, Bank of America, N.A., as syndication agent, Regions Bank and BMO Harris Bank, N.A., as co-documentation agents, and the lenders referred to therein (the "Credit Facility"). In connection with entering into the Credit Facility, the Firm terminated in its entirety its previous credit facility. Under the Credit Facility, the Firm will have a maximum borrowing capacity of \$300.0 million, which may, subject to certain conditions and the participation of the lenders, be increased up to an aggregate additional amount of \$150.0 million (the "Commitment"), which will be available to the Firm in the form of revolving credit loans, swingline loans, and letters of credit. Letters of credit and swingline loans under the Credit Facility are subject to sublimits of \$10.0 million. The maturity date of the Credit Facility is May 25, 2022.

Revolving credit loans under the Credit Facility will bear interest at a rate equal to (a) the Base Rate (as described below) plus the Applicable Margin (as described below) or (b) the LIBOR Rate plus the Applicable Margin.

Swingline loans under the Credit Facility will bear interest at a rate equal to the Base Rate plus the Applicable Margin. The Base Rate is the highest of: (i) the Wells Fargo Bank, National Association prime rate, (ii) the federal funds rate plus 0.50% or (iii) one-month LIBOR plus 1.00%, and the LIBOR Rate is reserve-adjusted LIBOR for the applicable interest period, but not less than zero. The Applicable Margin is based on the Firm's total leverage ratio. The Applicable Margin for Base Rate loans ranges from 0.25% to 0.75% and the Applicable Margin for LIBOR Rate loans ranges from 1.25% to 1.75%. The Firm will pay a quarterly non-refundable commitment fee equal to the Applicable Margin on the average daily unused portion of the Commitment (swingline loans do not constitute usage for this purpose). The Applicable Margin for the commitment fee is based on the Firm's total leverage ratio and ranges between 0.20% and 0.35%.

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The Firm will continually be subject to certain affirmative and negative covenants including (but not limited to), the maintenance of a fixed charge coverage ratio of no less than 1.25 to 1.00 and the maintenance of a total leverage ratio of no greater than 3.25 to 1.00. The numerator in the fixed charge coverage ratio is defined pursuant to the Credit Facility as earnings before interest expense, income taxes, depreciation and amortization, stock-based compensation expense and other permitted items pursuant to our Credit Facility (disclosed as “Consolidated EBITDA”), less cash paid for capital expenditures, income taxes and dividends. The denominator is defined as Kforce’s fixed charges such as interest expense and principal payments paid or payable on outstanding debt other than borrowings under the Credit Facility. The total leverage ratio is defined pursuant to the Credit Facility as total indebtedness divided by Consolidated EBITDA. Our ability to make distributions or repurchases of equity securities could be limited if an event of default has occurred. Furthermore, our ability to repurchase equity securities could be limited if (a) the total leverage ratio is greater than 2.75 to 1.00 and (b) the Firm’s availability, inclusive of unrestricted cash, is less than \$25.0 million. As of June 30, 2017, Kforce was not limited in making distributions and executing repurchases of its equity securities.

Borrowings under the Credit Facility are secured by substantially all of the assets of the Firm.

As of June 30, 2017, \$124.1 million was outstanding and \$172.4 million was available, subject to the covenants described above, under the Credit Facility. As of December 31, 2016, \$111.5 million was outstanding under the previous credit facility.

Note F - Employee Benefit Plans

Deferred Compensation Plans

The Firm maintains various non-qualified deferred compensation plans, pursuant to which eligible management and highly compensated key employees, as defined by IRS regulations, may elect to defer all or part of their compensation to later years. These amounts are classified in Accounts payable and other accrued liabilities if payable within the next year or in Other long-term liabilities if payable after the next year, upon retirement or termination of employment in the accompanying Unaudited Condensed Consolidated Balance Sheets. At June 30, 2017 and December 31, 2016, amounts included in Accounts payable and other accrued liabilities related to the deferred compensation plans totaled \$3.0 million and \$2.7 million, respectively. At June 30, 2017 and December 31, 2016, amounts included in Other long-term liabilities related to the deferred compensation plans totaled \$27.6 million and \$27.5 million, respectively. Kforce maintains a Rabbi Trust and holds life insurance policies on certain individuals to assist in the funding of the deferred compensation liability. If necessary, employee distributions are funded through proceeds from the sale of assets held within our Rabbi Trust. The balance of the assets within the Rabbi Trust, including the cash surrender value of the Company-owned life insurance policies, was \$29.4 million and \$27.3 million as of June 30, 2017 and December 31, 2016, respectively, and is included in Other assets, net in the accompanying Unaudited Condensed Consolidated Balance Sheets.

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.

The following table presents the components of net periodic benefit cost (in thousands):

| | Three Months Ended June 30, 2017 | | Six Months Ended June 30, 2016 | |
|---------------------------|--|-------|---|-------|
| Service cost | \$80 | \$328 | \$160 | \$656 |
| Interest cost | 135 | 113 | 269 | 226 |
| Net periodic benefit cost | \$215 | \$441 | \$429 | \$882 |

The service cost is recorded in Selling, general and administrative expenses and the interest cost is recorded in Other expense, net in the accompanying Unaudited Condensed Consolidated Statements of Operations and Comprehensive

Income.

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The projected benefit obligation as of June 30, 2017 and December 31, 2016 was \$13.9 million and \$13.4 million, respectively, and is recorded in Other long-term liabilities in the accompanying Unaudited Condensed Consolidated Balance Sheets. There is no requirement for Kforce to fund the SERP and, as a result, no contributions were made to the SERP during the six months ended June 30, 2017. Kforce does not currently anticipate funding the SERP during the year ended December 31, 2017.

Note G - Stock Incentive Plans

On April 18, 2017, the Kforce shareholders approved the 2017 Stock Incentive Plan (“2017 Plan”). The 2017 Plan allows for the issuance of stock options, stock appreciation rights, stock awards (including restricted stock awards (“RSAs”) and restricted stock units (“RSUs”)) and other stock-based awards. The aggregate number of shares of common stock that are subject to awards under the 2017 Plan is approximately 3.0 million shares. The 2017 Plan terminates on April 18, 2027. Prior to the effective date of the 2017 Plan, the Company granted stock awards to eligible participants under our 2016 Stock Incentive Plan (“2016 Plan”), 2013 Stock Incentive Plan (“2013 Plan”) and 2006 Stock Incentive Plan (“2006 Plan”). As of the effective date of the 2017 Plan, no additional awards may be granted pursuant to the 2016 Plan, 2013 Plan and 2006 Plan; however, awards outstanding as of the effective date will continue to vest in accordance with the terms of the 2016 Plan, 2013 Plan and 2006 Plan, respectively.

During the three months ended June 30, 2017 and 2016, Kforce recognized total stock-based compensation expense of \$1.8 million, respectively. During the six months ended June 30, 2017 and 2016, Kforce recognized total stock-based compensation expense of \$3.9 million and \$3.7 million, respectively.

Restricted Stock

Restricted stock (including RSAs and RSUs) are granted to executives and management either: (1) for awards related to Kforce’s annual long-term incentive (“LTI”) compensation program, or (2) as part of a compensation package and in order to retain directors, executives and management. The LTI award amounts are generally based on total shareholder return performance goals, which are established by Kforce’s Compensation Committee during the first quarter of the year of performance. Restricted stock granted during the six months ended June 30, 2017 will vest over a period between one to ten years, with equal vesting annually.

RSAs contain the same voting rights as other common stock as well as the right to forfeitable dividends in the form of additional RSAs at the same rate as the cash dividend on common stock and containing the same vesting provisions as the underlying award. RSUs contain no voting rights, but have the right to forfeitable dividend equivalents in the form of additional RSUs at the same rate as the cash dividend on common stock and containing the same vesting provisions as the underlying award. The distribution of shares of common stock for each RSU, pursuant to the terms of the Kforce Inc. Director’s Restricted Stock Unit Deferral Plan, can be deferred to a date later than the vesting date if an appropriate election was made. In the event of such deferral, vested RSUs have the right to dividend equivalents. The following table presents the restricted stock activity for the six months ended June 30, 2017 (in thousands, except per share amounts):

| | Number of Restricted Stock | Weighted Average Grant Date Fair Value | Total Intrinsic Value of Restricted Stock Vested |
|-------------------------------------|----------------------------|--|--|
| Outstanding as of December 31, 2016 | 1,708 | \$ 21.86 | |
| Granted | 124 | \$ 21.54 | |
| Forfeited/Canceled | (134) | \$ 22.02 | |
| Vested | (267) | \$ 21.28 | \$ 6,084 |
| Outstanding as of June 30, 2017 | 1,431 | \$ 21.91 | |

As of June 30, 2017, total unrecognized compensation expense related to restricted stock was \$25.6 million, which will be recognized over a weighted average remaining period of 4.4 years.

Note H - Derivative Instrument and Hedging Activity

Kforce is affected by changes in certain market and economic conditions and these changes may adversely impact the Firm’s financial results. Kforce uses an interest rate swap derivative as a risk management tool to mitigate the potential impact of interest rate risk on our financial results.

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On April 21, 2017, Kforce entered into a forward starting interest rate swap agreement with Wells Fargo Bank, N.A. (the "Swap"). The Swap rate is 1.81%, which is added to our interest rate margin to determine the fixed rate that the Firm will pay to the counterparty during the term of the Swap based on the notional amount of the Swap. The effective date of the Swap is May 31, 2017 and the maturity date is April 29, 2022. The notional amount of the Swap is \$65.0 million for the first three years and decreases to \$25.0 million for years four and five.

The Swap has been designated as a cash flow hedge and was effective as of June 30, 2017. The change in the fair value of the Swap was recorded as a component of Accumulated other comprehensive income, net of tax, on the Unaudited Condensed Consolidated Balance Sheets. As of June 30, 2017, the fair value of the Swap was approximately \$0.2 million and is recorded in Other long-term liabilities within the accompanying Unaudited Condensed Consolidated Balance Sheets.

Note I - Fair Value Measurements

There were no transfers into or out of Level 1, 2 or 3 assets or liabilities during the six months ended June 30, 2017. Kforce's financial statements include a contingent consideration liability related to a non-significant acquisition of a business within our GS reporting segment, which is measured on a recurring basis and is recorded at fair value, determined using the discounted cash flow method. The inputs used to calculate the fair value of the contingent consideration liability are considered to be Level 3 inputs due to the lack of relevant market activity and significant management judgment. An increase in future cash flows may result in a higher estimated fair value while a decrease in future cash flows may result in a lower estimated fair value of the contingent consideration liability. Remeasurements to fair value are recorded in Other expense, net within the accompanying Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income. There was no activity during the period in our recurring Level 3 fair value measurements. The contingent consideration liability is recorded in Other long-term liabilities within the accompanying Unaudited Condensed Consolidated Balance Sheets.

Kforce's interest rate swap is measured at fair value using readily observable inputs, such as the LIBOR interest rate. The inputs used to calculate the fair value of our interest rate swap derivative instrument are considered to be Level 2 inputs. The interest rate swap is recorded in Other long-term liabilities within the accompanying Unaudited Condensed Consolidated Balance Sheets. See Note H - "Derivative Instrument and Hedging Activity" in the Notes to Unaudited Condensed Consolidated Financial Statements, included in this report for a complete discussion of the Firm's derivative instrument.

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.

The estimated fair values on Kforce's financial statements as of June 30, 2017 and December 31, 2016 were as follows (in thousands):

| Assets/(Liabilities) Measured at Fair Value: Asset/(Liability) | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|--|---|--|---|
| As of June 30, 2017 | | | |
| Recurring basis: | | | |
| Contingent consideration liability | \$ (756) | \$ — | \$ (756) |
| Interest rate swap derivative instrument | \$ (182) | \$ (182) | \$ — |
| As of December 31, 2016 | | | |
| Recurring basis: | | | |
| Contingent consideration liability | \$ (756) | \$ — | \$ (756) |

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Note J - Reportable Segments

Kforce's reportable segments are as follows: (1) Technology ("Tech"); (2) Finance and Accounting ("FA"); and (3) Government Solutions ("GS"). This determination is supported by, among other factors: the existence of individuals responsible for the operations of each segment and who also report directly to our chief operating decision maker ("CODM"), the nature of the segment's operations and information presented to Kforce's Board and our CODM. Kforce also reports Flex and Direct Hire revenues separately by segment, which has been incorporated into the table below. Historically, and for the three and six months ended June 30, 2017 and 2016, 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. We do not report total assets or income separately by segment as our operations are largely combined. The following table provides information concerning the operations of our segments (in thousands):

| | Tech | FA | GS | Total |
|-------------------------------------|-----------|-----------|----------|-----------|
| Three Months Ended June 30, 2017 | | | | |
| Net service revenues: | | | | |
| Flex revenues | \$222,744 | \$80,038 | \$23,674 | \$326,456 |
| Direct Hire revenues | 5,625 | 8,228 | — | 13,853 |
| Total net service revenues | \$228,369 | \$88,266 | \$23,674 | \$340,309 |
| Gross profit | \$65,563 | \$31,302 | \$7,054 | \$103,919 |
| Operating expenses | | | | 85,916 |
| Income before income taxes | | | | \$18,003 |
| 2016 | | | | |
| Net service revenues: | | | | |
| Flex revenues | \$219,412 | \$76,769 | \$25,292 | \$321,473 |
| Direct Hire revenues | 5,146 | 8,428 | — | 13,574 |
| Total net service revenues | \$224,558 | \$85,197 | \$25,292 | \$335,047 |
| Gross profit | \$66,168 | \$31,435 | \$8,679 | \$106,282 |
| Operating expenses | | | | 88,557 |
| Income before income taxes | | | | \$17,725 |
| Six Months Ended June 30, 2017 | | | | |
| Net service revenues: | | | | |
| Flexible billings | \$439,630 | \$160,987 | \$48,326 | \$648,943 |
| Direct Hire fees | 10,784 | 14,574 | — | 25,358 |
| Total net service revenues | \$450,414 | \$175,561 | \$48,326 | \$674,301 |
| Gross profit | \$126,663 | \$59,957 | \$14,434 | \$201,054 |
| Operating expenses | | | | 173,829 |
| Income before income taxes | | | | \$27,225 |
| 2016 | | | | |
| Net service revenues: | | | | |
| Flexible billings | \$430,621 | \$152,075 | \$48,413 | \$631,109 |
| Direct Hire fees | 10,525 | 15,614 | — | 26,139 |
| Total net service revenues | \$441,146 | \$167,689 | \$48,413 | \$657,248 |
| Gross profit | \$127,959 | \$60,256 | \$15,256 | \$203,471 |
| Operating expenses | | | | 177,007 |
| Income before income taxes | | | | \$26,464 |

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Note K - Supplemental Cash Flow Information

Supplemental cash flow information is as follows (in thousands):

| | Six Months Ended June 30, 2017 2016 | |
|---|--|---------|
| Cash paid during the period for: | | |
| Income taxes, net | \$7,542 | \$9,077 |
| Interest, net | \$1,624 | \$1,059 |
| Non-cash transaction information: | | |
| Employee stock purchase plan | \$281 | \$384 |
| Equipment acquired under capital leases | \$465 | \$863 |

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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 as of and for the six months ended June 30, 2017.

• **Results of Operations** – an analysis of Kforce's unaudited condensed consolidated results of operations for the three and six months ended June 30, 2017 and 2016, 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, contractual obligations and commitments and the impact of changes in interest rates on our business.

• **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.

• **New Accounting Standards** – a discussion of recently issued accounting standards and their potential impact on our consolidated financial statements.

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EXECUTIVE SUMMARY

The following is an executive summary of what Kforce believes are highlights as of and for the six months ended June 30, 2017, which should be considered in the context of the additional discussions herein and in conjunction with the unaudited condensed consolidated financial statements and notes thereto.

Net service revenues for the six months ended June 30, 2017 increased 2.6% to \$674.3 million from \$657.2 million in the comparable period in 2016.

Flex revenues for the six months ended June 30, 2017 increased 2.8% to \$648.9 million from \$631.1 million in the comparable period in 2016. Flex revenues increased 2.1% and 5.9% for Tech and FA, respectively, and decreased 0.2% for GS.

Direct Hire revenues for the six months ended June 30, 2017 decreased 3.0% to \$25.4 million from \$26.1 million in the comparable period in 2016.

Flex gross profit margin for the six months ended June 30, 2017 decreased 100 basis points to 27.1% from 28.1% in the comparable period in 2016. Flex gross profit margin decreased 90 basis points for Tech, 120 basis points for FA and 160 basis points for GS. The overall reduction in Flex gross profit margin is primarily a result of compression in the spread between our bill rates and pay rates and higher benefit costs for the six months ended June 30, 2017. While we experienced year-over-year compression in the spread between bill rates and pay rates in our Tech and FA Flex lines of business, sequentially they were stable.

Selling, general and administrative (“SG&A”) expenses as a percentage of revenues for the six months ended June 30, 2017 decreased to 24.8% from 26.0% in the comparable period in 2016. The 120 basis point decrease was primarily driven by lower compensation costs reflecting leverage provided by our revenue growth, benefits from our realignment activities, increasing associate productivity levels as well as solid expense discipline in other areas of spend.

Net income for the six months ended June 30, 2017 increased 17.4% to \$17.0 million from \$14.5 million in the comparable period in 2016 driven by the items described above and a reduction in our effective tax rate.

Diluted earnings per share for the six months ended June 30, 2017 increased to \$0.67 from \$0.55 per share in the comparable period in 2016 primarily driven by the factors noted above.

The Firm declared and paid two quarterly dividends of \$0.12 per share during the six months ended June 30, 2017, resulting in a total cash payout of \$6.1 million.

The Firm entered into a new Credit Facility on May 25, 2017, which, among other things, increased the borrowing capacity by \$130.0 million to \$300.0 million.

The total amount outstanding under our Credit Facility as of June 30, 2017 was \$124.1 million. The total amount outstanding under our previous credit facility as of December 31, 2016 was \$111.5 million. This increase of \$12.6 million was primarily driven by lower than anticipated operating cash flows during the six months ended June 30, 2017 as a result of an increase in days’ sales outstanding.

The Firm entered into a forward starting interest rate swap agreement on April 21, 2017 to mitigate the risk of rising interest rates. The notional amount of the Swap is \$65.0 million for the first three years and decreases to \$25.0 million for years four and five.

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RESULTS OF OPERATIONS

Our Business at a Glance

Kforce provides professional and technical specialty staffing services and solutions to customers through our Tech, FA, and GS reporting segments. Kforce provides flexible staffing services and solutions on both a temporary (“Flex”) and permanent (“Direct Hire”) basis. We operate through our corporate headquarters in Tampa, Florida and 59 field offices located throughout the United States, as well as an office in Manila, Philippines. As of June 30, 2017, Kforce employed nearly 2,700 associates and had more than 11,000 consultants on assignment.

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

We continue to make progress in our key strategic focus areas including:

- Aligning our revenue-generating talent toward markets, products, industries and clients that we believe present Kforce with the greatest opportunity for profitable revenue growth.
- Providing our talent with the necessary tools to be more effective and efficient in performing their roles and to better evaluate business opportunities and allow us to evaluate and demonstrate the value we are bringing to our clients and candidates.
- Implementing new and upgrading existing technologies that allow us to more effectively and efficiently serve our clients, candidates and consultants and improve the productivity and scalability of our organization. We are very excited to have gone live in April 2017 with the initial pilot of our new customer relationship management system, which is expected to be fully deployed during the third quarter of 2017.

We believe that our portfolio of service offerings, which are almost exclusively in the U.S. and are focused in Tech and FA (which we anticipate to be areas of expected growth), are a key contributor to our long-term financial stability.

Industry Economic Factors

Based upon previous economic cycles experienced by Kforce, we believe that times of sustained economic recovery generally stimulate demand for additional workers in the U.S. and, conversely, an economic slowdown results in a contraction in demand for additional workers in the U.S. From an economic standpoint, temporary employment figures and trends are important indicators of staffing demand, which continued to be positive during 2017, based on data published by the Bureau of Labor Statistics (“BLS”) and Staffing Industry Analysts (“SIA”). The penetration rate (the percentage of temporary staffing to total employment) reached a record high of 2.07% in June 2017. While the health of the macro-employment picture was uncertain at times during 2016 and through mid-2017, it generally has shown continuous improvement, with the unemployment rate at 4.4% as of June 2017, and non-farm payroll expanding approximately 194 thousand jobs per month in the period April through June 2017. Also, the college-level unemployment rate, which we believe serves as a proxy for professional employment and therefore aligns well with the candidate and consultant population that Kforce most typically serves, was at 2.4% in June 2017. Further, we believe that the unemployment rate in the specialties we serve, especially in certain technology skill sets, is lower than the published averages, which we believe speaks to the demand environment in which we are operating. Management believes that the tepid growth in the overall U.S. economy, the recent change in administration, and the increasing costs and government regulation of employment may be driving a secular shift to an increased use of temporary staff as a percentage of the total workforce as employers may be reluctant to increase permanent hiring. If the penetration rate of temporary staffing grows in the coming months and years, we believe our Flex revenues may grow 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; however, the economic environment includes considerable uncertainty and volatility and therefore no reliable predictions can be made about the general economy, the staffing industry as a whole, specialty staffing in particular or our future performance.

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Three and Six Months Ended June 30, 2017 and 2016

Net Service Revenues. The following table presents, as a percentage of net service revenues, certain items in our Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income:

| | Three Months Ended June 30, 2017 | | Six Months Ended June 30, 2016 | |
|--|---|--------|---|--------|
| Net Service Revenues by Segment: | | | | |
| Tech | 67.1 % | 67.0 % | 66.8 % | 67.1 % |
| FA | 25.9 | 25.4 | 26.0 | 25.5 |
| GS | 7.0 | 7.6 | 7.2 | 7.4 |
| Net service revenues | 100.0% | 100.0% | 100.0% | 100.0% |
| Revenues by Type: | | | | |
| Flex | 95.9 % | 95.9 % | 96.2 % | 96.0 % |
| Direct Hire | 4.1 | 4.1 | 3.8 | 4.0 |
| Net service revenues | 100.0% | 100.0% | 100.0% | 100.0% |
| Gross profit | 30.5 % | 31.7 % | 29.8 % | 31.0 % |
| Selling, general and administrative expenses | 24.2 % | 25.5 % | 24.8 % | 26.0 % |
| Depreciation and amortization | 0.6 % | 0.7 % | 0.6 % | 0.7 % |
| Income before income taxes | 5.3 % | 5.3 % | 4.0 % | 4.0 % |
| Net income | 3.3 % | 3.2 % | 2.5 % | 2.2 % |

The following table presents net service revenues for Flex and Direct Hire by segment and the percentage change from the prior period (in thousands):

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|----------------------------|-----------------------------|------------------------|-----------|---------------------------|------------------------|-----------|
| | 2017 | Increase (Decrease) | 2016 | 2017 | Increase (Decrease) | 2016 |
| Tech | | | | | | |
| Flex | \$222,744 | 1.5 % | \$219,412 | \$439,630 | 2.1 % | \$430,621 |
| Direct Hire | 5,625 | 9.3 % | 5,146 | 10,784 | 2.5 % | 10,525 |
| Total Tech | \$228,369 | 1.7 % | \$224,558 | \$450,414 | 2.1 % | \$441,146 |
| FA | | | | | | |
| Flex | \$80,038 | 4.3 % | \$76,769 | \$160,987 | 5.9 % | \$152,075 |
| Direct Hire | 8,228 | (2.4)% | 8,428 | 14,574 | (6.7)% | 15,614 |
| Total FA | \$88,266 | 3.6 % | \$85,197 | \$175,561 | 4.7 % | \$167,689 |
| GS | | | | | | |
| Flex | \$23,674 | (6.4)% | \$25,292 | \$48,326 | (0.2)% | \$48,413 |
| Total GS | \$23,674 | (6.4)% | \$25,292 | \$48,326 | (0.2)% | \$48,413 |
| Total Flex | \$326,456 | 1.6 % | \$321,473 | \$648,943 | 2.8 % | \$631,109 |
| Total Direct Hire | 13,853 | 2.1 % | 13,574 | 25,358 | (3.0)% | 26,139 |
| Total Net Service Revenues | \$340,309 | 1.6 % | \$335,047 | \$674,301 | 2.6 % | \$657,248 |

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Our quarterly operating results are affected by the number of billing days in a quarter, which is provided in the table below. The following table presents the year-over-year growth rates, on a billing day basis, for the last five quarters:

| | Year-Over-Year Growth Rates (Per Billing Day) | | | | |
|------------------|--|----------|----------|----------|----------|
| | Q2 | Q1 | Q4 | Q3 | Q2 |
| | 2017 | 2017 | 2016 | 2016 | 2016 |
| Tech Flex | 1.5 % | 2.7 % | 1.4 % | (2.7)% | (2.9)% |
| Tech Direct Hire | 9.3 % | (4.1)% | (13.1)% | (10.2)% | (18.2)% |
| Total Tech | 1.7 % | 2.5 % | 1.1 % | (2.8)% | (3.3)% |
| FA Flex | 4.3 % | 7.5 % | 2.1 % | (0.5)% | 5.5 % |
| FA Direct Hire | (2.4)% | (11.7)% | (15.4)% | (6.9)% | 3.4 % |
| Total FA | 3.6 % | 5.8 % | 0.4 % | (1.2)% | 5.3 % |
| Total Staffing | 2.2 % | 3.4 % | 0.9 % | (2.4)% | (1.1)% |
| GS | (6.4)% | 6.6 % | 4.0 % | 10.1 % | 4.2 % |
| Total Firm | 1.6 % | 3.7 % | 1.1 % | (1.5)% | (0.7)% |

| | | | | | |
|--------------|----|----|----|----|----|
| Billing Days | 64 | 64 | 61 | 64 | 64 |
|--------------|----|----|----|----|----|

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.

Flex revenues for our largest segment, Tech, increased during the three and six months ended June 30, 2017 by 1.5% and 2.1%, respectively, as compared to the same periods in 2016. The secular drivers of technology spend have remained intact with many companies now becoming increasingly dependent on the efficiencies provided by technology and the need for innovation to support business strategies and sustain relevancy in today's rapidly changing marketplace. We expect Tech Flex revenues to increase sequentially and on a year-over-year basis (as adjusted for billing days) in the third quarter of 2017.

Our FA segment experienced an increase in Flex revenues of 4.3% and 5.9% during the three and six months ended June 30, 2017, respectively, as compared to the same periods in 2016. We expect FA Flex revenues to increase sequentially and on a year-over-year basis (as adjusted for billing days) in the third quarter of 2017.

Our GS segment experienced a decrease in revenues of 6.4% and 0.2% during the three and six months ended June 30, 2017, respectively, as compared to the same periods in 2016. The year-over-year decrease was driven by a decline in our product-based business due to timing of orders and shipments, partially offset by growth in service revenues. We expect GS revenues to increase sequentially and be stable on a year-over-year basis (as adjusted for billing days) in the third quarter of 2017.

The following table presents the key drivers for the change in Flex revenues for our Tech and FA segments over the prior period (in thousands):

| | Three Months | | Six Months | |
|-------------------|----------------|---------|----------------|---------|
| | Ended June 30, | | Ended June 30, | |
| | 2017 | | 2017 | |
| | Tech | FA | Tech | FA |
| Volume | \$2,347 | \$1,128 | \$10,183 | \$5,855 |
| Bill rate | 1,042 | 2,127 | (936) | 3,011 |
| Billable expenses | (57) | 14 | (238) | 46 |
| Total | \$3,332 | \$3,269 | \$9,009 | \$8,912 |

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The following table presents total Flex hours for our Tech and FA segments and percentage change over the prior period (in thousands):

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|-------------|--------------------------------|------------------------|-------|------------------------------|------------------------|--------|
| | 2017 | Increase (Decrease) | 2016 | 2017 | Increase (Decrease) | 2016 |
| Tech | 3,234 | 1.1 % | 3,200 | 6,479 | 2.4 % | 6,329 |
| FA | 2,398 | 1.5 % | 2,363 | 4,866 | 3.9 % | 4,685 |
| Total hours | 5,632 | 1.2 % | 5,563 | 11,345 | 3.0 % | 11,014 |

As the GS segment primarily provides integrated business solutions (both as a prime and subcontractor) as compared to staffing services, Flex hours are not presented above.

Direct Hire Revenues. The primary drivers of Direct Hire revenues are the number of placements and the fee for these placements. Direct Hire revenues also include conversion revenues (conversions occur when consultants initially assigned to a client on a temporary basis are later converted to a permanent placement for a fee). Our GS segment does not make permanent placements.

Direct Hire revenues increased 2.1% during the three months ended June 30, 2017, as compared to the same period in 2016, and decreased 3.0% during the six months ended June 30, 2017 as compared to the same period in 2016.

The following table presents the key drivers for the change in Direct Hire revenues for our Tech and FA segments over the prior period (in thousands):

| | Three Months Ended June 30, 2017 | | Six Months Ended June 30, 2017 | |
|---------------|--|---------|--------------------------------------|-----------|
| | Tech | FA | Tech | FA |
| Volume | \$(10) | \$(249) | \$(382) | \$(1,059) |
| Placement fee | 489 | 49 | 641 | 19 |
| Total | \$479 | \$(200) | \$259 | \$(1,040) |

The following table presents total placements for our Tech and FA segments and percentage change over the prior period:

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|------------------|--------------------------------|------------------------|------|------------------------------|------------------------|-------|
| | 2017 | Increase (Decrease) | 2016 | 2017 | Increase (Decrease) | 2016 |
| Tech | 317 | — % | 317 | 611 | (3.6)% | 634 |
| FA | 657 | (3.0)% | 677 | 1,186 | (6.8)% | 1,272 |
| Total placements | 974 | (2.0)% | 994 | 1,797 | (5.7)% | 1,906 |

The following table presents the average fee per placement for our Tech and FA segments and percentage change over the prior period:

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|-----------------------------|--------------------------------|------------------------|----------|---------------------------|------------------------|----------|
| | 2017 | Increase (Decrease) | 2016 | 2017 | Increase (Decrease) | 2016 |
| Tech | \$17,753 | 9.5 % | \$16,209 | \$17,649 | 6.3 % | \$16,600 |
| FA | 12,526 | 0.6 % | 12,451 | 12,292 | 0.1 % | 12,276 |
| Total average placement fee | \$14,227 | 4.2 % | \$13,651 | \$14,114 | 2.9 % | \$13,715 |

Gross Profit. Gross profit on Flex billings is determined by deducting the direct cost of services (primarily consultant payroll wages, payroll taxes, payroll-related insurance and certain fringe benefits, as well as subcontractor costs) from net Flex service revenues. In addition, there are no consultant payroll costs associated with Direct Hire placements, thus all Direct Hire revenues increase gross profit by the full amount of the fee.

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The following table presents the gross profit percentage (gross profit as a percentage of revenues) for each segment and percentage change over the prior period:

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|-------------------------------|-----------------------------|---------------------|-------|---------------------------|---------------------|-------|
| | 2017 | Increase (Decrease) | 2016 | 2017 | Increase (Decrease) | 2016 |
| Tech | 28.7% | (2.7)% | 29.5% | 28.1% | (3.1)% | 29.0% |
| FA | 35.5% | (3.8)% | 36.9% | 34.2% | (4.7)% | 35.9% |
| GS | 29.8% | (13.1)% | 34.3% | 29.9% | (5.1)% | 31.5% |
| Total gross profit percentage | 30.5% | (3.8)% | 31.7% | 29.8% | (3.9)% | 31.0% |

The change in our gross profit percentage for the three and six months ended June 30, 2017 as compared to the same periods in 2016, is primarily the result of a decline in our Flex gross profit and the overall mix of Flex and Direct Hire revenues.

Our Flex gross profit percentage (Flex gross profit as a percentage of Flex revenues) provides management with helpful insight into the other drivers of total gross profit percentage such as changes in volume evidenced by changes in hours billed for our Flex businesses and changes in the spread between the bill rate and pay rate for Flex. As noted above, our GS segment does not make permanent placements; as a result, its Flex gross profit percentage is the same as its gross profit percentage.

The following table presents the Flex gross profit percentage for each segment and percentage change over the prior period:

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|------------------------------------|-----------------------------|---------------------|-------|---------------------------|---------------------|-------|
| | 2017 | Increase (Decrease) | 2016 | 2017 | Increase (Decrease) | 2016 |
| Tech | 26.9% | (3.2)% | 27.8% | 26.4% | (3.3)% | 27.3% |
| FA | 28.8% | (4.0)% | 30.0% | 28.2% | (4.1)% | 29.4% |
| GS | 29.8% | (13.1)% | 34.3% | 29.9% | (5.1)% | 31.5% |
| Total Flex gross profit percentage | 27.6% | (4.2)% | 28.8% | 27.1% | (3.6)% | 28.1% |

The decrease in Flex gross profit percentage of 120 and 100 basis points for the three and six months ended June 30, 2017, respectively, as compared to the same periods in 2016 was due primarily to compression in the spread between our bill rates and pay rates and higher benefit costs. Kforce continues to focus on optimizing the spread between bill rates and pay rates by providing our associates with tools, training, 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. On a sequential basis, spreads in our Tech and FA Flex businesses were stable as we continue to intensify our focus in this area. We expect that the spread between our bill rates and pay rates may continue to be under pressure due to client pricing pressure, talent shortages as well as the potential for consultant wage inflation but to be mitigated to a degree by our internal programs.

The following table presents the key drivers for the change in Flex gross profit for our Tech and FA segments over the prior period (in thousands):

| | Three Months Ended June 30, 2017 | | Six Months Ended June 30, 2017 | |
|--------|----------------------------------|-------|--------------------------------|---------|
| | Tech | FA | Tech | FA |
| Volume | \$926 | \$981 | \$2,456 | \$2,617 |
| Rate | (2,010) | (914) | (4,011) | (1,876) |
| Total | \$(1,084) | \$67 | \$(1,555) | \$741 |

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SG&A Expenses. For the three and six months ended June 30, 2017, total compensation, commissions, payroll taxes, and benefit costs as a percentage of SG&A represented 83.9% and 84.3%, respectively, as compared to 84.3% and 84.8% for the comparable periods in 2016. Commissions and other bonus incentives for our revenue-generating talent (and related payroll taxes and benefit costs) are variable costs driven primarily by revenue and gross profit levels, and associate performance. Therefore, as gross profit levels change, these expenses would also generally be anticipated to change, but remain relatively consistent as a percentage of revenues.

The following table presents these components of SG&A along with an “other” caption, which includes bad debt expense, lease expense, professional fees, travel, telephone, computer and certain other expenses, as an absolute amount and as a percentage of total net service revenues (in thousands):

| | 2017 | % of Revenues | 2016 | % of Revenues |
|---|-----------|---------------|-----------|---------------|
| Three Months Ended June 30, | | | | |
| Compensation, commissions, payroll taxes and benefits costs | \$69,252 | 20.3 % | \$72,022 | 21.5 % |
| Other | 13,254 | 3.9 % | 13,452 | 4.0 % |
| Total SG&A | \$82,506 | 24.2 % | \$85,474 | 25.5 % |
| Six Months Ended June 30, | | | | |
| Compensation, commissions, payroll taxes and benefits costs | \$140,896 | 20.9 % | \$144,926 | 22.1 % |
| Other | 26,288 | 3.9 % | 26,003 | 3.9 % |
| Total SG&A | \$167,184 | 24.8 % | \$170,929 | 26.0 % |

SG&A as a percentage of net service revenues decreased 130 and 120 basis points for the three and six months ended June 30, 2017, respectively, as compared to the same periods in 2016. The decrease was primarily driven by lower compensation costs reflecting leverage provided by our revenue growth, benefits from our realignment activities, increasing associate productivity levels as well as solid expense discipline in other areas of spend.

Depreciation and Amortization. The following table presents depreciation and amortization expense and percentage change over the prior period by major category (in thousands):

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|-------------------------------------|-----------------------------|---------------------|---------|---------------------------|---------------------|---------|
| | 2017 | Increase (Decrease) | 2016 | 2017 | Increase (Decrease) | 2016 |
| Fixed asset depreciation (1) | \$1,763 | 6.5 % | \$1,656 | \$3,487 | 5.1 % | \$3,317 |
| Capitalized software amortization | 204 | (49.4)% | 403 | 444 | (49.4)% | 877 |
| Intangible asset amortization | 86 | (55.4)% | 193 | 172 | (55.3)% | 385 |
| Total depreciation and amortization | \$2,053 | (8.8)% | \$2,252 | \$4,103 | (10.4)% | \$4,579 |

(1) Fixed asset depreciation includes amortization of capital leases.

Other Expense, Net. Other expense, net for the three and six months ended June 30, 2017 was \$1.4 million and \$2.5 million, respectively, and consists primarily of interest expense related to outstanding borrowings under our credit facility. Other expense, net for the three and six months ended June 30, 2016 was \$0.8 million and \$1.5 million, respectively, and consists primarily of interest expense related to outstanding borrowings under our credit facility. The increase on a year-over-year basis is driven by higher levels of outstanding borrowings under our credit facility and the acceleration of unamortized deferred financing costs related to our previous credit facility of \$0.2 million and \$0.4 million for the three and six months ended June 30, 2017, respectively.

Income Tax Expense. Income tax expense as a percentage of income before income taxes (our “effective rate”) for the six months ended June 30, 2017 and 2016 was 37.4% and 45.2%, respectively. Kforce’s effective tax rate during the six months ended June 30, 2017 was positively impacted by the adoption of the recently issued share-based compensation accounting standard whereby excess tax benefits are recognized as a direct impact to income tax expense. The rate excluding this impact would have been 38.3%. This accounting standard guidance could continue to create volatility in the Firm’s effective tax rate in the future. Kforce’s effective rate during the six months ended June 30, 2016 was negatively impacted by certain one-time non-cash adjustments; the rate excluding these adjustments would have been 38.9%.

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Non-GAAP Measures

Adjusted EBITDA. “Adjusted EBITDA”, a non-GAAP financial measure, is defined by Kforce as net income before depreciation and amortization, stock-based compensation expense, interest expense, net and income tax 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 assess our operations including our ability to generate cash flows and our ability to repay our debt obligations and management believes it provides a good metric of our core profitability in comparing our performance to our competitors, as well as our performance over different time periods. Consequently, management believes it 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 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.

In addition, although we excluded amortization of 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 suggest that you evaluate these items and the potential risks of excluding such items when analyzing our financial position. The following table presents Adjusted EBITDA and includes a reconciliation of Adjusted EBITDA to net income (in thousands):

| | 2017 | 2016 |
|----------------------------------|-----------|-----------|
| Three Months Ended June 30, | | |
| Net income | \$ 11,144 | \$ 10,864 |
| Depreciation and amortization | 2,105 | 2,263 |
| Stock-based compensation expense | 1,805 | 1,762 |
| Interest expense, net | 1,345 | 841 |
| Income tax expense | 6,859 | 6,861 |
| Adjusted EBITDA | \$ 23,258 | \$ 22,591 |

| | | |
|----------------------------------|-----------|-----------|
| Six Months Ended June 30, | | |
| Net income | \$ 17,046 | \$ 14,514 |
| Depreciation and amortization | 4,208 | 4,600 |
| Stock-based compensation expense | 3,869 | 3,706 |
| Interest expense, net | 2,518 | 1,533 |
| Income tax expense | 10,179 | 11,950 |
| Adjusted EBITDA | \$ 37,820 | \$ 36,303 |

Free Cash Flow. “Free Cash Flow”, a non-GAAP financial measure, is defined by Kforce as net cash provided by operating activities determined in accordance with GAAP, less capital expenditures. Management believes this provides an additional way of viewing our liquidity that, when viewed with our GAAP results, provides a more complete understanding of factors and trends affecting our cash flows and is useful information to investors as it provides a measure of the amount of cash generated from the business that can be used for strategic opportunities including investing in our business, making acquisitions, repurchasing common stock or paying dividends. Free Cash Flow has limitations due to the fact that it does not represent the residual cash flow available for discretionary expenditures. Therefore, we believe it is important to view Free Cash Flow as a complement to our Unaudited Condensed Consolidated Statements of Cash Flows.

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The following table presents Free Cash Flow (in thousands):

| | Six Months Ended | |
|---|------------------|-----------|
| | June 30, | |
| | 2017 | 2016 |
| Net income | \$17,046 | \$14,514 |
| Non-cash provisions and other | 12,451 | 12,660 |
| Changes in operating assets/liabilities | (23,958) | (11,223) |
| Net cash provided by operating activities | 5,539 | 15,951 |
| Capital expenditures | (4,344) | (3,182) |
| Free cash flow | 1,195 | 12,769 |
| Change in debt | 12,582 | 15,313 |
| Repurchases of common stock | (2,952) | (22,185) |
| Cash dividend | (6,080) | (6,298) |
| Other | (2,695) | (53) |
| Change in cash | \$2,050 | \$(454) |

LIQUIDITY AND CAPITAL RESOURCES

To meet our capital and liquidity requirements, we primarily rely on operating cash flow, as well as borrowings under our existing Credit Facility. At June 30, 2017, Kforce had \$160.5 million in working capital compared to \$135.4 million at December 31, 2016.

The accompanying Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2017 and 2016 provide a more detailed description of our cash flows. Currently, Kforce is principally focused on achieving the appropriate balance in the following areas of cash flow: (1) generating positive cash flow from operating activities; (2) returning capital to our shareholders through our quarterly dividends and common stock repurchase program; (3) maintaining an appropriate outstanding balance on our Credit Facility; (4) investing in our infrastructure to allow sustainable growth via capital expenditures; and (5) having sufficient liquidity for the possibility of completing an acquisition.

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, a material deterioration in the economic environment or market conditions, among other things, could negatively impact operating results and liquidity, as well as the ability of our lenders to fund borrowings.

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

The following table presents a summary of our net cash flows from operating, investing and financing activities (in thousands):

| | Six Months Ended | |
|--|------------------|-----------|
| | June 30, | |
| | 2017 | 2016 |
| Cash provided by (used in): | | |
| Operating activities | \$5,539 | \$15,951 |
| Investing activities | (4,344) | (3,182) |
| Financing activities | 855 | (13,223) |
| Net increase (decrease) in cash and cash equivalents | \$2,050 | \$(454) |

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Operating Activities

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. When comparing cash flows from operating activities, the decrease in cash provided by operating activities during the six months ended June 30, 2017 as compared to the same period in 2016 is primarily a result of the timing of payment of our employee and consultant populations' compensation, trade accounts payable and other accrued liabilities, partially offset by improved earnings.

Investing Activities

Capital expenditures for the six months ended June 30, 2017 and 2016 were \$4.3 million and \$3.2 million, respectively, which excludes equipment acquired under capital leases.

We expect to continue selectively investing in our infrastructure in order to support the expected future growth in our business and evolution of our operating model. We believe that we have sufficient cash and availability under the 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

The following table presents the cash flow impact of the common stock repurchase activity (in thousands):

| | Six Months Ended June 30, | |
|--|---------------------------------|----------|
| | 2017 (1) | 2016 (2) |
| Open market repurchases | \$935 | \$20,763 |
| Repurchase of shares related to tax withholding requirements for vesting of restricted stock | 2,017 | 1,422 |
| | \$2,952 | \$22,185 |

(1) The open market repurchases during the six months ended June 30, 2017 relates exclusively to the settlement of 2016 repurchases.

(2) The open market repurchases during the six months ended June 30, 2016 includes \$1.0 million related to the settlement of 2015 repurchases.

During the six months ended June 30, 2017 and 2016, Kforce declared and paid two quarterly dividends of \$6.1 million, or \$0.24 per share, and \$6.3 million, or \$0.24 per share, respectively. The declaration, payment and amount of future dividends are discretionary and will be subject to determination by Kforce's Board each quarter following its review of, among other things, the Firm's financial performance and its legal ability to pay dividends.

Credit Facility

See Note E – "Credit Facility" in the Notes to Unaudited Condensed Consolidated Financial Statements, included in this report for a complete discussion of our Credit Facility. Under the Credit Facility, the Firm will have a maximum borrowing capacity of \$300.0 million, which may, subject to certain conditions and the participation of the lenders, be increased up to an aggregate additional amount of \$150.0 million, which will be available to the Firm in the form of revolving credit loans, swingline loans, and letters of credit. Letters of credit and swingline loans under the Credit Facility are subject to sublimits of \$10.0 million. As of June 30, 2017, \$124.1 million was outstanding and \$172.4 million was available, subject to the covenants described below, under the Credit Facility. As of December 31, 2016, \$111.5 million was outstanding under the previous credit facility.

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The Firm will continually be subject to certain affirmative and negative covenants including (but not limited to), the maintenance of a fixed charge coverage ratio of no less than 1.25 to 1.00 and the maintenance of a total leverage ratio of no greater than 3.25 to 1.00. The numerator in the fixed charge coverage ratio is defined pursuant to the Credit Facility as earnings before interest expense, income taxes, depreciation and amortization, stock-based compensation expense and other permitted items pursuant to our Credit Facility (disclosed as “Consolidated EBITDA”), less cash paid for capital expenditures, income taxes and dividends. The denominator is defined as Kforce’s fixed charges such as interest expense and principal payments paid or payable on outstanding debt other than borrowings under the Credit Facility. The total leverage ratio is defined pursuant to the Credit Facility as total indebtedness divided by Consolidated EBITDA. Our ability to make distributions or repurchases of equity securities could be limited if an event of default has occurred. Furthermore, our ability to repurchase equity securities could be limited if (a) the total leverage ratio is greater than 2.75 to 1.00 and (b) the Firm’s availability, inclusive of unrestricted cash, is less than \$25.0 million. As of June 30, 2017, Kforce was not limited in making distributions and executing repurchases of its equity securities.

Stock Repurchases

Kforce did not make any common stock repurchases on the open market during the six months ended June 30, 2017. As of June 30, 2017 and December 31, 2016, \$50.7 million of the Board-authorized common stock repurchase program remained available for future repurchases.

Off-Balance Sheet Arrangements

There have been no material changes during the period covered by this Quarterly Report on Form 10-Q to our off-balance sheet arrangements previously disclosed in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

Contractual Obligations and Commitments

Other than those changes described elsewhere in this Quarterly Report, there have been no material changes during the period covered by this report on Form 10-Q to our contractual obligations previously disclosed in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

CRITICAL ACCOUNTING ESTIMATES

Our unaudited condensed consolidated financial statements are prepared in accordance with GAAP. In connection with the preparation of our unaudited condensed consolidated 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 unaudited condensed consolidated financial statements are prepared. On a regular basis, management reviews the accounting policies, estimates, assumptions and judgments to ensure that our unaudited condensed 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” in the Notes to Consolidated Financial Statements and “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Estimates” in our 2016 Annual Report on Form 10-K for a more detailed discussion of our significant accounting policies and critical accounting estimates.

NEW ACCOUNTING STANDARDS

See Note A - “Summary of Significant Accounting Policies” in the Notes to Unaudited Condensed Consolidated Financial Statements, included in Item 1. Financial Statements of this report for a discussion of new accounting standards.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

In addition to the risks inherent in its operations, Kforce is exposed to certain market and economic risks, primarily changes in interest rates.

On April 21, 2017, Kforce entered into a forward starting interest rate swap agreement with Wells Fargo Bank, N.A. (the “Swap”) to mitigate the risk of rising interest rates on the Firm’s financial statements. The Swap rate is 1.81%, which is added to our interest rate margin to determine the fixed rate that the Firm will pay to the counterparty during the term of the Swap based on the notional amount of the Swap. The effective date of the Swap is May 31, 2017 and the maturity date is April 29, 2022. The notional amount of the Swap is \$65.0 million for the first three years and decreases to \$25.0 million for years four and five.

As of June 30, 2017, we had \$124.1 million outstanding under our Credit Facility. A hypothetical 10% increase in the interest rates in effect as of June 30, 2017 would not have a material effect on our consolidated financial statements.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

As of June 30, 2017, 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 CEO and 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 the design and operation of our Disclosure Controls were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is: (1) recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms; and (2) accumulated and communicated to management, including the principal executive officer and the principal financial officer, as appropriate to allow timely decisions regarding disclosure.

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.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

We are involved in legal proceedings, claims, and administrative matters that arise in the ordinary course of our business. We have made accruals with respect to certain of these matters, where appropriate, that are reflected in our unaudited condensed consolidated financial statements but are not, individually or in the aggregate, considered material. For other matters for which an accrual has not been made, we have not yet determined that a loss is probable or the amount of loss cannot be reasonably estimated. While the ultimate outcome of the matters cannot be determined, we currently do not expect that these proceedings and claims, individually or in the aggregate, will have a material effect on our financial position, results of operations, or cash flows. The outcome of any litigation is inherently uncertain, however, and if decided adversely to us, or if we determine that settlement of particular litigation is appropriate, we may be subject to liability that could have a material adverse effect on our financial position, results of operations, or cash flows. Kforce maintains liability insurance in 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, cyber liability, 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.

Accordingly, we disclose matters below for which a material loss is reasonably possible.

On August 25, 2016, Kforce Flexible Solutions LLC (along with co-defendant BMO Harris Bank) was served with a complaint brought in the Northern District of Illinois, U.S. District Court, Eastern District of Illinois; Shepard v. BMO Harris Bank N.A. et al., Case No.: 1:16-cv-08288. The plaintiff purports to bring claims on her own behalf and on behalf of a putative class of telephone-dedicated workers for alleged violations of the Fair Labor Standards Act, the Illinois Minimum Wage Law, and the Illinois Wage Payment and Collection Act based upon the defendants' purported failure to pay her and other class members all earned regular and overtime pay for all time worked. More specifically, the plaintiff alleges that class employees were required to perform unpaid work before and after the start and end times of their shifts. She seeks unpaid back regular and overtime wages, liquidated damages, statutory penalties, and attorney fees and costs. We are vigorously defending each of the plaintiff's claims. At this stage in the litigation it is not feasible to predict the outcome of this matter or reasonably estimate a range of loss, should a loss occur, from this proceeding. We believe, based on our current knowledge, that the final outcome of this matter is unlikely to have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows.

Item 1A. Risk Factors.

Unless otherwise noted below, there have been no material changes in the risk factors previously disclosed in our 2016 Annual Report on Form 10-K.

Kforce maintains debt which exposes us to interest rate risk and contains restrictive covenants that could trigger prepayment of obligations or additional costs.

We have a Credit Facility consisting of a revolving line of credit of up to \$300.0 million. Borrowings under the Credit Facility are secured by substantially all of the assets of the Firm.

Adverse changes in credit markets, including increases in interest rates, could increase our cost of borrowing and/or make it more difficult to refinance our existing indebtedness. We may reduce our exposure to rising interest rates by entering into interest rate hedging arrangements, although those arrangements may result in us incurring higher interest expenses than we would incur without the arrangements. If interest rates increase in the absence of such arrangements, we will need to dedicate more of our cash flow from operations to make payments on our debt.

Kforce is subject to certain affirmative and negative covenants under the Credit Facility. Our failure to comply with such restrictive covenants could result in an event of default, which, if not cured or waived, could result in Kforce being required to repay the outstanding balance before the due date. If this occurs, we may not be able to repay our debt or we may be forced to refinance on terms not acceptable to us, which could have a material adverse effect on our results of operations and financial condition.

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

Purchases of Equity Securities by the Issuer

The following table presents information with respect to our repurchases of Kforce common stock during the three months ended June 30, 2017:

| 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 | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
|---------------------------------|--|---------------------------------|--|--|
| April 1, 2017 to April 30, 2017 | 362 | \$ 22.03 | — | \$ 50,719,471 |
| May 1, 2017 to May 31, 2017 | 2,807 | \$ 20.41 | — | \$ 50,719,471 |
| June 1, 2017 to June 30, 2017 | — | \$ — | — | \$ 50,719,471 |
| Total | 3,169 | \$ 20.59 | — | \$ 50,719,471 |

(1) All activity presented in this table relates to shares of stock received upon vesting of restricted stock to satisfy statutory minimum tax withholding requirements.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

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Item 6. Exhibits.

| Exhibit Number | Description |
|-------------------|---|
| 3.1 | Amended and Restated Articles of Incorporation, incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 33-91738) filed with the SEC on April 28, 1995. |
| 3.1a | Articles of Amendment to Articles of Incorporation, incorporated by reference to the Registrant's Registration Statement on Form S-4/A (File No. 333-111566) filed with the SEC on February 9, 2004, as amended. |
| 3.1b | Articles of Amendment to Articles of Incorporation, incorporated by reference to the Registrant's Registration Statement on Form S-4/A (File No. 333-111566) filed with the SEC on February 9, 2004, as amended. |
| 3.1c | Articles of Amendment to Articles of Incorporation, incorporated by reference to the Registrant's Registration Statement on Form S-4/A (File No. 333-111566) filed with the SEC on February 9, 2004, as amended. |
| 3.1d | Articles of Amendment to Articles of Incorporation, incorporated by reference to the Registrant's Current Report on Form 8-K (File No. 000-26058) filed with the SEC on May 17, 2000. |
| 3.1e | Articles of Amendment to Articles of Incorporation, incorporated by reference to the Registrant's Annual Report on Form 10-K (File No. 000-26058) filed with the SEC on March 29, 2002. |
| 3.2 | Amended & Restated Bylaws, incorporated by reference to the Registrant's Current Report on Form 8-K (File No. 000-26058) filed with the SEC on April 29, 2013. |
| 10.1 | Credit Agreement, dated May 25, 2017, between Kforce Inc. and its subsidiaries and Wells Fargo Bank, National Association, and the other lenders thereto, incorporated by reference to the Registrant's Current Report on Form 8-K (File No. 000-26058) filed with the SEC on May 25, 2017. |
| 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 2350, 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. |

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SIGNATURES

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

Kforce Inc.

(Registrant)

Date: August 2, 2017 By: /s/ DAVID M. KELLY
David M. Kelly
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Date: August 2, 2017 By: /s/ JEFFREY B. HACKMAN
Jeffrey B. Hackman
Senior Vice President, Finance and Accounting
(Principal Accounting Officer)