

KFORCE INC
Form 10-K
March 07, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(MARK ONE)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

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
(State or other jurisdiction of
incorporation or organization)

59-3264661
(IRS Employer
Identification No.)

1001 EAST PALM AVENUE, TAMPA, FLORIDA

33605

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(address of principal executive offices)

(Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (813) 552-5000

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS

NAME OF EACH EXCHANGE ON WHICH REGISTERED

None

None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

Common Stock, \$0.01 par value

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of registrant's voting and non-voting stock held by nonaffiliates of registrant, as of June 30, 2006 was \$628,271,054.

The number of shares outstanding of registrant's Common Stock as of March 2, 2007, was 41,008,298.

DOCUMENTS INCORPORATED BY REFERENCE:

Parts of the registrant's definitive proxy statement for the Annual Meeting of the registrant's Shareholders to be held on June 19, 2007, are incorporated by reference into Part III of this Form.

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

This document contains forward-looking statements, particularly with respect to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations (MDA). Additional written or oral forward-looking statements may be made by Kforce from time to time, in filings with the Securities and Exchange Commission (SEC) or otherwise. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such statements may include, but may not be limited to, projections of revenue, income, losses, cash flows, capital expenditures, integration of acquisitions, plans for future operations, effects of interest rate variations, financing needs or plans, plans relating to products or services of Kforce, estimates concerning the effects of litigation or other disputes, as well as assumptions to any of the foregoing. In addition, when used in this discussion, the terms anticipates, estimates, expects, intends, plans, believes 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 can not 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

ITEM 1. BUSINESS

Who We Are

We are a national provider of professional and technical specialty staffing services. Kforce is a Florida corporation and was formed in August 1994 as a result of the combination of Romac & Associates, Inc. and three of its largest franchises. Following an Initial Public Offering in August 1995, Kforce grew to 31 offices in 18 major markets. On April 20, 1998, Kforce consummated a merger whereby Source Services Corporation (Source), was merged into Kforce. On June 7, 2004, we completed a transaction whereby Hall, Kinion and Associates, Inc. was merged into Kforce. On February 1, 2005, we completed the acquisition of VistaRMS, Inc. During 2006, Kforce completed the acquisition of PCCI Holdings, Inc. on January 31, 2006 and the acquisition of Bradson Corporation on October 1, 2006. These transactions are discussed in further detail later in Item 1. At December 31, 2006, we operated 74 field offices in 43 markets and we currently provide services in all 50 states and the District of Columbia through these offices or from our headquarters in Tampa, Florida. We provide our clients staffing services through four business segments: Technology (Tech), Finance and Accounting (FA), Health and Life Sciences (HLS) and Government. Substantially all Tech and FA services are sold and delivered through our field offices. The HLS segment includes our Clinical Research, Scientific, Healthcare-Nursing (Nursing) and Health Information Management (HIM) specialties. The sales and delivery functions of substantial portions of HLS, particularly Clinical Research and HIM, are concentrated in our headquarters. Substantially all the services of our Government segment are sold and delivered through prime contracts with Federal government agencies by field offices located in the Washington, D.C. metropolitan area. Our headquarters provides support services to our field offices in areas such as human resources, nationwide recruiting, training, and national sales initiatives, in addition to the traditional back office support services such as payroll, billing, accounting, legal, tax, data processing and marketing, which are highly centralized.

Kforce is focused on providing staffing services to our clients. Our staffing services include Flexible Staffing Services (Flex) and Search Services (Search). Kforce anticipates continued growth which may be organic and/or through acquisition of other entities that enhance or expand our existing businesses. We believe that we are positioned to acquire and integrate other businesses that are strategically beneficial. Acquisitions entail significant risks which are described below.

Flex

Through Flex, we provide clients with qualified individuals (consultants) on a temporary basis. To be successful, our employees (associates) endeavor to (1) understand the clients needs, (2) determine and understand the capabilities of the consultants being recruited, and (3) deliver and manage the client-consultant relationship to the satisfaction of both the clients and the consultants. Typically, the better job Kforce and our consultants do, the longer the assignments last and the more often those clients turn to Kforce for additional needs.

The Flex business comprised 92.4% of our revenues for the year ended December 31, 2006. Flex revenues are driven by hours billed and billing rates. Flex gross profit is determined by deducting consultant pay, benefits and other related costs from Flex revenues. Flex associate commissions, related taxes and other compensation and benefits as well as field management compensation are included in Selling, General and Administrative expenses (SG&A) along with administrative and corporate employee compensation. The Flex business model involves attempting to maximize consultant hours and billing rates while optimizing consultant pay and benefit costs, associate compensation and benefits, and the operating costs necessary to effectively support such activities.

Search

The Search business is a smaller, yet important part of our business that involves locating permanent or direct hire employees for our clients. We primarily perform such searches on a contingency basis, with fees being earned only if personnel are hired by our clients. Fees are typically structured as a percentage of the placed individual's first-year annual compensation. We recruit Search employment candidates from our Flex consultant population, from internet job boards, and from candidates we identify who are currently employed and not actively seeking another position. Sometimes consultants initially work with clients on a Flex basis and then later are converted into permanent employees, for which we may also receive Search fees. There can be no assurance or expectation that Search revenues will increase if economic conditions improve, as has been the case in previous economic cycles. Typically, Search revenues decrease as economic conditions deteriorate. Clients and recruits are often targets for both Flex and Search services, and this common focus contributes to our objective of providing integrated solutions for all of our clients human capital needs.

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Search revenues are driven by placements made and the fees billed. There are no consultant payroll costs associated with the placement and thus all Search revenue generally increases gross profit by a like amount. Search associate commissions, compensation and benefits are also included in SG&A. Search revenues comprised 7.6% of revenue in 2006.

Our Industry

We serve Fortune 1000 companies, as well as small and mid-size local and regional companies, with our top ten clients representing approximately 19% of revenues for the year ended December 31, 2006. The specialty staffing industry is made up of thousands of companies, most of which are small local firms providing a limited service offering to a small local client base. We believe Kforce is one of the ten largest specialty staffing firms in the United States, that the ten firms combined have a market share of less than 22% of the applicable market and that no single firm has larger than an approximate 4% market share. Competition in a particular market can come from many different companies, either large or small. We believe, however, that our geographic presence, diversified service offerings within our core businesses, and focus on consistent sales and delivery that is highly disciplined, provide a competitive advantage particularly with larger clients that have operations in multiple markets.

Selected industry reports indicate the United States temporary staffing industry has shown revenue levels of approximately \$81 billion in 2004, \$107 billion in 2005, and \$119 billion in 2006. While no predictions can or should be made about the general economy, the staffing industry as a whole, or specialty staffing in particular, we believe that a sustained economic recovery will stimulate demand for substantial additional U.S. workers or, conversely, an economic slowdown will cause demand for additional U.S. workers to contract, and that Flex demand generally increases before demand for permanent placements increases. We also believe that our three areas of functional focus, Tech, FA and HLS, will be among the higher growth categories in both the short and long-term and that over the long-term, temporary staffing may become a higher percentage of total jobs, particularly in the professional, technical and government areas. We also believe that the Government segment will have more stable growth during variable economic cycles due to the growth of the Federal agencies that are customers of Kforce and also partially due to the use of outsourced labor by many government agencies to replace employees who are retiring. Further, we believe that the recent positive trends in our operating results, which we believe have been enhanced by the streamlining of our operations and centralizing of certain support functions, have positioned Kforce well for the future.

There can be no assurance that customer demand or pricing in Kforce's specialty staffing sectors will return to previous historic levels. In addition, Kforce has a number of competitors that are increasingly utilizing a lower-priced staffing preferred-vendor model (VOP/VMS). Also, competition for skilled candidates, such as finance and accounting candidates, has increased. Each of these factors, among others, may impact the future growth and profitability of Kforce.

Acquisition of Hall, Kinion & Associates, Inc.

On June 7, 2004, Kforce acquired 100% of the outstanding common stock of Hall, Kinion and Associates Inc. (Hall Kinion) and its subsidiaries in exchange for approximately 5.7 million shares of Kforce stock. This acquisition was accounted for using the purchase method. Hall Kinion's first quarter 2004 and full year 2003 revenues were \$30.3 million and \$156.9 million, respectively. The results of Hall Kinion's operations since the date of acquisition have been included in Kforce's consolidated financial statements. Hall Kinion specialized in providing technology and finance and accounting related talent on a temporary and permanent basis to its customers primarily in the United States. The results of the technology and finance and accounting businesses (previously provided by Hall Kinion's OnStaff group) are included in Kforce's Technology and Finance and Accounting business segments, respectively.

As a result of this acquisition, Kforce expanded its market presence by adding 18 offices, not including 25 offices that were consolidated with existing Kforce offices. The acquisition also expanded Kforce's service offerings in technology and finance and accounting in certain market segments. We believe the integration of the operations of Hall Kinion into Kforce has had a positive effect on revenues, net income and earnings per share beginning in the third quarter of 2004. We have not compiled separate results for the former Hall Kinion operations because these operations have been fully integrated into Kforce and it is not feasible to track their results.

Details of the terms of the acquisition are included in a Registration Statement on Form S-4 that we filed on December 24, 2003, and amended on February 9, 2004, April 13, 2004, May 3, 2004 and May 5, 2004.

Acquisition of VistaRMS, Inc.

On February 1, 2005, Kforce completed the acquisition of substantially all of the assets of VistaRMS, Inc. (Vista), a privately held company based in Herndon, Virginia, in exchange for 2.3 million shares of Kforce common stock. This transaction was accounted for using the purchase method. The results of Vista's operations since the date of acquisition have been included in Kforce's consolidated financial statements. Vista had

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produced revenue of approximately \$50 million in technology staffing over the 12 months prior to the acquisition.

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We believe the integration of the operations of Vista into Kforce has had a positive effect on revenues, net income and earnings per share beginning in the first quarter of 2005. We have not compiled separate results for the former Vista operations because these operations have been fully integrated into Kforce and it is not feasible to track their results.

Acquisition of PCCI Holdings, Inc.

On January 31, 2006, Kforce acquired PCCI Holdings, Inc., pursuant to an Agreement and Plan of Merger (the **Merger Agreement**) by and among Kforce, Trevoise Acquisition Corporation, a Delaware corporation and a wholly-owned subsidiary of Kforce (**Merger Sub**), PCCI Holdings, Inc., a Delaware corporation (**PCCI**), H.I.G. Pinkerton, Inc., a Cayman company, in its capacity as Representative, William D. Pinkerton and Richard J. Quigley. Under the terms of the Merger Agreement, Kforce acquired all of the outstanding stock of PCCI for approximately \$60 million (the **Purchase Price**) paid in cash at closing, subject to certain adjustments as provided for in the Merger Agreement. On the closing date, Kforce placed into escrow \$6 million of the total Purchase Price to secure PCCI's indemnification obligations, and to satisfy certain adjustments to the Purchase Price.

PCCI was a privately held company based in Trevoise, Pennsylvania that, through its wholly-owned subsidiaries (primarily Pinkerton Computer Consultants, Inc.), produced revenue of approximately \$95 million in technology staffing and the Federal government technology services sector during the 12 months ended January 31, 2006. Approximately 35% of that revenue was generated in the government sector through primarily prime contract relationships. As a result of the above acquisition, Kforce expanded its presence in technology staffing in both the Federal government and commercial sectors.

Acquisition of Bradson Corporation

On October 1, 2006, Kforce entered into and closed a Stock Purchase Agreement (the **Stock Purchase Agreement**) by and among Kforce, Bradson Corporation (**Bradson**), Kforce Government Holdings Inc., a Florida corporation and a wholly-owned subsidiary of Kforce (**KGH**), Ronald M. Bradley individually and on behalf of the other shareholders, Barbara J. Lewis and David M. Halstead.

Bradson was a privately held company based in Arlington, Virginia, and has been a prime contractor of finance and accounting professional services to the Federal government for over 20 years. Bradson's primary customers include the Department of Defense and the Department of Homeland Security. Bradson generated approximately \$26 million in revenues during the 12 months ended June 30, 2006.

Pursuant to the terms of the Stock Purchase Agreement, KGH acquired all of the outstanding capital stock of Bradson for a purchase price of \$73 million (the **Purchase Price**), which was subject to Bradson delivering a minimum of \$4 million in working capital at the time of closing. The cash consideration paid by KGH was comprised of Kforce's cash on hand and borrowings under Kforce's credit facility. On October 2, 2006, KGH placed into escrow \$5 million of the total Purchase Price to secure Bradson's indemnification obligations and to satisfy certain adjustments to the Purchase Price. KGH, Bradson, and the shareholders have made certain customary representations, warranties and covenants in the Stock Purchase Agreement. Kforce is a party to the Stock Purchase Agreement as a guarantor of the performance of all obligations of KGH, including all obligations to make the payments of the Purchase Price to the shareholders.

Kforce anticipates continued growth which may be organic and/or through acquisition of other entities that enhance or expand our existing businesses. We believe that we are positioned to acquire and integrate other businesses that are strategically beneficial.

Business Strategy

Kforce is a national provider of professional and technical specialty staffing services. Key elements of our business strategy include the following:

Focus on Value-Added Services. We focus on providing specialty staffing services to our clients, specifically in the areas of Technology, Finance and Accounting and Health and Life Sciences. We believe, based upon data published by the U.S. Bureau of Labor Statistics and other sources, that future employment growth may be significant in these sectors. The placement of highly skilled personnel requires operational and technical knowledge to effectively recruit and screen personnel, match them to client needs, and develop and manage the resulting relationships. We believe our historical focus in these markets, combined with our staff's operating expertise, provides us with a competitive advantage.

Build Long-Term, Consultative Relationships. We believe we have developed long-term relationships with our clients by providing solutions to their specialty staffing requirements. We strive to differentiate ourselves by working closely with our clients to maximize their return on human assets. In addition, Kforce's ability to offer flexible staffing services, coupled with its permanent placement capability, offers the client a multi-faceted provider of specialty staffing services. We believe this ability enables Kforce to emphasize consultative rather than just

transactional client relationships.

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Achieve Extensive Client Penetration. Our client development process focuses on contacts with client employees responsible for staffing decisions. Contacts are made within numerous functional departments and at many different organizational levels within the client. Our associates are trained to develop a thorough understanding of each client's total staffing requirements.

Recruit High-Quality Consultants. We place great emphasis on recruiting qualified consultants. We believe we have a recruiting advantage over those of our competitors that lack the ability to offer candidates flexible and permanent opportunities. We frequently place candidates seeking permanent employment in flexible assignments until a permanent position becomes available as well as convert temporary candidates into permanent employees of our client companies.

Encourage Employee Achievement. We promote a quality-focused, results-oriented culture. Our field associates and corporate personnel are given incentives to encourage the achievement of Kforce's corporate goals.

Business Segments/Reporting Units

Kforce provides staffing services in four business segments:

Technology. The Bureau of Labor Statistics lists computer and data processing services among the fastest growing industries over the last decade. The shortage of technical expertise to operate the advanced systems that businesses have acquired over the last decade is a major catalyst contributing to the growth of this segment. Our Tech services focus primarily on more sophisticated areas of information technologies (i.e., systems/applications programmers, systems analysts, and e-business and networking technicians). The economic slowdown of 2000-2003 significantly affected the willingness and ability of companies to commit capital resources to their technology systems/infrastructure. While our Tech staffing revenue increased substantially throughout 2004, 2005, and 2006, and we believe that the long-term business catalysts of technology remain in place, there can be no assurance that spending in the sector will return to the historic levels seen over the last decade.

Finance and Accounting. Our FA personnel provide both temporary staffing and search placement services to our clients in areas such as taxation, budget preparation and analysis, financial reporting, cost analysis, accounts payable, accounts receivable, professional administrative, credit and collections, general accounting, audit services and systems and controls analysis and documentation to support compliance work under Section 404 of the Sarbanes-Oxley Act of 2002. We believe we have built a reputation for providing qualified finance and accounting professionals to businesses. Historically, this business segment typically experiences its strongest demand in the months preceding and subsequent to the end of the calendar year as the result of increased demand for finance professionals to work on year-end closing and tax related assignments. During the 2000-2003 economic slowdown, FA revenues decreased significantly. While these areas improved substantially in 2004, 2005, and 2006, there can be no assurance that revenue in the FA sector will return to prior peak levels.

Health and Life Sciences. Our HLS segment consists of skilled professionals and technical services in the clinical research, health care and scientific fields. Examples of positions in these categories are: clinical research associates (CRAs) for the pharmaceutical industry, and health care information management professionals and nurses for hospitals. The Scientific specialty group supplies laboratory, research and development, quality assurance and quality control professionals to a variety of industries. Our HLS segment, and in particular the clinical research and scientific businesses, exhibits decreases in demand the final two weeks of the year as the result of holiday shutdowns at many large clients.

Government. Our Government segment provides FA and Tech professionals to the Federal government primarily as a prime contractor. We believe that our proven method for sourcing professional candidates for long term staffing assignments in combination with the prime contractor relationships which were acquired through the Bradson and PCCI acquisitions will allow us to pursue additional opportunities in the Federal government sector. The Bureau of Labor Statistics estimates 50% of Federal government employees and 70% of Federal senior managers will be eligible to retire by 2010. We believe that these statistics represent the opportunity that is available to Kforce as a prime contractor.

Kforce organizes and manages its FA and Tech business units along regional market lines: atlantic, eastern and western markets. Kforce believes this operational alignment supports a more customer centric organization, leverages our best leaders, leverages client relationships across functional offerings and streamlines the organization by placing senior management closer to the customer as well as achieving greater cost-efficiency. The HLS and Government segments are organized and managed by specialty because of the unique operating characteristics of each business.

Financial information regarding our business segments is included in Item 8 of Part II.

Staffing Services

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Staffing services are provided to our clients based on an analysis of each client's individual functional needs, including a determination of time duration of services required. Kforce offers staffing services in two categories: Flexible Staffing Services and Search Services. In 2006, Flexible Staffing and Search Services accounted for 92.4% and 7.6% of revenue, respectively.

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Flexible Staffing Services

Kforce offers Flexible Staffing Services, providing personnel in the fields of information technology, finance and accounting and health and life sciences. Flexible Staffing Services entail placing skilled workers in the client environment on a contractual basis. Assignments typically run from three months to one year in duration. We currently offer Flexible Staffing Services in most large metropolitan market areas and as a prime contractor to the Federal government.

Search Services

Kforce provides Search Services (permanent placement) for professional and technical personnel in the areas of information technology, finance and accounting and health and life sciences.

Kforce primarily performs contingency searches. A contingency search results in revenue to Kforce only when personnel are hired by a client. Our strategy is to perform contingency searches primarily in our core businesses. Fees are typically structured as a percentage of the placed individual's first-year annual compensation. Sometimes consultants initially work with clients on a Flex basis and then later are converted into permanent employees, for which we may also receive Search fees.

Client searches that are outside a core business area are typically restricted to management or executive level positions and require a targeted research and recruiting effort. Kforce typically performs these searches as retained searches where the client pays a part of the search fee in advance and the remainder upon completion of the search. Retained searches represent only a nominal portion of our search services.

An active database of candidates is maintained as the result of our continuous recruiting efforts and reputation in the industry. In addition, many candidates are located as a result of referrals from Flexible Staffing Services activities.

The clients targeted for Search Services are typically the same as those targeted for Flexible Staffing Services. This common focus is intended to contribute to Kforce's objective of providing an integrated solution for our clients' personnel needs. Search Services were severely impacted by the economic downturn during 2000-2003. Although we have seen recovery in 2004, 2005, and 2006, there can be no assurance or expectation that Search Services revenues will return to prior levels.

Technology

Our focus for Kforce's technology activities is to improve efficiency and maintain a leveragable platform. During 2006, we entered into an Enterprise Optimization Process (EOP), whereby we upgraded our back office financial systems, and whereby we plan to upgrade our human resources, time collection and billing systems in 2007. During 2005, we completed a data center refresh whereby virtually all of the hardware in our data center was replaced or upgraded with new hardware, which management believes will provide improved service to our corporate and field operations. In 2004, we continued to consolidate key technology activities to improve access to data and improve operating leverage. We completed a field server consolidation project which consolidated over 50 Microsoft Exchange (E-mail & Calendaring) servers in the field into one centralized Exchange system in our data center located in Tampa. We also completed the acquisitions of Hall Kinion in June 2004, Vista in February 2005, PCCI in January 2006, and Bradson in October 2006. We believe that we have successfully integrated Hall Kinion's, Vista's, PCCI's and Bradson's technical processes into Kforce processes and established a methodology for technical integration of future acquisitions.

While we believe our technology systems are adequate to meet our current needs, there can be no assurance that they will not be subject to system outages or data loss caused by natural or man-made disaster. In addition, Kforce depends on certain third-party vendors whose reliability we can not guarantee going forward. One or more of such events could negatively impact our ability to conduct our normal course of business.

Trade Names and Trademarks

The Kforce and OnStaff trade names, and the following trademarks: Data Confidence, DC Vector, Data Confidence Vector, DC Empower, and DC Method, are important to our business. Each of these trade names and trademarks are registered with the United States Patent and Trademark Office.

Competition

The specialty staffing services industry is very competitive and fragmented. There are relatively few barriers to entry and new competitors frequently enter the market. A number of our competitors have substantially greater resources than we possess. We face substantial competition

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from large national firms and local specialty staffing firms. The local firms are typically operator-owned, and each market generally has one or more significant competitors. We also face competition from national clerical and light industrial staffing firms and national and regional accounting firms that also offer certain specialty staffing services.

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In addition, many companies utilize Vendor Management Systems (VMS) for the purchase of staffing services. Generally, VMS are software systems that allow companies to manage service providers. According to a survey conducted in 2005 by Staffing Industry Analysts, 24% of the Fortune 1000 have VMS installed, up from 20% in 2004, with another 17% planning to do so by the end of 2007. Data shows that larger, more sophisticated companies are more likely to add VMS. Approximately 35% of companies with at least 10,000 employees currently use VMS. Typically, VMS providers charge staffing firms 1% to 3% of total service revenues, which are usually recorded by staffing firms as a cost of services, thereby compressing margins. Kforce's strategy has been to work with all VMS providers to enable us to provide Flexible Staffing Services to the broadest customer base possible in the sectors we serve.

In the United States, approximately 100 national competitors operate; and more than 9,500 smaller organizations compete in varying degrees at local levels. Several similar companies global, national, and local compete in foreign markets. In 2006, Kforce's largest competitors included Adecco, S.A., Manpower, Inc., MPS Group, Inc., Robert Half International Inc., Spherion Corporation, Ciber Resources Connection, Jefferson Wells and CDI Corporation.

Kforce believes that availability and quality of personnel, level of service, effective monitoring of job performance, scope of geographic service and price of service are the principal elements of competition in our industry. We believe that availability of quality personnel is especially important. In order to attract candidates, we place emphasis upon our ability to provide permanent placement opportunities, competitive compensation and benefits, quality and varied assignments and scheduling flexibility. Because personnel pursue other employment opportunities on a regular basis, it is important that we respond to market conditions affecting these individuals. Additionally, in certain markets and in response to economic softening, we have experienced significant pricing pressure from some of our competitors. Although we believe we compete favorably with respect to these factors, we expect competition and pricing pressure to continue, and there can be no assurance that we will remain competitive.

Insurance

Kforce maintains a number of insurance policies including general liability, automobile liability and employers' liability (each with excess liability coverage). We also maintain workers compensation, fidelity, fiduciary, directors and officers, professional liability, and employment practices liability policies. These policies provide coverage subject to their terms, conditions, limits of liability, and deductibles, for certain liabilities that may arise from Kforce's operations. There can be no assurance that any of the above coverage will be adequate for our needs, or that we will maintain all such policies in the future.

Financial Information About Foreign and Domestic Operations

Materially all of Kforce's revenues are derived from domestic operations with customers located in the United States, for the years ended December 31, 2006, 2005 and 2004.

Operating Employees and Personnel

As of December 31, 2006, Kforce employed 2,160 operating employees and had approximately 10,300 consultants on assignment (Flexible Consultants) providing flexible staffing services to our clients. Flexible Consultants are primarily individuals who are employed directly by Kforce (Flexible Employees) representing approximately 87% of Flexible Consultants; the balance are individuals who are employed by other entities (Independent Contractors) that provide their employees to Kforce for assignment to its clients. As the employer, Kforce is responsible for the operating employees' and Flexible Employees' payrolls and the employer's share of applicable social security taxes (FICA), Federal and state unemployment taxes, workers compensation insurance, and other direct labor costs relating to our employees. We offer access to various health, life and disability insurance programs and other benefits for operating employees and Flexible Employees. We have no collective bargaining agreements covering any of our operating employees or Flexible Employees, have never experienced any material labor disruption, and are unaware of any current efforts or plans to organize any of our employees.

Available Information

We make available, free of charge, through the Investor Relations page on our website, and by responding to requests addressed to our Vice President Investor Relations, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports. These reports are available as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Our website address is <http://www.kforce.com>. The information contained on our website, or on other websites linked to our website, is not part of this document.

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ITEM 1A. RISK FACTORS

Kforce may not be able to recruit and retain qualified personnel.

Kforce depends upon the abilities of its staff to attract and retain personnel, particularly technical and professional personnel, who possess the skills and experience necessary to meet the staffing requirements of our clients. We must continually evaluate and upgrade our base of available qualified personnel to keep pace with changing client needs and emerging technologies. We expect competition for individuals with proven technical or professional skills for the foreseeable future. If qualified personnel are not available to us in sufficient numbers and upon economic terms acceptable to us, it could have a material detrimental effect on our business.

Kforce's current market share may decrease as a result of limited barriers to entry for new competitors and discontinuation of clients outsourcing of their staffing needs.

Kforce faces significant competition in the markets we serve, and there are limited barriers to entry for new competitors. The competition among staffing services firms is intense. Kforce competes for potential clients with providers of outsourcing services, systems integrators, computer systems consultants, temporary personnel agencies, search firms and other providers of staffing services. A number of our competitors possess substantially greater resources than we do. From time to time, we experience significant pressure from our clients to reduce price levels. During these periods, we may face increased competitive pricing pressures and may not be able to recruit the personnel necessary to fill our clients needs. We also face the risk that certain of our current and prospective clients will decide to provide similar services internally. There can be no assurance that we will continue to successfully compete.

We rely on short-term contracts with most of our clients.

Because long-term contracts are not a significant part of our business, future results cannot be reliably predicted by considering past trends or extrapolating past results. Further, our reliance on short-term contracts exerts continued pressure on us when we try to renew contracts with existing clients who may seek better terms at each renewal.

Our offshore outsourcing solutions are limited.

Many staffing customers are now seeking an offshore solution to support their technology and business process function and, as a result, a significant amount of technology and financial staffing may be replaced by offshore resources. Prior to January 31, 2006, we did not provide an offshore program. Following the acquisition of PCCI on January 31, 2006, we now provide a limited technology staffing solution through a location in the Philippines to certain clients whose contracts were acquired in conjunction with the acquisition of PCCI. There can be no assurance that we will be able to compete successfully against other offshore solution providers or that we will not lose significant market share and revenue.

We do not provide a Vendor Management System (VMS) solution.

Many staffing customers are seeking to consolidate their use of staffing services through the use of VMS solutions. Kforce provides consultants to these clients through other staffing companies who utilize a VMS solution, but we do not currently provide this service directly to our clients. There can be no assurance that we can continue to effectively compete with those companies that provide a VMS solution.

Currently, Kforce is unable to recruit enough nurses to meet our clients' demands for nurse staffing services, limiting the potential growth of our healthcare staffing business.

Kforce relies on its ability to attract, develop, and retain nurses and other healthcare personnel who possess the skills, experience and licensure necessary to meet the specified requirements of our healthcare staffing clients. We compete for healthcare staffing personnel with other temporary healthcare staffing companies, as well as actual and potential clients. Currently, there is a shortage of qualified nurses in most areas of the United States and competition for nursing personnel is increasing. At this time, we do not have enough nurses to meet our clients' demands for our nurse staffing services. This shortage of nurses limits Kforce's ability to grow our healthcare staffing business. Furthermore, we believe that the aging of the existing nurse population and declining enrollments in nursing schools will result in further competition for qualified nursing personnel.

Decreases in patient occupancy at healthcare clients' facilities may adversely affect the profitability of Kforce's business.

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Demand for temporary healthcare staffing services is significantly affected by the general level of patient occupancy at healthcare clients facilities. When a hospital's occupancy increases, temporary employees are often added before full-time employees are hired. As occupancy decreases, clients may reduce their use of temporary employees before undertaking layoffs of their regular employees. Kforce may also experience more competitive pricing pressure during periods of occupancy downturn. This reduction in occupancy could adversely affect the demand for services and Kforce's profitability. Although demand has improved for our healthcare staffing services during 2004, 2005, and 2006, there can be no assurance that such demand will remain at current levels.

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Significant legal actions, particularly relating to our healthcare staffing services, could subject Kforce to substantial uninsured liabilities.

In recent years, healthcare providers have become subject to an increasing number of legal actions alleging malpractice, product liability or related legal theories. Many of these actions involve large claims and significant defense costs. In addition, we may be subject to claims related to torts or crimes committed by our employees or temporary staffing personnel. In some instances, we are required to indemnify clients against some or all of these risks. A failure of any of our employees or personnel to observe our policies and guidelines intended to reduce these risks, relevant client policies and guidelines or applicable Federal, state or local laws, rules and regulations could result in negative publicity, payment of fines or other damages. To protect ourselves from the cost of these claims, we maintain professional malpractice liability insurance, fidelity insurance and general liability insurance coverage in amounts and with deductibles that we believe are appropriate for our operations. Our insurance coverage, however, may not cover all claims against us or continue to be available to us at a reasonable cost. If we are unable to maintain adequate insurance coverage, we may be exposed to substantial liabilities.

The addition of offices and entry into new geographic markets may not occur on a timely basis or achieve anticipated financial results.

Kforce's growth depends in part on our ability to enter new vertical or geographic markets successfully. This expansion is dependent on a number of factors, including our ability to:

develop, recruit and maintain a base of qualified professionals within a new geographic market;

initiate, develop and sustain corporate client relationships in each new vertical or geographic market;

attract, hire, integrate and retain qualified sales and sales support employees; and

accurately assess the demand in a new market.

The addition of new offices and entry into new vertical or geographic markets typically result in increases in operating expenses, primarily due to increased employee headcount. Expenses are incurred in advance of forecasted revenue, and there is typically a delay before our new employees reach full productivity. Additionally, demand for our services in new markets that we enter might also be less than we anticipate. If we are unable to enter new vertical or geographic markets in a cost-effective manner or if demand for our services in new markets does not meet or exceed our forecasts, our business, operating results and financial condition could be negatively impacted. In 2004, 2005 and 2006, we closed and consolidated offices to improve efficiency, and further closures or consolidation may occur depending on market and competitive conditions.

Competition for acquisition opportunities may restrict Kforce's future growth by limiting our ability to make acquisitions at reasonable valuations.

Kforce's business strategy includes increasing market share and presence in the staffing industry through strategic acquisitions of companies that complement or enhance our business. We have historically faced competition for acquisitions. In the future, this could limit our ability to grow through acquisitions or could raise the prices of acquisitions and make them less accretive or possibly non-accretive to us. In addition, Kforce may be limited by its ability to obtain financing to consummate desirable acquisitions.

Kforce may face difficulties integrating acquisitions into existing operations and acquisitions may be unsuccessful, involve significant cash expenditures or expose Kforce to unforeseen liabilities.

Kforce continually evaluates opportunities to acquire staffing companies that complement or enhance our business and frequently has preliminary acquisition discussions with some of these companies.

These acquisitions involve numerous risks, including:

potential loss of key employees or clients of acquired companies;

difficulties integrating acquired personnel and distinct cultures into a single business;

diversion of management attention from existing operations; and

assumption of liabilities and exposure to unforeseen liabilities of acquired companies.

These acquisitions may also involve significant cash expenditures, debt incurrence, integration expenses and exposure to unforeseen liabilities that could have a material adverse effect on our financial condition and results of operations. Any acquisition may ultimately have a negative impact on our business and financial condition.

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Kforce faces significant employment liability risk.

Kforce employs and places people in the workplaces of other businesses. An inherent risk of such activity includes possible claims of errors and omissions, misuse of client proprietary information, misappropriation of funds, discrimination and harassment, employment of illegal aliens, theft of client property, other criminal activity, torts or other claims. We have policies and guidelines in place to reduce our exposure to such risks. However, failure of any employee or personnel to follow these policies and guidelines may result in negative publicity, injunctive relief, payment by Kforce of monetary damages or fines or other material adverse effects upon our business. Moreover, we could be held responsible for the actions at a workplace of persons not under our immediate control. To reduce our exposure, we maintain insurance covering general liability, workers compensation claims, errors and omissions, and employee theft. Due to the nature of our assignments, in particular, access to client information systems and confidential information, and the potential liability with respect thereto, we may not be able to obtain insurance coverage in amounts adequate to cover any such liability on acceptable terms. In addition, we face various employment-related risks not covered by insurance, such as wage and hour laws and employment tax responsibility.

Kforce may be adversely affected by government regulation of the staffing business.

Our business is subject to regulation and licensing in many states. While we have had no material difficulty complying with regulations in the past, there can be no assurance that we will be able to continue to obtain all necessary licenses or approvals or that the cost of compliance will not prove to be material. If we fail to comply, such failure could materially adversely affect Kforce's financial results.

There are proposed changes in government visa rules that may materially impact our ability to bring foreign-born nurses to the United States. Our ability to bring nurses into the United States in the future may be severely impacted, which would affect our nurse staffing revenue. Kforce relies partially on foreign-born nurses in order to provide nurse staffing services to our healthcare customers.

Kforce may be adversely affected by government regulation of the workplace.

Part of our business entails employing individuals on a temporary basis and placing such individuals in clients' workplaces. Increased government regulation of the workplace or of the employer-employee relationship could have a material adverse effect on Kforce.

If Kforce becomes subject to material liabilities under our self-insured programs, our financial results may be adversely affected.

Kforce provides workers compensation coverage through a program that is partially self-insured. In addition, we provide medical coverage to our employees through a partially self-insured preferred provider organization. If we become subject to substantial uninsured workers compensation or medical coverage liabilities, our financial results may be adversely affected.

Future changes in reimbursement trends could hamper our clients' ability to pay Kforce.

Many of Kforce's healthcare clients are reimbursed under the Federal Medicare program and state Medicaid programs for the services they provide. In recent years, Federal and state governments have made significant changes in these programs that have reduced government rates. In addition, insurance companies and managed care organizations seek to control costs by requiring that healthcare providers, such as hospitals, discount their services in exchange for exclusive or preferred participation in their benefit plans. Future Federal and state legislation or evolving commercial reimbursement trends may further reduce, or change conditions for, our clients' reimbursement. Limitations on reimbursement could reduce our clients' cash flow, hampering their ability to pay us. This situation could have a significant impact on our cash flow.

Significant increases in payroll-related costs could adversely affect Kforce's business.

Kforce is required to pay a number of Federal, state, and local payroll and related costs, including unemployment taxes, workers compensation and insurance, FICA, and Medicare, among others, for our employees. Significant increases in the effective rates of any payroll-related costs likely would have a material adverse effect upon Kforce. Costs could also increase as a result of health care reforms or the possible imposition of additional requirements and restrictions related to the placement of personnel. Recent Federal and state legislative proposals have included provisions extending health insurance benefits to personnel who currently do not receive such benefits. We may not be able to increase the fees charged to our clients in a timely manner and in a sufficient amount to cover increased costs, if any such proposals are adopted.

Kforce depends on the proper functioning of our information systems.

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Kforce is dependent on the proper functioning of information systems in operating its business. Critical information systems are used in every aspect of Kforce's daily operations, most significantly, in the identification and matching of staffing resources to client assignments and in the customer billing and consultant payment functions. Kforce's information systems

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are protected through physical and software safeguards including the use of a third party data processing center. However, Kforce and its systems are still vulnerable to natural disasters (we are headquartered in a hurricane prone area), fire, terrorist acts, power loss, telecommunications failures, physical or software break-ins, computer viruses and similar events. If our critical information systems fail or are otherwise unavailable, we would have to accomplish these functions manually, which could temporarily impact our ability to identify business opportunities quickly, to maintain billing and clinical records reliably, and to bill for services efficiently. In addition, we depend on third-party vendors for certain functions whose future performance and reliability we can not warrant.

Due to inherent limitations, there can be no assurance that our system of disclosure and internal controls and procedures will be successful in preventing all errors and fraud, or in making all material information known in a timely manner to management.

Our management, including our CEO and CFO, does not expect that our disclosure controls and internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Kforce have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, a control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Kforce may not be able to maintain sufficient cash flow or borrowing capacity to support operations.

Kforce's liquidity may be adversely impacted by covenants in our Credit Facility. On October 2, 2006, Kforce entered into a Second Amended and Restated Credit Agreement with a syndicate led by Bank of America, N.A. ("The Credit Facility"). Under the Credit Facility, Kforce increased its indebtedness under its existing \$100 million revolving credit facility. Kforce's maximum borrowings under the Credit Facility are now limited to \$140 million, including a revolving loan tranche of up to \$100 million (the "Revolving Loan Amount"), an additional revolving loan tranche (the "Additional Availability Amount") of up to \$25 million, and a \$15 million sub-limit for letters of credit. Borrowings under the Credit Facility are limited to 85% of eligible accounts receivable, plus the lesser amount of \$25 million or 20% of the net amount of eligible accounts receivable, minus certain minimum availability reserves. Under the Credit Facility, Kforce is required to meet certain minimum availability and fixed charge coverage ratio requirements and is prohibited from making any dividend distributions. The Additional Availability Amount is reduced by \$1.25 million per month beginning November 2006, until the Additional Availability Amount is entirely eliminated, which will result in its elimination no later than June 2008. The Credit Facility expires on November 3, 2011.

At no time during the existence of the Credit Facility have we ever failed to meet the minimum availability and fixed charge coverage ratio requirements. If we did not comply with these financial covenants, such a breach of the Credit Facility could materially adversely affect our liquidity and financial condition and could result, among other things, in the acceleration of all amounts borrowed under the Credit Facility. See the Liquidity and Capital Resources section of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Adverse results in tax audits could result in significant cash expenditures or exposure to unforeseen liabilities.

Kforce is subject to periodic Federal, state and local tax audits for various tax years. Although Kforce attempts to comply with all taxing authority regulations, adverse findings or assessments made by the taxing authorities as the result of an audit could have a material adverse affect on Kforce.

Kforce's success depends upon retaining the services of its management team.

Kforce is highly dependent on its management team and expects that continued success will depend largely upon their efforts and abilities. The loss of the services of any key executive for any reason could have a material adverse effect upon Kforce. Success also depends upon our ability to identify, develop, and retain qualified operating employees; particularly management, client servicing, and candidate recruiting employees. Kforce expends significant resources in the recruiting and training of its employees, as the pool of available applicants for these positions is limited. The loss of some of our key operating employees could have an adverse effect on our operations, including our ability to establish and maintain client and candidate, professional and technical relationships.

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Kforce's stock price may be volatile.

Kforce's common stock is traded on The NASDAQ Global Select Market under the symbol KFRC. The market price of our stock has fluctuated substantially in the past and could fluctuate substantially in the future, based on a variety of factors, including our operating results, changes in general conditions in the economy, the financial markets, the employment services industry, or other developments affecting us, our clients, or our competitors, some of which may be unrelated to our performance.

In addition, the stock market in general, especially the NASDAQ Global Select Market tier, along with market prices for staffing companies, has experienced volatility that has often been unrelated to the operating performance of these companies. These broad market and industry fluctuations may adversely affect the market price of our common stock, regardless of our operating results.

Among other things, volatility in our stock price could mean that investors will not be able to sell their shares at or above the prices that they pay. The volatility also could impair our ability in the future to offer common stock as a source of additional capital or as consideration in the acquisition of other businesses.

Provisions in Kforce's articles and bylaws and under Florida law may have certain anti-takeover effects.

Kforce's articles of incorporation and bylaws and Florida law contain provisions that may have the effect of inhibiting a non-negotiated merger or other business combination. In particular, our articles of incorporation provide for a staggered board of directors and permit the removal of directors only for cause. Additionally, management may issue up to 15 million shares of preferred stock, and fix the rights and preferences thereof, without a further vote of the shareholders. In addition, certain of our officers and managers have employment agreements containing certain provisions that call for substantial payments to be made to such employees in certain circumstances upon a change in control. Certain of these provisions may discourage a future acquisition of Kforce, including an acquisition in which shareholders might otherwise receive a premium for their shares. As a result, shareholders who might desire to participate in such a transaction may not have the opportunity to do so. Moreover, the existence of these provisions may have a depressive effect on the market price of our common stock.

RISKS RELATED TO OUR GOVERNMENT BUSINESSES

In 2006, Kforce acquired Pinkerton Computer Consultants, Inc., now named Kforce Government Solutions, Inc. (KGS) and Bradson Corporation (Bradson). These firms, which operate as subsidiaries of Kforce, are substantially dedicated to contracting with and serving U.S. Federal government agencies (hereafter Federal agency business). Federal contractors, including KGS and Bradson, face a number of risks, including the following:

Our failure to comply with complex procurement laws and regulations could cause us to lose business, incur additional costs, and subject us to a variety of penalties.

We must comply with complex laws and regulations relating to the formation, administration, and performance of Federal government contracts. These laws and regulations create compliance risk and affect how we do business with our Federal agency clients, and may impose added costs on our business.

If a government review or investigation uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, harm to our reputation, suspension of payments, fines, and suspension or debarment from doing business with Federal government agencies. The government may in the future reform its procurement practices or adopt new contracting rules and regulations, including cost accounting standards, that could be costly to satisfy or that could impair our ability to obtain new contracts. A failure to comply with applicable laws and regulations could result in contract termination, price or fee reductions, or suspension or debarment from contracting with the Federal government, each of which could lead to a material reduction in our revenue and operating results.

Our employees may engage in misconduct or other improper activities, which could harm our business.

Like all government contractors, we are exposed to the risk that employee fraud or other misconduct could occur. Misconduct by our employees could include intentional failures to comply with Federal government procurement regulations, engaging in unauthorized activities, seeking reimbursement for improper expenses or falsifying time records. Employee misconduct could also involve the improper use of our clients sensitive or classified information, which could result in regulatory sanctions against us and serious harm to our reputation. It is not always possible to deter employee misconduct, and precautions to prevent and detect this activity may not be effective in controlling such risks or losses, which could adversely affect our business.

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Our Federal agency business is dependent upon maintaining our reputation, our relationships and our performance.

The reputation and relationships that we have established and maintain with government personnel and agencies are important to maintaining existing business and identifying new business. If our reputation or relationships were damaged, it could have a material adverse impact. In addition, if our performance does not meet agency expectations, our revenue and operating results could be materially harmed.

Competition is intense in the Federal agency business.

There is often intense competition to win Federal agency contracts. If we are unable to successfully compete for new business or win competitions to maintain existing business, our revenue growth and margins may decline. Many of our competitors are larger and have greater resources than we do, larger client bases, and greater brand recognition. Our larger competitors also may be able to provide clients with different or greater capabilities or benefits than we can provide.

Loss of our General Services Administration (GSA) schedule contracts would impair our ability to win new business.

GSA schedule contracts constitute a significant percentage of revenue from our Federal agency clients. If we were to lose one or more of these contracts, we could lose revenue and our operating results could be adversely affected. These contracts typically have an initial term with multiple options that may be exercised by our government agency clients to extend the contract for successive periods of one or more years. We can provide no assurance that our clients will exercise these options.

Unfavorable government audit results could force us to refund previously recognized revenues and could subject us to a variety of penalties and sanctions.

The Federal agencies can audit and review our performance on contracts, pricing practices, cost structure, and compliance with applicable laws, regulations, and standards. An audit of our work, including an audit of work performed by companies Kforce has acquired or may acquire, or subcontractors we have hired or may hire, could force us to refund previously recognized revenues.

If a government audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with U.S. Federal government agencies. In addition, we could suffer serious harm to our reputation if allegations of impropriety were made against us, whether or not true.

If we were suspended or debarred from contracting with the Federal government generally or with any specific agency, if our reputation or relationships with government agencies were impaired, or if the government otherwise ceased doing business with us or significantly decreased the amount of business it does with us, our revenue and operating results would be materially adversely affected.

Our failure to obtain and maintain necessary security clearances may limit our ability to perform classified work for government clients, which could cause us to lose business.

Some government contracts require us to maintain facility security clearances and require some of our employees to maintain individual security clearances. If our employees lose or are unable to timely obtain security clearances, or we lose a facility clearance, a government agency client may terminate the contract or decide not to renew it upon its expiration.

Security breaches in sensitive government systems could result in loss of our clients and cause negative publicity.

Many of the systems we develop, install, and maintain involve managing and protecting information used in intelligence, national security, and other sensitive or classified government functions. A security breach in one of these systems could cause serious harm to our business, damage our reputation, and prevent us from being eligible for further work on sensitive or classified systems for Federal government clients. We could incur losses from such a security breach that could exceed the policy limits under our insurance. Damage to our reputation or limitations on our eligibility for additional work resulting from a security breach in one of our systems could materially reduce our revenue.

Changes in the spending policies or budget priorities of the Federal government could cause us to lose revenue.

Changes in Federal government fiscal or spending policies could adversely affect our government agency business.

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The failure by Congress to approve budgets on a timely basis for the Federal agencies we support could delay or reduce spending and cause us to lose revenue.

On an annual basis, Congress must approve budgets that govern spending by each of the Federal agencies we support. When Congress is unable to agree on budget priorities and is unable to pass the annual budget on a timely basis, Congress typically enacts a continuing resolution. A continuing resolution allows government agencies to operate at spending levels approved in the previous budget cycle. When government agencies must operate under a continuing resolution, it may delay funding we expect to receive from clients on work we are already performing and will likely result in any new initiatives being delayed, and potentially cancelled.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease our corporate headquarters in Tampa, Florida, as well as space for our other locations. The aggregate area of office space under leases for locations is approximately 538,000 square feet. Field office leases generally run from month-to-month to five years. In September 2001, we relocated our corporate offices and local branches into a new headquarters in Tampa, Florida, which we have leased for 15 years. The aggregate annual rent expense in 2006 on all properties was approximately \$9.3 million. We believe that our facilities will be adequate for our current needs.

ITEM 3. LEGAL PROCEEDINGS

In the ordinary course of business, we are, from time to time, threatened with litigation or named as a defendant in various lawsuits and administrative proceedings, including workers compensation claims, discrimination claims, restrictive covenant disputes, service related disputes and other claims. We maintain liability insurance in such amounts and with such coverages and deductibles as management believes are reasonable. The principal risks that we insure against are workers compensation, personal injury, property damage, professional malpractice, errors and omissions, employment practices liability and fidelity losses. We are not aware of any pending legal proceedings that are likely to have a material adverse impact on Kforce.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Table of Contents**PART II****ITEM 5. MARKET FOR KFORCE COMMON EQUITY AND RELATED SHAREHOLDER MATTERS**

Our common stock trades on The NASDAQ Global Select Market, under the symbol **KFRC**. The following table sets forth, for the periods indicated, the range of high and low closing sale prices for our common stock, as reported on The NASDAQ Global Select Market. These prices represent inter-dealer quotations without retail markups, markdowns or commissions and may not represent actual transactions.

	HIGH	LOW
Calendar Year 2005:		
First Quarter	\$ 11.71	\$ 10.06
Second Quarter	\$ 11.03	\$ 6.98
Third Quarter	\$ 11.36	\$ 8.09
Fourth Quarter	\$ 12.71	\$ 9.76
Calendar Year 2006:		
First Quarter	\$ 13.18	\$ 11.28
Second Quarter	\$ 16.20	\$ 12.74
Third Quarter	\$ 15.49	\$ 10.10
Fourth Quarter	\$ 14.97	\$ 12.07

On March 2, 2007, there were approximately 239 holders of record of our common stock. On March 2, 2007, the last reported sale price of our common stock on The NASDAQ Global Select Market was \$13.03 per share.

Dividends

Since our initial public offering, we have not paid any cash dividends on our common stock. Under the terms of our Second Amended and Restated Credit Agreement, we are not allowed to make dividend distributions.

Equity Compensation Plan Information

The following table provides information about our common stock that may be issued under all of our existing equity compensation plans as of December 31, 2006, including the Kforce Inc. Non-Employee Director Stock Option Plan, the Kforce Inc. Stock Incentive Plan, the Kforce Inc. Executive Investment Plan, the Kforce Inc. 1999 Employee Stock Purchase Plan and the Kforce Inc. 2006 Stock Incentive Plan:

Plan Category	Number of Securities	
	to be Issued Upon	Exercise of
	Outstanding Options,	Warrants, Rights and
	Restricted Stock	Weighted Average
	Awards	Exercise Price of
		Outstanding Options,