

KFORCE INC
Form 10-Q
October 29, 2008
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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 September 30, 2008

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)

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FLORIDA
(State or other jurisdiction
of incorporation or organization)
1001 East Palm Avenue
TAMPA, FLORIDA
(Address of principal executive offices)
59-3264661
(I.R.S. Employer
Identification No.)
33605
(Zip-Code)
Registrant's telephone number, including area code: (813) 552-5000

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

The number of shares outstanding of the registrant's common stock as of October 27, 2008, was 38,725,828.

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SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

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, including but not limited to those found in 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. 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, and are made in reliance upon the protections provided by such acts for forward-looking statements. Such statements may include, but may not be limited to, projections of revenue, income, losses, cash flows, capital expenditures, future prospects, anticipated costs and benefits of proposed (or future) acquisitions, integration of acquisitions, plans for future operations, capabilities of business 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 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 MD&A section. In addition, when used in this discussion, the terms anticipates, estimates, expects, intends, plans, believes, will, should, could 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 any adjustments or updates to these forward-looking statements that may be made to reflect new information, unexpected events or events occurring on or after the date of this report.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Flexible billings	\$ 235,431	\$ 226,642	\$ 702,852	\$ 667,732
Search fees	15,487	19,828	53,211	58,094
Net service revenues	250,918	246,470	756,063	725,826
Direct costs of services	164,351	155,132	492,117	462,312
Gross profit	86,567	91,338	263,946	263,514
Selling, general and administrative expenses	71,613	69,505	220,691	203,421
Depreciation and amortization	3,028	3,842	10,650	10,800
Income from operations	11,926	17,991	32,605	49,293
Other expense, net	422	922	1,766	3,393
Income from continuing operations before income taxes	11,504	17,069	30,839	45,900
Income tax expense	4,522	6,742	12,122	18,147
Income from continuing operations	6,982	10,327	18,717	27,753
Income from discontinued operations, net of income taxes	910	697	5,053	2,643
Net income	7,892	11,024	23,770	30,396
Other comprehensive income (loss):				
Defined benefit pension plan actuarial gain (loss), net of tax	6		(380)	
Comprehensive income	\$ 7,898	\$ 11,024	\$ 23,390	\$ 30,396
Earnings per share basic:				
From continuing operations	\$.18	\$.25	\$.47	\$.67
From discontinued operations	.02	.02	.13	.07
Earnings per share basic	\$.20	\$.27	\$.60	\$.74
Earnings per share diluted:				
From continuing operations	\$.18	\$.24	\$.46	\$.66
From discontinued operations	.02	.02	.13	.06
Earnings per share diluted	\$.20	\$.26	\$.59	\$.72

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Weighted average shares outstanding	basic	39,249	41,463	39,858	41,226
Weighted average shares outstanding	diluted	39,977	42,544	40,353	42,324

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents**KFORCE INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS***(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)*

	September 30, 2008	December 31, 2007
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 921	\$ 1,083
Trade receivables, net of allowance for doubtful accounts and fallouts of \$6,663 and \$3,002, respectively	140,483	166,777
Income tax refund receivable	488	377
Deferred tax asset, net	8,684	8,409
Prepaid expenses and other current assets	6,577	4,268
Total current assets	157,153	180,914
Fixed assets, net	15,111	13,355
Other assets, net	31,152	31,982
Intangible assets, net	9,291	12,276
Goodwill	235,324	237,609
Total assets	\$ 448,031	\$ 476,136
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable and other accrued liabilities	\$ 24,506	\$ 25,222
Accrued payroll costs	54,142	53,613
Other current debt	2,016	3,859
Income taxes payable	3,525	2,872
Total current liabilities	84,189	85,566
Long-term debt - credit facility	12,000	50,330
Long-term debt - other	2,761	2,670
Deferred tax liability, net	6,097	6,624
Other long-term liabilities	21,005	18,478
Total liabilities	126,052	163,668
Commitments and contingencies		
Stockholders' Equity:		
Preferred stock, \$0.01 par; 15,000 shares authorized, none issued or outstanding		
Common stock, \$0.01 par; 250,000 shares authorized, 61,862 and 60,919 issued, respectively	619	609
Additional paid-in capital	324,405	310,165
Accumulated other comprehensive loss	(380)	
Retained earnings	136,350	112,580
Treasury shares at cost; 22,539 and 19,365 shares, respectively	(139,015)	(110,886)
Total stockholders' equity	321,979	312,468
Total liabilities and stockholders' equity	\$ 448,031	\$ 476,136

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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)

	Nine Months Ended September 30, 2008
Common stock – shares:	
Shares at beginning of period	60,919
Issuance of restricted stock	575
Exercise of stock options	368
Shares at end of period	61,862
Common stock – par value:	
Balance at beginning of period	\$ 609
Issuance of restricted stock	6
Exercise of stock options	4
Balance at end of period	\$ 619
Additional paid-in capital:	
Balance at beginning of period	\$ 310,165
Issuance of restricted stock	(6)
Exercise of stock options	2,577
Income tax benefit from restricted stock and stock option exercises	442
Stock-based compensation	11,026
Employee stock purchase plan	201
Balance at end of period	\$ 324,405
Accumulated other comprehensive loss:	
Balance at beginning of period	\$
Pension adjustment, net of tax and amortization	(380)
Balance at end of period	\$ (380)
Retained earnings:	
Balance at beginning of period	\$ 112,580
Net income	23,770
Balance at end of period	\$ 136,350
Treasury stock – shares:	
Shares at beginning of period	19,365
Shares tendered in payment of the exercise price of stock options	52
Minimum tax withholding on restricted stock awards and stock option exercises	134
Open market repurchases of common stock	3,063
Employee stock purchase plan	(75)

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Shares at end of period		22,539
Treasury stock cost:		
Balance at beginning of period	\$	(110,886)
Shares tendered in payment of the exercise price of stock options		(579)
Minimum tax withholding on restricted stock awards and stock option exercises		(1,219)
Open market repurchases of common stock		(26,776)
Employee stock purchase plan		445
Balance at end of period	\$	(139,015)

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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

	Nine Months Ended	
	September 30, 2008	September 30, 2007
Cash flows from operating activities:		
Net income	\$ 23,770	\$ 30,396
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Deferred income tax provision, net	(519)	5,861
Gain on sale of discontinued operations	(7,330)	
Depreciation and amortization	10,650	10,800
Stock-based compensation	11,026	2,516
Provision for bad debts on accounts receivable and fallouts	5,449	1,142
Supplemental executive retirement plans expense	2,116	1,550
Amortization of alternative long-term incentive award		853
Deferred compensation liability (decrease) increase, net	(2,832)	1,265
Tax benefit attributable to option exercises	578	1,530
Excess tax benefit attributable to option exercises	(51)	(940)
Loss (gain) on cash surrender value of company-owned life insurance	3,502	(1,571)
Loss (gain) on asset sales/disposals	160	(432)
(Increase) decrease in operating assets:		
Trade receivables	17,737	(33,154)
Income tax refund receivable	(111)	735
Prepaid expenses and other current assets	(1,159)	(148)
Other assets, net	473	1,032
(Decrease) increase in operating liabilities:		
Accounts payable and other accrued liabilities	(1,686)	7,432
Accrued payroll costs	23	13,221
Income taxes payable	517	(691)
Other long-term liabilities	2,578	370
Cash provided by operating activities	64,891	41,767
Cash flows from investing activities:		
Acquisitions, net of cash received		(31)
Proceeds from disposition of businesses	12,036	
Capital expenditures	(7,048)	(9,719)
Premiums paid for company-owned life insurance	(3,705)	(2,861)
Cash proceeds from asset sales	29	515
Cash provided by (used in) investing activities	1,312	(12,096)
Cash flows from financing activities:		
Proceeds from bank line of credit	248,602	208,147
Payments on bank line of credit	(286,932)	(240,262)
Proceeds from exercise of stock options, net of shares tendered in payment of exercise price of stock options	2,002	4,118
Excess tax benefit attributable to option exercises	51	940
Payment of capital expenditure financing	(2,093)	(3,151)
Minimum tax withholding on restricted stock awards and stock option exercises	(1,219)	
Open market repurchases of common stock	(26,776)	
Cash (used in) financing activities	(66,365)	(30,208)
Decrease in cash and cash equivalents	(162)	(537)

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Cash and cash equivalents at beginning of period	1,083	1,589
Cash and cash equivalents at end of period	\$ 921	\$ 1,052
 Supplemental Cash Flow Information:		
Cash paid during the period for:		
Income taxes, net	\$ 14,591	\$ 11,942
Interest, net	\$ 1,668	\$ 4,091
 Non-Cash Transaction Information:		
Release of funds from escrow adjustment to purchase price	\$	\$ 4,126
Shares tendered in payment of exercise price of stock options	\$ 579	\$
Employee stock purchase plan	\$ 646	\$ 829
Equipment acquired under capital leases	\$ 1,850	\$ 1,562
Proceeds from discontinued operations held in escrow	\$ 1,150	\$
Cash used in connection with acquisitions, net	\$	\$ (31)

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

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Kforce Inc. and subsidiaries (Kforce) is a provider of professional staffing services and solutions to its customers in the following segments: Technology, Finance and Accounting, Health and Life Sciences, and Government Solutions. Kforce provides flexible staffing services and solutions on both a temporary and full-time basis and also provides search services on both a contingency and retained basis. Kforce operates through its corporate headquarters in Tampa, Florida as well as its 57 field offices, which are located throughout the United States. One of our subsidiaries, Kforce Global Solutions, Inc., provides outsourcing services internationally through two offices in the Philippines. Our international operations comprise approximately 1% of net service revenues.

Kforce serves Fortune 1000 companies, the Federal government, local and regional companies, and small to mid-sized companies.

Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared pursuant to SEC rules and regulations 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 condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007. In management's opinion, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments) considered necessary for a fair presentation of our financial condition as of September 30, 2008 and our results of operations and cash flows for the three and nine months then ended. The data in the condensed consolidated balance sheet as of December 31, 2007 was derived from our audited consolidated balance sheet as of December 31, 2007, as presented in our Annual Report on Form 10-K for the year ended December 31, 2007.

Principles of Consolidation

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

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The most important of these estimates and assumptions relate to the following: allowance for doubtful accounts and fallouts, accounting for goodwill and identifiable intangible assets, self-insured liabilities, stock-based compensation, pension obligations, 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.

Cash and Cash Equivalents

Kforce classifies all highly liquid investments with an original initial maturity of three months or less as cash equivalents.

Revenue Recognition

We earn revenue from two primary sources: Flexible billings and Search fees. Net service revenues represent services rendered to customers less credits, discounts, rebates and allowances for fallouts. Revenue includes reimbursements of travel and out-of-pocket expenses (billable

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expenses) with equivalent amounts of expense recorded in direct costs of services.

Flexible billings are recognized as the services are provided by Kforce s temporary personnel while they are working on assignments. For employees, Kforce pays costs of employment, including workers compensation insurance, state and federal unemployment taxes, social security, and certain fringe benefits. Our Government Solutions segment typically generates its revenue from time and-materials contractual arrangements, which is recognized based upon contractually-established bill rates, as services are provided.

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Search fees are recognized by Kforce when employment candidates accept offers of permanent employment. Kforce records revenue net of an estimated reserve for fallouts, which is based upon Kforce's historical fallout experience. Fallouts occur when the candidate does not remain employed with the client through the contingency period, which is typically a period of ninety days or less.

Allowance for Doubtful Accounts and Fallouts

Kforce has established a reserve for expected credit losses and fallouts on trade receivables based on past experience and estimates of potential future write-offs. Kforce performs an ongoing analysis of factors including recent write-off and delinquency trends, changes in economic conditions, a specific analysis of material receivable balances that are past due, which is based on each receivable's contractual terms and concentration of accounts receivable among clients, in establishing this reserve. Trade receivables are written off by Kforce after all collection efforts have been exhausted. The allowance as a percentage of gross accounts receivable was 4.5% and 1.8% as of September 30, 2008 and December 31, 2007, respectively. Management considered significant recent developments such as the rise in sudden business failures resulting primarily from the turmoil in the financial and credit markets, growing concerns of a U.S. recession as well as Kforce's exposure to customers in high-risk sectors such as the financial services industry, in determining the allowance for doubtful accounts and fallouts reserve as of September 30, 2008.

As of September 30, 2008 and December 31, 2007, there was no individual client that had a receivable balance greater than 4.2% and 7.3%, respectively, of gross accounts receivable.

Fixed Assets

Fixed assets are carried at cost, less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The cost of leasehold improvements is amortized using the straight-line method over the shorter of the estimated useful lives of the assets or the terms of the related leases, which range from three to fifteen years.

Income Taxes

Kforce accounts for income taxes under the principles of Statement of Financial Accounting Standards (SFAS) 109, *Accounting for Income Taxes*. SFAS 109 requires the asset and liability approach to the recognition of deferred tax assets and liabilities for the expected future tax consequences of the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. SFAS 109 requires that unless it is more likely than not that a deferred tax asset can be utilized to offset future taxes, a valuation allowance must be recorded against that asset. The tax benefits of deductions attributable to the employees' disqualifying dispositions of shares obtained from incentive stock options, exercises of non-qualified options, and vesting of restricted stock are reflected as increases in additional paid-in capital.

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). This interpretation clarified the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Under this interpretation, the evaluation of a tax position involves a two-step process. First, the enterprise determines whether it is more-likely-than-not that a tax position will be sustained upon examination, based on the technical merits of the position. The second step measures the benefit to be recorded from tax positions that meet the more-likely-than-not recognition threshold, whereby the enterprise determines the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement, and recognizes that benefit in its financial statements.

Fair Value of Financial Instruments

Kforce uses fair value measurements in areas that include, but are not limited to: the allocation of purchase price consideration to tangible and identifiable intangible assets; impairment testing of goodwill and long-lived assets; share-based compensation arrangements and capital lease obligations. The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and other current assets and liabilities approximate their fair values because of the short-term nature of these instruments. The carrying value of our long-term debt approximates fair value due to the variable nature of the interest rates under our Credit Facility. Kforce, using available market information and appropriate valuation methodologies, has determined the estimated fair value of its financial instruments. However, considerable judgment is required in interpreting data to develop the estimates of fair value.

On January 1, 2008, Kforce adopted the provisions of SFAS 157, *Fair Value Measurements* (SFAS 157), which established a framework for measuring fair value and expands disclosures about fair value measurements. The adoption of SFAS 157 did not have any impact on our consolidated financial statements upon adoption.

Table of Contents***Goodwill and Intangible Assets***

Kforce performs an annual review to ensure that no impairment of goodwill exists or more frequently if events or circumstances dictate. As discussed in Note B, Kforce disposed of a portion of its Health and Life Sciences reporting unit during the three month period ended June 30, 2008. In accordance with SFAS 142, *Goodwill and Other Intangible Assets*, Kforce performed an impairment test of the remaining Health and Life Sciences reporting unit after the disposition. In addition, Kforce considered the recent economic developments and determined that there was no triggering event necessitating an interim review of the carrying value of our goodwill and other identifiable intangible assets. There were no impairment charges recorded during the nine months ended September 30, 2008 and 2007.

Identifiable intangible assets arising from certain of Kforce's acquisitions include non-compete agreements, customer lists, contractual relationships, customer contracts, trademarks and trade names. Kforce has determined that the straight-line method is an appropriate methodology to allocate the cost over the periods of expected benefit, which range from 1 to 15 years.

Impairment of Long-Lived Assets

Kforce periodically reviews the carrying value of long-lived assets including its identifiable intangible assets to determine if impairment has occurred. Impairment losses, if any, are recorded in the period identified. Significant judgment is required to determine whether or not impairment has occurred. The determination is made by evaluating expected future undiscounted cash flows or the anticipated recoverability of costs incurred and, if necessary, determining the amount of the loss, if any, by evaluating the fair value of the assets. There were no impairment charges recorded during the nine months ended September 30, 2008 and 2007.

Capitalized Software

Kforce purchases, and in certain cases develops, and implements new computer software to enhance the performance of its accounting and operating systems. Direct internal costs, such as payroll and payroll-related costs, and external costs incurred during the development stage of each project, are capitalized and classified as capitalized software. Kforce capitalized development-stage implementation costs of \$487 and \$1,511 during the three and nine months ended September 30, 2008, respectively, compared to \$1,490 and \$5,592 during the three and nine months ended September 30, 2007, respectively.

Capitalized software development costs are classified as other assets, net in the accompanying unaudited condensed consolidated balance sheets and are being amortized over the estimated useful lives of the software, which range from 1 to 5 years, using the straight-line method.

Commissions

Our associates make placements and earn commissions as a percentage of actual revenue or gross profit pursuant to a calendar-year-basis commission plan. The amount of commissions paid as a percentage of revenue or gross profit increases as volume increases. Kforce accrues commissions for actual revenue or gross profit at a percentage equal to the percent of total expected commissions payable to total revenue or gross profit for the year.

Stock-Based Compensation

Kforce accounts for stock-based compensation under the provisions of SFAS 123R, *Share-Based Payment* (SFAS 123R). This statement requires Kforce to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is recognized over the period in which the employee is required to provide service in exchange for the award, which is usually the vesting period. No compensation cost is recognized for equity instruments for which employees do not render the requisite service.

Accounting for Postretirement Benefits

We adopted the provisions of SFAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158) on December 31, 2006. This statement requires Kforce to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its consolidated balance sheet and to recognize changes in that funded status in the year in which the changes occur, through comprehensive income. This statement also requires Kforce to measure the funded status of a plan as of the date of its fiscal year-end, with limited exceptions.

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Under this statement, Kforce continues to apply the provisions of SFAS 87, *Employers Accounting for Pensions* (SFAS 87), and SFAS 88, *Employers Accounting for Settlements and Curtailment of Defined Benefit Pension Plans and for Termination Benefits* (SFAS 88), in measuring plan assets and benefit obligations and in determining the net periodic benefit cost associated with the Supplemental Executive Retirement Plan. In addition, Kforce continues to apply the provisions of SFAS 106, *Employers Accounting for Postretirement Benefits Other Than Pensions* (SFAS 106), in measuring plan assets and benefit obligations and in determining the net periodic benefit cost associated with the Supplemental Executive Retirement Health Plan.

Table of Contents**Workers Compensation**

Except for states which require participation in state-operated insurance funds, Kforce retains the economic burden for the first \$250 per occurrence in workers compensation claims. Workers compensation includes ongoing healthcare and indemnity coverage for claims and may be paid over numerous years following the date of injury. Workers compensation expense includes the insurance premiums for claims in excess of \$250, claims administration fees charged by Kforce's workers compensation administrator, premiums paid to state-operated insurance funds, an estimate for Kforce's liability for Incurred but Not Reported (IBNR) claims and for the ongoing development of existing claims.

Kforce estimates its workers compensation liability based upon historical claims experience, actuarially-determined loss development factors, and qualitative considerations such as claims management activities.

Health Insurance

Kforce retains liability up to \$250 annually for each health insurance participant. Health insurance costs are accrued using estimates to approximate the liability for reported claims and IBNR claims, which are based primarily upon an evaluation of historical claims experience and a review of expected changes in health insurance costs.

Business Combinations

Kforce utilizes the purchase method of accounting for acquisitions whereby the total purchase price is first allocated to the assets acquired and liabilities assumed, and any remaining purchase price is allocated to goodwill. Kforce recognizes intangible assets apart from goodwill if they arise from contractual or other legal rights, or if they are capable of being separated or divided from the acquired entity and sold, transferred, licensed, rented, or exchanged. Assumptions and estimates are used in determining the fair value of assets acquired and liabilities assumed in a business combination. Valuation of intangible assets acquired requires that we use significant judgment in determining fair value and whether such intangibles are amortizable and, if the asset is amortizable, the period and the method by which the intangible asset will be amortized. Changes in the initial assumptions could lead to changes in amortization charges recorded in our financial statements. Additionally, estimates for purchase price allocations may change as subsequent information becomes available.

Earnings per Share

Basic earnings per share is computed as earnings divided by the weighted average of common shares outstanding during the period. Diluted earnings per share includes the dilutive effects of stock options and other potentially dilutive securities such as non-vested stock grants using the treasury stock method. The following table sets forth the computation of basic and diluted earnings per share from continuing and discontinued operations for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Numerator:				
Income from continuing operations	\$ 6,982	\$ 10,327	\$ 18,717	\$ 27,753
Income from discontinued operations, net of tax	910	697	5,053	2,643
Net income	\$ 7,892	\$ 11,024	\$ 23,770	\$ 30,396
Denominator:				
Weighted average shares outstanding - basic	39,249	41,463	39,858	41,226
Common stock equivalents	728	1,081	495	1,098
Weighted average shares outstanding - diluted	39,977	42,544	40,353	42,324
Earnings per share - basic:				
From continuing operations	\$.18	\$.25	\$.47	\$.67
From discontinued operations	.02	.02	.13	.07

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Earnings per share	basic	\$.20	\$.27	\$.60	\$.74
Earnings per share	diluted:								
	From continuing operations	\$.18	\$.24	\$.46	\$.66
	From discontinued operations		.02		.02		.13		.06
Earnings per share	diluted	\$.20	\$.26	\$.59	\$.72

Awards to purchase or receive 2,243 and 3,035 shares of common stock for the three and nine months ended September 30, 2008, respectively, were not included in the computation of diluted earnings per share because their impact would have been anti-dilutive. Awards to purchase or receive 742 and 829 shares of common stock for the three and nine months ended September 30, 2007, respectively, were not included in the computation of diluted earnings per share because their impact would have been anti-dilutive.

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New Accounting Standards

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS 141R), which replaces SFAS No. 141. This statement retains the purchase method of accounting for acquisitions but establishes principles and requirements for how an acquirer entity recognizes and measures in its financial statements the identifiable assets acquired (including intangibles), the liabilities assumed and any non-controlling interests in the acquired entity. This statement also changes the recognition of assets acquired and liabilities assumed arising from contingencies, and requires the expensing of acquisition-related costs as incurred, among others. The statement will apply prospectively to business combinations occurring in our fiscal year beginning January 1, 2009.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. It also establishes presentation and disclosure requirements to facilitate comparisons between companies using different measurement attributes for similar types of assets and liabilities. The statement is effective for our fiscal year beginning January 1, 2008. We did not elect to adopt the provisions of SFAS 159.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. As previously mentioned, we adopted SFAS 157 on January 1, 2008, which did not have any impact on our consolidated financial statements upon adoption.

In February 2008, the FASB issued FASB Staff Position (FSP) No. 157-2 (FSP 157-2). FSP 157-2 delays the effective date of SFAS 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. In February 2008, the FASB also issued FSP No. 157-1 that would exclude leasing transactions accounted for under SFAS No. 13, *Accounting for Leases*, and its related interpretive accounting pronouncements. We do not expect the SFAS 157-related guidance to have a material impact on our consolidated financial statements.

In April 2008, the FASB issued FSP No. FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*, and requires enhanced disclosures relating to: (a) the entity's accounting policy on the treatment of costs incurred to renew or extend the term of a recognized intangible asset; (b) in the period of acquisition or renewal, the weighted-average period prior to the next renewal or extension (both explicit and implicit), by major intangible asset class and (c) for an entity that capitalizes renewal or extension costs, the total amount of costs incurred in the period to renew or extend the term of a recognized intangible asset for each period for which a statement of financial position is presented, by major intangible asset class. FSP 142-3 must be applied prospectively to all intangible assets acquired as of and subsequent to fiscal years beginning after December 15, 2008, and interim periods within those fiscal years.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162). The new standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP for nongovernmental entities. SFAS 162 is effective 60 days following SEC approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The adoption of SFAS 162 is not anticipated to have an effect on the Company's consolidated financial statements.

International Financial Reporting Standards (IFRS) are a set of standards and interpretations adopted by the International Accounting Standards Board. The SEC is currently considering a potential IFRS adoption process in the U.S., which could, in the near term, provide domestic issuers with an alternative accounting method and ultimately could replace U.S. GAAP reporting requirements with IFRS reporting requirements. It is anticipated that the SEC will issue guidance on this potential adoption by December 31, 2008. We are currently investigating the implications to the Company should we be required to adopt IFRS.

Note B Discontinued Operations

Scientific

On April 29, 2008 (the Scientific Closing Date), Kforce entered into an Asset Purchase Agreement (the Scientific APA) pursuant to which it sold its Scientific business, a non-core business within its Health and Life Sciences segment, to Aerotek Scientific, LLC (the Scientific Buyer) for \$10,500 in cash, including \$1,150 held in escrow, plus additional earnout potential of up to an aggregate of \$1,500, measured over a 16-week

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period from the Scientific Closing Date. During the three months ended June 30, 2008, Kforce recorded a working capital adjustment of \$314, which reduced the gain on sale of discontinued operations.

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In addition, during the three months ended September 30, 2008, Kforce received \$1,500 from the Scientific Buyer representing the maximum earnout, which has been reflected as a gain on sale of discontinued operations.

In connection with the closing of the sale, Kforce entered into certain ancillary agreements with the Scientific Buyer, including a Transition Services Agreement (the Scientific TSA). Through the Scientific TSA, Kforce provided various temporary support services. The fees for these services were generally equivalent to Kforce's cost. No such services will be provided in future periods.

Although the services provided under the Scientific TSA generate continuing cash flows between Kforce and the Scientific Buyer, the amounts are not considered to be either direct cash flows or significant to the ongoing operations of either entity. Also, Kforce received an earnout payment of \$1,500 from the Scientific Buyer in September. However, under the provisions of EITF Issue No. 03-13, *Applying the Conditions of Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operation* (EITF 03-13), contingent purchase consideration is considered an indirect continuing cash flow. In addition, Kforce has no contractual ability through the Scientific APA or any other agreement to significantly influence the operating or financial policies of the Scientific Buyer. As a result, pursuant to the provisions of EITF 03-13, Kforce has no significant continuing involvement in the operations of its Scientific business and, as such, has classified such operating results as discontinued operations.

In accordance with the Scientific APA, Kforce is obligated to indemnify the Scientific Buyer for certain losses, as defined, in excess of \$50. Kforce's obligations under the indemnification provisions of the Scientific APA shall, with the exception of certain items, cease 18 months from the Scientific Closing Date and are limited to an aggregate of \$3,475. Kforce believes any exposure under the indemnification provisions is remote and, as a result, has not recorded a liability as of September 30, 2008.

Nursing

On June 29, 2008 (the Nursing Closing Date), Kforce entered into an Asset Purchase Agreement (the Nursing APA) pursuant to which it sold its per-diem Nursing business, a non-core business within its Health and Life Sciences segment, to Realtime Services, Inc. (the Nursing Buyer) for \$1,500 in cash, which was paid at closing. Additionally, Kforce and the Nursing Buyer entered into a subordinated secured promissory note in the amount of \$500 (the Note) that bears interest at a fixed rate of 6.00%. The interest and principal amount of the Note have been fully reserved. A balloon payment of \$500 plus all accrued and unpaid interest is due on June 30, 2011, the maturity date of the Loan. The Note is collateralized by a lien on all of the Nursing Buyer's assets but is subordinated to the Nursing Buyer's obligations to its lender.

In connection with the closing of the sale, Kforce entered into certain ancillary agreements with the Nursing Buyer, including a Transition Services Agreement (the Nursing TSA). Through the Nursing TSA, Kforce provided various temporary support services. The fees for these services were generally equivalent to Kforce's cost. No such services will be provided in future periods.

Although the services provided under the Nursing TSA generate continuing cash flows between Kforce and the Nursing Buyer, the amounts are not considered to be direct cash flows of the discontinued operation, as defined in EITF 03-13, nor are they significant to the ongoing operations of either entity. Kforce has no contractual ability through the Nursing APA or any other agreement to significantly influence the operating or financial policies of the Nursing Buyer. As a result, under the provisions of EITF 03-13, Kforce has no significant continuing involvement in the operations of the per-diem Nursing business sold to the Nursing Buyer and, as such, has classified such operating results as discontinued operations.

In accordance with the Nursing APA, Kforce is obligated to indemnify the Nursing Buyer for certain losses, as defined, in excess of \$50. Kforce's obligations under the indemnification provisions of the Nursing APA shall, with the exception of certain items, cease 12 months from the Nursing Closing Date and are limited to an aggregate of \$375. Kforce believes any exposure under the indemnification provisions is remote and, as a result, has not recorded a liability as of September 30, 2008.

In addition, during the three months ended June 30, 2008, Kforce commenced and completed efforts to wind down the remaining operations of its non per-diem Nursing business, which included the permanent placement of a number of its temporary employees that were previously on assignment with its customers.

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The financial results of Scientific and Nursing have been presented as discontinued operations in the accompanying unaudited condensed consolidated statements of operations and comprehensive income. The following summarizes the results from discontinued operations for the three and nine months ended September 30, 2008 and 2007:

	Three Months		Nine Months	
	Ended September 30 2008	2007	Ended September 30 2008	2007
Net service revenues	\$	\$ 15,590	\$ 23,671	\$ 48,466
Direct costs of services and operating expenses		(14,438)	(22,567)	(44,096)
		1,152	1,104	4,370
Gain on sale of discontinued operations	1,499		7,330	
Income from discontinued operations, before income taxes	1,499	1,152	8,434	4,370
Income tax expense	(589)	(455)	(3,381)	(1,727)
Income from discontinued operations, net of income taxes	\$ 910	\$ 697	\$ 5,053	\$ 2,643

As was previously mentioned, Kforce received \$1,500 from the Scientific Buyer in full achievement of the earnout during the three months ended September 30, 2008, which has been reflected as a gain on sale of discontinued operations in the table above.

Included in the gain on sale of discontinued operations for the nine months ended September 30, 2008 are transaction expenses, which primarily include commissions, legal fees and transaction bonuses totaling \$1,437. As of December 31, 2007 and September 30, 2008, accounts receivable pertaining to discontinued operations of \$8,848 and \$201, respectively, were outstanding and are classified in trade receivables. Accounts receivable pertaining to the discontinued operations of Scientific as of the Scientific Closing Date were sold to the Scientific Buyer. Kforce does not currently anticipate incurring any significant costs related to discontinued operations in future periods.

Kforce utilized the cash proceeds from the sale of our Scientific and per-diem Nursing businesses to reduce outstanding borrowings under our Credit Facility as well as to repurchase common stock.

Acceleration of Equity Awards

Kforce granted an aggregate of 361 Stock Appreciation Rights (SARS) and an aggregate of 575 shares of Performance Accelerated Restricted Stock (PARS) on January 2, 2008, to Kforce's Chief Executive Officer and the next four highest compensated executive officers (which group is hereinafter referred to as Named Executive Officers or NEOs). These equity awards included a provision whereby their vesting could be accelerated at the discretion of the Compensation Committee should there be a sufficient gain on the disposal of a portion of Kforce's business. As a result of the dispositions discussed above, Kforce's Compensation Committee approved the acceleration of the vesting of these equity awards on June 30, 2008, which resulted in the acceleration and recognition of \$6,009 of compensation expense during the quarter ended June 30, 2008. This expense has been classified in selling, general and administrative expenses in the accompanying unaudited condensed consolidated statements of operations and comprehensive income.

Note C Commitments and Contingencies*Litigation*

In the ordinary course of its business, Kforce is, from time to time, threatened with or named as a defendant in various lawsuits. Kforce maintains insurance in such amounts and with such coverage and deductibles as management believes is reasonable. The principal risks that Kforce insures against are workers' compensation, personal injury, bodily injury, property damage, professional malpractice, directors and officers liability, errors and omissions, employment practices liability and fidelity losses. Kforce is not aware of any litigation that would reasonably be expected to have a material adverse effect on its results of operations or financial condition.

Table of Contents**Employment Agreements**

Kforce has entered into employment agreements with certain executive officers and managers that provide for minimum compensation, salary and continuation of certain benefits for a six-month to three-year period under certain circumstances. 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 employment is terminated without good cause by the employer or for good reason by the employee. These agreements contain certain post-employment restrictive covenants. Kforce's liability at September 30, 2008 was approximately \$42,226 if, following a change of control, all of the employees under contract were terminated without good cause by the employer or the employees resign for good cause and \$17,168 if, in the absence of a change in control, all of the employees under contract were terminated by Kforce without good cause or the employees resign for good cause.

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

Note D Employee Benefit Plans**Supplemental Executive Retirement Plan**

Effective December 31, 2006, Kforce implemented a Supplemental Executive Retirement Plan (the "SERP") for the benefit of certain executives. 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 the Named Executive Officers. The SERP is a nonqualified benefit plan, and does not include elective deferrals of covered executive officers' salaries. The SERP is funded entirely by Kforce, and benefits are taxable to the executive officer upon receipt and deductible by Kforce when paid. Benefits payable under the SERP are targeted at 45% of the covered executive officer's average salary and bonus from the three years where the executive earned the highest salary and bonus during the last ten years of employment, which is subject to adjustment for early retirement and the participant's vesting percentage. Benefits under the SERP are expected to be paid as a lump sum present value payment, but may be commuted to a 10-year annuity or paid over the life of the covered executive officer, as elected by the covered executive officer upon commencement of participation in the SERP. Normal retirement age under the SERP is defined as age 65. Vesting under the plan is defined as 100% upon the attainment of age 55 and 10 years of service and 0% prior to the attainment of age 55 and 10 years of service or upon death, disability, change in control or an involuntary separation of service for any reason other than for cause after attaining 5 years of service. Certain conditions allow for early retirement as early as age 55 or upon change in control. The benefits under the SERP are reduced for a participant that has not reached age 62 with 10 years of service or age 55 with 25 years of service. None of the benefits earned pursuant to the SERP are attributable to services provided prior to December 31, 2006.

Net Periodic Benefit Cost

The following represents the net periodic benefit cost, which was determined based upon actuarial calculations, for the following periods:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Service cost	\$ 610	\$ 428	\$ 1,706	\$ 1,285
Interest cost	37		103	
Expected return on plan assets				
Plan amendment				
Actuarial (gain)/loss	6		6	
Net periodic benefit cost	\$ 653	\$ 428	\$ 1,815	\$ 1,285

Remeasurement of Benefit Obligation

The net periodic benefit cost recognized for the six months ended June 30, 2008 was based upon the actuarial valuation at the beginning of the year, which utilized the assumptions noted in our Annual Report on Form 10-K for the year ended December 31, 2007. As of June 30, 2008, Kforce evaluated the continued propriety of the assumptions in light of the current operating environment and determined that more recent data became available that necessitated the need for a remeasurement of the benefit obligation in accordance with SFAS 87, *Employers' Accounting for Pensions* (SFAS 87).

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As a result of the remeasurement as of June 30, 2008, Kforce recognized \$669 to accumulated other comprehensive loss, net of a deferred income tax benefit of \$283 during the three months ended June 30, 2008, which is being amortized as a component of net periodic benefit cost over the attribution period.

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The following table represents the changes to the benefit obligation during the nine months ended September 30, 2008:

Benefit obligation beginning of period	\$ 1,718
Net periodic benefit cost	1,815
Remeasurement of benefit obligation, net of amortization	663
Benefit obligation end of period	\$ 4,196

Actuarial Assumptions

The following represents the assumptions used subsequent to the measurement date to determine the net periodic benefit cost for the three months ended September 30, 2008:

Discount rate (1)	6.50%
Expected long-term rate of return on plan assets (2)	
Average assumed rate of compensation increase	4.00%

- (1) *The discount rate is based upon the yield of a portfolio of high quality, long-term corporate bonds with a maturity commensurate with the expected payout of the SERP obligation and is expected to be adjusted annually. Kforce also compares this discount rate to the Citigroup Pension Discount Curve to ensure the rate used is reasonable.*
- (2) *Due to the SERP being unfunded, it is not necessary for Kforce to determine the expected long-term rate of return on plan assets. Once funded, Kforce will determine the expected long-term rate of return on plan assets by determining the composition of the asset portfolio, the historical long-term investment performance and current market conditions.*

Contributions

There is no requirement for Kforce to fund the SERP and, as a result, no contributions were made to the plan during the nine months ended September 30, 2008. Kforce does not currently anticipate funding the SERP during the year ending December 31, 2008.

Supplemental Executive Retirement Health Plan

Effective April 20, 2007, the Board of Directors approved the Supplemental Executive Retirement Health Plan (SERHP) to provide postretirement health and welfare benefits to certain executives. The vesting and eligibility requirements mirror that of the SERP and no funding is required by Kforce or the participants. The expected postretirement benefit obligation is being accrued ratably based upon the anticipated vesting dates of the participants. Consistent with the SERP, none of the benefits earned are attributable to services provided prior to the effective date.

The following represents the net periodic benefit cost, which was determined based upon actuarial calculations at the beginning of the year, for the following periods:

	Three Months		Nine Months	
	Ended September 30 2008	2007	Ended September 30 2008	2007
Service cost	\$ 96	\$ 242	\$ 287	\$ 265
Interest cost	4		14	
Expected return on plan assets				

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Amortization of unrecognized transition (asset)/obligation

Recognized net (gains)/losses

Net periodic benefit cost	\$ 100	\$ 242	\$ 301	\$ 265
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The following table represents the changes to the accumulated postretirement benefit obligation during the nine months ended September 30, 2008:

Accumulated postretirement benefit obligation	beginning of period	\$ 416
	Net periodic benefit cost	301
Accumulated postretirement benefit obligation		\$ 717
end of period		

There is no requirement for Kforce to fund the SERHP. As a result, no contributions were made to the plan during the nine months ended September 30, 2008. Kforce does not currently anticipate funding the SERHP during the year ending December 31, 2008.

Table of Contents**Note E Stock Incentive Plans**

In 1994, Kforce established the Employee Incentive Stock Option Plan that allows the issuance of Incentive Stock Options. The Employee Incentive Stock Option Plan was subsequently amended in 1996 to allow for the issuance of Nonqualified Stock Options, Stock Appreciation Rights, and Restricted Stock. The Employee Incentive Stock Option Plan expired in March of 2005. During 1995, Kforce established the Non-Employee Director Stock Option Plan, which authorized the issuance to non-employee directors of options to purchase common stock. The Non-Employee Director Stock Option Plan expired in October of 2005.

On June 20, 2006, the shareholders approved the Stock Incentive Plan. The aggregate number of shares of common stock that may be subject to awards under the Stock Incentive Plan, subject to adjustment upon a change in capitalization, is 3,000. The Stock Incentive Plan terminates on April 28, 2016. Vesting of equity instruments issued under the Stock Incentive Plan is determined on a grant-by-grant basis.

Stock Options

A summary of stock option activity under all of Kforce's plans for the nine months ended September 30, 2008 is as follows:

	Employee Incentive Stock Option Plan	Non-Employee Director Stock Option Plan	Stock Incentive Plan	Total	Weighted Average Exercise Price per Share	Weighted Average Grant Date Fair Value	Total Intrinsic Value of Options Exercised
Outstanding as of December 31, 2007	3,602	111	113	3,826	\$ 10.96		
Granted			35	35	\$ 9.13	\$ 6.47	
Exercised	(368)			(368)	\$ 7.02		\$ 1,499
Forfeited/Cancelled	(290)	(10)	(40)	(340)	\$ 21.43		
Outstanding as of September 30, 2008	2,944	101	108	3,153	\$ 10.27		
Unvested awards as of September 30, 2008 (1)			108	108			
Exercisable at September 30, 2008	2,944	101		3,045	\$ 10.21		

(1) All unvested awards as of September 30, 2008 are expected to vest in the future.

Kforce uses the Black Scholes option pricing model to derive the fair value of options granted. Options expire at the end of ten years from the date of grant. Kforce issues new shares upon exercise of options. During the three and nine months ended September 30, 2008, Kforce recognized compensation expense of \$169 and \$306, respectively. Kforce recognized compensation expense of \$98 and \$210 during the three and nine months ended September 30, 2007, respectively.

As of September 30, 2008, total unrecognized compensation expense related to non-vested options was \$276, which will be recognized over a weighted average remaining period of 0.63 years.

Stock Appreciation Rights

The following table presents the SARS activity under the Stock Incentive Plan for the nine months ended September 30, 2008:

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	# of SARS Outstanding	Weighted Average Exercise Price Per SAR	Weighted Average Grant Date Fair Value	Total Intrinsic Value of SARS Exercised
Outstanding as of December 31, 2007	469	\$ 12.66		
Granted	361	\$ 8.94	\$ 5.30	
Exercised				
Forfeited/Cancelled				
Outstanding as of September 30, 2008	830	\$ 11.04		
Unvested awards as of September 30, 2008 (1)	469			
Exercisable at September 30, 2008	361	\$ 8.94		

(1) All unvested awards as of September 30, 2008 are expected to vest in the future.

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During January 2008, Kforce granted an aggregate of 361 SARS to certain executives, which were scheduled to vest 100% three years from the date of issuance. Vesting was to be accelerated if Kforce's stock price were to exceed \$11.62 for a period of 10 trading days or certain performance conditions were met that related to the disposition of a portion of the business at a sufficient gain, which was subject to Compensation Committee approval.

Kforce uses the Black Scholes option pricing model to derive the fair value of the SARS. Compensation expense attributable to the SARS granted during the nine months ended September 30, 2008, was being recognized over the derived service period of 2.17 years, which was determined using a lattice model and was subject to any acceleration provisions being met.

As was previously discussed, on June 30, 2008, the Compensation Committee approved the acceleration of the vesting of the SARS issued in January 2008 as a result of the sale of Kforce's Scientific and per-diem Nursing businesses. As a result, Kforce accelerated the previously unrecognized compensation expense associated with these awards of \$1,475 during the three months ended June 30, 2008. Kforce recognized total compensation expense related to the SARS of \$499 and \$3,385 during the three and nine months ended September 30, 2008, respectively. Kforce recognized total compensation expense related to the SARS of \$496 and \$1,489 during the three and nine months ended September 30, 2007, respectively.

As of September 30, 2008, total unrecognized compensation expense related to the SARS was \$76, which will be fully recognized during October 2008.

Performance Accelerated Restricted Stock

The following table presents the PARS activity under the Stock Incentive Plan during the nine months ended September 30, 2008:

	SHARES
Outstanding as of December 31, 2007	299
Granted	575
Vested	(575)
Forfeited	(2)
Outstanding as of September 30, 2008	297

During January 2008, Kforce granted an aggregate of 575 PARS to certain executives, which had a 6-year vesting period. Vesting was to be accelerated if Kforce's stock price were to exceed \$13.41 for a period of 10 trading days or certain performance conditions were met that related to the disposition of a portion of the business at a sufficient gain, which was subject to Compensation Committee approval.

The valuation of the PARS was determined by its intrinsic value (as if the underlying shares were vested and issued on the grant date) and had a grant date fair value of \$8.94. The fair value of these awards was being amortized over a weighted average derived service period of 4.2 years, which was determined using a lattice model and was subject to any acceleration provisions being met.

As was previously discussed, on June 30, 2008, the Compensation Committee approved the acceleration of the vesting of the PARS issued in January 2008 as a result of the sale of Kforce's Scientific and per-diem Nursing businesses. As a result, Kforce accelerated the previously unrecognized compensation expense associated with these awards of \$4,534 during the three months ended June 30, 2008. Kforce recognized total compensation expense related to the PARS of \$264 and \$5,946 during the three and nine months ended September 30, 2008, respectively. Kforce recognized total compensation expense related to the PARS of \$258 and \$702 during the three and nine months ended September 30, 2007, respectively.

During the nine months ended September 30, 2008, certain executives elected to satisfy minimum tax withholding obligations related to the vesting of the PARS by directing Kforce to withhold 104 of these shares. Kforce accounts for these shares as treasury stock until they have been formally retired and have been reflected as such in the accompanying unaudited condensed consolidated financial statements.

As of September 30, 2008, total unrecognized compensation expense related to the PARS was \$2,195, which will be recognized over a weighted average remaining period of 2.10 years.

Table of Contents**Restricted Stock**

The following table presents the restricted stock activity under the Stock Incentive Plan during the nine months ended September 30, 2008:

	SHARES
Outstanding as of December 31, 2007	80
Granted (1)	517
Vested	
Forfeited	(19)
Outstanding as of September 30, 2008	578

(1) The restricted stock granted during the nine months ended September 30, 2008 has the following vesting periods: (i) 323 have a 6-year vesting period and (ii) 194 vests 100% one year from the date of issuance.

The value of time-based restricted stock is determined by its intrinsic value (as if the underlying shares were vested and issued) on the grant date. The weighted average grant date fair value of the restricted stock issued during the nine months ended September 30, 2008 was \$8.30, which is being recognized over the requisite service period. During the three and nine months ended September 30, 2008, Kforce recognized compensation expense related to restricted stock of \$527 and \$1,389, respectively. Kforce recognized compensation expense related to restricted stock of \$44 and \$115 during the three and nine months ended September 30, 2007, respectively.

Total unrecognized compensation expense related to restricted stock awards that were unvested as of September 30, 2008 was \$3,625, which will be recognized over a weighted average remaining period of 4.33 years.

Note F Goodwill and Other Intangible Assets

The following table sets forth the activity in goodwill and other intangible assets from December 31, 2007 through September 30, 2008:

	Goodwill	Other Intangible Assets, Net	Total
Balance as of December 31, 2007	\$ 237,609	\$ 12,276	\$ 249,885
Goodwill allocated to dispositions (1)	(2,132)		(2,132)
Adjustment to PCCI Goodwill	(153)		(153)
Amortization of intangible assets		(2,985)	(2,985)
Balance as of September 30, 2008	\$ 235,324	\$ 9,291	\$ 244,615

(1) In accordance with SFAS 142, *Goodwill and Other Intangible Assets*, Kforce allocated \$1,866 to the carrying value of Scientific, which was sold on April 29, 2008, and \$266 to the carrying value of per-diem Nursing, which was sold June 29, 2008, in determining the gain on disposal. This allocation was based on the relative fair values of the Scientific and per-diem Nursing businesses to the portion of the Health and Life Sciences reporting unit that has been retained. As a result, the goodwill associated with the Health and Life Sciences reporting unit was \$10,397 as of September 30, 2008 as compared to \$12,529 as of December 31, 2007.

As of September 30, 2008 and December 31, 2007, intangible assets, net in the accompanying unaudited condensed consolidated balance sheets consisted of non-compete agreements, employment agreements, trade names, trademarks, customer relationships, customer contracts and customer lists. Indefinite-lived intangible assets, which consist of trade names and trademarks, amounted to \$4,090 as of September 30, 2008 and December 31, 2007. All of the intangible assets represented less than 5% of total assets.

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As of September 30, 2008 and December 31, 2007, accumulated amortization on intangible assets was \$19,604 and \$16,619, respectively. The estimated remaining amortization expense is \$623 for 2008, \$1,436 for 2009, \$981 for 2010, \$488 for 2011 and \$384 for 2012.

Table of Contents**Note G Reportable Segments**

Kforce's reportable segments are: (i) Technology (Tech), (ii) Finance and Accounting (FA), (iii) Health and Life Sciences (HLS) and (iv) Government Solutions (GS). This determination was supported by, among others: the existence of segment presidents responsible for the operations of each segment and who also report directly to our chief operating decision maker, the nature of each segment's operations, and information presented to the Board of Directors. During this assessment, it was determined that Kforce also reports Flexible billings and Search fees separately by segment, which has been incorporated into the table below.

Although the GS segment does not meet quantitative thresholds for separate segment reporting, management believes that the information would be useful to the readers of our financial statements.

As was previously discussed, the financial results of Scientific and Nursing, which have historically been included in our HLS segment, have been presented as discontinued operations in the accompanying unaudited condensed consolidated statements of operations and comprehensive income. As a result, the following table excludes the results of our Scientific and Nursing businesses. See Note B for the results of discontinued operations.

Historically, and for the nine months ended September 30, 2008, Kforce has generated only revenue and gross profit information on a segment basis. As such, asset information by segment is not disclosed. Substantially all operations and long-lived assets are located in the U.S.

	Technology	Finance and Accounting	Health and Life Sciences	Government Solutions	Total
<i>Three Months Ended September 30:</i>					
2008					
Net service revenues:					
Flexible billings	\$ 125,019	\$ 42,604	\$ 49,280	\$ 18,528	\$ 235,431
Search fees	6,184	8,578	725		15,487
Total revenue	\$ 131,203	\$ 51,182	\$ 50,005	\$ 18,528	\$ 250,918
Gross profit	\$ 40,426	\$ 23,075	\$ 15,841	\$ 7,225	\$ 86,567
2007					
Net service revenues:					
Flexible billings	\$ 124,373	\$ 45,082	\$ 41,363	\$ 15,824	\$ 226,642
Search fees	7,967	10,946	915		19,828
Total revenue	\$ 132,340	\$ 56,028	\$ 42,278	\$ 15,824	\$ 246,470
Gross profit	\$ 44,469	\$ 26,353	\$ 14,322	\$ 6,194	\$ 91,338
<i>Nine Months Ended September 30:</i>					
2008					
Net service revenues:					
Flexible billings	\$ 369,634	\$ 134,846	\$ 142,844	\$ 55,528	\$ 702,852
Search fees	21,452	29,985	1,774		53,211
Total revenue	\$ 391,086	\$ 164,831	\$ 144,618	\$ 55,528	\$ 756,063
Gross profit	\$ 122,078	\$ 74,887	\$ 46,212	\$ 20,769	\$ 263,946
2007					
Net service revenues:					
Flexible billings	\$ 364,069	\$ 143,661	\$ 114,689	\$ 45,313	\$ 667,732
Search fees	23,055	33,072	1,967		58,094
Total revenue	\$ 387,124	\$ 176,733	\$ 116,656	\$ 45,313	\$ 725,826

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Gross profit	\$	127,712	\$	80,741	\$	37,213	\$	17,848	\$	263,514
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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.

On April 29, 2008 and June 29, 2008, respectively, Kforce sold its Scientific and per-diem Nursing businesses. See Note B of the Notes to the Unaudited Condensed Consolidated Financial Statements for a more detailed discussion. The results presented in the accompanying unaudited condensed consolidated statements of operations and comprehensive income for the three and nine months ended September 30, 2008 and 2007, include activity relating to the Scientific and Nursing businesses as discontinued operations. For comparison purposes, prior period financial information was recast. Except as specifically noted, our discussions below exclude any activity related to the Scientific and Nursing businesses, which are addressed separately in the discussion of income from discontinued operations, net of income taxes.

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

Executive Summary an executive summary of our results of operations for the three and nine months ended September 30, 2008.

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.

Results of Operations an analysis of Kforce's unaudited condensed consolidated results of continuing operations for each of the three and nine months ended September 30, 2008 and 2007, which have been presented in its unaudited condensed consolidated financial statements. In order to assist the reader in understanding our business as a whole, certain metrics are presented for each of our segments.

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

EXECUTIVE SUMMARY

The following is an executive summary of what Kforce believes are important highlights as of September 30, 2008 and during the three and nine months ended September 30, 2008, which should be considered in the context of the additional discussions in this quarterly report and in conjunction with its condensed consolidated financial statements. We believe such highlights are as follows:

Net service revenues for the nine months ended September 30, 2008 increased 4.2% to \$756.1 million from \$725.8 million in the comparable period in 2007.

Search revenue for the nine months ended September 30, 2008 decreased 8.4% to \$53.2 million from \$58.1 million in the comparable period in 2007.

Gross profit margin decreased 140 basis points for the nine months ended September 30, 2008 to 34.9% from 36.3% in the comparable period in 2007, primarily resulting from a decline in Search fees as well as a contraction in the spread between Flex bill rates and pay rates.

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Selling, general and administrative expenses as a percentage of revenue were 29.2% and 28.0% for the nine months ended September 30, 2008 and 2007, respectively, which was primarily due to increases in stock-based compensation, compensation and other employee benefits, and bad debt expense.

During the three months ended June 30, 2008, Kforce disposed of its Scientific business for \$10.5 million and received an additional \$1.5 million during the three months ended September 30, 2008, representing the maximum earnout. In addition, Kforce disposed of its per-diem Nursing business during the three months ended June 30, 2008 for \$1.5 million. Kforce management believes that the disposition of Scientific and per-diem Nursing, which was based on management's review of our core businesses, will allow the Firm to focus on the growth opportunities that are believed to exist in our continuing core businesses.

During the nine months ended September 30, 2008, Kforce repurchased 3.2 million of its shares at a total cost of \$28.0 million, which includes shares repurchased in the open market and those that Kforce withheld upon the vesting of restricted stock awards and the exercise of stock options to satisfy minimum tax withholding requirements. Our Board of Directors increased the share repurchase authorization by \$50.0 million in February 2008. The remainder at September 30, 2008 is \$36.8 million.

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Total outstanding borrowings under the Credit Facility as of September 30, 2008 were \$12.0 million compared to \$50.3 million as of December 31, 2007.

Cash provided by operating activities was \$64.9 million for the nine months ended September 30, 2008, which represents an increase of \$23.1 million, or 55.4%, over the comparable period in 2007.

CRITICAL ACCOUNTING ESTIMATES

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In connection with the preparation of our 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, revenue, expenses and the related disclosures. We base our assumptions, estimates, and judgments on historical experience, current trends, and other factors that management believes are relevant at the time our consolidated financial statements are prepared. On a regular basis, management reviews our accounting policies, estimates, assumptions and judgments to ensure that our consolidated financial statements are presented fairly 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.

Our significant accounting policies are discussed in Note A, *Summary of Significant Accounting Policies*, of the Notes to Unaudited Condensed Consolidated Financial Statements included in Item 1. Financial Statements. Please also refer to our annual report on Form 10-K for the year ended December 31, 2007 filed with the SEC on February 27, 2008 for a more detailed discussion of our critical accounting estimates. The only significant change to our critical accounting estimates during the first nine months of 2008 relates to our adoption of SFAS 157 on January 1, 2008, which is discussed in Note A to the Unaudited Condensed Consolidated Financial Statements.

NEW ACCOUNTING STANDARDS

See the *New Accounting Standards* section within Note A, *Summary of Significant Accounting Policies*, of the Notes to the Unaudited Condensed Consolidated Financial Statements for a more detailed discussion.

RESULTS OF OPERATIONS

Net service revenues for the three and nine months ended September 30, 2008 were \$250.9 million and \$756.1 million, respectively, which represent increases over the comparable periods in 2007 of 1.8% and 4.2%, respectively. This growth was fueled primarily by strong Flex revenue performance from our Tech, HLS and GS segments, which all experienced increases in Flex revenues versus the comparable three and nine month periods in 2007. Management believes that the HLS and GS segments will have more stable growth in net service revenues during variable economic cycles, due to the nature of their operations. For the GS segment, this is a result of the growth of the Federal agencies that are customers of Kforce, such as the Department of Defense and the Department of Homeland Security, which has been spurred by an increase in the use of outsourced labor by many of these governmental agencies in order to replace employees who are reaching the age of retirement. We do not currently anticipate any significant adverse impacts to our GS segment as a result of a potential Administration change resulting from the upcoming election due to the areas of the government that our GS segment participates; however, we may experience delays in the timing of project awards. Net service revenues for our GS segment for the three and nine months ended September 30, 2008 were \$18.5 million and \$55.5 million, respectively, which represents an increase of 17.1% and 22.5%, respectively, over the comparable periods in 2007.

As we have progressed through 2008, there have been growing concerns about the U.S. macro-economic environment including the significant turmoil in the credit and financial markets, declining GDP growth, an increase in the unemployment rate for individuals with college degrees, and increasing jobless claims; as well as several significant sudden business failures. Coinciding with these events, Kforce experienced (i) significant reductions in Search revenue for the three and nine months ended September 30, 2008 over the comparable period in 2007 and (ii) declines in the Flex gross profit percentages within many of our segments. As a result, our gross profit percentage decreased 260 and 140 basis points in the three and nine months ended September 30, 2008 as compared to the comparable periods in 2007. Although there can be no assurance that historical trends will continue, Search activity and Flex gross margins historically decrease heading into the troughs of an economic cycle, increase after economic conditions have shown sustained improvement, and are the strongest during the peak of an economic cycle. In addition, we believe that Flex demand generally increases before demand for Search activity increases.

The economic uncertainties in which we currently operate make it challenging for Kforce to predict the near-term future. A U.S. recession, if one should occur, would likely have a significant adverse impact on our clients and our business. We believe, however, that initiatives undertaken during the last several years, such as restructuring both our back office and field operations, and upgrading our corporate systems and technology, have increased our operating efficiencies, and also enable us to be more responsive to our clients. We believe our field operations model, which allows us to deliver our service offerings in a disciplined and consistent manner across all geographies and business lines, as well as our highly centralized back office operations, are competitive advantages and keys to our future growth and profitability.

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Net Service Revenues. The following table sets forth, as a percentage of net service revenues, certain items in our consolidated statements of operations and comprehensive income for the indicated periods:

	Three Months		Nine Months	
	Ended September 30, 2008	2007	Ended September 30, 2008	2007
Net Service Revenues by Segment:				
Tech	52.3%	53.7%	51.7%	53.3%
FA	20.4	22.7	21.8	24.4
HLS	19.9	17.2	19.1	16.1
GS	7.4	6.4	7.4	6.2
Net service revenues	100.0%	100.0%	100.0%	100.0%
Revenue by Time:				
Flex	93.8%	92.0%	93.0%	92.0%
Search	6.2	8.0	7.0	8.0
Net service revenues	100.0%	100.0%	100.0%	100.0%