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PRESENTATION

Operator

Welcome to the ICF International Second Quarter 2014 Results Conference Call. (Operator Instructions) As a reminder, this conference is also being recorded on Wednesday, August 6, 2014 and cannot be reproduced or rebroadcasted without permission from the company. And now, I would like to turn the program over to Mr. Douglas Beck, Senior Vice President, Corporate Development. Please go ahead.

Douglas Beck - *ICF International, Inc - SVP, Corporate Development*

Thank you operator. Good afternoon everyone and thank you for joining us to review ICF's second quarter 2014 performance. With us today from ICF International are Sudhakar Kesavan, Chairman and CEO; John Wasson, President and COO; and James Morgan, CFO.

During this conference call, we will make forward-looking statements to assist you in understanding ICF management's expectations about our future performance. These statements are subject to a number of risks that could cause actual events or results to differ materially, and I refer you to our August 6, 2014 press release and our SEC filings for discussions of those risks.

In addition, our statements during this call are based on our views as of today. We anticipate that future developments will cause our views to change. Please consider the information presented in that light. We may, at some point, elect to update the forward-looking statements made today, but specifically, disclaim any obligation to do so.

I will now turn the call over to our CEO, Sudhakar Kesavan, to discuss the second quarter 2014 performance. Sudhakar?

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

Thanks Doug and good afternoon everyone. Thank you for participating in today's call to review our second quarter and first half results and discuss our outlook for the second half of the year.

We saw strong growth in both gross revenue and service revenue in the second quarter. Gross revenues grew by 9.2% and service revenue grew by 9.5%. Overall, organic revenue growth was up 1% and the organic growth in our commercial, state and local, and international government businesses more than offset the 5% decline in our US federal revenue.

In our commercial area, we achieved strong organic growth in our digital interactive, energy infrastructure, energy advisory, and commercial health advisory markets. In addition, our acquisition of CityTech further increased the size of our digital interactive business. Energy efficiency revenues were slightly down this quarter compared to last year's second quarter, but were modestly up for the first half, and we see continued growth there that John Wasson will discuss in a moment.

Our domestic commercial business, which accounts for almost 90% of our commercial book, actually increased 17% compared to last year's second quarter.

State and local revenues increased 28% compared to last year's levels, thanks primarily to our recent contract wins in the area of disaster recovery following superstorm Sandy. And our international government business grew 21% organically, benefiting from a doubling of sales last year; and total revenues are up 130%, reflecting the addition of Mostra, which we acquired in February of this year.

In the aggregate, our commercial, state and local, and international government businesses accounted for 48% of total revenues in the second quarter, up from 41% in last year's second quarter. This was the result of our strategy to diversify ICF revenue sources in the face of the uncertain outlook for federal government spending. It proved to be a sound decision, as headwinds in the federal government market persists even after the budget agreement in January.

As I mentioned above, we did see another overall decline in federal government revenues in the second quarter, primarily due to the reduction in our work for US federal agencies in the public safety and defense areas. We have strong revenue growth across our federal civilian agencies, where we have strong domain expertise, such as Health and Human Services, EPA, the State Department and Department of Veterans Affairs.

The decline in certain federal agencies and continued softness in certain parts of our aviation consulting business, caused us to realign our resources in the second quarter to address our changing business mix and ensure that our profitability is clearly reflective of our revenue growth.

As we look ahead, we see significant growth drivers in all our markets. On the commercial side, we expect a continuation of the positive business trends that have driven our growth to date. First, in energy, we are seeing a significant pickup in the number of transactions and projects that our energy market group is advising on. We're also getting additional assignments and plans surrounding tracking and increased domestic natural gas production.

There has been a lot of activity and conversation around the energy efficiency opportunities that are included in the EPA's Clean Power Plan proposal and overall compliance with state regulations and energy fatuity mandates. John will elaborate on this further.

Second, our digital interactive business is benefiting from both the secular trends with increased customer engagement and ICF's broadened suite of services, which is enabling us to capture new business and effectively cross-sell to existing clients.

Third, we are building headcount in our commercial health unit to accommodate the strong demand we are seeing for our advisory work, where we have been able to leverage our subject matter expertise to successfully penetrate the payers and providers market.

In terms of federal government work, ICF is well-positioned in the broad areas of health and energy that have continued to grow faster than overall spending. First, we have nearly 100 contracts with the Department of Health and Human Services, where we are assisting agencies that are responsible for issues relating to public health threats, current health issues such as obesity and HIV/AIDS, and protective services for children and families, both US citizens and those crossing our borders.

Second, following the recent Supreme Court ruling that confirms EPA's authority to regulate carbon emissions as pollutants, as well as awareness of planetary effects such as sea level rise on coastal communities, regulatory agencies have a full agenda in dealing with carbon pollution, the power grid and the mix of energy that will drive the US economy going forward.

Third, our work with travel agencies focus on international work, particularly USAID, is at the forefront of monitoring the health and well-being of developing countries. Press coverage every day brings home the point that health and population migration are interconnected with US interest.

We're also continuing to develop our international business to create an analog to the business model we have here in the US. Our first initiative off the GHK acquisition was to build a business development capability that would drive organic revenue growth. That has been successfully achieved, as is evidenced by the strong organic growth of our business in Europe.

Now, with the Mostra acquisition, we've added communication capabilities and at some point, we will add IT services. This will enable us to offer the full lifecycle of services and projects to our government and commercial clients in Europe. We also now focus on increasing the profitability of our business in Europe.

I would now like to turn the call over to our President, John Wasson, who will provide a more detailed review of our contract wins and pipeline. John?

John Wasson - *ICF International, Inc - President & COO*

Thanks Sudhakar and good afternoon. Second quarter sales were solid across all of our client areas, with commercial showing considerable strength and accounting for 37% of total sales for the period.

Our book-to-bill ratio for commercial markets in Q2 was 1.18. This was led by a new $24 million, five-year environmental infrastructure contract with a major national utility to manage the environmental restoration of a large transmission line that we were already working on. This latest win was a very competitive procurement, and we were pleased to have the confidence of this utility to see this project through to its completion over the coming years.

As Sudhakar mentioned, another area of our commercial business, our energy consulting work for the power sector, has been quite strong, both in sales and revenue growth. There are three key reasons for this. First, the pace of mergers and acquisitions in the utility industry has accelerated, and therefore, our advisory business supporting such transactions is very healthy.

Two, the surging natural gas resources are causing dramatic changes in our domestic energy supply mix, and we are one of the leading firms providing impartial assessments of gas market developments and what they need for utilities, investors, consumers and, now, potential exporters.

If you follow these developments, you will note that our studies of gas market developments and the implications for the industry are widely cited. This reflects our deep institutional knowledge and proprietary analytics, and as a result, stakeholders from virtually all perspectives see us as a trusted source of expertise and advice.

Finally, the release of EPA's Clean Power Plan under Rule 111(d) under the Clean Air Act has far reaching implications for the entire power sector. In setting a 30% reduction target for carbon from existing power plants by the year 2030, the proposed regulation would permit states to achieve their reduction goals by increasing the use of energy efficiency, promoting renewable energy, encouraging greater use of natural gas, and joining carbon trading markets.

As a result, industry stakeholders want to begin preparing for a variety of these options, and the announcement of the plan rules has resulted in a wave of new assignments to analyze, interpret and assess these implications.

The rules are in the comment stage now and will not be made final until 2015, and the states will have another year to drop their plans for implementation. Although we can expect some modification to the rules based on public comments and litigation that may affect the timing, the implications are significant enough that we're seeing strong interests from clients.

Now let me turn to our energy efficiency business, where we now expect to end the year with low to mid-single-digit growth, and we are very bullish about increasing this growth to high-single digits to low-double digit rate in 2015 and beyond for a number of reasons.

Our pipeline is still very strong and growing and it includes over $50 million in contracts for which ICF has been selected and that are in the late stages of negotiation. We hope to announce these wins in the third quarter. There are another $50 million or so in submitted proposals that have not yet been awarded, and more than $300 million of opportunities that are in the earlier pre-proposal stages of our active pipeline.

Also, we are executing well on our strategy of growing our share of the commercial and industrial market, while maintaining our leadership in the residential market. Thus far this year, we have actively captured or are in final negotiation on projects for three new and several existing utility clients. They include new pilots, demonstrations for new program offerings and innovative technologies to drive better and faster performance and results.

All of these give us entree to new clients and provide the foundation for ICF's growth in the C&I market. And we have significantly grown our staff and senior presence in the West Coast markets, especially to position ourselves for a new multi-year cycle of energy efficiency procurements in California that are expected to appear in the second half of 2015.

Finally, although today's $6 billion in energy efficiency program spending is nearly 10 times larger than it was in the late 1990s, this market can move to another level, given the EPA Clean Power Plan mentioned earlier. The proposed plan includes as one of its key components, use of energy efficiency programs for offsetting carbon emissions from existing power generation. This unprecedented flexibility in utilizing offsetting programs to meet the new standards provides a strong catalyst for choosing energy efficiency efforts to meet carbon reduction goals.

In addition to our continued strong growth in commercial health care, which Sudhakar mentioned, I want to spend a moment outlining what we are seeing in the digital interactive market, as we continue to coalesce the resources we have developed and acquired to address this market.

We are pleased with the pace of integration of our three acquisitions in this arena and the ability to cross-sell successfully between the various components and with existing resources within legacy ICF. As we combine our offerings and business development efforts, we can see, for example, that we can bring CityTech's Adobe and managed services experience into our legacy clients, and ICF digital and interactive and customer experience capabilities into theirs.

Our strong sales and revenue growth already attest to success of our efforts to bring a full range of digital interactive and marketing services across our markets. This market is evolving quickly, and we are increasingly seeing digital technologies and digital marketing align.

Today, a growing proportion of our business opportunities are with the CMO, (Chief Marketing Officer), not just the CIO, reflecting the importance of the marketing functions within commercial clients for segmenting their customers and determining where they should be directing their sales efforts. Our ability to combine digital marketing and associated analytics and customer experience skills, on top of the digital infrastructure, is a competitive advantage in which we will continue to invest.

As I mentioned earlier, overall sales were good across all of our markets. In the federal space, they were led by a $50 million contract with the US Army Research Laboratory to continue cyber network defense research and services. This will continue our 25-year history of working with ARL to help research and develop next generation cyber tools and techniques. Moreover, the other federal sales were well-spread across our major client agencies.

Our pipeline remains strong at $3.7 billion. Our large contract pipeline stands at 26 opportunities greater than $25 million; and 73 opportunities greater than $10 million.

Finally, our turnover for the quarter was 3%; equivalent to an 11% at an annualized rate.

I'll now turn the call over to our CFO, James Morgan, for the finance review. James?

James Morgan - *ICF International, Inc - EVP & CFO*

Thanks John. Good afternoon everyone. On a consolidated level, we achieved solid revenue growth in the second quarter. As Sudhakar noted, we took actions in the quarter to better align our resources with the changing mix of our business, and we incurred certain 'special charges' related to those actions, which impacted a number of line items on the P&L.

Specifically, we incurred $1.7 million in severance expenses associated with a reduction in staff of more than 80 personnel with annual salaries of approximately $10 million. Further, we recognized a currency loss of $0.5 million related to our closure of our Moscow office and nearly $100,000 acquisition-related expense. I will cover the financial impact of each of these items as I walk through the major elements of our income statement.

We reported total revenue of $263.9 million, or 9.2% above last year's second quarter. Organic revenue growth, which is total revenue, excluding acquisitions completed within the last 12 months, was up 1% compared to last year's second quarter.

Q2 2014 gross profit margin was 36.8%. Exclusive of the special severance costs, Q2 gross margin would've been approximately 37.3%, flat to 37.3% in Q2 of last year.

Reported indirect and selling expenses for the second quarter were $74.2 million, up $6.6 million or 9.8% compared to the second quarter of 2013. The increase in indirect and selling expenses was primarily due to the additions of Mostra and CityTech, as well as severance related to the staff realignments and acquisition cost.

Reported operating income of $17.6 million for this year's second quarter, up 1% year-over-year. Adjusted for the severance and M&A costs that I quantified earlier, operating income would've been $19.3 million, up 10.2% from the $17.6 million in operating income, (excluding M&A cost), reported in last year's second quarter.

Reported EBITDA was $23.0 million for the quarter, 2.3% higher than the $22.4 million reported in last year's second quarter. Adjusted EBITDA, which excludes the severance and the acquisition-related costs was $24.7 million for the quarter. 8.9% higher than the $22.7 million of adjusted EBITDA reported in last year's second quarter. As a percentage of revenue, adjusted EBITDA was 9.4% for both periods.

Depreciation and amortization expense was $3.2 million, up from $2.8 million in 2013's second quarter. Amortization of purchased intangibles was $2.2 million for the second quarter of 2014, down from $2.4 million in 2013's second quarter, primarily due to reduced amortization of intangible assets related to the acquisition of Ironworks and Macro, partially offset by the impact of our recent acquisitions of Mostra and CityTech.

The effective tax rate was 38.2%, as compared to 38.0% reported in the second quarter of 2013. Reported net income was $10.0 million or $0.50 per diluted share. Exclusive of the previously mentioned special charges, adjusted EPS was $0.57 for Q2.

Through the first six months, we reported cash used in operating activities of $7.8 million, compared to cash provided by operating activities in last year's first half of $30.3 million. In this year's first half, operating cash flow was reduced by additional working capital requirements associated with our recent acquisitions and temporary delays in the collection of accounts receivable due to administrative billing issues on certain new contracts.

We now expect the cash flow from operating activities for the full year of 2014 will be in the $60 million to $70 million compared to our previous guidance of $70 million to $80 million.

As a result of the temporary collection issues and the acquisitions of Mostra and CityTech, days sales outstanding for the quarter were 80 days. Excluding Mostra and CityTech from the DSO calculation, the company's DSO would've been 76 days for the second quarter. Given the collection cycles of our recently acquired businesses, we anticipate the DSO for the year will be in the 72 to 77-day range, including the impact of deferred revenue.

Capital expenditures for the first six months of 2014 were $8.1 million and in line with our expectations. In Q2, we repurchased approximately 510,000 shares, which will allow us to achieve our goal of offsetting the dilution caused by our employee incentive programs and maintain a fairly flat year-over-year diluted share count.

Consistent with our prior guidance and based on our current portfolio of business, we are currently forecasting full year depreciation and amortization expense to be in the range of $12.5 million to $13 million, amortization of intangibles of $8.5 million to $9.5 million, full year interest expense to range from $3 million to $3.5 million, and we expect the full year tax rate to be not more than 38.5%. Also consistent with prior guidance, capital expenditures are anticipated to be in the $14 million to $15 million range for the year.

With that, I'd like to turn the call back to Sudhakar.

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

Thanks James. As you know, when we provided guidance for 2014, we had assumed relatively flat US federal government revenues this year compared to 2013. The 6% decline in that business that we experienced in the first half, along with the softness in certain areas of our aviation consulting business, have caused us to revise that expectation.

Our current expectations are for revenue of $1.015 billion to $1.045 billion, which at the midpoint equates to 8.5% growth over 2013 levels. Using the adjusted EPS of $1.06 in the first half, we are now looking at adjusted EPS of between $2.19 to $2.27 for the year, which at the midpoint represents 12.6% year-on-year growth. On a GAAP basis, our diluted EPS guidance range is $2.12 to $2.20.

We believe that the book in our business and the soft realignment that we undertook in the second quarter has positioned us to post positive earnings per share comparisons in each of the third and fourth quarters of this year. At the same time, we're adding resources in areas such as digital and interactive, energy, environment, health care and public health, where we continue to see strong demand from both commercial and government plans.

Operator, I would like to now open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Bill Loomis; Stifel.

Bill Loomis - *Stifel, Nicolaus & Company - Analyst*

Sudhakar, when you were talking about the federal business, did you say that the work with EPA and HHS and the other clients you mentioned on the civil side, was actually up in the first half? Did I understand that right?

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

Yes, Bill.

Bill Loomis - *Stifel, Nicolaus & Company - Analyst*

So when I do your percentages, and I know it's not precise because of rounding, but your public safety and defense looks like it was off, about 16% year-over-year in the quarter. Can you tell us a little more about that, what the types of programs and clients drove that weakness in the quarter?

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

I think that, Bill, let me start and then John could perhaps expand on it. I think the one thing we see in the trend in that specifically, especially Homeland Security, is there is a massive amount of conversion to small business set-aside. So contracts which we thought we were well-positioned for and etc. are basically just switched to small business set-aside. So that's been the most significant impact, actually, the small business set-aside switch. John, you want to add something?

John Wasson - *ICF International, Inc - President & COO*

I think that's certainly been a strong driver. I think the second part of the story is there were several contracts where we were a sub to primes, where the prime was not successful in keeping the work. And so, we've lost some work as the sub to primes who did not win their re-compete. And then the small business set-aside, it's primarily a program management-related work with the DHS.

Bill Loomis - *Stifel, Nicolaus & Company - Analyst*

And then you mentioned about procurement activity picking up. What do you mean by that specifically in terms of just looking at the federal side? Are you seeing more increase in bid or proposal activity or are you actually seeing better award activity? And what was the book-to-bill in the quarter just for the federal business?

John Wasson - *ICF International, Inc - President & COO*

I would say that we've certainly seen a pickup in activity and are busy on the bid and proposal front. I would say, on the award front, things are a bit slow and we're waiting on quite a few awards. And so, we haven't seen as much of a pickup there. I think for Q2, our book to bill ratio in the federal space was 0.75. That's Q2, yes, 0.75.

Operator

Tobey Sommer; SunTrust.

Tobey Sommer - *SunTrust Robinson Humphrey, Inc. - Analyst*

What was organic growth in the quarter and what does your guidance imply for organic growth in the back half of the year or 2014, whichever number you want to give?

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

Organic growth, as I said, was 1%, and we anticipate low-single digits for the year.

Tobey Sommer - *SunTrust Robinson Humphrey, Inc. - Analyst*

Okay. And if you gave this, I apologize. But, what's the assumption for the federal government piece for growth in the back half of the year?

James Morgan - *ICF International, Inc - EVP & CFO*

Yes, for the federal business, as far as revenue growth for the back half of the year? Is that your question? Yes, we're assuming that it's going to be kind of flat to low-single digit decline growth for the back half of the year.

Tobey Sommer - *SunTrust Robinson Humphrey, Inc. - Analyst*

So on a comparison basis, would that imply sequential improvement? What does that mean on a sequential basis compared to 2Q?

James Morgan - *ICF International, Inc - EVP & CFO*

I would say, you're saying kind of an H1 to H2 perspective? It's somewhat flat, maybe slightly up.

Tobey Sommer - *SunTrust Robinson Humphrey, Inc. - Analyst*

Okay. Kind of switching gears. Sudhakar, when you were speaking about international, you talked about eventually extending the company strategy that you've implemented here domestically to do even more implementation work, which means more IT. Can you build that organically in your international footprint or is that something that's more likely to come via acquisition?

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

Yes, I think there's certainly a time to build it. I think, for us to be serious players, I think we have to make an acquisition. So I think that we have some implementation capability, Tobey, because communications business, just like it is here, which is quite significant. We are the sixth largest independent PR firm in the United States based on PR Week rankings.

Similarly, that is all implementation work, which we do. We're getting the message out to our clients in health industry or the energy industry, etc. So we have half the implementation capability with the acquisition of Mostra, and what we need is the other half, where currently, we are teaming with other companies to provide the IT services. So, we're certainly going to try and build it, but I think the better way would be through acquisitions if we want to be a player more quickly.

Tobey Sommer - *SunTrust Robinson Humphrey, Inc. - Analyst*

Okay. And then how do you feel like the integration is proceeding so far? Any more color on the DSOs would be helpful, whether you think that will resolve itself, or kind of be an ongoing issue.

John Wasson - *ICF International, Inc - President & COO*

Sure. So I think in general, the integration is going quite well. I think with the Mostra acquisition, there we obviously added significant capabilities on the implementation side around communications, marketing. And I think we're seeing opportunities to bid deals in the European Commission that neither company would've bid without the marriage. And so I think on the business development front, we're positive on leveraging the Mostra acquisition. I think also the company has performed well and had a strong second quarter. And so certainly, I think the Mostra acquisition has gone as planned.

CITYTECH, in the digital interactive space, I think has also been a very strong acquisition, brought considerable capabilities around the Adobe platform, Amazon Web Services, so very complementary services to what we already had in the digital interactive technology space. It's performed well. And I think again, we see a lot of leverage points to cross-sell and grow the business. And certainly, in the second quarter, our digital interactive business grew quite robustly. So I think both the acquisitions that we did this year are going well, generally, very positively.

James Morgan - *ICF International, Inc - EVP & CFO*

And then with regard to the DSOs, I mean, certainly the acquisitions that we've brought on board, the commercial and then the international with Mostra, they do have a longer building cycle and collection cycle typically than what our US government business would have. So that, as I mentioned during my part of the script, is having about a four-day impact year-to-date on our DSOs.

We do think that overall for the company as a whole, it's going to have -- and by the year end, it'll have about a two-day impact on average. We certainly have some fairly large receivables associated with some of our acquisitions, that are being collected during Q3 and Q4, so that will help to improve the situation to some degree.

And overall then, going forward, as far as looking at the core legacy business, I mean it's really just timing issues associated with some of our existing billings and when we're making payments on prepaids and taxes and things of that nature, that's impacting cash flow. So there's not a systemic issue there, it's just it'll flip in the second half of the year. So that's (multiple speakers). Go ahead.

Tobey Sommer - *SunTrust Robinson Humphrey, Inc. - Analyst*

Just a couple of other ones I want to sneak in if you could. It sounds like you've got some contracts that are just kind of finalizing the terms in the energy efficiency space. Is it fair to say that you've kind of got some visibility into growth in that piece of the business improving? And then I was hoping you could make a comment about if you have opportunity to get more work related to superstorm Sandy as well.

John Wasson - *ICF International, Inc - President & COO*

On the energy efficiency front, I think it's certainly the case, I think, with the work's moved to the right to some extent. I think as I mentioned, and as you said in your question, we have $50 million of contract that are in final negotiation and are taking a longer to finalize than we expected. We have another $50 million of proposals submitted, awaiting award.

And so we do have very good visibility, another $300 million of opportunities in the pipeline. And so we do have good visibility in the energy efficiency area. I think things have moved a bit to the right, but we're still quite optimistic and believe that as we go into 2015, certainly, we'll be in the high-single digits to low-double digit growth range for energy efficiency, and have visibility to make that happen.

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

Is that a question on Sandy, Tobey?

Tobey Sommer - *SunTrust Robinson Humphrey, Inc. - Analyst*

Yes, please, and that's my last one.

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

I think Sandy, basically, we won a large contract. And we won it last quarter and we are starting off on it, and we believe that it will -- it's cranking away nicely. Part of the reason why our organic growth on local work is as high as it is, is because of the fact that we've gotten a lot more Sandy work. And I will note that you are the one who predicted it before we did.

John Wasson - *ICF International, Inc - President & COO*

So I would just add, I think, Sudhakar is exactly right. I mean, we actually have a suite of contracts up there, several contracts that are housing-related, which we've been working on for three or four -- more than a year, I think, at this point. And then we just recently won in the last quarter or two, an environmental contract to support some of the environmental reviews on the some rebuilding in New Jersey, and so that contract is getting off. We're starting that contract. It is winding up. We're doing more work on it and I expect that will drive additional growth. So, I think we will see more growth out of Sandy, certainly for this year.

Operator

(Operator Instructions) Tim McHugh; William Blair & Company.

Tim McHugh - *William Blair & Company - Analyst*

I guess first, just the government sector. So if you're looking for, I think you said flattish to slightly down revenue, how do you factor in the comp in Q4 here versus the government shutdown? Is that really implying that you're going to continue to see kind of mid-single-digit declines more on, I guess, an underlying basis? Is that right way to think about it?

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

Yes.

Tim McHugh - *William Blair & Company - Analyst*

Okay. That's straightforward, I guess. And then the guidance here, just the revenue, if I run the math, it's kind of, to be very precise, the midpoint is coming down by 1.4%, but you're bringing down the EPS by closer to 4%. I guess, I would've thought the margin is lower on the government side of the business. Are we getting negative leverage of operating costs? Or I guess, why is the drag on EPS bigger than the drag on revenue?

James Morgan - *ICF International, Inc - EVP & CFO*

Yes, keep in mind, too, that we certainly have incurred quite a bit with regard to the severance costs that we have, and we talked about that. So I mean, that's one of the biggest hits that's having a larger hit on EPS than what it is on the revenue side, Tobey.

Tim McHugh - *William Blair & Company - Analyst*

Well, yes, I was looking at the adjusted numbers, kind of excluding that.

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

Yes. So I think that the fundamental situation here is, Tim, what we are trying to do is make sure that the aviation business, which is a very profitable business, is not doing as well as we would like it to do. So that certainly has an impact on our margins. And second, we are certainly trying to make sure that, while the international business is growing quite rapidly, we need to make sure that we now focus on the profitability of the international business, which should be around slightly more than the government business here, but is not quite there yet. So we are focused on that, too. So when you merge -- meld all those things, the margins get affected a little bit.

Tim McHugh - *William Blair & Company - Analyst*

And then just as we go into next year, I guess, are we seeing the full impact of kind of the contract losses in the defense and homeland sector or will that kind of carry forward into next year? I know you're not ready to give guidance yet, but I'm trying to think whether you can stay flattish or even start growing in the government sector next year.

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

I think, yes. I think fundamentally, what I was trying to say, that's something which we're obviously looking at, and given that there are certain sectors in our government business which are growing and we have very significant -- HHS is our biggest federal client by far, three or four times the next one. So I think that if we can crank up the growth in our traditional domain area, rich places which are already growing, than some of the areas where potentially, especially Homeland Security, etc, we don't have that much work.

If that stays flat and the other part starts growing, we could potentially have positive comps going forward next year. So I think that the sense I have is that if HHS grows a little bit, that has a huge impact on our overall government revenue. And I think, generally, those trends are good.

So I'm more optimistic that year-on-year trends next year will be positive on the government side, because we would have flushed out all the agencies or areas where we potentially work where we don't have a real, strong discriminator, or where the small business set-aside impacts have all been washed through in the whole procurement cycle.

So I'm hoping that it's not like one of these things which goes down consistently. I think that we are seeing the flattening out and up, and the positive growth in certain markets where we have the biggest market share and where we have the biggest revenue. So I'm hoping that that improves going forward next year.

Operator

And at this time, I'm showing no further questions from the audience. I will now turn the call back over to management for closing remarks.

Sudhakar Kesavan - *ICF International, Inc - Chairman & CEO*

Thank you very much for joining us, and we will see you for the third quarter call sometime in the late fall.

Operator

And thank you, ladies and gentlemen. This concludes today's conference. Thank you for your participation, and you may now disconnect.