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PRESENTATION

Operator

Welcome to the ICF International Third Quarter 2018 Earnings Conference Call. My name is Vanessa, and I will be your operator for today's call. (Operator Instructions) Please note this conference is being recorded on Thursday, November 1, 2018, and cannot be reproduced or rebroadcast without permission from the company.

And now I would like to turn the program over to Lynn Morgen of AdvisIRy Partners. Please go ahead.

Lynn Morgen

Thank you, Vanessa. Good afternoon, everyone, and thank you for joining us to review ICF's third quarter 2018 performance. With us today from ICF 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 and results to differ materially, and I refer you to our November 1, 2018 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 over the call to ICF's CEO, Sudhakar Kesavan, to discuss third quarter 2018 performance. Sudhakar?

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

Thank you, Lynn, and thank you all for joining us this afternoon to review our third quarter results and discuss our business outlook.

This was another quarter of solid execution for ICF, with total revenues up 9.1% year-on-year, consistent with our expectations and putting us firmly on track to achieve our full year 2018 revenue and earnings guidance. Our results continue to benefit from the diversified revenue sources inherent in our business, and the positive demand dynamics that align with ICF's domain expertise and implementation capabilities.

Third quarter revenue performance reflected substantial year-on-year increases in both state and local and international government work, which more than offset slightly lower revenues from federal government clients. Growth in state and local government was closely tied to our recent contract to provide disaster recovery assistance in Puerto Rico. And international government revenue growth represented continued execution on the substantial backlog that we have built over the last several years.

Our large commercial businesses, energy markets and marketing services, are both up year-on-year, more than offsetting the wind down of several infrastructure and aviation consulting projects.

Adjusted EBITDA margin on service revenue rebounded sequentially by 190 basis points to 13.8% while we continued our investments. These results, along with a lower tax rate, enabled us to convert this quarter's high single-digit revenue growth into substantial double-digit increases in diluted earnings per share and non-GAAP EPS.

The growth drivers that benefited our third quarter and year-to-date results have also set the stage for ICF's strong performance in 2019. First, we expect a significant pickup in federal government work next year. The dollar value of our year-to-date federal government contract wins is over 75% higher than the dollar amount of what we won all of last year, and our new business pipeline from federal work is robust, with additional contracts expected to be awarded in this year's fourth quarter.

We see opportunities across a broad range of our federal agency clients. Specifically, one, we see significant potential to leverage our public health expertise to win additional work at our largest federal client, the Department of Health and Human Services, particularly in the areas of opioid and other substance abuse. Year-to-date, we have won new contracts with an aggregate value of $20 million at the Centers for Disease Control, which was supported by opioid funding, and we are tracking additional opportunities there for next year. Two, we have won a significant dollar amount this year in cybersecurity, thanks to a renewed focus in that area by new leadership, and we are building an impressive pipeline of opportunities that align with our specialized skills. And finally, three, based on recent wins and pipeline data, we expect 2019 revenue growth at the Department of State, Department of Justice, the Environmental Protection Agency, the Department of Homeland Security and the Department of Defense. In short, after a year of flat revenues from federal government clients, which accounted for 43% of our total revenues, we're expecting substantial growth in this market in 2019.

Work for state and local government clients will be a key revenue driver next year, primarily tied to the disaster recovery contracts that we have won to date to assist in the rebuild after the 2017 hurricanes. As you know, these are federally funded contracts in which monies have been segregated and appropriated for recovery activities and then disbursed by state and local authorities. Year-to-date, we have several contract wins and award notifications that aggregated close to $245 million to be delivered over 3 years. The potential to expand the scope of these contracts and our ability to win additional work should provide a major growth platform for us in 2019 and for the next several years.

Also enhancing our growth prospects in this market is our recent acquisition of DMS, which has broad disaster recovery expertise in state and local markets and extends ICF's reach in performing response work. For example, we're pursuing several opportunities today in North Carolina and the Florida Panhandle related to response work post hurricanes Florence and Michael, which damaged those areas in September and October of this year.

Following 3 quarters of significant revenue growth, our international government business has moved up its contribution year-to-date to total revenues by over 2 percentage points. We anticipate additional revenue growth from this market in 2019 based on both our current backlog and a growing pipeline.

Thus as we look out to next year, we see substantial growth potential across our federal, state and international government markets. At the same time, we are enthusiastic about the prospects of our commercial business next year. In commercial marketing services, we expect to see further growth in the dollar value of our integrated contract wins and in our business development pipeline. Also, earlier this month, we announced the acquisition of We are Vista, a 100-person U.K.-based consulting and digital services provider. Highly recognized for its work in communication strategy, research, digital engagement and content development, We are Vista has developed successful campaigns for well-known brands in the technology, financial, retail, transportation and energy industries. This acquisition expands the support that we can offer both our public and private sector clients in Europe.

Energy markets should continue to benefit from both our robust pipeline in energy efficiency, where we expect some important RFPs will release in 2019, and the growth in our consulting work around distributed energy and resiliency planning.

In summary, therefore, one, we're looking ahead to a year in which we are growing in each of our client categories, representing virtually all organic growth; and two, the benefits of greater scale should enable us to expand our margin on service revenue in 2019 while we continue to invest in our infrastructure to drive and support future growth.

We will provide more specifics around our growth expectations in each of these markets when we give our full year 2019 guidance at the time of our annual 2018 results announcement early next year.

At this point, I will turn the call over to John Wasson, ICF's President and Chief Operating Officer, to provide additional insight into our operating performance. John?

John Wasson ***ICF International, Inc. - President and COO***

Thank you, Sudhakar, and good afternoon, everyone. Third quarter results were in line with our expectations, supporting our decision to increase our guidance last quarter and positioning us for significant sequential growth in this year's fourth quarter.

Revenues in our government business increased 14.1% in the third quarter and represented 65.1% of total year-to-date revenues. In the third quarter, revenues from federal government clients increased sequentially by just under 1% but declined by a little under 2% year-on-year. These results are consistent with what we anticipated and have spoken throughout the year about, given the issues associated with budgets going through the appropriations phase and then developing into RFPs.

Also, in line with our expectations, we saw a pickup in RFP activity and contract awards in the third quarter, with awards from federal government agencies representing the lion's share of our record contract wins this quarter. As a result, we expect an acceleration in federal government revenue in this year's fourth quarter, representing a strong finish to this year and enabling us to achieve our guidance of flat revenues from federal clients for full year 2018.

Federal government contract wins in the third quarter amounted to $522 million. In addition to our $200 million 5-year recompete with USAID to continue to implement its Demographic and Health Surveys Program, key federal contracts won in the third quarter included: a new $20 million task order from the U.S. Department of Justice to provide financial management and technical assistance; a new $35 million single-award IDIQ from the Environmental Protection Agency to support the National Water Program and EPA major water policy and regulatory actions; and the $20 million recompete contract with the U.S. Centers for Disease Control to support the BioSense Program, in which we were awarded significant additional funding to add new data sources and advanced analytical capabilities. BioSense is a critical surveillance system for public health used by the CDC and states to monitor disease outbreaks across the country. We ended the quarter with a robust federal government pipeline of over $3 billion after this quarter's significant contract wins, supporting our expectation for favorable business trends in this market in 2019.

Our international government business continued to perform well in the third quarter, reporting 18.4% year-on-year growth and putting us on track to achieve full year 2018 growth of over 30%. International government accounted for just over 9% of total year-to-date revenues, up from just under 7% only 1 year ago. Additionally, at the end of the quarter, the pipeline was significantly above last year's level, indicating positive trends heading into 2019.

The major driver of third quarter revenue growth was our state and local government business, which increased by 86.7% and represented 17% of our total revenues for the quarter and 13% of year-to-date revenues. Year-to-date, revenues from this client category have increased over 24% and will be up over 30% for the full year. Here, the catalyst was the start-up of our large contract we were awarded last quarter by the government of Puerto Rico to assist in disaster recovery post hurricanes Irma and Maria.

In terms of additional disaster recovery-related contracts, in the third quarter we were awarded a $5 million contract to provide on-the-job training services in the U.S. Virgin Islands in response to last year's hurricanes. Additionally, after the end of the third quarter, we were notified of awards and are currently in negotiations for contracts with a potential value of $50 million to support disaster recovery activities in Texas. Given that we are in negotiations, we are limited in what else we can say. Also, we continue to pursue several other CDBG-related opportunities in Puerto Rico, Texas and Florida, which we expect to be decided over the next several months and into next year.

The DMS acquisition is an excellent strategic fit for ICF. It significantly expands the number of opportunities available to us each time there is a major natural disaster, and we are seeing the first round of community-level opportunities associated with that in North

Carolina and Florida in the wake of hurricanes Florence and Michael. These are not large, state-wide contracts, but this acquisition has clearly expanded the scope of our disaster recovery capabilities.

Further, we see continuing revenue growth potential associated with the shift in how disaster recovery funds can be spent, with a percentage of the relief funds available for mitigation planning and resiliency projects. These projects would both strengthen at-risk communities as well as reduce future disaster recovery costs and could drive new spending that aligns well with ICF's core competencies in this area.

Now let me comment on our commercial business. Total revenues from commercial clients were stable with last year's third quarter and are positioned to grow at a mid-single-digit rate for full year 2018, consistent with our expectations. The key components of our commercial business, namely energy efficiency, energy markets advisory and commercial marketing services, were all up year-on-year, but the category's revenue comparisons were impacted by the wind-down of environmental services projects for utilities and aviation consulting projects.

In commercial marketing, our focus on integrated sales continues to yield positive results, bringing the dollar value of contracts won since we acquired Olson to over $155 million, work that neither ICF nor Olson could have won independently. In the third quarter, we executed on programs that bring together our expertise in engagement with our domain expertise in aviation and energy. Additionally, we have succeeded in leveraging the acquisition of London-based The Future Customer to win additional work with existing clients. And the acquisition of We are Vista earlier this month provides further cross-sell potential.

The integrated growth opportunities for marketing services have increased significantly with ICF's greater scale. As a result, we were pleased to announce in early September that John Armstrong has joined ICF as Executive Vice President and Group Lead for ICF Olson. John has significant experience in bringing together key disciplines across engagement, technology, creativity and behavioral analytics to optimize the capabilities of multidisciplinary organizations. He is a tremendous resource as we look across our organization to determine how to most effectively brand and go to market with what is, today, a more than $300 million business serving a broad swath of commercial and government clients.

Our energy markets business was up 7.4% year-to-date but was only modestly up in the third quarter due to the wind-down of several environmental services support contracts with utilities. The quarter benefited from several significant restructurings in the power sector and growing demand for ICF's financial and technical advisory services to support significant transaction activity, largely driven by renewables and gas asset development. Our distributed energy resources consulting business has also performed well as states and utilities address the impact of distributed energy-generating resources.

In terms of energy efficiency, which represents the majority of this category, we saw a continuation of existing programs and expansion in the beneficial electrification area. We ended the quarter with a substantial pipeline comprised of some recompetes as well as new opportunities in expansion states such as California, New Jersey and Virginia.

As we have said in the past, the California energy efficiency market represents solid growth opportunities, with smaller RFPs expected to be released in Q4 and early 2019 and larger ones later next year, as the state alters its approach to energy efficiency, renewable energy and greenhouse gas reduction.

Also, through our continued collaboration with marketing services, we are finding new ways to leverage our digital engagement, social listening and loyalty work with ICF utility clients, and expand our reach into behavioral engagement and energy efficiency programs. In essentially all regional markets, utilities continue to leverage energy efficiency programs to further engage their customers by market segment needs, and many are using these programs to address localized delivery constraints.

To summarize, we are pleased with our third quarter and year-to-date performance and the prospects ahead for continued growth. We see favorable business conditions in each of our government client categories in 2019, and we expect to see continued growth in revenues from commercial clients.

At the end of the third quarter, our business development pipeline was almost $5.5 billion, after a record quarter of contract wins. There were 46 opportunities bigger than $25 million and 80 opportunities between $10 million and $25 million. Our annualized personnel turnover rate was 16.3%.

I will now turn the call over to James Morgan, our CFO, for a financial review. James?

James C. Morgan ***ICF International, Inc. - CFO & Executive VP***

Thank you, John. Good afternoon, everyone. I'm pleased to report on our third quarter financial performance and provide you with additional insight into our thinking for the remainder of 2018.

Third quarter revenue was $333 million, up 9.1% from the $305.3 million that we reported in last year's third quarter. This growth was driven by a 14.1% increase in total government revenues, which reflected double-digit increases in revenue from work for state and local and international government clients, which more than offset a 1.9% year-over-year decline in revenue from federal government clients.

Pass-through revenues increased 21.8% year-on-year and accounted for 30.5% of third quarter revenues. This is related in part to the disaster recovery work in Puerto Rico as well as our increased communications and events work with the European Commission, for which subcontractors account for more than 50% of the revenue.

Service revenue increased 4.3% to $231.3 million, up from $221.8 million in the third quarter of 2017. Gross profit increased 4% to $119.9 million from $115.3 million, driven by higher revenue. Due largely to a shift in client mix and higher pass-through revenues that yield lower margins, we reported a 180 basis point decline in gross margin to 36% in the third quarter of 2018 as compared to the third quarter of last year. However, our gross margin on service revenue was 51.9%, down a more modest 10 basis points year-on-year mostly due to lower revenues from certain higher-margin aviation projects.

Indirect and selling expenses for the third quarter amounted to $89 million compared to $84.6 million in the third quarter of last year--but as a percentage of service revenues and after exclusion of special charges, it stayed essentially flat at 38.1%. Bid and proposal activities, which had accelerated in the first half of this year, eased in the third quarter.

EBITDA for the third quarter was $30.9 million, slightly above last year's $30.8 million. Exclusive of special charges, to include acquisition-related expenses, severance cost and facilities consolidation and office closures, adjusted EBITDA was $31.9 million compared to $31 million in the third quarter of 2017.

Adjusted EBITDA margin on service revenue was 13.8% compared to 14% in the third quarter of 2017, with the 20 basis point variance reflecting the reduction in gross margin due to the business mix that I mentioned earlier as well as increased investment in infrastructure to support future growth. It should be noted that adjusted EBITDA margin on service revenue showed significant sequential improvement, up 190 basis points above this year's second quarter.

For full year 2018, we continue to expect adjusted EBITDA margin on service revenue to be even with the 13.3% reported for 2017. The unusually high margin we are expecting in the fourth quarter to reach this guidance reflects the confluence of several positive factors, including the benefit of incentive payments that are expected to be greater than normal and higher utilization due to the ramp-up of new contracts.

Net income for the quarter was $16.7 million, up 21.8% year-over-year, and diluted EPS was $0.86 per diluted share. The 19.4% increase in diluted EPS from the comparable quarter in 2017 was driven by significant revenue growth, lower depreciation and amortization expense, as well as a lower tax rate of 22.9% compared to 34.5% in the year-ago period. This quarter's tax rate was lower sequentially and below our full year guidance due to lower tax expense from deductible equity-based compensation and various domestic return to provision adjustments.

Non-GAAP diluted EPS of $1.01, exclusive of $0.15 for amortization of intangibles and for previously mentioned special charges, marked a 21.7% increase from the $0.83 reported in the third quarter of 2017.

At quarter-end, we had $10.4 million of cash provided by operating activities, considerably below the $70.3 million of operating cash flow that we reported at this point last year. There were several contributing factors driving the year-over-year variance, all related to timing issues--about 70% of which can be explained by 4 items--to include:

First, there was roughly $50 million paid for media buys during the first quarter of 2018, but for which an advance payment was received in the fourth quarter of 2017, the sum of which benefited 2017 year-end cash flow but reduced our 2018 year-to-date cash flow. We expect a similar advance payment in the fourth quarter of 2018, which will benefit the 2018 fourth quarter cash flow and more than offset the year-over-year impact.

Second, we had more than $15 million of advanced milestone payments from international government and marketing services clients in the first 9 months of 2017 that were not replenished during the first 3 quarters of 2018. However, we expect nearly $20 million of milestone payments related to our business with international government and marketing services clients to be collected in the fourth quarter of 2018.

Third, we had roughly $7 million receivables for which collection slipped into the first week of the fourth quarter.

And lastly, there was roughly a $3.5 million receivable for which collection was delayed due to the respective client switching to a new accounting system, the majority of which has since been collected.

Given these 4 working capital items plus our expected fourth quarter operating performance and the fact that we will receive a cash flow benefit of more than $8 million associated with taxes, we are expecting our fourth quarter operating cash flow to be extremely strong. We are, however, reducing our 2018 operating cash flow guidance to $80 million to $100 million from our previous estimate of $100 million to $110 million. This is a result of the time and resources that have been required by both us and the client to stand up a new invoicing and related approval process associated with a recently awarded large contract.

As I mentioned on past calls, we continue to invest in developing our infrastructure and intellectual property. These investments resulted in a $7.1 million year-over-year increase in capital expenditures to $15.6 million for the first 9 months of 2018. Borrowings on our credit facility at the end of September increased $26.3 million from the year-end 2017 due mainly to the acquisitions of The Future Customer and DMS. Days sales outstanding for the third quarter was 84. It was higher by 9 days in the third quarter of 2017 due to the previously mentioned timing issues. We continue to anticipate days sales outstanding for 2018 to be in the range of 72 to 77 days.

Now for a summary of our year-end guidance. I'll highlight several financial line items to help you fine-tune your models. First, we continue to expect our full year 2018 revenue to range from $1.295 billion to $1.335 billion, representing a 7% year-over-year growth at the midpoint. We continue to expect 2018 GAAP diluted EPS to range from $3.35 to $3.55, exclusive of any special charges. We expect depreciation and amortization expense to be in the range of $17 million to $18 million for 2018. We anticipate the amortization of intangibles to be in the range of $9.5 million to $10 million. We expect full year interest expense will be in the range from $8.5 million to $9 million. Capital expenditures for 2018 are expected to be in the range of $24 million to $26 million. And lastly, we now expect our effective tax rate for the year will be closer to 25%, and 2018 fully diluted weighted average shares outstanding will be approximately 19.3 million.

Our capital allocation priorities remain the same: investing in our business, making acquisitions, delivering, and paying our quarterly dividend. In the first 9 months of 2018, we repurchased 138,537 shares under our share repurchase program for a total outlay of $8.6 million to partially offset the dilution from our employee incentive programs.

Lastly, today, November 1, 2018, ICF declared a quarterly cash dividend of $0.14 per share payable on January 16, 2019 to shareholders of record on December 7, 2018.

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

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

Thank you, James. To sum up, the third quarter was another period of strong performance for ICF and supports our guidance for solid double-digit earnings growth this year. Additionally, higher backlog, record contract wins and a business development pipeline of close to $5.5 billion all set the stage for strong growth in 2019.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we have our first question from Tobey Sommer with SunTrust.

Tobey O'Brien Sommer ***SunTrust Robinson Humphrey, Inc., Research Division - MD***

With respect to the disaster recovery work stemming from the storms in 2017, the company's had some success winning some contracts. I'm trying to get a sense for the remaining sort of addressable market in terms of those Community Development Block Grant funds sort of yet to be allocated and paying it off to a consulting firm to assist with. Or perhaps, you could even quantify the addressable market available to consulting firms.

John Wasson ***ICF International, Inc. - President and COO***

Sure, Tobey. It's John Wasson. I guess I would -- so let's do that geography by geography. I would just remind folks, as we've talked about in the past, that Congress has appropriated $35 billion of funds under the Community Development Block Grant program to help Puerto Rico, Texas, Florida and the U.S. Virgin Islands respond to the damage from the storms. And so -- and we've indicated that, that money has been allocated by HUD such that Puerto Rico has gotten about $20 billion of CDBG funds; Texas, about $10 billion; and Florida and the U.S. Virgin Islands, $2.5 billion each. So the largest opportunity, obviously, remains in Puerto Rico. No contracts have been awarded yet to undertake CDBG-related implementation yet in Puerto Rico. We are in capture and in proposal stage on opportunities there and expect awards going forward. And into next year, that remains a very significant opportunity, certainly, the largest opportunity for us. Second largest opportunity is Texas. Texas was allocated $10 billion. We noted that we've been awarded a couple of contracts. We've been notified of intent to award us a couple of contracts in Texas to help support CDBG opportunities that are about $50 million potential value to us. There's certainly more to come and more opportunity in Texas, and we expect that to also play out throughout the rest of this year and into next year. And so I would say that in the 2 areas with the most -- have been allocated the largest resources, there's still significant opportunity, and that will play out here in the next months and quarters.

Tobey O'Brien Sommer ***SunTrust Robinson Humphrey, Inc., Research Division - MD***

Okay. With respect to Puerto Rico, is the -- if you're successful in winning additional work, is the most likely path for that to transpire by applying additional funds to your existing FEMA contract? Or would it be a separate sort of contract vehicle?

John Wasson ***ICF International, Inc. - President and COO***

I mean, my expectation is it would be a separate contract vehicle. I mean, the CDBG requirements and rules are specific for programs that -- to that program. They are different than FEMA programs. And so I would certainly expect it will be different -- separate contracts and that there will be a set of contracts awarded to support CDBG activities in Puerto Rico.

Tobey O'Brien Sommer ***SunTrust Robinson Humphrey, Inc., Research Division - MD***

Okay. With respect to the cash flow guidance for this year, could you give us some color, without giving specific numbers if you're not prepared to, but is there some sort of catch-up that we should expect next year, at least, based on what we know now in the business?

James C. Morgan ***ICF International, Inc. - CFO & Executive VP***

Yes, you would. This is James, Tobey. We certainly would expect that there would be a little bit of a catch-up into the beginning of next year, in the first quarter. So that would help to benefit the 2019 cash flow.

Tobey O'Brien Sommer ***SunTrust Robinson Humphrey, Inc., Research Division - MD***

Okay. And then I wanted to ask a question on the commercial side, and I'll get back in the queue. You mentioned some energy projects winding down. Could you just provide a little bit more color about the nature of those projects in -- whether that was anticipated, a natural phenomenon? Or any other color you could provide?

John Wasson ***ICF International, Inc. - President and COO***

Sure. I mean, the environmental work, it tends to be environmental -- support environmental permitting or construction monitoring for large energy infrastructure projects, so electric transmission lines -- primarily electric transmission lines. We've had several large projects that had been winding down, and I think we expected them to wind down. I think as I noted, we do expect our commercial business to grow in the mid-single digits for the year, and that's, I think, what we've been guiding for the year. And so I think we've -- this is factored into our guidance, and think it was not a surprise.

Operator

We have our next question from Lucy Guo with Cowen and Company.

Lucy Guo ***Cowen and Company, LLC, Research Division - VP***

Wanted to just follow up on Tobey's question about the disaster recovery funding situation, just to clarify maybe. It doesn't seem like you have received any chunky awards this quarter. Would you characterize that there may be postponement and -- or at least, prolonged adjudication pace in terms of the getting the awards done?

John Wasson ***ICF International, Inc. - President and COO***

I mean, I wouldn't say that there's been a prolonged adjudication or delay. I mean, I think we've -- our experience has generally been it takes a year from time of the storms and the appropriation to kind of run the process out, to design programs, get out approval, run the RFPs and select one or more firms that will help support the implementation. And so I think we're -- so I don't think there's been -- I would not characterize it as delayed. I would expect that over the next -- through the end of this year and into early next year, these will play out. And we should have clarity. There certainly are, as you note, chunky opportunities still out there that were certainly in capture or bidding and awaiting decision.

Lucy Guo ***Cowen and Company, LLC, Research Division - VP***

Okay. And the opportunities that you had named, over $25 million, some of those are clearly related to disaster recovery. Is that right?

John Wasson ***ICF International, Inc. - President and COO***

That's correct, yes. And some of the largest in that category would be related to disaster recovery.

Lucy Guo ***Cowen and Company, LLC, Research Division - VP***

Okay. That's great. And then you had mentioned in your prepared comments there are some Q4 potentials on the federal government side. Are there any besides the opioid opportunity that was mentioned? Or just any color you can give there.

John Wasson ***ICF International, Inc. - President and COO***

I mean, I would say that I think we've been pretty consistent in our commentary on the federal civilian budgets that we expected, given the increase in budget from Trump 2-year budget for 2018 and 2019, that the time it will take for that money to flow and we'd start seeing real opportunities and awards and start impacting our growth will start to occur as we go into Q4 and ramp into early next year. I think the opportunities we're seeing and our expectation is they'll be pretty broad-based. I think as Sudhakar noted in his commentary, I mean, Department of State, including AID, Department of Justice, EPA, Homeland Security, HHS, we're seeing opportunities across all those clients. I guess, what I would say is that the money associated with increase in the civilian budgets, we're starting to see that flow. And as expected, and we expect it'll ramp up our growth here in the fourth quarter and into next year on federal. I mean, as we noted in the commentary, we were slightly under 2%, a decline in federal through the first 3 quarters. We're saying we're going to be back to flat at the end of the year. So that obviously implies a ramp-up in growth, and we think it'll continue into next year.

Lucy Guo ***Cowen and Company, LLC, Research Division - VP***

Got it. And then just going to the commentary that James made about the revenue mix on some of the higher-margin, aviation-related consulting projects, do you expect to do more of those going forward? Just there's hardly -- maybe the mix getting better there.

John Wasson ***ICF International, Inc. - President and COO***

Yes. I mean, our aviation business, I mean, it's a cyclical business. It goes up and down. It's dependent. We can win very large strategy opportunities that can really drive the margins and drive the growth. We had some of those last year. This year, we haven't had quite those set of projects. And so it's a volatile business. It is a very profitable business, one of our most profitable businesses. And so it's a small business. It's less than 2% of our revenues. But when it's cranking, it can really help drive our earnings. This has been a challenge year for that business. I don't think there's a broad kind of industry trend that would lead us to believe that will. I think it should show improvement, and we're cautiously optimistic for next year. But when that business is strong, it can really drive earnings. It is very profitable.

Lucy Guo ***Cowen and Company, LLC, Research Division - VP***

Make sense. Lastly, just on the commercial side, which is you typically have very good seasonality in Q4. Is there any reason why that wouldn't be the case this year?

John Wasson ***ICF International, Inc. - President and COO***

No, I don't expect anything unusual with our seasonality. I think we'll see the typical seasonality. And again, we've certainly indicated our commercial business will be mid-single-digit growth this year, and we think we'll experience growth in the fourth quarter. I think we're -- and certainly are positive on energy and marketing services.

Operator

Our next question comes from Kevin Steinke with Barrington Research.

Kevin Mark Steinke ***Barrington Research Associates, Inc., Research Division - MD***

I believe you talked about some incentive payments or fees that you expect to come through in the fourth quarter. I assume those are higher-margin opportunities. And I'm just curious about how secure those are in terms of the timing that they're going to hit the fourth quarter, if you've already received them. Or is there any potential for slippage on those?

James C. Morgan ***ICF International, Inc. - CFO & Executive VP***

Kevin, this is James Morgan. Majority of those payments relate to our energy efficiency work incentives. And certainly, we have very -- they're paid based on us achieving certain metrics, success metrics on those contracts. We manage it very tightly. We have very good insight as to what we expect at year-end, and so I don't see that there is going to be any significant slippage of those in the fourth quarter.

Kevin Mark Steinke ***Barrington Research Associates, Inc., Research Division - MD***

Okay. And that ramp-up in margin you're expecting in the fourth quarter, I guess, relates to gross margin and -- but how are proposals and bid and proposal expenses trending? I think you expected them to tick down in third quarter and further in the fourth quarter, so is that kind of the trend you've been seeing?

James C. Morgan ***ICF International, Inc. - CFO & Executive VP***

Yes. With regard to our proposal expenses, certainly, it's eased in Q3. And we expect it to be little bit less in Q4. But I will also say, depending on the timing of some of these opportunities that come out with regard to disaster recovery, that could have a little bit of impact on spending. And that will -- that's going to drive our investments. If those come out, we have to do what's necessary to go after it.

Kevin Mark Steinke ***Barrington Research Associates, Inc., Research Division - MD***

Right. Okay. You talked about a potentially significant pickup in federal government growth in 2019. I was just wondering if there's any way to frame that in terms of maybe relative to some of your best years historically in terms of growth in your federal government business. I mean, would you say that, that would be -- this could potentially be one of your best years or -- I'm just trying to get a -- or could trend above your longer-term targets for the federal government business growth?

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

Kevin, I think that basically, what we see, it's a very substantial part of our business. The federal business is between 40% and 45%. So I think traditionally, it's been flat to low single digits. I think it'll certainly increase from there, and we will certainly give you a better sense of it. But it will be much better. Now I don't recall what our best years were, but we've had -- after ARA, we had 13%, 14% growth. I wouldn't expect that. But I think it'll be, certainly, good growth. And given the size of our business, relative to the rest of our businesses, I think it will make a significant difference to our profitability going forward.

Kevin Mark Steinke ***Barrington Research Associates, Inc., Research Division - MD***

Okay. That's helpful. And any more detail on the We are Vista acquisition in terms of size or the strategy there with the rest of your commercial marketing business?

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

Sure. I think that the -- it's 100-person firm based in London and -- in the U.K. and 1 or 2 of the other locations. I think that the strategy -- our strategy has been quite consistent over the last many years. We have had an ICF here in North America. We've had a strong set of federal government-type business. But on top of that, we build our commercial businesses. Similarly, in Europe, both in the U.K. and in the European continent, we've had a strong federal-like business, the European Commission and the U.K. government business. And we are doing the same analog here. We have commercial clients there, which are serviced out of the London office. And we have government clients. And as we get more need for engagement services, we want to make sure that the resources available for that kind of activity for our clients. And it's just an analog of what we've done here. So I think we are going to just build a business in Europe, which is an economy which is very large and has lots of data and has need, which is similar to us, in a similar way to what we did -- what we are doing here. So that's basically the strategy.

Operator

Our next question comes from Tim McHugh with William Blair.

Timothy John McHugh ***William Blair & Company L.L.C., Research Division - Partner & Global Services Analyst***

First, I want to follow up on a question on seasonality in the commercial business. I think last year, in the fourth quarter, you had a big -- kind of a spike in revenue that, if I look years prior to that, really wasn't -- it was much more pronounced. And I know you also had a spike in pass-through costs last year. Is that -- I guess, when we think about the normal seasonality is what, I guess -- the heart of the question I'm trying to get to and how much pass-through expenses impact that growth for the commercial in the fourth quarter.

John Wasson ***ICF International, Inc. - President and COO***

Yes. I mean, I think -- Tim, so I'd say a couple of things. I think we do expect a significant amount of pass-through revenues on the commercial side in 2018, like we had in 2017. Those are media buys associated with several of our commercial clients who, for business reasons, make those investments in the fourth quarter. So I would expect that to certainly be the case in 2018. I also think that certain parts of our business do ramp up in the fourth quarter, particularly our -- on Olson side around advertising, marketing services associated with the holidays. And so that drives it. And then as we've talked about, we do get these incentive payments from energy efficiency programs in the fourth quarter. And we expect them to be particularly high this year. So I think those are the things that are really driving higher fourth quarter service revenue and total revenue that we'll see in 2018, much like we saw in 2017.

Timothy John McHugh ***William Blair & Company L.L.C., Research Division - Partner & Global Services Analyst***

Okay. And have you -- I don't know, did you give a number for reimbursable or pass-through expenses this year? They're what you expect at this point?

James C. Morgan ***ICF International, Inc. - CFO & Executive VP***

As far as the full year -- for the full year estimate?

Timothy John McHugh ***William Blair & Company L.L.C., Research Division - Partner & Global Services Analyst***

Yes. Yes.

James C. Morgan ***ICF International, Inc. - CFO & Executive VP***

We have in total. I mean, we've said that on a Q3 basis, we were running at 30%. I would say that as we move forward, certainly for subcontract activity, there's going to be a higher level. If you think about the disaster recovery work we do, there's quite a bit of subcontract activity that goes with that. So I would suspect as we move forward into future quarters that -- in the past, we used to run closer to 25%, 26%. I think in the future, we'll be 30% or a little bit more.

Timothy John McHugh ***William Blair & Company L.L.C., Research Division - Partner & Global Services Analyst***

Okay. And seasonally higher in the fourth quarter? Or is that...

James C. Morgan ***ICF International, Inc. - CFO & Executive VP***

Yes, it's seasonally higher in the fourth quarter. That's correct.

Timothy John McHugh ***William Blair & Company L.L.C., Research Division - Partner & Global Services Analyst***

Okay. The hurricane -- I apologize. I joined the call slightly late, but could you quantify at all the impact from hurricane work? And is this as simple as thinking about the growth in the state and local business mostly related to that?

John Wasson ***ICF International, Inc. - President and COO***

I think we reported on the growth in the state and local business today. Obviously, that has been driven over the last quarter, a couple of quarters by our significant Puerto Rico contract, which, I guess, I'll remind everybody, it was an award of $189 million over 3 years. And so if you did the math on an average basis, you'd get a sense of the growth. And we've talked about there's potential upside on that contract. And then I -- we also described the small contract we've won in the U.S. Virgin Islands, the opportunities in Texas where we've had a notice of award for up to $50 million of CDBG-related work over a couple of years. And so I mean, those are the activities that are -- that we have in hand that will continue to drive that business. And then we've talked about the robust opportunity and pipeline in Puerto Rico and Texas. That needs to play out here over the next months and quarters.

Timothy John McHugh ***William Blair & Company L.L.C., Research Division - Partner & Global Services Analyst***

Let me ask maybe one other way. I guess, if we look at the third quarter in terms of the contracts you've won, are you -- does this reflect a ramped up run rate from those? Or such that we need additional contracts to drive growth from hurricanes? Or I guess, are you still on the ramp stages...

John Wasson ***ICF International, Inc. - President and COO***

No. Well, I would say that in Puerto Rico, we've come a long way on the ramp-up. I would not say that we're fully ramped up yet. I think there's more ramp -- we're still ramping up fully on that contract, certainly, in the fourth quarter. And once we get going on this Texas work, we'll need to ramp that up. And so there's still -- we're still ramping up the work. We're not at full capacity here at the end of the third quarter.

Operator

Our next question is from Joseph Vafi with Loop Capital.

Joseph Anthony Vafi ***Loop Capital Markets LLC, Research Division - Analyst***

On that Texas, I guess, down-select or notice of award -- first of all, congratulations on that. But secondly, do you have a feel for, if there's been some other down-selects that you haven't gotten there yet, that you haven't gotten? Or do you think this is kind of the first notice of award coming out from Texas? And then I have a follow-up.

John Wasson ***ICF International, Inc. - President and COO***

I think this is the first -- there's an initial set of contract awards in Texas from multiple jurisdictions. I would say that we've won -- so this is an initial set of wins for us. We've won our fair share. We weren't the only winners, and there's more to come. I mean, I think there still remains significant opportunity in Texas.

Joseph Anthony Vafi ***Loop Capital Markets LLC, Research Division - Analyst***

Okay. And then just as Puerto Rico starts to ramp, can you just kind of remind us what the margin profile is overall on that business? And then just finally, could you just remind us again how you're differentiated in some of the cyber work you say is starting to ramp?

James C. Morgan ***ICF International, Inc. - CFO & Executive VP***

Joe, this is James Morgan. I'll cover the margin piece. I think as we've said in the past, the Puerto Rican work, it is disaster recovery work. Typically, it's government-type work. But it's at the upper end of our government profitability spectrum typically. So yes, you can picture that to be -- we've said in the past that our government work can run anywhere from, say, 7% to 10% or so. It's certainly near that upper end from a profitability perspective. John?

John Wasson ***ICF International, Inc. - President and COO***

Yes. On the cyber side, I mean, I would say that we -- I'd say a couple of things. We have a long history of supporting the Air Force on cyber-related activities -- I'm sorry, the Army, Army. I'm sorry, the Army Research Lab on cyber-related opportunities. And so we have deep relationships there, and so we're leveraging those. And then we have -- obviously, we have a variety of clients on the cyber side in civilian arenas. And we obviously have deep relationships into our civilian clients, and so we're able to leverage those relationships to pull through some of the cyber work. And so I would say that's the primary drivers. I mean, we do first-rate work in that area, and we're leveraging the relationships, both at the Army and on the civilian side.

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

And we also won a contract, Joe, based on the Army work with the Air Force, which does want similar work done. So I used to have TS clearance. I don't have it any longer. So they will shoot me if they tell me what they do. But I think whatever they're doing is interesting enough that a lot of the services are also seeking Army assistance, and the Air Force contract we won was also very similar to what we are doing for the Army.

Joseph Anthony Vafi ***Loop Capital Markets LLC, Research Division - Analyst***

Okay. But just to kind of -- just drill down on that just a little more, it's not a really kind of IT cyber. It's more process and kind of workflow sites? It's not just pure IT cyber, if I recall. Just a little more clarity there would be great.

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

Yes. It's quite sophisticated cyber in that it's pattern recognition cyber, that is, they look at ways in which potentially there's incoming cyber attacks and what patterns you can detect. So it requires some really highly trained people who look at the patterns which are emerging and, therefore, figure out ways in which we can perhaps respond. So I think that there are -- it is -- I don't know what you'd call that, but it is not processed. And that is not -- I don't know exactly what the process aspect you're referring to but it's (inaudible)

James C. Morgan ***ICF International, Inc. - CFO & Executive VP***

Yes, that's right. So in defensive cyber...

John Wasson ***ICF International, Inc. - President and COO***

Defensive cyber, I mean. And we have folks working on site 24/7 who are doing defensive, protective measures. So I do think we have some real technology capability here.

Operator

Our next question comes from Marc Riddick with Sidoti & Company.

Marc Frye Riddick ***Sidoti & Company, LLC - Business and Consumer Services Analyst***

I wanted to touch base on some of the preparation for disaster recovery contracts. And I was -- I guess, maybe taking a step back to -- from the standpoint of looking at it historically, what you're doing now versus what you've seen historically, are you finding yourself now spending more to prepare for these, given -- it seems as though from the outside looking in, there are more opportunities. The number of opportunities are more. How should we be thinking about sort of that initial investment in preparing for disaster recovery and then what that may be portend to for just sort of being more of a steady-state going forward?

John Wasson ***ICF International, Inc. - President and COO***

I mean, I think from the 2017 storms, I think we've been pretty clear that there's significant opportunity there. The 2 quarters prior to this, we made significant investments to build the pipeline and position for the opportunities. Those are playing out. I think we continue to invest. With the investments coming down here in Q3 related to the 2017 storms, we would expect it to come down even further in Q4 although we'll still be investing. I think we'll see decisions on many of those 2017 storm opportunities on the CDBG front in the coming months and early -- and into next year. I then would say that we've had 2 storms this year, and I would expect that there'll be appropriations in response to those storms to address the recovery. And as we get into later next year, as we get 9 months into a year after those storms, there'll be a set of opportunities. And we'll need to invest in that, and we'll reflect that in our guidance. But I think there's a cycle to this. And I think we're -- from the 2017 storms, we're kind of getting deep into that cycle in terms of investments coming down. We think we're at a point out now where proposals are being written and awards are going to shake out here. And then we'll -- as I say, we'll bake into our 2019 guidance the investments we need to make later in 2019 in response to the storms this year, depending on what amounts that Congress ultimately appropriates.

Marc Frye Riddick ***Sidoti & Company, LLC - Business and Consumer Services Analyst***

Okay. I was wondering, as far as overall, how we should be thinking about overall head count expectations going into next year, not just around disaster recovery of course, but just overall, what you're thinking may be necessary in order to take advantage of total opportunities, given the increased backlog.

John Wasson ***ICF International, Inc. - President and COO***

Yes. I mean, I think we're a people business and we -- and so if we're going to grow, we're going to need additional people. I would say that generally, our philosophy is if we're growing -- let's pick a number -- 8%, we would look to add 7% additional -- but we'd look to get some leverage and leverage our existing staff as much as possible and then add additional staff over time. I mean, we would hope the utilization would go up with existing staff as the firm grows and we have more opportunity. But at the end of the day, if we're growing 8%, we're going to have to add...

James C. Morgan ***ICF International, Inc. - CFO & Executive VP***

Staff...

John Wasson ***ICF International, Inc. - President and COO***

A lot of staff to get that work done.

Operator

I see no further questions at this time. I will now turn the call over to management for closing remarks.

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

Well, thank you for -- all for participating in today's call. Here's wishing you all a very happy holiday season, and we'll see you next year. Thank you.

Operator

And thank you, ladies and gentlemen. This concludes today's conference. We thank you for participating, and you may now disconnect.

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