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ICFI - Q1 2018 ICF International Inc Earnings Call

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PRESENTATION

Operator

Welcome to the ICF International First Quarter 2018 Results Conference Call. My name is Vanessa, and I will be your operator for today's call. (Operator Instructions) As a reminder, this conference is being recorded on Wednesday, May 2, 2018, and cannot be reproduced or rebroadcast without permission from the company.

I will now turn the program over to Lynn Morgen of AdvisIRy Partners.

Lynn Morgen - AdvisIRy Partners

Thank you, Vanessa. Good afternoon, everyone, and thank you for joining us to review ICF's first 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 or results to differ materially, and I refer you to our May 2, 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 the call over to ICF's CEO, Sudhakar Kesavan, to discuss first quarter 2018 performance. Sudhakar?

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

Thank you, Lynn and thank you all for joining us today to review our first quarter results and discuss our business outlook.



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The first quarter 2018 results were in line with our expectations and represented a good start to what we expect will be a year of solid growth for ICF. This performance underscores the benefits of our diversified revenue sources. First quarter revenue growth in 2018 was led by strong increases in our commercial energy markets and international government businesses and positive year-on-year growth in commercial marketing services.

As you know, we consider our expertise in post hurricane recovery to be one of the growth catalysts on the horizon for ICF. Almost \$90 billion has been earmarked by the federal government for disaster relief in Texas, Florida, California, Puerto Rico and the U.S. Virgin Islands.

We noted in today's earnings release that we are pleased with the opportunities that we have seen to leverage our expertise on contracts funded by both FEMA and HUD. Based on forthcoming RFPs from jurisdictions affected by the 2017 hurricanes, we are seeing a significant increase in our new business pipeline during the second quarter.

As a result, we'll be investing significantly in capture and proposal activities over the next several months in pursuit of these opportunities.

Beyond disaster recovery, there are 4 key growth catalysts for ICF in 2018 and 2019. First, there's the bipartisan budget agreement, which represents the highest increase for civilian agency budgets in years. Within that general opportunity, the 2018 budget of our largest federal client, the Department of Health and Human Services, has increased 14%. Both the National Institutes of Health and the Centers for Disease Control, where we do the bulk of our work, have received increased funding.

Also, there is substantial funding going to initiatives to combat opioid abuse, an area in which ICF has significant expertise. Additionally, we see several opportunities emerging at the Departments of Transportation, Energy, Homeland Security and Defense. We expect RFPs to be issued related to these increased budget dollars in the coming months, but revenues from contracts won are not expected to accrue until the fourth quarter, with ramp-up of new contracts taking place in 2019.

Second, we see positive growth prospects in our international government business, where we are executing well on existing contracts and increasing both our business development pipeline and our win rate.

Third, in our commercial business, marketing services is seeing an improved business environment and is benefiting from increased emphasis on loyalty marketing, digital commerce and social media to drive customer engagement.

And fourth, our commercial energy markets group continues to be an important growth engine for ICF. We are well-positioned to benefit from the increase in mandated energy efficiency programs across the country and from advisory work associated with transformation in the utility industry.

In summary, these 4 business trends support our positive outlook for 2018. Additionally, our backlog remained steady at \$2 billion at the end of the first quarter, and the funded portion of the backlog was at 53%. Also, contract wins this quarter were just over \$300 million, a 20% year-on-year increase, and our pipeline at the end of the first quarter was \$4.4 billion before including the value of disaster recovery-related RFPs that are being issued in the current quarter.

At this point, I'd like to turn the call over to John Wasson, our President and COO, for our first quarter business review. John?

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

Thank you, Sudhakar, and good afternoon, everyone. The pace of our business in the first quarter was consistent with the trends we have identified in our markets. We are enthusiastic about the growth catalysts for our business and especially pleased with the expansion of our pipeline.

Our government business was steady, with revenues increasing by 1.8% overall. Strong revenue growth from our international government business more than offset the impact of timing issues on year-on-year comparisons in our federal and state and local government businesses.

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Federal government revenues were up sequentially, but 3% below last year's levels. Approximately 1/2 of the decline in the first quarter 2018 federal government revenues was due to lower pass-through revenues, with the remainder representing delays on a handful of contracts in our health and social programs market. Federal government revenue accounted for 44% of first quarter revenue compared to 46% in the same period last year.

We were awarded a significant number of important federal contracts in the first quarter across a broad group of agencies with notable wins in cybersecurity, both at the Social Security Administration and the U.S. Army Research Lab; in IT Services, at the U.S. General Services Administration to support its IT modernization plan; and at the U.S. Substance Abuse and Mental Health Services Administration, or SAMHSA, to provide web content management and support services for the National Center on Substance Abuse and Child Welfare. At the Department of Housing and Urban Development, we won an important re-compete for the Community Compass Initiative to help HUD's customers navigate complex housing and community development challenges.

Also, under an existing HUD grant, we have been asked to provide assistance on a few small CDBG-related projects, one on technical assistance in the U.S. Virgin Islands, one on a solar energy storage project in Puerto Rico, and a third to support a national CDBG problem-solving clinic. The revenue associated with these projects is modest, but ICF's positioning as a resource in this area is indicative of our recognized domain expertise on CDBG issues.

First quarter state and local government revenues were up substantially on a sequential basis, but 4% lower year-on-year, reflecting the timing associated with certain infrastructure projects. Revenues from state and local government clients accounted for approximately 10.5% of total first quarter 2018 revenues, about 50 basis points lower than the same period last year.

We continue to track and respond to additional opportunities in all jurisdictions that were impacted by last year's hurricanes. As we have discussed in previous calls, we expect most of these RFPs to be issued in Q2 and early Q3. In the last month alone, our pipeline has increased by more than 10% from the \$4.4 billion at the end of Q1.

Rounding out the government category is our international government business, which continues to show substantial year-on-year progress. Revenue growth was 44%, or 30% adjusting for a favorable currency effect. Here we are executing on a solid backlog of work won over the last 2 years, driving revenues from international clients to almost 10% of first quarter revenues, up from the 6.7% at the same time last year. Additionally, we had another strong quarter of contract wins, posting a double-digit increase in the value of contracts won in the 2018 first quarter compared to last year's first quarter.

Our commercial business continues to be a solid growth driver. In the first quarter, revenues from marketing services and energy markets clients more than offset the fall-off in aviation consulting revenues, which tend to be uneven quarter-to-quarter.

Revenues from commercial marketing services clients increased year-on-year at a low-single digit rate and accounted for 43% of commercial revenues in this year's first quarter. Our focus on larger and more integrated opportunities is paying off as contract wins were up significantly, led by the loyalty and PR areas of the business.

We have completed the integration of the small London-based loyalty firm that we acquired earlier this year, which expands our opportunities to do more global work for existing clients. Also, ICF Engage, our PR firm, won a number of new assignments and was just named midsized agency of the year by PR Week.

It is noteworthy that ICF, together with ICF Olson, was ranked the eighth largest PR firm in the U.S and the 15th largest globally. And together, we have achieved more than \$120 million of integrated contract wins since the acquisition.

Quarterly comparisons in this business can vary, but we believe that our array of talent and services has positioned us for continued growth.

Finally, in commercial energy markets, revenues increased over 10% in the first quarter, reflecting growth in both the energy efficiency and our energy advisory parts of the business.



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In energy efficiency, certain of our utility clients are expanding the scope of their contracts with us; this was a strong quarter for contract wins and the pipeline remains robust.

Several states are significantly expanding their energy efficiency goals via new legislation or regulatory action, including Illinois, New York and Virginia. We are actively seeking to expand our contract opportunities with utilities in these and other states that are pursuing more aggressive goals, in some cases driven by greenhouse gas-related targets, in others by grid modernization. Also, California remains an important opportunity for us as the state starts to outsource a higher percentage of its energy efficiency work efforts, and the first tranche of RFPs is expected to be released in the third quarter.

Of the \$4.4 billion in our business development pipeline at the end of the first quarter, there were 33 opportunities greater than \$25 million and 81 opportunities between \$10 million and \$25 million. Our annualized personnel turnover was 13.5%.

To sum up, we are pleased with our first quarter execution on programs across our client sets and the level of RFP activity in our areas of expertise.

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 solid first quarter financial performance, which provides the foundation for continued growth in 2018.

Total revenue for the first quarter of 2018 was \$302.8 million, a 2.2% increase over last year's \$296.3 million, driven by revenue growth in both our government and commercial markets.

Revenue growth from government clients of 1.8% was led by a 44% revenue increase in our international government business. And as John mentioned, exclusive of foreign currency effects, the revenue growth with our international government clients was an impressive 30%.

The 2.9% growth in revenue from commercial was mainly attributable to revenue growth with our clients in the energy markets, which grew 10.7% and was supported by a year-over-year improvement in revenues from digital marketing services clients.

Service revenue increased 1.9% to \$223.9 million when compared to \$219.8 million in the first quarter of 2017.

Gross profit increased to \$114 million in the first quarter of 2018 from \$112.7 million in the year-ago quarter. During Q1, we recorded a reserve to write-off our receivables due from a large retailer that declared bankruptcy. That write-off, in combination with our business mix and higher pass-throughs, led to a 40-basis-point quarter-over-quarter decline in gross margin to 37.6%.

Indirect and selling expenses for the first quarter were \$89.7 million, up from the \$88.8 million in the year-ago quarter. However, as a percentage of total revenue, we saw a 40-basis-point reduction in indirect and selling expenses to 29.6% despite a spike in capture and proposal expenses associated with disaster recovery work as well as an increase in ongoing investments associated with improving the scalability and efficiency of the company.

We expect that the increased bid and proposal expenses associated with the disaster recovery work will accelerate in the second quarter as we pursue a number of opportunities.

GAAP EBITDA for the first quarter was \$24.3 million, 1.7% above last year's \$23.9 million. Exclusive of special charges related to severance expense for staff realignment, adjusted EBITDA was \$25 million compared to \$25.6 million for the first quarter of 2017. Adjusted EBITDA margin on service revenue was 11.1% compared to 11.6% in the first quarter of 2017.

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The quarter-over-quarter decline is due to the reduction in gross margin and the impact of previously mentioned investments. It should be noted that we continue to expect to have 10 to 20 basis points of improved adjusted EBITDA margin on service revenue for the full year of 2018 as compared to 2017.

Net income for the quarter was \$12.4 million, or \$0.65 per diluted share, representing a 22% year-over-year increase from \$10.2 million, or \$0.52 per diluted share last year. This positive comparison was partially attributed to a lower tax rate of 22.5% in the first quarter as compared to 31.2% last year. The 2018 Q1 lower tax rate was driven by the change in the corporate tax rate due to the Tax Reform Act.

Non-GAAP diluted EPS of \$0.77, which excludes \$0.03 from the previously mentioned special charges as well as \$0.09 in amortization of intangible expense, increased 11.6% compared to the \$0.69 reported in the first quarter of 2017.

During the first quarter, we had negative operating cash flow of \$5.8 million compared to positive operating cash flow of \$6.7 million in the first quarter of 2017. Quarter-over-quarter variance was primarily due to the significant receivable collection activity that took place in the fourth quarter of 2017, which was partially due to the pull-forward of collections from the first quarter of 2018.

We continue to expect operating cash flow to be in the range of \$100 million to \$110 million for 2018.

Our CapEx in the first quarter of 2018 was \$4 million. As we've previously guided, we expect CapEx to increase in 2018 as we make additional investments in our infrastructure to further improve our operating efficiencies, and in developing our intellectual property.

Debt outstanding under our credit facility at the end of the first quarter of 2018 increased by \$25 million, in part due to the acquisition of The Future Customer, as well as cash flow seasonality.

Day sales outstanding for the first quarter of 78 days was slightly higher than the 76 days in the first quarter of 2017 due to timing of collections. We continue to anticipate DSOs for 2018 to be in the range of 72 to 77 days, including the impact of deferred revenues.

In addition to our DSO guidance, I will summarize our guidance on several financial line items to assist your modeling. We continue to expect our depreciation and amortization expense to be in the range of \$19.5 million to \$20.5 million for 2018. Amortization of intangibles are anticipated to be approximately \$9 million. Our full year interest expense is expected to range from \$6.5 million to \$7.5 million; capital expenditures are anticipated to be in the \$24 million to \$26 million range; we now expect our effective tax rate for the full year to be no more than 26%, down from 26.5%; and we continue to expect fully diluted weighted average shares of approximately 19.1 million for 2018.

With respect to our capital allocation strategy, we'll continue to invest organically and de-lever while we evaluate appropriate acquisitions. We currently expect to continue repurchasing shares under our share repurchase program to minimize the dilutive effect of our employee incentive programs. In fact, we repurchased 88,052 for a total outlay of \$4.9 million in the first quarter of 2018.

Lastly, we are pleased to declare our second quarterly dividend of \$0.14 per share, payable on July 16, 2018, to the shareholders on record as of June 8, 2018.

With that, I would like to turn the call back over to Sudhakar.

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

Thank you, James. Based on our current portfolio of business, we are pleased to reaffirm our current guidance of GAAP earnings per diluted share in the range of \$3.25 to \$3.45 exclusive of any special charges on total revenue of \$1.245 billion to \$1.285 billion. Non-GAAP diluted EPS is expected to range from \$3.60 to \$3.80.



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This guidance does not contemplate a benefit from the increase in appropriations for federal civilian agencies included in the 2-year federal budget -- government budget, given the time it takes for funds to become available to the agencies and departments. Nor does it include significant new disaster recovery-related contract wins.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we have our first question from Joseph Vafi with Loop Capital Markets.

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

I was just wondering if we could talk a little bit on some of the disaster relief. I know it's still early, but do you have a feel for the adjudication cycle on some of these contracts when they are -- when the RFPs do indeed come out? And then secondly, I was wondering, it may be early, but do you have a feel yet for how contract structures may look here versus like, say, what we saw back against Hurricane Katrina and those disaster recovery questions? Then I have a follow-up.

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

Sure, Joe. It's John Wasson. I think in terms of the opportunities we're seeing and their adjudication, I think we have been pretty consistent over the last 6 to 9 months that we thought community development block grant-related opportunities for housing recovery from hurricanes that given the funding cycle and HUD and the states need to work out the action plan, how they're going to approach it, that we would see the RFPs in Q2 and early Q3. And we would expect to begin to win them, and we may want -- when -- we would see adjudication on one -- a handful in Q2 and the remainder in Q3 in the second half of the year. And so I think it's playing out just like we had expected in terms of the schedule. And we're certainly seeing significant opportunity, as we said in our remarks, quite busy on the proposal and capture front. In terms of the structure of the opportunities, I think they are going to be similar to what we've seen in the past in New Jersey and Louisiana. We'll see a mix of fixed price and T&M-oriented contracts to deliver the services. And so I would say it will generally be consistent with what we've seen in the past. And we certainly learned a lot from the past, so -- but it will be similar to the contracts we have seen -- contract structure wins in the past.

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

Okay. That's a pretty positive update, John. And then just maybe kind of a similar question on some of the base federal business. I know Sudhakar was commenting on seeing some more RFPs out on the government -- on the base government side here over the next couple of quarters. I was wondering if you started to see any of those yet? Or is it still a little bit too early?

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

Yes, I think, Joe, it's a little too early. I think the appropriation process has to complete itself then OMB allocates the money based on the appropriations and then -- so it will take a while for, I think, the departments to get the money. So I am sure we'll see them, but I don't think we'll see them before Q3.

Operator

Our next question comes from Tobey Sommer from SunTrust.



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

With respect to the disaster recovery, 2 questions on that. Are there any constraints to you kind of winning work in terms of your internal capability and resources if there are similar RFPs in multiple geographies? And then secondly in terms of the timing, would you or other consultants be bought -- brought on by clients ahead of the action plans being submitted to HUD for approval? Or coincident or after, kind of how does that sequence hold?

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

Sure. I think on the constraints side, I would say we're a market leader in this market. I think we have significant depth on the advisory front. We've implemented, as you know, several of the largest disaster recovery housing programs in the history of the country. And so I think we have significant depth. I think there is significant opportunity in front of us, so I would say we are very busy, working very hard. But I think it's our view we'll be able to take advantage or bid all the opportunities in front of us and believe that we can staff them and deliver the work. We do have history here in staffing up quickly and hiring people in the geographies to deliver this type of work.

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

And we also do contingent hiring in different geographies just to make sure that we are ready to go as and when we win the work. So I think that's something, which we have learned over the years. And I think we do have to make sure that we are well-positioned, so we certainly make sure that we do that. And I think that it's always good to have people in the geographies who understand what the issues are locally. And so having people spend some time in the geographies and understand what's going on even if it's ahead of the opportunity I think is an important element in order for us to respond to the RFP in an appropriate way. So I think that on the action plan front, we try -- there are some -- we try and make sure that we find out exactly how the action plan -- if we do the action plan, then we want to make sure that we can still do the implementation, so we are always a little careful to see who -- what we do in each of these geographies too.

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

Okay. That makes sense. Can you focus on the California procurements for energy efficiency this year?

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

Yes, as I said in my remarks, I think we do expect to see those RFPs starting to be released in the third, going into the fourth quarter. As you know, the PUC has mandated a significantly higher proportion of the work we outsourced, and that will play out over the next 18 months. But we do expect to start to see some of those RFPs later this year.

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

Okay. And still similar order of magnitude that we talked about?

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

Same magnitude. Yes, I mean, we talked about that. Currently, 20% of the total spend on energy efficiency programs is outsourced to consultants, and we expect that to go up to 60% based on PUC mandate in California. And I think we still think that will be the case, and that has not changed.



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

Okay. Just a couple of detail questions then. On your DSO and cash flow kind of outlook, is it a heavy lift for the company to kind of hit the middle to lower end of the DSO range in the annual outlook, given 1Q performance? Or is that something you can do through normal course activities?

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

It's not a heavy lift. It's James, Tobey. We can certainly do that through normal course. There's really nothing that surprised us with regard to the Q1 performance, given the performance that we had at the end of last year. So we fully expect that we can still hit our guidance.

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

With respect to the write-off that you cited, what does the company's retail exposure look like and have you scrubbed that for what has been kind of a secularly challenged sector?

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

Yes, we have looked at that. We really don't have significant exposure in other -- with other retailers. So I don't expect there will be any further activity like we had in Q1.

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

Okay. Last numeric question for me. With respect to the commercial business, in the new sales of \$126 million, do you have a breakdown of that between your energy markets and your marketing services?

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

I don't think we have a breakdown on that, Tobey. I don't think we have -- no, I don't have that. We don't have that.

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

I can ask it off-line. I think you might have mentioned it in prior quarters, here. So I didn't know...

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

Okay.

Operator

Our next question is from Tim McHugh with William Blair & Company.

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

Just another one on the hurricanes, I guess. Is there any particular geographies where you are seeing better or I guess larger opportunities? Or you feel better positioned to get to work, if we were to think about that?



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

I would say we are seeing opportunities across all 3 geographies, Florida, Texas and Puerto Rico. And we are seeing significant opportunities there, both at the state level, primarily at the state or territory level and also within the city of Houston. But across all 3 geographies, we're seeing opportunities for both CDBG-related support and FEMA-related support.

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

And I would just add that the very significance hurricane -- the dollars associated with the hurricanes are fairly significant and, therefore, there is enough to go around. So I think that the potential opportunities are substantial, and I doubt that they'll all go to 1 or 2 firms. So I think there is an opportunity for firms to pick up work because I think the states would also be careful to spread the money around.

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

Okay. And did you -- second question, did you quantify how big was that write-off in terms of the impact on the margins this quarter?

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

We haven't quantified it, but it's in the 20 to 30 basis points of gross margin.

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

Okay. And then I guess just the marketing services, can you -- it's good to hear the bookings are better. I did notice there is another kind of change in leadership there. Or at least there's a new leader announced. I guess can you kind of talk about to turnover there and I guess that leadership came and how you're kind of running the business from that perspective?

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

Sure, yes. I mean, I think we feel like we have a strong leadership there. There's very strong folks running each of the businesses. We did announce a new leader for our digital technology business, Chip Knicker, who has significant experience. He replaced Matt Van Bergen, who was the Founder and CEO of CITYTECH who retired 6 or 9 months ago. And so we brought Chip on board. He's very experienced, Accenture, Acquity, knows that business quite well. So we feel quite good about that addition to our leadership team, which, as you pointed out, we announced a week or 10 days ago. We have very strong people running the -- components of our business, Bryan Specht leading the brand and PR business. Guy Cierzan leading our loyalty business, strong leader for the Canadian business. So I think we feel like we have a good experienced leadership team there.

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

And they've all been there for a while. I think the turnover at least at the leadership level is not that high. I mean, the traditional turnover in that business is higher than our legacy ICF business turnover, but that's true for the whole industry. But I think in terms of leadership level, we are pretty stable and pleased about how they are doing.

Operator

Our next question comes from Lucy Guo from Cowen & Company.



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

So I wanted to start off maybe also with hurricane recoveries. It seems like everyone's favorite question. On the last call, you had sort of anticipated about \$20 million revenues in the -- toward the end of 2018, essentially, and ramping up next year once you have more information, but is that still the case?

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

Yes, I think we haven't changed the assumption that -- in our initial guidance, we had assumed \$20 million of hurricane disasters-related work, \$5 million of Sandy-related work and \$15 million -- roughly \$15 million of new work. And, obviously, we had said that if we win significant contracts, we would update that guidance and I think that's still our position.

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

Great. And can you just maybe give some context around how the bidding process may differ with HUD and CDBG work versus the rest of federal government in terms of the rounds of solicitations and RFPs and the protesting process?

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

Yes, I think our experience is the bid process is very similar to federal and state and local work. I don't think there's anything unique or particularly different about it. And so I think it's pretty consistent with typical federal procurements. In terms of the protests, I don't know, James, do you have any?

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

No, it's mainly -- it's obviously, it's the money is being passed out to respective states, and so really goes through the normal state procurement processes. And I can't remember (inaudible).

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

I don't think we have seen -- in our history, I can't recall a single contract where we had a protest on them -- disaster-related recovery program, certainly on the CDBG front.

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

Got it. I was wondering if there are any potential delays in the timeline. There is some kind of early predictions on when action plans will be put together in HUD, giving their approval and some of the -- those information. It seems like May, June, July time frame. And what you're saying that you are already sort of expecting some adjudications in Q2. It just sounds like kind of a tight timeline.

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

You just have to understand that the jurisdictions -- different jurisdictions have gotten different amounts of money at different times. So some are ahead in certain areas, some are behind in certain areas. So I think also HUD approves action plans of each jurisdiction separately. So depending on how they approve them, et cetera, that's the first. So I think that all the timeous will be determined by jurisdictions. And HUD doesn't have a uniform way of looking at every jurisdiction at the same time, and therefore, coming up with their approvals. So I think it will all sort of start varying



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quite significantly, depending on how quickly the state, or the city or whatever is involved. Get their act together, get their action plans better, get the HUD approvals -- HUD approvals, the FEMA approvals before they start the process. So I think that it's all going to be at a different time, which is why we are saying it's going to happen about Q2 and Q3.

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

Got you. And just -- it looks like you are keeping your margin target of up 10 to 20 bps, but you're expecting some ramp up on bid and proposals, spend on recovery, right? What's sort of upsetting that headwind? Is it mix? Is it other opportunities?

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

I am not sure if I completely followed your question there, Lucy.

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

You said you are ramping up your bid and proposal investments for hurricane recovery RFPs, but you are keeping your margin target of 10 -- up 10 to 20 bps year-over-year. So I'm wondering what's offsetting the increase in your proposal spend?

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

I think that we expect that we can, obviously, it's going to be more in the back half. If we can -- investments we're making now in bid and proposal, hopefully, we'll be able to pick up a little bit of work here soon. But I think this normal utilization, we can offset, manage our personnel and be able to offset the investments in the back half of the year to be able to fund the additional investments that we're making in Q2. So it's -- luckily, the services business, we have the ability to be flexible and manage expenses and try to offset these expenses that we are incurring in Q2 and Q1.

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

That's helpful. And lastly, I was wondering if you have any updated number in terms of the revenue synergies you've seeing with Olson and their collaboration potentially on the government side.

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

I think we reported -- I think in my remarks I said \$120 million.

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

\$120 million.

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

\$120 million for the synergistic cross-selling, and so I think that's the updated number.

Operator

Our next question comes from Kevin Steinke with Barrington Research.

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

In terms of the increased RFP spending activity in the first quarter as well as the even higher spending in the second quarter, I don't know if you can you maybe characterize it in terms of the basis point impact? What it was in the first quarter? What you might expect in the second quarter on margins?

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

I'm not sure if we want to say exactly what the impact is or give too much detail on how much we are spending on marketing and B&P activity for this. But I will tell you, it's 7 figures is what we are investing certainly, in Q2.

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

Okay. Fair enough. So both in federal government and state and local markets. I think you mentioned federal government, maybe a few project delays. State and local, timing of infrastructure projects. Should we see those projects and that revenue start to flow in as soon as the second quarter? Or how do you see that playing out?

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

I think we would expect to see them flow throughout the year, and so our expectation is they'll occur. When it exactly they start I think will depend on the project, early second quarter or later in the second quarter or the second half of the year. But I think when you look at the year, we expect most of that to occur end of year.

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

All right. And then you mentioned growth in commercial marketing services in the first quarter. I don't know if you could characterize an approximate rate of growth through that business in the first quarter and what you might expect as you move throughout the year, given the stronger pipeline?

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

The growth in the first quarter was in the low single digits. I think in the prior 2 quarters, we're in the mid-single digits, at the end of -- last 2 quarters of 2017. And so I would say we expect it to be in the low to mid-single digits for the year.

Operator

Our next question comes from Ben Klieve from NOBLE Capital markets.

Christian Francisco Herbosa - *NOBLE Capital Markets, Inc., Research Division - Government Services and Defense Technology Associate Analyst*

This is Christian Herbosa on for Ben. I have a couple of questions. First, what areas do you find to be the most attractive for inorganic growth in the current environment?

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

Inorganic growth, you said?



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Christian Francisco Herbosa - *NOBLE Capital Markets, Inc., Research Division - Government Services and Defense Technology Associate Analyst*

Yes. Inorganic.

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

Well, I mean, as I've said before, we are not going to go and buy something which we don't understand. So it's our traditional areas. There are certain areas in the federal government, which are always interesting. There are certain energy, utility areas. The marketing services arena is very interesting to us. And there are certain skills which we can always add in our specialty areas like disaster recovery, there could be specific skill sets which we want, which we think will be useful going forward. So I think we're looking at our traditional areas, and I think that we -- there is significant opportunity there. And we'll continue to see and evaluate those things. So I think you can expect we will do stuff in the areas in which we currently work.

Christian Francisco Herbosa - *NOBLE Capital Markets, Inc., Research Division - Government Services and Defense Technology Associate Analyst*

And my second question is now that uncertainty related to the government's budget is behind you, what macroeconomic factors are you most concerned about looking forward?

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

I mean, I think that for us, the economy is doing well. Our commercial business will, we think, do better because it's, I think, related to some extent to economic growth. I think with the federal government spending likely to go up in the future, we think that it's generally a good sign for us because it's something which 45%, 50% of our business is dependent on. And I think that if you are alluding to labor rates, et cetera, we manage that quite carefully. I think our turnover rates haven't gone up with the economy doing better. We think that we've always attracted people who like the kinds of work we do, so we have, I think, more -- or lesser turnover than most of our competition. So I think that we generally do well on that front. We, obviously, try and be proactive also on that front, so I think our utilization, et cetera, has been managed quite carefully in an environment where perhaps salaries are going up, potentially could go up. But I think we are managing that and I think we're quite confident we would be able to manage that going forward.

Operator

(Operator Instructions) And our next question comes from to Tobey Sommer with SunTrust.

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

Just a couple of follow-ups. You mentioned delays in a couple of areas impacting revenue growth in the quarter. I wondering if you could elaborate on those, if anything's changed, you're seeing in the quarter?

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

No, I don't think -- I wouldn't read any deep trends into that. I mean, we had a couple of projects, handful of projects broadly within the Department of Health and Human Services that were delayed for specific client reasons, and we expect those projects to occur this year. So -- I think it was specific client and project issues with just -- those projects were slower to get going in the first quarter.



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

Okay. For a couple of quarters now, you mentioned intellectual property associated with your CapEx. I'm wondering when might should be able to clue us in as to what it is you are investing in when you got some, I don't know, products out on the marketplace perhaps as a result of those investments?

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

Yes, let me emphasize that we are a services business which uses intellectual property to generate more services. So I think that we are investing, for example, it's not a -- we are investing in Tally, the loyalty platform, which we think will be used in a variety of ways in addition to the ways it's being used now. I think we've talked about it. There are ways in which we can use it in very effective, the utility sector. We can use it in certain government, especially in certain public health areas. So I think that we are just trying to make sure we make it flexible enough, and we continue investing in it so as to make -- to ensure that we can discriminate our offering by specific intellectual property, which is quite impressive. For example, in the energy efficiency arena, we think that customer engagement, the utilities are quite keen as they restructure to engage with the customers. They've never really cared about their customers that much. So now that they are worried about the changing structure of the industry, the distributable energy resourcing, which is happening, they would like to be much more customer friendly. So in order to be customer friendly, we have the ideal tool to be customer friendly, which is sort of a way to get loyalty from customers. And to use in a utility setting, we have to make certain changes and invest a little bit of money into it. So I think that's what we're trying to do to ensure that we continue to make sure that we are slightly ahead of the competition in terms of as -- as the major clients start to spend the money, we continue to do that. So I think that's all we are doing. We are also doing stuff on add to the data analytics platform in Tally, do other specific upgrades to existing modeling frameworks, which will allow us to do what we need to do in sort of as different trends develop on the analytics side too. So I think these are things, which we think are essential for us to keep our edge in our traditional areas of expertise.

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

Is this year's CapEx level considered to be sort of a step function higher than it might be 1 year or 2 from now? Or is this a good level for ongoing CapEx?

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

Yes, this is James, Tobey. I think this is a higher year because in addition to the investments from an intellectual property perspective that we're making for various tools to help improve our service offerings, we're also, as I mentioned before, we're making various investments to improve the operating efficiencies and scalability of the company. Those will -- activities we expect the majority of those will take place between this year and next year and then those will tail off. So with that happening, I think that there'll be some reduction, at least from a percentage of revenue perspective. Obviously, as the company gets bigger and bigger, there'll be some increases in other areas. But from a percentage of revenue perspective, I would expect it to fall down a little bit.

Operator

And we have 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*

Thank you all for participating in today's call. We look forward to keeping you up-to-date on developments at ICF. Thank you again.



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Operator

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

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