FINAL TRANSCRIPT

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ICFI - Q2 2007 ICF INTERNATIONAL INC Earnings Conference Call

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CORPORATE PARTICIPANTS

Doug Beck
ICF International - SVP of Corporate Development

Sudhakar Kesavan
ICF International - Chairman and CEO

Alan Stewart
ICF International - CFO

John Wasson
ICF International - COO

CONFERENCE CALL PARTICIPANTS

Bill Loomis
Stifel Nicolaus - Analyst

Allison Heiken
UBS - Analyst

Joseph Vafi
Jefferies and Company - Analyst

Tim McHugh
William Blair - Analyst

PRESENTATION

Operator

Welcome to the ICF International Second Quarter 2007 Conference Call. During the presentation, all participants will be in a listen-only mode. Afterwards, you will be invited to participate in a question-and-answer session.

(OPERATOR INSTRUCTIONS)

As a reminder, this conference is being recorded on Thursday, August 9, 2007, and cannot be reproduced or rebroadcast without permission from the Company.

And now I would like to turn the program over to Doug Beck, Senior Vice President of Corporate Development. Please go ahead.

Doug Beck - *ICF International - SVP of Corporate Development*

Thank you. Good afternoon, everyone, and thank you for joining us to review ICF's Second Quarter 2007 performance. With us today from ICF International are Sudhakar Kesavan, Chairman and CEO; Alan Stewart, CFO; and John Wasson, COO.

During this conference call, we will make forward-looking statements to assist you in understanding ICF management's expectations about 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 August 9, 2007, 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 the 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 we specifically disclaim any obligation to do so.

During this call, we refer you to non-GAAP financial measures such as backlog and EBITDA. A reconciliation of these measures to the most directly comparable GAAP measures is available in the Investor Relations section of our website.

I will now turn the call over to our CFO, Alan Stewart, to discuss second quarter 2007 financial highlights. Alan?

Alan Stewart - *ICF International - CFO*

Thank you, Doug, and good afternoon to all. Our revenue for the second quarter ending June 30th was $190.2 million, up 25.3% sequentially from $151.7 million reported in this year's first quarter. This quarter direct cost increased as a percentage of gross revenue to 75% from 71.3% in the prior quarter, primarily due to increasing levels of subcontract and other direct cost, which were primarily unit cost work associated with growth on the contract.

Gross margin for the quarter was 25.0%, slightly below the 28.7% reported in the prior quarter. This result in an increase in the second quarter in revenue, direct cost to gross margin of $38.5 million and $34.5 million and $4.0 million respectively. Revenue for the Road Home contract was approximately $128.6 million for the second quarter.

Indirect from selling expenses were approximately the same at $27.7 million from the first quarter of '07 to the second quarter of 2007. The charges for non-cash compensation, attributable to equity was $0.8 million in the second quarter of this year, compared to $0.6 million in the first quarter of 2007. So indirect and selling expenses, excluding non-cash equity going to compensation, declined $159,000 from the first quarter to the second quarter of 2007.

Interest expense for the second quarter of 2007 was $414,000 compared to $324,000 for the first quarter of 2007, and the effective tax rate for the second quarter was 39.2% compared to 40.6% in the first quarter. This decline in tax rate is attributable to a higher level of profitability and lower proportion of permit differences. We would anticipate a tax rate of approximately 40% for the remainder of the year.

This resulted in second quarter net income of $11.2 million, or $0.75 for fully diluted share. This compares to net income of $8.7 million or $0.60 per fully diluted share in the first quarter. It should be noted that the acquisition of Z-Tech Corporation was closed on June 28th. No impact on operations was recorded in the second quarter for this activity of the acquired company.

The fully diluted shares for the second quarter includes 14,123,000 for basic weighted average shares and 725,000 common stock equivalents for a fully diluted total share count of 14,848,000.

It should be noted that we issued approximately 29,600 restricted stock units in the second quarter of 2007. And as we mentioned, non-cash stock compensation was [778,000] in the second quarter, compared to 619,000 in the first quarter.

In reviewing our balance sheet as of June 30, 2007, there are several important points to note. Our net accounts receivable balance was $144.3 million compared to $155.4 million balance on March 31st. If you exclude the $6.6 million in receivables from the Z-Tech acquisition, this represents 65 days sales outstanding, compared to 92 days and 87 days of March 31, '07, December 31, '06 respectively.

If you further deduct the amount of deferred revenue for these periods, the adjusted DSOs would then be 60 days, 83 and 73 days, respectively, for the periods ending June 30th, March 31st, December 31st. The decrease in DSOs is primarily attributable to accelerated cash collections at the end of the quarter. We continue to anticipate DSOs in the long term for range to follow our more traditional 75 to 85 days historical average.

At the end of our second quarter our revolving bank debt was $5.0 million compared to $18.9 million at the end of the first quarter of this year. It should be noted that this $5 million revolving debt level was after the expenditure of approximately $27.1 million Z-Tech corporation acquisition on June 28th. We have increased our revolving line of credit capacity to $95 million in connection with this acquisition, which gives us significant capacity to pursue a solid pipeline of acquisition opportunities, given our low current level of debt as we move into the third quarter of 2007.

Turning to our cash flow statement for the six months ending June 30, 2007. Our cash flow from operations provided $30.2 million, primarily due to the decline of accounts receivable, because of accelerated collections in the quarter, attributable to the Road Home program. In addition, accounts payable and accrued expenses increased $14.3 million and $25.9 million, respectively, which is primarily attributable to the growth of the Road Home contract and a significant increase in unit price activity of the six-month period.

We had capital expenditures of $1.4 million for the quarter and payments for this acquisition was during the six-month period to $40.0 million, net of cash [required] for these three companies.

I'll now turn this over to our CEO, Sudhakar Kesavan, to provide additional discussion.

Sudhakar Kesavan - *ICF International - Chairman and CEO*

Thank you, Alan. Good afternoon, everyone. This was ICF's strongest quarter yet in terms of financial performance, and we are very pleased with the progress made in several key areas.

Notably, we gained good traction in our traditional business and significantly increased that portion of our backlog. We executed well on the Road Home contract, bringing the number of closings to over 40,000 as of this week. We completed an important strategic acquisition in the health and information technology arena. And we continue to build our pipeline of both new business and potential acquisitions.

In the second quarter, our historical business revenue increased by 12.1% when compared to the first quarter and 10.6% on the year-over-year basis. We reiterate what we have said previously, that we expect to achieve consistent 8% to 10% year-over-year growth in the historical business. We had anticipated that this would be evident by the end of the year, so we are ahead of schedule.

Overall demand for advisory and implementation services within our target markets is solid, and we are seeing particular strength coming the from the energy and transportation, homeland security and climate change sector.

Our work on the Road Home contract further accelerated in the second quarter, generating revenues of $128.6 million. As you know, this is a three-year, $756 million contract with the Office of Community Development in the state of Louisiana that was awarded to ICF in mid-June of last year. It involves compensating owners for losses suffered during Hurricanes Katrina and Rita.

As of July 31st, which was the deadline for homeowners to submit applications, we have received over 180,000 applications, which is about 50% more than the original estimate. And if you look at the likely number of qualified applicants versus expected, it is probably 60% higher than the numbers you originally working with. Therefore, we now expect the level of activity on this program to continue at an accelerated pace in second half of 2007 and well into next year.

At the end of June, we completed the acquisition of Z-Tech, a 200-person firm specializing in implementation services including software engineering, web design and development assigned to competing services for the federal health care market.

On an annualized basis, we expect this acquisition to contribute approximately $25 million in revenues. From a business perspective we see significant opportunity to leverage our respected expertise to gain a greater share of the large federal health care market, which is estimated to exceed $25 billion. This acquisition is consistent with our strategy of leveraging our knowledge base into implementation projects.

Excluding this acquisition and the Road Home contract, ICF's backlog at the end of the second quarter was $406 million, an increase of 82.1% over last year's second quarter and 13.1% above quarter one of this year. In fact, we have seen solid progressive increases in our traditional business backlog over the past five quarters, which points to the favorable trends that exist in our markets and ICF's strong competitive position.

Our new business pipeline stood at about $840 million on July 31st, up from approximately $720 million in the beginning of May.

I would now like to ask John Wasson, our COO, to talk about new business and operating activities before I close. John?

John Wasson - *ICF International - COO*

Thank you, Sudhakar, and good afternoon. The total value of contract wins in the quarter was approximately $131 million, compared to the $83 million reported in the first quarter.

As noted in today's earnings release, key wins included a climate change market contract with the EPA worth up to $37 million, two contract vehicles with the Office of Personnel Management, under which we did $21 million in human capital implementation work across the federal government over the last five years -- our recent acquisitions should help us increase our competitive advantage in this arena going forward.

The key homeland security contract at FEMA on radiological emergency preparedness worth up to $26 million, and yet another significant piece of Energy Star energy efficiency work at the state level for $2.5 million in Massachusetts.

Our personnel retention rate continues to be strong. Total turnover for the second quarter was 4%. Excluding the Road Home, it was 3%.

We're also pleased that ICF continues to attract top talent in our key business areas. During the second quarter, we hired a number of new officers who are nationally known experts in organizational development, child development, defense, information technology, emergency management and homeland security.

In addition to new talent, we also continue to work with new clients on significant projects. In climate change, for example, we secured approval from the European bank's multilateral carbon credit facility for acquiring more than 5 million certified emission reductions, or CERs, from four Kyoto clean technology development projects.

Also in climate change, we are working for the Massachusetts Technology Collaborative in evaluating the state's 25 million green affordable housing initiative.

In human capital, we are working with the Census Bureau in preparation for hiring a half a million workers for the 2010 census.

For homeland security, we're evaluating an incident command system at the Department of Agriculture for responding to foreign animal disease outbreaks.

These new clients in important growth areas are helping to fuel ICF's pipeline, which increased over 20% in the last three months. Now, I'd like to turn the call back over to Sudhakar.

Sudhakar Kesavan - *ICF International - Chairman and CEO*

Thank you, John. Before ending our formal remarks, I would like to go over the outlook for the second half of 2007. As I noted earlier, at over 180,000 applications the Road Home contract is above -- significantly above original expectations. At this time we see the level of activity on Road Home resulting in revenues of between $195 million and $225 million in the second half of 2007.

The Z-Tech acquisition should add around $12.5 million in revenues in the second half of the year. Thus, we are raising our full year 2007 guidance to a range of $670 million to $700 million and projecting third quarter revenue levels of $170 million to $185 million.

Our preliminary view of calendar year 2008 revenue is $500 million, which expects to be approximately 60% historical business and 40% Road Home. Our 2007 and 2008 guidance for net margins remains at 5%.

As you can see, we are very positive about the opportunities we have to leverage our expertise and our strong financial position.

At this point, Operator, we'd like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS)

And your first question comes from the line of Mr. Bill Loomis of Stifel Nicolaus. Please proceed, sir.

Bill Loomis - *Stifel Nicolaus - Analyst*

Hi, thank you. Great quarter, guys. Looking at the -- just this year's guidance, if I just assume 9% operating margins in the back half and looking at the -- within your guidance range for revenues. I'm getting an EPS figure for the year that's about $0.15 or more higher than the upper end of your annual EPS guidance range.

Is there some type of negative margin implications we should be looking for in the fourth quarter because the revenue looks reasonable, but the implied margins on the fourth quarter, not the third quarter seem quite a bit lower. Is there anything going on there?

Alan Stewart - *ICF International - CFO*

No. Clearly we're still being a little cautious in the fourth quarter in terms of potential implications on the Road Home contract. And so I think there is potential for upside on the 5% guidance, but I think that is the number we're most comfortable with.

Bill Loomis - *Stifel Nicolaus - Analyst*

Okay. I understand. And the two small acquisitions, the EA, APCG earlier in the year, what did they contribute in the quarter for revenue?

Sudhakar Kesavan - *ICF International - Chairman and CEO*

They've contribute about $5 million or something like that revenue --

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Alan Stewart - *ICF International - CFO*

On an annual basis.

Sudhakar Kesavan - *ICF International - Chairman and CEO*

On an annual basis about --

Alan Stewart - *ICF International - CFO*

Each, probably $10 million total.

Sudhakar Kesavan - *ICF International - Chairman and CEO*

$10 million total on an annual basis. I think they contributed for the first half of the year perhaps -- what? -- $5 million.

Bill Loomis - *Stifel Nicolaus - Analyst*

Okay. And then so Z-Tech in -- begin in the third quarter -- and you're assuming just take that kind of $25 million -- divide by four, is that the kind of revenue contribution you expect from Z-Tech in the third quarter?

Sudhakar Kesavan - *ICF International - Chairman and CEO*

Yes, yes, yes. That would be -- that would be [likely to do].

Bill Loomis - *Stifel Nicolaus - Analyst*

Okay. Thanks a lot, guys.

Operator

And your next question comes from the line of Mr. Jason Kupferberg of UBS. Please proceed, sir.

Allison Heiken - *UBS - Analyst*

Hi, guys. This is Allison Heiken in for Jason. After reporting almost 11% in [core owners] this year -- this quarter you commented that you're ahead of schedule for the 8% to 10% organic growth exiting '07. And we're just curious what your expectations are for the core business that are included in your '08 guidance.

Sudhakar Kesavan - *ICF International - Chairman and CEO*

I think it's the same guidance we expected to be at the 8% to 10% range by the end of the year. We've gotten there a little earlier. So I think that I would suggest that the core business would be in that range, 8% to 10% for 2008.

Allison Heiken - *UBS - Analyst*

Okay. And then, as far as the Louisiana contract, what's the likelihood that you'll get some follow on work for that to push it kind of beyond the mid '09 or even before that time frame?

Sudhakar Kesavan - *ICF International - Chairman and CEO*

We, at the moment are quite focused on making sure that we complete this contract. So I think people there are quite busy making sure that we get the money to the homeowners. I think we are committed to making sure that that happens as quickly as we can. And so we haven't really thought about that and I think it is -- right now we are doing all we can to make sure that we run this program as well as we can.

So I think it's a little premature to talk about it. As we get to know more we will certainly share that with you, but right now I don't really have any comment on that.

Allison Heiken - *UBS - Analyst*

Okay.

And then, just lastly, can you discuss the acquisition pipeline and kind of the areas that are of most interest to ICF, I guess given your balance sheet flexibility, how large of an acquisition would you guys consider to backfill, for Louisiana?

John Wasson - *ICF International - COO*

I think we will continue to look at companies in the midsize range of $30 million to $80 million revenue and try to have a quite active pipeline of looking at opportunities.

Allison Heiken - *UBS - Analyst*

Okay. Great. Thanks, guys.

Operator

And your next question comes from the line of Mr. Joseph Vafi of Jefferies and Company. Please proceed, sir.

Joseph Vafi - *Jefferies and Company - Analyst*

Hi, guys. Good afternoon. Great results here. If we look at the growth in the core business, which was nice and a little ahead of schedule, it looks like you've been able to do this without -- let's say inking new business that's in the kind of management of large contracts versus just your traditional consulting business, which seems to be driving the growth.

Is there a change or should we look at the strategy of the core business outside or Road Home to be changing at all, or are we just executing well without winning any of these larger management contracts?

Sudhakar Kesavan - *ICF International - Chairman and CEO*

I think we -- I think our strategy remains pretty focused on making sure that we win some of the larger contracts. The contracts we have won in the implementation arena perhaps are our $30 million, $40 million, $50 million contracts. They're not, perhaps, the big guys like Road Home. But we certainly have in the pipeline at least two contracts which are in the $100 million range, and we are pursuing them.

So I don't think there is any strategic change in that way. It's just that we need to make sure that we align our goals with the opportunities, which are out there. And I think that that happens reasonably frequently, it's just that we don't see an -- $750 million contract out there, which we can -- which is aligned right now. But we do see some big ones and we are pursuing them.

So I wouldn't say there's a change in our strategy, it's just that we've perhaps only shown you the $30 million, $40 million, $50 million ones and to some extent we are spoiled because we have won a big one and now everyone is waiting for us to win the next big one of the same size.

So we're trying hard, and I think we'll get there. But right now we are at least winning the ones which we can win.

And I think the big ones take some time to develop. There is a lot of positioning you have to do, et cetera. And I think there are very strong trends we have in the implementation arena on energy, climate change, and homeland security and we are quite focused on those and I think we will do well going forward.

Joseph Vafi - *Jefferies and Company - Analyst*

Okay. That's helpful. And then, just maybe one more follow up. I know John, you gave some kind of preliminary margin guidance for '08. And I think we all kind of know that there's some good leverage in Road Home, and you're clearly above that 5% net level now.

Is there anything that we should be thinking about in terms of what the Company might be doing in '08 as potentially the -- as Road Home contract winds down that's going to have to be required by the Company and ensure that that 5% net margin is achievable or I guess even beaten at this point?

Sudhakar Kesavan - *ICF International - Chairman and CEO*

I think that we -- we have been looking at our costs, we have looked at our costs quite carefully over the last few years, if you recall we -- there are costs associated with the Road Home contract and as it winds down those costs will go away because those are costs which we don't need to incur as it winds down.

On our other costs, which are more permanent and more corporate. We have, I think, held them quite carefully at levels which we think are sustainable for the margins which we are telling you and we are quite focused on making sure that we deliver those margins.

So I think that we -- I'll just tell you that over the last few years, prior to going public, we were a highly leveraged company and we managed our costs very, very carefully to make sure that we delivered the earnings.

So I think that we have a whole culture and tradition of managing our costs and I think we'll continue to do that and are continuing to do that going forward. So when we tell you we'll hit 5%, we are quite focused on making sure that we do that and perhaps exceed it.

Joseph Vafi - *Jefferies and Company - Analyst*

Okay, that's helpful, Sudhakar. Then one final question, did I just -- it's a housekeeping question. Did I hear right that you were expecting $195 million to $225 million for Road Home in H2, is that the right numbers?

Alan Stewart - *ICF International - CFO*

Yes, correct. Yes.

Joseph Vafi - *Jefferies and Company - Analyst*

Okay. Thank you very much.

Operator

(OPERATOR INSTRUCTIONS)

And your next question comes from the line of Mr. Tim McHugh of William Blair. Please proceed, sir.

Tim McHugh - *William Blair - Analyst*

Yes, first on the legacy business, can you talk about the improvement in the organic growth rate? Do you attribute that to people returning from the Road Home program and performing quicker than you thought, or an improvement necessarily in the demand environment?

Sudhakar Kesavan - *ICF International - Chairman and CEO*

I think, to some extent, it's both. I think the energy and resources business is doing very well. It's growing quite rapidly. In fact, our transportation and even the environment business is growing quite rapidly. So I think both those businesses have done well.

Our -- and I think it helps that some people have come back and have had some -- have had a chance to sort of re-engage. So I think both the demand environment is certainly much better and we have some of the legacy people back who are helping us. So I think it is -- it is both. I didn't expect it to happen so quickly, but it has.

Tim McHugh - *William Blair - Analyst*

Where are you with regard to that? Is everyone back that you would like to pull back at this point, or are you still in the process of bringing people back?

Sudhakar Kesavan - *ICF International - Chairman and CEO*

We are still in the process of -- as I have said I think in an earlier call, that we will be done by the third quarter or so, by the late third quarter. So we're still focused on making sure that that happens. But they'll still be coming back.

But as you know, and as I've stated in this call, given that this program is again -- the acceleration has stayed up, we basically -- it just requires a little more management bandwidth and we are therefore still, I think, sticking to the schedule but we are getting them back slowly.

Tim McHugh - *William Blair - Analyst*

Okay. And then touching on the Road Home, you mentioned it's the number of applications, as much as 60% higher than originally planned. Can you relate that to the original estimate of the contract size of $756 million? Is that $756 million a hard cap or is that something that can be adjusted now as the level of the work might be higher than previously thought?

Sudhakar Kesavan - *ICF International - Chairman and CEO*

I think that we are in the process of -- it's a P&M contract. Just to answer your question, it's a P&M contract with a cap of $756 million. Last time when we spoke to you, the state had not even set a deadline for these applications. So the deadline for the application was set about two months, two and a half months ago -- on July 31st -- and we received over 10,000 applications on the last day. So it was difficult to predict exactly how many people would want to apply to the program.

It's going to take us some time to analyze the data and make a projection of how many applications are likely to qualify and pass through the program. And once we do that we will sit down with the state and discuss what the social requirements will be going forward. So it's only been like seven or eight days since the deadline passed and we will have a much better sense of -- and I'll be able to answer your question more fully perhaps in the next earnings call.

Tim McHugh - *William Blair - Analyst*

Okay. Then lastly, you mentioned the deadline. I know this can vary quite a bit on a case-by-case basis, but on average, once someone has filed an application how long in a very rough sense before they work themselves all the way through the process.

Sudhakar Kesavan - *ICF International - Chairman and CEO*

Three to four months. I think would be a reasonable estimate, in three to four months. Some take longer because they don't have the documentation. Some are quicker but three to four months is sort of a reasonable number, estimate.

Tim McHugh - *William Blair - Analyst*

Okay. Thank you very much.

Operator

(OPERATOR INSTRUCTIONS)

And at this time, there are no further questions in the queue, and I would like to turn the call back over to management for closing remarks. Please proceed.

Sudhakar Kesavan - *ICF International - Chairman and CEO*

Thank you for being with us. We appreciate your interest and support and we look forward to talking to you at the end of third quarter. Thank you.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect, and have a great day.