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PRESENTATION

Operator

Welcome to the ICF International Third Quarter 2017 Results Conference Call. (Operator Instructions) As a reminder, this conference is being recorded on Thursday, November 2, 2017, and cannot be reproduced or rebroadcast without written permission from the company.

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

Lynn Morgen - *MBS ValuePartners, Inc. - Founding Partner*

Thank you, Vanessa. Good afternoon, everyone, and thank you for joining us to review ICF's third quarter 2017 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 for 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 2, 2017, 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 third quarter 2017 performance. Sudhakar?

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

Thank you, Lynn, and good afternoon, everyone. Our third quarter results have put us on track to achieve the full year 2017 revenue, EPS and cash flow guidance ranges that we provided in late February. In addition, our year-to-date contract wins and pipeline opportunities have set the stage for continued growth in 2018. We were pleased with third quarter operating profitability levels. Our EBITDA margins were 10.1% on total revenues and 13.9% on service revenues, benefiting from several factors, including efficiencies in program performance and staff utilization; a favorable mix of higher margin revenues; and the initial effects of ongoing programs to reduce our administrative and infrastructure costs that we have implemented.

Third quarter revenue performance was stable with last year's levels despite the impact of 1 less working day, which James will detail a little later, and revenues for the first 9 months were up 1.4%. Similar to trends we discussed on our second quarter call, we continued to experience delays in pass-through revenues in Q3 on a handful of contracts with government clients. We expect these pass-through revenues to increase in the fourth quarter, which will result in a further shift in the historical seasonality of our revenue trends this year, with the 2017 fourth quarter showing sequential revenue growth from third quarter levels.

Excluding the impact from lower pass-through revenues, our federal government revenue remained essentially flat quarter-over-quarter and year-on-year. Spending on existing contracts continued apace. The volume of RFP releases varied agency by agency, with some contracts being extended rather than re-competed on schedule. Within this environment, which has been the norm for much of 2017, ICF had another good quarter of contract wins, and the dollar amount of the proposals we have submitted in the first 9 months of this year is up considerably from the similar period last year.

ICF has benefited from having recognized domain knowledge in key federal markets that enjoy bipartisan support. For example, at the Department of Human Services (sic) [Department of Health and Human Services], our largest client, we saw an uptick in RFPs at the end of the third quarter, which we believe is due to confidence that the HHS budget in 2018 will be similar to 2017. As we have said previously, the administration has yet to fill many key agency political positions, which has resulted in a certain reluctance at some agencies to begin new policy and programmatic activities, a situation that we expect to improve in 2018.

Our Commercial business continued to perform well, with revenues up 4.3% in the third quarter and 6.5% for the first 9 months of this year. This growth has been primarily driven by our work on energy efficiency contracts. Based on our year-to-date results, we are in line to exceed our expectations of mid-single digit revenue growth in Commercial business in full year 2017.

A major opportunity on the horizon for ICF is the potential to put our disaster recovery expertise to work in the aftermath of Hurricanes Harvey, Irma and Maria. As you know, ICF is recognized for its expertise in assisting states, municipalities and other jurisdictions with housing recovery programs that are federally funded through the Department of Housing and Urban Development Community Development Block Grants. John Wasson will discuss this in more detail in a moment. We are deploying significant resources within ICF to ensure that ICF is positioned to capture the opportunities in this area as they develop.

I will summarize ICF's year to date performance in each of our markets as follows: Solid execution in the federal sector in the first year of the new administration; strong growth in our international government business; stable year-over-year revenues from state and local government clients; and an increasing mix of commercial business.

At the end of the third quarter, our funded backlog was $1 billion. Our business development pipeline was $4.3 billion, up 8% from the same period last year, which lays the foundation for ICF's continued growth.

I would now like to turn the call over to John Wasson, ICF's President, for a more detailed review of our operating results. John?

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

Thank you, Sudhakar, and good afternoon, everyone. Third quarter results demonstrated the benefits of our diversified business model and the strength of our key markets amid a shift in the seasonality of our federal government business that we signaled last quarter.

Excluding the impact of pass-through revenues, federal government revenues were basically flat year-on-year for both the third quarter and first 9 months. This is in line with the expectations we had at the beginning of this year, given the impact of the change in administration and the uncertainty around budgets and staffing at certain agencies.

The lower pass-through revenues that caused us to report a decline in total revenues from our federal government agency clients related to several different client contracts, including our largest contract with the Department of State. We expect to capture a portion of these and some additional pass-through revenues in the fourth quarter of this year, which will change this year's seasonal revenue pattern.

Approval of the fiscal 2017 budget in May alleviated some of the bottlenecks at our federal government agency clients. Early indications are that fiscal 2018 federal civilian budgets will be similar to this year's, which should result in more certainty next year.

As Sudhakar noted, the volume of RFPs continues to vary agency by agency. At the Department of Health and Human Services, we are seeing an uptick in activity. We had 3 large contract wins at HHS in the third quarter: 2 were with the National Cancer Institute to provide a variety of communications support services; the other was a single award IDIQ re-compete to continue the development and operation of the agency's information gateway and technical assistance center for healthcare system preparedness and response.

Additionally, ICF recently launched 2 very successful high-profile campaigns for the Centers for Disease Control this year, the "RX Awareness" campaign and the "Get Ahead of Sepsis" campaign. Both campaigns are receiving high praise from the client. This positions us well for work in 2 priority areas for CDC, prescription drug overdose/ opioid abuse and antibiotic resistance, the former being one of the recent signature initiatives of the administration.

Communications are critical to the success of campaigns and to reduce opioid abuse, and ICF is very well positioned with our government communication expertise and our Olson digital qualifications to support the federal health agencies on this front-burner issue. CDC budgets remain a bipartisan priority in Congress, which should lead to increased spending in 2018.

Another key contract award in the third quarter was with the U.S. Department of the Interior Bureau of Reclamation to provide site assessment and outreach support for the long-term operation of the Central Valley Project and the State Water Project in California.

Commercial revenue increases in the third quarter and for the first 9 months were again driven by strong growth in energy markets. In the third quarter, we continued to ramp up and expand energy efficiency projects won in the latter part of 2016 and early 2017, and our energy efficiency pipeline remains very robust.

Also, our distributed energy resources consulting business has performed well and acquired several new contracts in the quarter. Additionally, we have been assisting several utilities with resiliency planning activities and through continued collaboration with ICF Olson, our commercial energy staff is working to leverage loyalty program expertise with ICF utility clients.

Commercial marketing services revenues declined in the third quarter, primarily due to the wind down of several projects in ICF's legacy digital technology services area, which we combined with ICF Olson in early 2015. We are working on building up our pipeline in this area, in part through deeper integration with the Olson offerings.

Since we integrated Olson into ICF, we have captured revenue synergies of $93 million, representing new business that neither ICF nor Olson could have won independently. And we are pleased to report that commercial marketing new business wins are up over 20% in the first 9 months of the year. We continue to leverage our integrated capabilities, which is helping mitigate against the softness in the overall advertising industry. For example, in the third quarter, ICF Olson teamed up with the ICF sustainability team to win corporate sustainability work at a large commercial real estate firm, and we are now doing employee engagement work and loyalty programming for a major healthcare payer, which is a client of ICF's commercial health practice.

As Sudhakar mentioned, we see significant opportunities for ICF arising from the housing recovery programs that will be needed following the devastation of Hurricanes Harvey, Irma and Maria.

In October, we were awarded 2 IDIQ contracts from the State of Texas that represent contract vehicles for which ICF will bid on task orders that fall within our area of expertise. We expect additional RFPs to be released for support of Community Development Block Grant funded housing recovery programs at the state, county and local levels in Texas and Florida, and in the territories of Puerto Rico and the U.S. Virgin Islands, over the next several quarters. Contracts are likely to begin to be awarded in the late spring/early summer of 2018, consistent with past housing recovery programs. In the meantime, we have begun deploying ICF staff members on-site who are providing technical assistance support to certain of the affected areas through FEMA response-focused task orders under existing subcontracts with large engineering firms.

Moving to our State and Local Government business, revenues declined by $3.7 million, or 11% in the third quarter, but were flat for the first 9 months of this year. And we now expect them to be flat to slightly down for full year 2017 after increasing by 19% in 2016. As you know, this part of our business tends to be uneven quarter-to-quarter, and the decline in Q3 was related to the temporary postponement of work on a couple of environmental and infrastructure projects in California.

In the fourth quarter, our work on a few California projects is likely to be affected by red flag warning days associated with fire risk, but the market out west continues to be strong in the sectors we work in-- transportation, water, and planning and development--particularly in major metropolitan areas that are experiencing growth, such as Los Angeles, San Francisco, San Diego and Seattle. As we have discussed previously, there will be an increase in the gas tax in California in 2018 and beyond to fund statewide infrastructure projects and a new dedicated tax in Los Angeles County in 2018 and beyond to fund light-rail projects associated with the upcoming Los Angeles Olympics.

We continued to see a significant rebound in our International Government business, with revenues up 31% in the third quarter and up 12% for the first 9 months of this year. International Government now accounts for 6.9% of total year-to-date revenues, up from 6.2% at the same time last year. Sales were strong in the third quarter and market conditions are generally positive with continued activation of new work, putting us on track for low double-digit growth in international government revenues for 2017.

ICF business development pipeline stood at $4.3 billion at the end of the third quarter and included 29 opportunities greater than $25 million and 78 opportunities between $10 million and $25 million.

Our annualized personnel turnover rate was 15.1%.

In summary, as you can see, we are moving forward across all client categories and are looking to sequential revenue growth in the fourth quarter driven primarily by higher pass-through revenues. And, we are well positioned to take advantage of additional growth opportunities in [2018] (corrected by company after the call) with federal health agencies, on hurricane-related housing recovery projects, utility consulting and implementation work, and in commercial marketing services.

With that, I will turn the call over to our CFO, James Morgan, for a financial review of the third quarter. James?

James C. Morgan - *ICF International, Inc. - CFO and EVP*

Thank you, John. Good afternoon, everyone. We're pleased to report that ICF's third quarter metrics were broadly in line with our expectations heading into Q3, and we are well positioned to achieve our full year guidance for 2017.

With regard to our third quarter performance, total revenue was $305.3 million, slightly down from the $306.5 million we reported in last year's third quarter, as 1 less working day reduced the current quarter revenues by an estimated $4.8 million. Service revenue of $221.8 million was also slightly down as compared to the $223.2 million reported in last year's third quarter, with the 1 less day reducing current quarter service revenue by an estimated $3.5 million.

U.S. federal government revenue was $142.3 million for the third quarter of this year. As John mentioned, the year-over-year 4.9% decline was largely due to lower pass-through revenues, the majority of which have been delayed to the fourth quarter of 2017 and into 2018, and the year-over-year reduction of work days also negatively impacted growth in federal revenues by an estimated 1.6%. Federal government revenue accounted for 47% of total revenues compared to 49% of total revenue in the third quarter of 2016.

As expected, our Commercial business continued to be a key revenue generator, posting 4.3% growth in the third quarter and increasing as a percentage of total revenue to 36%, compared to 35% of total revenue in the third quarter 2016.

Gross profit dollars remained steady at $115.3 million for the third quarter 2017 and gross margin was 37.8%, up 20 basis points year-on-year. Indirect and selling expenses for the third quarter were $84.6 million, stable with the $84.2 million reported last year. Indirect and selling expenses as a percentage of total revenue were 27.7%.

Operating income was $23.4 million, similar to the $23.8 million reported in last year's third quarter. Operating income increased 5.3% sequentially, reflective of the efficiencies in contract execution and staff utilization that we generally experience in the third quarter as well as the initial benefits from better aligning resources and reducing our infrastructure footprint.

EBITDA was $30.8 million for the quarter, inclusive of approximately $0.3 million in special charges related to our ongoing programs to reduce costs, and consistent with the $31 million of EBITDA reported in the third quarter of last year. EBITDA margin was also consistent with the third quarter of last year at 10.1%. As we have noted -- as we noted last quarter, as revenue from commercial clients accounts for an increasing percentage of total revenue, we believe it is relevant to consider EBITDA as a percentage of service revenue. On that basis, our EBITDA margin in the third quarter was 13.9%. Adjusted EBITDA margin, exclusive of the special charges I just mentioned, was 10.2% of total revenue and 14% of service revenue. On a year-to-date basis, adjusted EBITDA margin as a percentage of service revenue was a 13% for 2017 as compared to 12.8% for the similar period last year, which reflects our ongoing efforts to improve year-over-year margins.

Depreciation and amortization for the quarter was $4.6 million, $0.5 million higher than last year. Conversely, amortization of intangibles decreased to $2.7 million, $0.4 million or 11.9% below last year's third quarter.

The effective tax rate was 34.5% for the quarter compared to 39.2% for the third quarter of 2016. The lower rate was primarily due to tax benefits related to the vesting of restricted stock and the exercise of stock options in the third quarter. For the full year of 2017, we now expect our effective tax rate to be no more than 37.5%.

Net income was $13.7 million, 1.9% higher as compared to the $13.4 million reported in the third quarter of 2016. Diluted earnings per share was $0.72, 2.9% above the $0.70 in the third quarter of last year. Non-GAAP EPS, which excludes amortization of intangibles, special charges, and the related income tax effects of the amortization and special charges, was $0.83 per diluted share for the quarter, an increase of 2.5% over the $0.81 reported in last year's third quarter. I should note that during third quarter 2017, our EPS benefited by approximately $0.02 due to the lower-than-expected tax rate, which was then partially offset by roughly $0.01 due to a small foreign exchange adjustment and slightly higher-than-expected interest costs.

Looking at the first 9 months of 2017, total revenues increased 1.4%, led by a 6.5% increase in revenues from commercial clients, and service revenues were up 1.3% to $666.5 million. Diluted earnings per share of $1.86 was reported for the first 9 months of 2017, a year-over-year increase of 6.3%. And non-GAAP EPS was $2.24, up from $2.11 last year, a 6.2% year-over-year increase.

Year-to-date cash provided by operating activities was $70.3 million, up 21.6% year-over-year, putting us firmly on track to meet our cash flow guidance range of $90 million to $100 million for 2017. Day sales outstanding for the third quarter were 75 days and within our anticipated year-end DSO target of 72 to 77 days, including the impact of deferred revenues.

During the third quarter, we continued to allocate capital to repurchase shares and pay down our outstanding debt. In the third quarter, we repurchased 169,100 shares and year-to-date, we repurchased 684,335 shares under our share repurchase program. As a result of the repurchases so far this year, we anticipate a full year weighted average diluted share count of approximately 19.2 million for 2017.

With regard to paying down debt, during the third quarter we reduced our outstanding long-term balance by $29.3 million. As of the end of the third quarter, we had a long-term debt balance of $230.1 million and a debt to trailing 12-month EBITDA leverage ratio of slightly less than 2. I should also mention that in the third quarter of 2017 and similar to last year, we entered into a hedging transaction to mitigate the financial risk associated with potential future interest rate volatility for a portion of the debt outstanding under our credit facility. The details of this transaction are presented in our 8-K filing dated August 31, 2017.

And lastly, with regard to capital allocation, we have capital expenditures for the first 9 months of this year of $11.9 million.

Looking ahead, as Sudhakar and John noted, we expect to see a sequential increase in revenues for the fourth quarter compared to third quarter levels. Keep in mind that this revenue increase will be from a higher volume of pass-through revenues, on which we earn much lower margin.

Also for modeling purposes, please note that we expect depreciation and amortization expense to be in the range of $18.1 million to $18.6 million for the year. Amortization of intangibles is estimated to be approximately $11 million for the year. Interest expense is expected to be in the range of $8.2 million to $8.7 million for the year. Capital expenditures are expected to be in the $17.5 million to $18.5 million range. Cash flow from operations is expected to be in the range of $90 million to $100 million. And as I previously mentioned, we now expect the full year tax rate to be no more than 37.5%.

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

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

Well, thank you, James. To sum up, we are pleased with our results to date and our prospects heading into the fourth quarter and into 2018. Based on year-to-date results and current visibility, we have narrowed our full year 2017 guidance ranges. We expect revenues to range from $1.21 billion to $1.23 billion, diluted earnings per share to be between $2.50 and $2.60, and non-GAAP EPS to range from $2.95 to $3.05. Additionally, we continue to expect operating cash flow to be in the range of $90 million to $100 million.

We are looking ahead to 2018 as a year of continued organic growth for ICF across our key client categories. ICF is well positioned in those federal government agencies where spending is likely to remain stable or increase next year.

Our housing recovery expertise should benefit our state and local governments business for 2018, and indications for continued growth in our work for international government clients. On the commercial side, we expect continued growth in energy markets and for our marketing services business to build on its positive business development momentum.

Operator, 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*

I was wondering if you could comment a little bit more with detail about the 2 IDIQs you won related to the hurricanes. Were they sole-source, multi-award? Do you expect that kind of business to be chunky or piecemeal? And maybe you could tell us what geographies they serve or maybe if they're broad and can touch multiple geographies?

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

Sure. This is John Wasson. I think the 2 contracts we won, as we said, they were in Texas. One is at the state level, one is for Houston Galveston Area Council, so it would serve those geographies. They're multiple award IDIQs, so there were several awardees. The scope of work is pretty broad, it certainly wouldn't cover all the types of work that we typically do on housing recovery under Community Development Block Grant programs. And as we said in the remarks, we would expect that we would start seeing task orders sometime next year in the second quarter, late second quarter. And so start seeing those opportunities come to fruition sometime towards the end of the second quarter next year.

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

John, do the other companies that -- one, do they have your skill set in CDBG projects? Or do they have other skill sets that may be procured under the IDIQs?

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

I think that we -- I think we bring the full spectrum of capabilities needed to design and implement these programs. So I think from that perspective, we're unique. We obviously have a deep subject matter expertise around community development block grant programs and supporting those for 30-plus years for HUD and with state and local governments. We've also done the implementation of these programs kind of from end to end.

As you know, Tobey, we obviously designed our largest -- or implemented the largest housing recovery program in the history of the United States in the Southern United States, and we've been deeply involved in Superstorm Sandy activities in the northeast in the last 5 years. And so I think we're -- so from that perspective, we bring a unique set of full-service capabilities.

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

Okay. And when you look at all of the storm activity in the residential reconstruct or damage, do you have an estimate for how much you think will ultimately be spent on the 3 geographies in question? The Caribbean territories, including Puerto Rico, Florida and Texas?

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

I don't think we have a specific estimate for that, Tobey. I do know, obviously, FEMA and HUD are doing damage assessments and trying to come up with their estimates of that as part of their response. I think it's too early for us to have a set of numbers on that. I mean, I would say if you look across the 3 hurricanes and the geographic spread here, Texas, Florida and U.S. territories, I think we're -- I think we're looking at higher damage than some of the recent storms that certainly we've been involved in, Hurricane Rita and Katrina 10 years ago and Superstorm Sandy in New Jersey. So I think -- so there's been -- so these are significant opportunities with a broad geographical spread to support housing recovery programs. But we -- I don't have a set of updated damage estimates.

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

Okay. And a few numbers questions to run through if I could quickly. What are the pass-throughs that you talked about in the fourth quarter? How -- what's the value on those?

James C. Morgan - *ICF International, Inc. - CFO and EVP*

Yes, I would say that...

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

And then I have a couple other ones just in case you need to find that. I was curious if you had a preliminary tax rate estimates for 2018 as well.

James C. Morgan - *ICF International, Inc. - CFO and EVP*

We don't yet have a preliminary tax estimate for 2018. I would say that typically we would -- I mean obviously, there's a lot that may happen with regard to tax legislation that may have some differences. But I would expect that, so going-in position, that it would be fairly similar to where we were -- where we are for this year, probably in the 38% to 38.5% range.

And with regard to pass-throughs, if you look at kind of the value of the pass-throughs that are shifting more to the right, that's more in the, I would say, roughly $10 million range, give or take $1 million or $2 million.

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

For the quarter or...

James C. Morgan - *ICF International, Inc. - CFO and EVP*

On a year-to-date basis.

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

On a year-to-date basis. And what about in the fourth quarter? Didn't you say that some kind of...

James C. Morgan - *ICF International, Inc. - CFO and EVP*

Yes, I would say that's kind of more in the roughly $5 million range, $4 million to $5 million range.

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

Okay, perfect. And last kind of numerical question for me. Are there any accounting changes that we should be contemplating and start doing work on as we look as we look into 2018 that impact the business and how you report to us?

James C. Morgan - *ICF International, Inc. - CFO and EVP*

They -- I mean, obviously, there are new revenue recognition rules that will be in place starting 2018, but based on our analysis of what we've done, gone through, there's really no significant impact to our revenue recognition results. So that won't be -- it shouldn't be anything material. And certainly, that is something as we go through next year we'll be required to report any impact of what those changes are.

Operator

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

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

First, maybe on the pass-throughs, just another question there. How much visibility do you have to those not, I guess, being pushed out further?

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

I think we have a good visibility for the rest of the year. I mean, we're in the fourth quarter here, we're a month into the fourth quarter. And so I think that gives us some clear visibility of how this is going to play out over the next -- in this quarter. Also on some of the federal pass-throughs, we know the clients want to get some of the work done by the end of the year, and so I think we're actually highly confident that we'll see these pick up in pass-throughs in Q4.

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

And the marketing services piece? The -- was that 21% new business growth rate, was that for the entire marketing services business, I guess? Just want to understand that and...

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

It's for the commercial marketing services business, yes.

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

Right, okay, yes. That piece. What, I guess, what are you seeing in the end markets, just given -- I think you've referenced it, but it's obviously a very mixed set of results that you see from a lot of marketing services companies out there. Is the environment getting tougher, I guess? And how much do you put on the environment versus, I guess, the internal initiatives there?

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

Yes, I think that -- let me take this, because I think that the environment might be tougher for these large companies. I think our focus is to make sure that we continue to grow that $93 million number, which is the one which where we are trying to make sure that they continue to sell services in our legacy verticals in addition to doing their own thing. So as long as we continue to grow that, I think that we will be okay.

And I think in that arena, when we go in and talk to clients about specific programs, for example, in the utility vertical or in the health vertical and the government vertical, I think that there is significant receptivity to the kinds of things which they do because they haven't necessarily seen that level of sophistication. So I think that certainly the -- their legacy environment continues to be very competitive, but I think our whole focus is to help them, of course, do whatever they can there, but also make sure that we focus in on all the legacy verticals we have.

Operator

Our next question comes from Joseph Vafi with Loop Capital.

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

I was wondering, Sudhakar, I know you said there were a couple federal contracts where there have been delays. If you could provide a little more color there, is that due to the political appointee situation or something else? And any more color as to what they are and to the extent when those delays may be resolved would be helpful. And then I have a follow-up.

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

Well, I think -- and this is John, Joe. I think we -- so our largest contract with the Department of State is our USAID Demographic Health Survey work. I think we've seen certain delays, and we talked about this last quarter. We've seen certain delays on the start of new projects because the USAID mission here in Washington is coordinating with the regional missions more closely on survey efforts over the last several quarters, and that takes more time.

And so that's slowed down the beginning of new work a bit. There's also, in certain countries, we just had some political issues, security issues, that have delayed work. And so the biggest impact has been on the USAID work. I think we do have visibility, assuming that that's going to be improve in Q4 and we'll recapture a good portion of those pass-throughs that have been delayed certainly as we go into next year, too. I think that from the federal level is the, I think the largest driver of the pass-through issue.

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

Okay. And then on Olson project ramp down. Do you have visibility to, if we kind of -- if we ramp down, what's going to ramp down now out of the legacy business or is there some of that base that's potentially still at risk?

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

I think that we've -- the projects we rolled off that impacted us in Q3, we've rolled off those projects. We have -- and so we've taken that impact. I think we have a good pipeline. We see visibility to improve the business. And so I don't -- if your question is, is there more roll off coming and is the business going to decline further, no, we don't see that.

James C. Morgan - *ICF International, Inc. - CFO and EVP*

(inaudible) too.

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

I think given the pipeline and the backlog and what we have visibility on, we're pretty confident that it's not going to be a continuing trend and that it's just a matter of now closing a couple of deals to get that business back on a growth trajectory. We did roll off a couple of technology projects, significant technology projects for clients that we're just winding down or wrapping up at the end of the third quarter.

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

Okay. And then just one housekeeping question or, I guess, on the energy efficiency business. Did you disclose how much, what percentage it is of the total or of the Commercial business?

James C. Morgan - *ICF International, Inc. - CFO and EVP*

I thought it was in the press release.

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

It should be in the release, I believe, Joe.

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

Okay. All right. I'll find it. Great. Okay.

James C. Morgan - *ICF International, Inc. - CFO and EVP*

Sure. It's 40%.

Operator

(Operator Instructions) And we have our next question from Kevin Steinke with Barrington Research.

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

I wanted to make sure I heard correctly in your prepared comments. I believe you said you're on track to exceed your mid-single-digit growth target in Commercial this year. Is that correct?

James C. Morgan - *ICF International, Inc. - CFO and EVP*

Yes. That is correct, yes.

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

What -- so can you just talk about what's driving that? I mean, is it just the ramp up of energy efficiency is going more quickly than planned or anything that's really changed from your outlook last quarter?

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

I think it's continued strong performance in the energy efficiency arena and I think we have visibility on health care-related marketing and communication work we'll do in the commercial sector in the fourth quarter that's going to ramp up in a significant way.

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

Okay. Okay, that's helpful.

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

That will drive the commercial growth to high-single digits. It'll be strong in the fourth quarter, high digits -- high single-digit growth for the year.

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

Okay. Oh, for the year, oh, yes. And then ramping up growth rate in the fourth quarter, obviously. Okay. So yes, also on the commercial business and the commercial marketing services specifically, you obviously called out the decline there in the quarter due to roll off of legacy ICF business projects. I'm just wondering if you have a sense or can separate out how the acquired Olson business did if you're able to separate that out or not.

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

Yes, I think the Olson business was generally flat for the quarter.

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

Okay. Okay. So the international government, the ramp up in growth there, is that again just a matter of previously signed contracts ramping up or are there new business wins in there as well?

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

I think it's both. I think it's we are seeing strong activation on contracts that we won throughout 2017 and we've talked -- we talked for many quarters about the fact that we were looking for this activation to take place. We're certainly experiencing robust activation and we are winning additional contracts. And so I think our outlook on the international front is quite bullish right now.

James C. Morgan - *ICF International, Inc. - CFO and EVP*

Right.

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

Okay, great. And then just lastly here. Last couple quarters, you've called out impact of the change in labor cost allocation methodology on the gross margin and also the indirect and selling expenses. I don't know if you have that handy or not?

James C. Morgan - *ICF International, Inc. - CFO and EVP*

Yes. Roughly, on gross margin, the labor dilution has somewhere in the kind of 50, 60 basis point impact for the quarter and for the full year, is what that impact would be. And then, obviously, that flows through other metrics.

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

Yes. So I mean. Yes, it looks like...

James C. Morgan - *ICF International, Inc. - CFO and EVP*

Down through service revenue. Obviously, it nets out at the EBITDA, it basically neutralizes itself at the EBITD level.

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

Okay. Part of the reason for asking is that if you factor that shift in methodology into the indirect and selling expenses, it looks like they were probably down year-over-year again. So I'm just trying to figure out how much more room there is to take out cost on the indirect and selling expense line as we move forward?

James C. Morgan - *ICF International, Inc. - CFO and EVP*

Yes. I think the way to think about it is that we've stated that we're looking at trying to year-over-year improve our adjusted EBITDA margins as a percent of service revenue by 10 to 20 basis points per year and we have visibility to continue doing that for the next several years. A lot of that's driven by the timing of when we can get out of facilities and things of that nature and as we're able to take other actions to streamline how we're operating internally. So we have visibility to continue doing that for the next several years and certainly, as I mentioned, we're on track for it this year as we're 20 basis points higher than where we were last year on a year to date basis.

Operator

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

Marc Frye Riddick - *Sidoti & Company, LLC - Research Analyst*

Wanted to go over couple of things, some of them smaller than others. I guess I wanted to know if you had any general estimates or thoughts around any direct impacts to ICF results that came from the storms? I don't recall seeing any mention of that, but I want to see if there's anything we should be thinking about there.

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

No, there was no impact, No material impact. No impact to ICF from the storms.

Marc Frye Riddick - *Sidoti & Company, LLC - Research Analyst*

Okay. All right. And this one is more a little housekeeping, while you actually had the extra day. I was wondering on the next, as far as calendar going forward, do we have an extra or 1 less or 1 more working day in any of the upcoming quarters? I just wanted to be reminded, make sure I'm not missing something there.

James C. Morgan - *ICF International, Inc. - CFO and EVP*

Yes, we actually do. So this year is a year that has 1 less day than last year. That occurred during Q3. Next year, there is 1 more day than this year and that 1 additional day is actually in Q4 of next year compared to Q4 of this year.

Marc Frye Riddick - *Sidoti & Company, LLC - Research Analyst*

Okay. All right. Okay, great. And I guess then, this one is more sort of wide-ranging, but the last time you were competing for these housing recovery programs, certainly you were a private company at that point, just before coming public. I just wanted to get a sense of maybe how we should be thinking about the preparations that go into that, whether or not we should be looking at, maybe some hiring ahead of these opportunities or maybe the pacing of -- do you expect to see some additional expenses before we get to sort of the middle of next year when you're actually competing for these things? Or just maybe some general thoughts as to sort of how you expect things to flow going into those competition?

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

Sure. I think that -- let me take it and then maybe John can add his comments. I mean usually, in the response phase, we do have some expertise, but we traditionally, those response contracts are usually given to very large engineering firms and we are subcontractors to them. So they always ask us for specific positions.

So we have given them a bunch of resumes, which potentially have been looked at by the response agencies and which -- who are in the process of being deployed. So that's in the response phase. And we expect that we will some minimal revenue starting in Q4 on the response phase, maybe a little bit in Q1. But that's not where the real action is as far as we're concerned. The real action is when we start doing housing recovery and where the CDBG monies, Community Development Block Grant monies are used. And those are traditionally -- those take a little bit of time after, as John said, the damage assessments are done and FEMA has a better sense, then the state and the local and the county, etc. have to figure out how to go to administer the monies and how they're going to issue task orders.

So for example, the State of Texas, they could use -- they do it at the state level or they could do it at a country level. They have to decide all that. And in order to decide all that, once they decide all that, they will have to develop an action plan, which will have to be approved by the feds. And once that action plan is approved, then they can start spending the money.

And that's the phase where we traditionally either have them write the action plan or we help them implement the action plan and all that happens over the next 9 months or so. So I think that, that's traditionally the way it happens. And I think you will not see that much of prehiring. We already have a bunch of folks who potentially can work on the response phase, and we have -- that we provided those resumes to the primes. When in the recovery phase, usually you win the contract and then you hire up for that contract. You have to have some contingent hiring before that, but you won't necessarily see it in our numbers until such time as we're deployed.

Marc Frye Riddick - *Sidoti & Company, LLC - Research Analyst*

Okay, great. And I appreciate the color on that. And then I guess one last thing. We talked about the opportunities from the storms, what have you. I was curious, and this is a little bit out of left field, I guess, But I was wondering if there was anything that would directly affect ICF or some opportunities given the fires in California.

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

There's the potential that there could be recovery work related to the California fires. And we're certainly monitoring that. I think -- and so it's on our radar. I think the initial intelligence I've had is I do think a lot of the damage in California from the fires will be insured and so it will part of people's homeowners' insurance will help them rebuild. And so but we're certainly monitoring that and if opportunities arise to work in the recovery phase from the California fires, we would certainly -- we're following that carefully.

As you know, we have a significant presence in California, 700 people. We're located in those communities that have been impacted. And so it is on our radar. We're watching it. I think it's -- we'll have to see how it plays out. I don't think it's going to be as material an opportunity as the hurricane-related housing recovery programs.

Operator

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 very much for joining us today. We will talk to you next year. Thank you.

Operator

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