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EDITED TRANSCRIPT

ICFI.OQ - Q3 2026 ICF International, Inc. Earnings Call

EVENT DATE/TIME: NOVEMBER 05, 2026 / 9:30PM GMT

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PRESENTATION

Operator

Good day and thank you for standing by. Welcome to the third-quarter 2026 ICF earnings conference call. My name is Lauren Cannon, and I will be your operator for today's call. (Operator Instructions) Please be advised that today's conference is being recorded.

I will now turn the call over to Lynn Morgen of AdvisIRy Partners. Lynn, you may begin.

Lynn Morgen - *ICF International, Inc. - Advisiry Partners*

Thank you, operator. Good afternoon, everyone, and thank you for joining us to review ICF's third-quarter 2026 performance. With us today from ICF are John Wasson, Chair and CEO; Anne Choate, President; and James Morgan, Chief Operating and Financial Officer.

During this conference call, we will make forward-looking statements to assist you in understanding ICF management's expectations about our future performance. These statements are subject to a number of risks that could cause actual events and results to differ materially, and I refer you to our November 5, 2026, 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, John Wasson, to discuss third-quarter 2026 performance. John?

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

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

Also, to briefly comment on Tuesday's election, it is clear that Democrats have won significant majorities in both the US Senate and the US House of Representatives. This change should benefit budgets at civilian agencies and increase the likelihood that monies appropriated

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by Congress will be fully spent. Given ICF's diversified portfolio, we also see the midterm results as a tailwind for our broader energy and environmental business. Let me start by reviewing several positive highlights of our third quarter performance.

First, the third quarter marked a return to year-on-year revenue growth for ICF, which we expect to continue in Q4 and into 2027.

Second, revenue from federal government clients increased 3.4% sequentially, as anticipated, and we experienced 7.6% year-on-year revenue growth from state and local clients and 12% revenue growth from international government clients.

Third, contract awards were up 4.5% year on year, representing a book-to-bill ratio of 1.59 for the quarter, and 1.11 for the trailing 12 months. Other forward-looking metrics, including our $3.5 billion backlog and our $8.2 billion business development pipeline, were all supportive of future growth.

Lastly, our adjusted EBITDA margin was 11.5%, 10 basis points ahead last year and notable given that it was achieved on lower-than-expected revenues. Our margin strength, together with a lower tax rate, lower interest expense and a reduced share count, enabled us to report 19% growth in non-GAAP EPS in the third quarter and have enabled us to maintain the midpoint of our non-GAAP EPS guidance range for 2026 of $7.10, representing 4.9% year-on-year growth on full year revenues that we now expect to be similar to last year's levels.

Our lower-than-expected third-quarter revenues were the result of a confluence of factors that constrained our commercial energy revenues. What's notable among them was the significantly heightened political and regulatory focus on utility-bill affordability, which moved from a marginal theme in early 2026 political advertising to one of the fastest-growing issues of the fall campaign.

In fact, spending on House, Senate and gubernatorial ads mentioning utility, electric or electricity bills increased from $25 million in Q1 to $47 million in Q2 and almost tripled in Q3 to $138 million, with another $96 million spent just in the first 16 days of October. This has put substantial near-term pressure on utilities to further refine plans to address affordability, which has recently caused our utility program clients to abruptly pause some incremental energy efficiency initiatives.

Anne will review the details and our remarks later in the call and discuss the opportunities we are pursuing in the commercial energy arena, including ways our advisory energy practice is supporting utility clients on the affordability issue.

In summary, we expect commercial energy to continue to be a long-term growth driver for ICF given our clients' needs to deliver reliable, affordable energy, which is tied to many of the services we provide. Over the near term, it is likely to grow more slowly than it has historically.

The remainder of our business performed as expected, and we continued to benefit from the diversified and integrated portfolio that distinguishes ICF and drives our strong new business success, as well as our efforts to position our federal portfolio to win awards at agencies with increasing budgets. We are seeing greater opportunities to bring insights and capabilities from across client categories and domain expertise to help clients address complex challenges.

One good example of the benefits of our integrated model is our work for the Department of Energy in assessing the market's regulatory and grid-operational changes required to integrate aggregated distributed resources while maintaining reliability. We have taken that expertise directly into our commercial utility work, helping utilities develop the strategy, operating capabilities and regulatory frameworks needed to make these resources work in practice.

Another example is how we're bringing together disaster management, energy, utility and program management expertise to deliver energy-efficient housing to disaster-impacted homeowners. Under a five-year contract awarded by California's RISE Homes, an initiative funded by the California Public Service Commission, ICF is helping eligible property owners rebuild all electric, energy-efficient homes following natural disasters.

And in the third quarter, we won two new multiyear work orders under the County of Los Angeles Energy Support Services Master Agreement with a combined ceiling value of $70.9 million. ICF will service as one of three implementers supporting the Southern California Regional

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Energy Network's public sector energy efficiency programs, leveraging our track record as a leader in energy efficiency programs for commercial clients to win work on this important state government contract.

In the federal arena, we continue to pivot to align our portfolio with federal agency spending priorities. As you can see from our release this quarter, we have been successful in winning several new awards with agencies responsible for national security, public safety, and law enforcement.

As I mentioned earlier, we ended the third quarter with a business development pipeline of $8.2 billion after having won $746 million in contracts in the quarter. Opportunities in the key long-term growth markets we identified, mainly commercial energy, technology modernization and disaster management and related state and local government work, accounted for approximately $5 billion or 60% of that pipeline, supporting our expectation for continued growth in these markets.

Summing up the quarter, we were pleased that our revenues demonstrated the return to year-on-year growth that we anticipated would begin in the second half of this year. Looking ahead to the fourth quarter, we expect year-on-year revenue growth across our client set, with revenues from commercial energy clients rebounding to mid- to high single-digit growth.

With respect to capital allocation, we continue to review acquisition opportunities, but we remain very disciplined and are focused on transactions that have the potential to provide meaningful revenue synergies and will be accretive soon after completion.

I'll now turn over the call to ICF's President, Anne Choate, for a business review. Anne?

Anne Choate - *ICF International, Inc. - President*

Thank you, John, and good afternoon. I'm pleased to present a business review of ICF's third-quarter results while providing additional color on the factors that reduced our expected revenues from utility programs and highlighting the growth opportunities we see ahead across the full portfolio.

I've organized my remarks by client categories, starting with commercial, of which nearly 90% is represented by commercial energy revenues. Before it's overshadowed, let me touch on our energy advisory work where revenues increased 14.1% in the third quarter and 10.5% year to date. We experienced particularly strong client demand this quarter for our support on grid engineering and planning, transmission and interconnection, resource adequacy and storage. Some of these services relate to the affordability issues that John mentioned and provide opportunities for ICF.

Our work with hyperscalers is small but growing as a component of our energy advisory practice. We're advising on a broad set of issues created by the scale of data center development, including energy efficiency, community impacts, power supply and reliability. And we gain valuable perspective on pressing data center issues through the assistance that we provide to states, counties and other local governments as they evaluate the economic energy, infrastructure and community impacts of data center development.

Now to our utility programs, which represent the majority of our commercial energy work. As John mentioned, the large variation between our third-quarter revenue projections and revenue performance reflected a combination of factors that materialized quickly during the second half of Q3 and continue to impact our clients.

The most significant factor relates to political pressure on utilities and regulators. This heightened pressure is a consequence of the focus on energy affordability amid drastic increases in energy demand and inadequate enabling infrastructure. Political pressure on the issue of affordability has grown exponentially, driving several utilities to pause incremental spending on certain demand side management programs, while they consider how to best deploy these programs to address the affordability challenge.

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This shift caused a sharp falloff in the typical contract add-ons that we capture in the second half of the year. The pause and add-ons combined with some slower-than-anticipated ramp-up on contracts were the main driver of the miss, costing us approximately $15 million in third quarter revenues and what we expect to be a similar amount in the fourth quarter.

While our utility clients navigate this swift uptick in affordability concerns, we are leaning in to support them in new and expanded ways. We've built a meaningful pipeline in areas where we see utility spending increasing, including in audits and weatherization, virtual power plants and demand response opportunities. These opportunities, when you pair them with innovative marketing campaigns that reimagine the utility-customer relationship, provide solutions to support utilities as they meet this moment. Keep in mind that energy efficiency is one of the most economical ways to increase electricity capacity and therefore, it's key to any long-term solution to address increased energy demand and affordability for customers.

Commercial energy wins accounted for approximately 26% of year-to-date contract awards, and commercial energy opportunities represent more than $1.6 billion of our pipeline at the end of the third quarter, indicating strong underlying momentum. Contract wins are on track to exceed our annual plan range, and our win rates have improved across every measure.

Lastly, our utility programs practice has taken away a handful of contracts from competitors this year, adding 6 new portfolios and 10 new logos. During the same time frame, we can report successful retention of all key utility program clients.

Now I'll move to our state and local portfolio. Third-quarter revenues from state and local government clients increased 7.6%, demonstrating ICF's ability to leverage its deep domain expertise and robust technology capabilities across its client set. The projects driving growth in this client category include developing and managing energy efficiency programs in the Northeast and California, where we're seeing state agencies step in to support energy efficiency efforts as a complement or an alternative to utilities' programs. Other drivers of growth in this client set include deployment of advanced technology solutions to several states and territories and providing rural health services at the state level that were formerly administered by the federal government.

During the quarter, ICF supported more than 50 active disaster recovery programs in more than 20 states and territories. While we continue to view the disaster management market as a driver of long-term growth, funding delays and the slower pace of major events have constrained near-term activity in this arena.

One recent development that could unlock opportunity is the presidential declaration for Hurricane Isaias recovery support in Florida, where we hold a relevant prime contract.

In the third quarter, we won a large number of new on-call contracts with state and local governments, bringing our total to approximately 70 contracting vehicles, a 30% increase over where we were last year. These contracts accelerate our ability to support current and future state clients that may need additional capabilities and capacity at the time of a major weather event and to provide additional resources as a reduced federal support model is implemented.

State and local government opportunities represented approximately $1.1 billion of the total pipeline at the end of the third quarter.

Moving to our international government work. We continued to see strong growth in the third quarter with revenues increasing by 12% year on year. This growth reflects our team's effective execution of the significant contracts that we've won over the last two years, serving the European Union and the UK government. ICF has been successful in key recompetes pursued to date, and the pipeline remains healthy across the business, supported by continued demand for ICF's integrated policy, communications, evaluation and implementation expertise.

Lastly, I'll talk about our work with US federal government clients. We were pleased to see the 3.4% sequential growth in revenues in the third quarter. Procurement activity is improving, but bottlenecks continue to constrain award activity and protests of large opportunities are common. Within this environment, we're framing our business development initiatives around rapid prototyping and demonstration of capabilities.

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We continue to see strong demand for technology modernization, with agencies maintaining their focus on mission-critical modernization needs. As we align our federal portfolio around administration profile -- priorities, we have increased our focus on the Department of War, particularly non-mission areas, as well as national security and the Department of Transportation. We are seeing tangible progress from these efforts.

Within DOW, we have responded to multiple task order opportunities and are beginning to see awards come through, expanding our footprint and building a solid pipeline of new opportunities.

We are also gaining ground at the Department of Health and Human Services agencies, where we are winning new work and recompetes in childcare capacity building, public health surveillance modernization and work for the Office of Dietary Supplements and the National Library of Medicine. We also recently won an HIV elimination project supporting the Office of Infectious Disease Prevention and HIV Policy.

In summary, the majority of our revenue base performed as expected in the third quarter. In utility programs, we understand the challenges our clients are facing, and we are working with them to cost effectively, reliably and affordably deliver energy to their customers. Our business leaders are collaborating across client categories and are committed to bringing the breadth of ICF expertise along with speed and agility to every client program and project.

Now I will turn the call over to Chief Operating and Financial Officer, James Morgan.

James Morgan - *ICF International, Inc. - Chief Operating and Financial Officer*

Thank you, Anne. Good afternoon, everyone. I will provide some overall comments regarding our top- and bottom-line performance as well as cash flow and then discuss our third-quarter financial results in more detail and walk through our updated outlook for the year.

As expected, we returned to year-over-year revenue growth in the third quarter. Revenue was up modestly, led by state and local and international government clients. Federal government revenue was in line with our expectations, growing sequentially and remaining on track to return to year-over-year growth in the fourth quarter.

However, while revenue from commercial energy clients grew, the rate of growth was below our expectations due to the near-term challenges as previously discussed. That shortfall is the primary cause for our lower revenue outlook for the full year.

We are pleased that our profitability continued to improve, with gross margin up 50 basis points year on year and adjusted EBITDA margin up 10 basis points. We delivered these gains while continuing to invest in the business. As we expected, indirect expenses were slightly higher this quarter, and we expect to keep reinvesting in our key growth areas while we modernize our systems and apply AI tools across our internal processes to drive efficiencies.

In our work for clients, our AI investments are strengthening our ability to deliver complex data, survey and program support work more efficiently. Importantly, AI is not replacing our subject matter expertise. It is augmenting that expertise, allowing our teams to move faster, modernize established processes and help clients make better use of the technology environments in which they have already invested.

Margin expansion in the third quarter, together with lower interest expense and a lower tax rate, allowed us to maintain the midpoint of our non-GAAP EPS guidance for the full year of 2026, despite a lower revenue forecast.

We are also maintaining our operating cash flow guidance, as our cash generation has been strong year to date, with operating cash flow excluding restricted cash more than doubling from last year.

Now to discuss our third-quarter results in more detail. Total revenue increased 1.1% to $470.5 million, up from $465.4 million in last year's third quarter. Revenue from state and local clients increased 7.6% and international government clients were up 12% as our EU and UK contracts continued to scale.

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Together, these gains more than offset a 3.5% year-over-year decline in federal revenue, which reflects last year's contract cancellations and slower procurement environment.

Sequentially, federal revenue increased 3.4%, representing the third consecutive quarter of sequential growth, led by our technology modernization work, and we continue to expect year-on-year growth in federal revenues in the fourth quarter.

While the year-over-year comparisons benefit from the impact of last year's government shutdown, we expect this year's fourth-quarter revenues to show positive growth beyond the approximately $12 million in federal revenues that we lost during last year's fourth quarter shutdown.

Total commercial revenue increased 1.5%, remaining about one-third of total revenue, consistent with last year's third quarter.

Gross margin expanded 50 basis points to 38.1%, benefiting from efficient contract delivery and a favorable contract mix. Higher-margin fixed-price contracts represented 50.2% of our third-quarter revenues, up from 48.7% in last year's third quarter. Fixed price and T&M contracts together represented 94.3% of third-quarter revenue, up from 92.9% last year. Indirect and selling expenses increased 2.8% to $125.6 million, representing 26.7% of total revenue compared with 26.3% a year ago and consistent with our expectations.

Gross margin expansion more than offset the slightly higher indirect and selling expenses, and EBITDA increased 1.6%, with adjusted EBITDA up 1.9% to $54.2 million. Adjusted EBITDA margin expanded 10 basis points to 11.5%, consistent with the 10 to 20 basis points expansion we anticipate for the full year and that we have consistently guided to as our annual objective.

Net interest expense fell 18.9% to $6.4 million as we continued to use our strong cash generation to pay down debt. Our tax rate for the quarter was 15% compared to 22.7% a year ago. Our tax rate is benefiting from various strategic tax-related actions. And as we discussed on our last call, the third quarter of this year was expected to reflect the largest discretionary tax benefit related to those actions. We expect to realize further benefits from these actions and now expect our tax rate to be approximately 19% for the full year, down from our previous guide of 20.5%.

The effective tax rate management, along with higher adjusted EBITDA and lower interest expense and a lower year-over-year share count, drove strong bottom-line growth. Net income increased 33.5% to $31.7 million and diluted EPS increased 37.5% to $1.76, while non-GAAP EPS increased 18.6% to $1.98.

Operating cash flow was $35.2 million in the third quarter. Excluding restricted cash related mainly to our utility programs, which fluctuates with the timing of incentive payments to utility customers, operating cash flow was $45.5 million, up from the $17.3 million a year ago. For the first nine months of the year, operating cash flows totaled $131.7 million. Excluding restricted cash, year-to-date operating cash flows were $88.7 million, up from the $30.2 million in the first nine months of 2025 on a similar adjusted basis. This improvement in year-to-date operating cash is being driven by lower year-over-year cash tax payments associated with our ongoing tax strategies as well as timing of vendor and payroll payments.

We continue to expect operating cash flow excluding restricted cash of $135 million to $150 million for the full year. Our cash generation continues to fund debt reduction as net debt was $368 million at quarter end, down from the $447 million a year ago and $403 million at the end of June. And our adjusted leverage ratio declined to 1.87 times from 2.06 times at the end of the second quarter.

Consistent with what we said on our last call, we expect our leverage ratio at the end of this year to be roughly 1.6 times, absent any acquisitions or share buybacks. Approximately 47% of our debt carries a fixed rate.

DSOs came in at 75 days versus 77 days a year earlier. Capital expenditures were $5.6 million, consistent with the prior year. Our balance sheet gives us considerable flexibility, and our capital allocation priorities have not changed, and those are funding organic growth, paying our dividend, buying back shares opportunistically, and pursuing acquisitions within our long-term growth markets.

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Today, we announced a quarterly dividend of $0.14 per share payable on January 8, 2027, to shareholders of record on December 4, 2026.

Now to our outlook. We are updating our full-year revenue guidance to reflect the lower-than-expected third-quarter commercial energy revenue and our pared down expectations for fourth quarter. We now expect revenue to be roughly in line with fiscal year 2025 at approximately $1.87 billion, which assumes low- to mid-single-digit growth in commercial energy for the full year. That said, our underlying demand metrics for the longer term remain healthy.

More specifically, our book-to-bill ratio was 1.59 in the third quarter and 1.11 on a trailing 12-month basis. And third-quarter contract awards increased 4.5% year over year with new business accounting for the majority of the awards. And our business development pipeline stood at $8.2 billion at quarter end.

With respect to profitability, we expect GAAP EPS of approximately $5.95, inclusive of the impact of $0.11 of year-to-date special charges. Non-GAAP EPS is projected at approximately $7.10, which is the midpoint of our range, as higher margins, lower interest expense and strategic tax planning actions have offset the impact of lower revenue.

As I noted earlier, we continue to expect operating cash flow of $135 million to $150 million, excluding the impact of restricted cash.

To help with your financial models, our guidance for a few additional metrics is as follows: Depreciation and amortization is now expected to be $22 million to $23 million compared to our prior range of $22 million to $24 million, and amortization of intangibles is expected to be $23 million, the midpoint of our previously provided range.

Interest expense is expected to be between $25 million and $26 million compared with prior guidance of $26 million to $28 million. We anticipate full-year capital expenditures to be $21 million to $22 million versus the prior guidance of $23 million to $25 million.

As I mentioned earlier, we now expect our full year tax rate to be approximately 19%, and we continue to expect a weighted average share count of approximately 18.2 million.

Now I will turn the call back to John for his closing remarks.

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

Thank you, James.

ICF is on the path to second half year-on-year revenue growth, and we see positive momentum as we head into 2027. In addition to the change in the political landscape, several factors support our confidence in the future, notably our consistently strong margin performance, our considerable backlog, the strength of our new contract awards, and our robust new business pipeline.

I would like to take a moment to recognize the hard work and dedication of our people who show tremendous commitment to our clients and to ICF. They set us apart and drive our success.

And with that, operator, let's open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Jason Tilchen, Canaccord Genuity.

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Jason Tilchen - *Canaccord Genuity Corp - Equity Analyst*

To start, in the prepared remarks, you talked a little bit about the midterm elections and being a tailwind to the business. I was maybe hoping you could spend a minute or two talking about the comments surrounding sort of fully spending that money appropriated by Congress and just a little bit more about how you expect the phasing and timing of when ICF may benefit from that?

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

Okay, sure. And so as I obviously talked about in my remarks, I think we see a number of positive impacts for ICF's business associated with the election.

First, I would say, certainly, as a minimum, I think we believe it will ensure that we see no further unexpected budget cuts or cancellation of any key civilian programs going forward given Democratic support for such activities. Obviously, there will also be compromises with a Democratic Congress and a Republican President to pass the annual budget and sign it into law, certainly under the new Congress.

And with that, I think we would expect increases or decreases in civilian budgets to move in the same way or at the same levels as a percentage change, in defense and national security budgets going forward. And certainly, I think this change should benefit budgets at civilian agencies and increase the likelihood of the monies appropriated will be fully spending.

By that, I mean, there will be -- the likelihood of impoundments or rescissions will be reduced. I also think that given our diversified portfolio, we will -- we should see some midterm -- benefits of the midterms around tailwinds in our broader energy and environmental business. Much of that is focused on either utility infrastructure or changes going on in the energy industry, renewable energy and other issues that I think could see some benefits from the election.

There's always the possibility that negotiations around the budget could also result in compromises that result in restoration of civilian programs or programs that have been simply cut back in the last couple of years. We'll have to see how that plays out.

And I would just say that we would expect Congress to assert its authority and responsibility for the federal purse, as I say, particularly with respect to impoundment and rescission type activities.

And when will we see the benefits? I mean, it could be as early as 2027, depending on how the budget negotiations work during the lame-duck session and what's required for next year.

And so it could start in 2027. It's hard for me to put specific quantification of the potential benefit, but I think there should be a benefit as we look to the future, and we're certainly going to stay close to our clients and stay on top of the budget developments as we look forward.

Jason Tilchen - *Canaccord Genuity Corp - Equity Analyst*

Okay. That's very helpful. And one quick follow-up. You talked a lot over the past quarter too about integrating AI into your go-to-market strategy in the federal tech modernization. You recently announced you became an OpenAI Select Partner.

Just hoping you could help frame the commercial opportunity that stems from that relationship. And whether this is more an enhancement to existing engagements or an avenue for some incremental standalone opportunities?

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

Would you like to take that?

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Anne Choate - *ICF International, Inc. - President*

Sure. So yes, we are working to expand our network of partners and AI, OpenAI is one example. I think that our opportunities there are expanded through those partnerships. I think that firms like OpenAI benefit from the services and the experience that we bring.

In fact, what we are seeing is that when we are able to bring sort of an agnostic approach to a customer, understand their challenge and then go back and assemble from our partner network the right technologies, the clients themselves appreciate it, and we have the benefit of all of the computing power and the technologies that these partners can bring to the forefront, even though they don't have the same sort of domain expertise and some of the same depth of understanding of some of the internal workings of these agencies.

So it's been a good partnership, and I think we are seeing that as an avenue for continued growth.

Operator

Tim Mulrooney, William Blair.

Tim Mulrooney - *William Blair Capital Partners - Equity Analyst*

Yes, 19% EPS growth in the face of some of these continuing challenges, I think that's pretty strong execution in the quarter. So congrats on that.

So first, I want to dig in the commercial energy a little bit more. And you talked about utilities shifting spending priorities for certain existing utility programs, I think, around energy efficiency. How much of your commercial energy business are these energy efficiency programs versus advisory and other things? And why wouldn't energy efficiency resonate as well with utility clients right now given higher energy cost is such a major issue right now?

Anne Choate - *ICF International, Inc. - President*

Well, that is a very good question. So I'll tell you why. The vast majority of the commercial energy revenues are related to those -- the energy efficiency, whether it's traditional demand response programs or demand-side management programs or the more nontraditional sort of demand response, virtual power plant type programs. That expanse of programmatic support that we provide to utilities does make sense in this moment.

However, the scrutiny on utilities for any spending that they're doing that might impact the customer bill has been intense recently, as you probably have read. And so it's, I think that what we saw in the third and fourth quarter and the lack of these incremental add-ons was a response to that pressure because any sort of -- the kind of flexibility that we see in the past or the kind of urgency to meet a particular kilowatt hour saving target or maybe a greenhouse gas emission reduction target was not as intense as it was to make sure that you did everything you could to keep those bills low.

And so that's what we're trying to navigate right now, which is the long-term rational need for these programs with the short-term conflation of these programs and this small public surcharge that goes on the bill with another conversation, which is the utility business model as a whole and how hyperscalers and the need for additional energy infrastructure may or may not be being passed on to customers.

It's a completely separate process, a completely separate bucket of funding. But in the soundbytes, it's been hard to separate.

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John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

I mean, I would also just add I mean, part of what I also think is going on here, was pausing some of the spend is, I think clients are also trying to figure out, given the set of programs they can run under these public goods charges, energy efficiency, flexible load management, low income, weatherization.

Should they -- they're taking a step back and saying, can I continue to get the savings, but shift the spend, it also helps on the affordability and perhaps put more money in lower income or other of their customers. And so I think a bit of that is also going on is, rather than plusing these programs up and just keep driving them hard, let's step back here and think about that, too.

So I think that's also playing into this. But it is true that this public goods charge that shows up on the bills, it's actually quite small for any customer. I think it's pennies on any one bill, but it is a lever that the Public Utility Commission could look at and has control in the short run to demonstrate they're aware of affordability and looking at all the expenditures.

Most of the issue, if not the vast majority of the issue, is who's going to pay for the generation and who's going to pay for the upgrade to the grid and how is that going to happen? And that's also a discussion that the regulators are having, but that's a more complicated problem, and that's going to take a longer time frame to solve. And so I think that's also part of what's going on here, Tim.

There's no question that if you step back, in the long run, if you're going to solve this problem, energy efficiency programs should absolutely be core to it. They're some cost-effective programs. And I think everybody who's looked at this issue agrees, you're going to need everything you can get to solve this problem.

As many forms of generation, if you can, you need to push these programs. But this became that political issue as we got into the midterm elections after Labor Day. And so the focus on the bill and on affordability has been very high here in the short run.

Tim Mulrooney - *William Blair Capital Partners - Equity Analyst*

Okay, thank you for the detail. It does sound like maybe it's more of a shorter-term thing and coinciding a little bit with the midterms and there'll be a refocus maybe on longer-term cost-effective programs as we enter '27.

Anne Choate - *ICF International, Inc. - President*

Yes. And so on the -- we've seen it before, come and go. And so in a very, very limited way during one of the gubernatorial elections a couple of years ago. And so we feel as you do, that this is -- the elections particularly turned up the dial.

It's not that -- we've been talking about affordability on these calls. We've been talking about it with our customers for several years. We've moved our solution in the direction of those authorization audit programs. The programs we believe in the long run are going to be most cost effective.

So it's not to say that there is not a shift happening in terms of how we can support the utilities. But this spike that we experienced, we think was highly correlated to the politics of this midterm season.

Tim Mulrooney - *William Blair Capital Partners - Equity Analyst*

Okay. That's really helpful color. Thank you, guys, for that. And then if I could just squeeze one more quick one in, James.

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The gross margin was quite strong in the quarter, up 50 bps year over year. Can you just dive in a little more detail on what the primary drivers of that were? And do you think that strong level of profitability can carry into the fourth quarter? Or are there other seasonal or other factors we should be aware of?

James Morgan - *ICF International, Inc. - Chief Operating and Financial Officer*

Yes. I mean, I think it's no one single thing, but the overall thematic is that we've just -- we continue to make sure that we are very disciplined in how we manage our programs. And certainly, as you get a larger and larger percentage of your programs that are fixed price, that effective management certainly helps improve profitability. So I think that's part of it.

And if we look at our full year, we expect our gross margins to improve slightly from year over year, maybe 20, 30 bps range, something like that. And I would expect that as we move forward and move into the next year, that we'll continue to see -- there'll be some variation, as you would expect quarter to quarter depending on which programs are more rapidly being worked on versus others, but -- and the timing of pass-throughs and things of that nature.

But I think the overall trend will be that we'll be able to continue to try to drive some improvement there. And at the end of the day, we're obviously very tightly focusing on managing margins at the EBITDA level and continuing to drive that 10 to 20 basis points of margin improvement year over year, which certainly, we're continuing to target this year and into the out years.

Operator

Tobey Sommer, Truist.

Jasper Bibb - *Truist Securities - Analyst*

This is actually Jasper Bibb on for Tobey. I apologize if you covered this in the prepared remarks. Could you maybe frame what you're assuming in kind of 4Q for some of the deferred kind of energy projects? Do you think that kind of rebounds sequentially or it remains at more of a low level, and it's more of kind of '27 thing as utilities figure out their priorities and budgets?

James Morgan - *ICF International, Inc. - Chief Operating and Financial Officer*

For the fourth quarter, we are -- I'm not sure if we covered this directly, but what we are thinking is that with the fourth quarter, we're going to be more in the high-single-digit growth rate in the commercial area.

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

I think we said in mid- to high single digits in fourth quarter. We see a rebound there, I think. I think we've assumed with that, that will still be impacted by the --

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James Morgan - *ICF International, Inc. - Chief Operating and Financial Officer*

That's assuming that these impacts will continue.

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

That will continue through the end of the year. And so that's what we assume through the end of this year.

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Jasper Bibb - *Truist Securities - Analyst*

Okay. No, all that makes sense. And there's a nice quarter for the bookings and makes a ton of sense you benefit from the midterms in terms of some of the kind of priority shifting. But I wanted to ask you if you have any kind of detail or thoughts on what next year might look like for the federal business, like kind of what that business could potentially grow at next year based on what you're seeing today?

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

I mean, I think as we look at 2027, I mean, if I were to give you an early preview, I would say -- I mean, first of all, we expect to grow across all of our client categories next year. So federal, commercial, state and local, international for 2027. And as I said, we've said that we will have second-half growth.

We should exit 2026 with a growth rate of about 4% at the company level for the second half of 2026 and that includes normalizing for last year's Q4 government shutdown. So that's basically 4% organic growth, normalizing for the shutdown. I think that's an indicator of our growth potential or our actual growth as we head into the 2027.

I think it's a little too early for us to provide specific guidance. We just obviously had the election. We're awaiting the outcome of the federal budget for next year, and we have the short-term affordability issue.

Like you know, our positive metrics looking forward, are very positive sales book to build that but pipeline. We'll obviously cover our guidance at our end-of-year call. But so we certainly expect to grow, and I think that -- I don't know if we have to say anything -- you want to say something --

James Morgan - *ICF International, Inc. - Chief Operating and Financial Officer*

For next year, I mean, for the federal government?

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

I think we provided specific guidance for them.

Anne Choate - *ICF International, Inc. - President*

I think just to add a little bit of color on federal. So the outlook for Federal is stable. I think we've seen -- we're encouraged by a healthy award, a bit of award activity that happened at the close of the government fiscal year. We definitely have seen the market improve and the cadence of RFIs that are coming through as awards is becoming if not predictable, it's definitely less chaotic than it was. And as John said, we're looking for year-over-year growth there in the federal space.

Operator

Kevin Steinke, Barrington Research Associates.

Kevin Steinke - *Barrington Research Associates Inc - Analyst*

Just wanted to follow up on the commercial energy discussion. With regard to the public goods charges funding the energy efficiency programs, are you actually seeing some of those charges ripped off of consumers' bills?

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And if so, I mean, how easy is it to remove those charges? And how easy is it to get them back on if utilities wanted to continue funding the energy efficiency programs?

Anne Choate - *ICF International, Inc. - President*

So maybe I'll start, and if you have anything you want to add you can.

So just to be clear, when we talked about our commercial energy results, we didn't lose any programs. We haven't had programs go away. It was that we didn't get add-ons or mods on the programs that we already have under contract, but that is -- and it's typical for us to get those mods and add ons.

But as you talk about the public goods charges and the effects there, I think we have not seen public goods charges be removed from utility customers' bills. We have seen some of the program budgets go forward with a lower budget than in the previous year. And so that's the -- and we also see in some other states, you see that they've increased the program spending.

So it really is very state-specific. And I think that it's going to be interesting to see how the activities of earlier this week impact how states want to go forward because it's -- they're trying to balance a number of priorities, whether it's affordability, which is at the forefront, obviously, this fall, but also some of these other priorities, which can swing in terms of their rank order on that list, whether it's energy efficiency or energy conservation or jobs, clean energy jobs or energy justice or climate or whatever. I think that's what we're watching.

Kevin Steinke - *Barrington Research Associates Inc - Analyst*

Okay. That makes sense. That's helpful.

Okay. Well, I have another couple of questions here. So yes, I think on your last call, you talked about targeting mid- to high-single-digit revenue growth in 2027. Just from the commentary here, it seems like it's probably less certain realizing that you haven't given guidance and you're still working through the budgets and all that, but just kind of trying to frame what you had said before compared to kind of the commentary today.

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

Yes. I mean, I think the comments I gave in terms of how we're thinking about 2027 today, given the election and waiting to see what the federal government plans, and what -- this issue we've had without getting the plus-ups with the energy, we'll see if that clears or improves by the end of the year.

So I think we're going to wait to see that to provide any further updates, Kevin. I mean, I think as I said, we'll exit the year growing 4%. And I think that's good momentum, and we'll update the guidance.

James Morgan - *ICF International, Inc. - Chief Operating and Financial Officer*

4% for the back half of the year.

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

Right. For the back half of the year, which would be in the range of mid-single digit. But we'll see how the budgets shake out and where we are at with this issue with these plus-ups being held up on our energy efficiency work and provide further guidance on our next call.

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Kevin Steinke - *Barrington Research Associates Inc - Analyst*

Okay. Understood. Maybe just to ask one last one here. Just you talked about focusing more on defense and national security with your IT modernization services in the federal arena. Maybe just give us a sense for the size of the opportunity there. And I would assume there are some pretty well-established competitors there and just kind of how that looks from a competitive standpoint.

Anne Choate - *ICF International, Inc. - President*

Yes. So in that area, obviously, Department of War, Department of Defense is a massive market, but we are not trying to become a defense contractor. In fact, what we're trying to do is to take the services in the areas where we have specific expertise and really build a brand that is recognized into sort of non-mission-critical areas of DoD.

So childcare is an example of that. There's some other places where we've seen that our skill sets seem to match up well as well as the modernization, but modernization as it relates to some of those same topic areas.

And so that's -- national security is another area. We know that -- we feel that enterprise IT and digital modernization are sort of bipartisan priorities. I mean, obviously, we've been doing it for civilian agencies as well. But in the -- over the course of this year, we really did make a push into some of these others, and I think we're starting to see traction there. Trying to think of anything else.

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

I mean, I think we're not working in the core. We're working in programs that kind of, across DoD, that kind of leverage our traditional support services, childcare, mental health, public health, substance of use, suicide, leveraging systems, leveraging technology to support those kinds of activities.

So I think that's -- when the right opportunities come along, we can be quite competitive because we'll have the technology capability and we have the programmatic and domain expertise to work on those kinds of systems.

Operator

(Operator Instructions) Marc Riddick, Sidoti.

Marc Riddick - *Sidoti & Company LLC - Analyst*

I wanted to see if we could touch a little bit on a couple of areas that maybe we haven't as of yet in the call. Talk a little bit about the international marketplace and what you're seeing there? It seems as though there was a fairly solid growth level on international. And maybe you could talk a little bit about the catalysts that you're seeing there?

And then I have a follow-up after that.

Anne Choate - *ICF International, Inc. - President*

Sure. So yes, it's been a great year for the nongovernmental team. We have had significant media-related activity that serve us across that non-US government business. In particular, we've been pursuing large recompetes successfully and then new business contracts for -- the main customers there are the European Commission and the agencies and then also the UK government.

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A lot of the growth that you've seen over the year has been activation of these large framework contracts that are on topics like media relations, events, monitoring and evaluation of government services. And then we have seen an interest in training as an area of significant growth. We have a new contract to deliver training to the Director General of the European Commission, which is pretty exciting.

And so anyway, so that's -- there's been a very positive trajectory there. And I think that we are also seeing -- as we've ramped up these programs, I think there is a risk that we had so much growth in a short period of time, but the client satisfaction has been excellent. The partnerships seem very strong. And the outcomes of some of these outcome-oriented projects have been fantastic. So it's been doing a great job.

James Morgan - *ICF International, Inc. - Chief Operating and Financial Officer*

Yes. The only thing I would add to that, too, is that even as we've been winning this work, these contracts and performing well on them, we still have a very, very healthy pipeline there. I mean, the pipeline that they have of opportunities to go after is the highest level it's been at in the last several years.

Anne Choate - *ICF International, Inc. - President*

Yes. And the other thing that's interesting there is that we've had luck this year in combining some of the policy expertise alongside some of the campaign support, and that's been a benefit to the clients.

Marc Riddick - *Sidoti & Company LLC - Analyst*

Great. And then I wanted to shift on to cash usage and prioritization. Maybe you could talk a little bit about how you're feeling about the acquisition pipeline and what's out there currently and as far as valuations and the like.

But then also comfort levels as there's been debt pay down and the like so perhaps you could talk a little bit about comfort levels and, I guess, overall acquisition appetite these days.

James Morgan - *ICF International, Inc. - Chief Operating and Financial Officer*

I think the acquisition environment is -- obviously, we're very active looking for opportunities that are in our growth areas, and it makes sense for us to get them at the right price, the right cultural fit, the right strategic fit. And obviously, it has to, as John mentioned in his prepared remarks, that we're looking to see that they can be accretive in the short term at the same time.

So as far as prices, what we've been seeing, they've -- they're still pretty frothy, I would say, within the energy space recently. And that space still continues to be, as you would expect, a little bit hotter than the other areas.

And with regard to -- if you think about the technology modernization space, it's pretty much where you would expect them to be somewhere in the kind of low-double-digit range on multiples. So that's what we're seeing there.

As far as our comfort level, as we talked about, we're looking at having a leverage ratio at year-end, if we don't do any further or do any acquisitions or significant buybacks or anything of that nature, we'd be at roughly 1.6 times. And I think that the synergistic value and the opportunity for a potential acquisition, I think we'd be willing to go to the lower 3 times, but that's -- so that gives us plenty of capacity there to go after a fairly sizable acquisition.

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Marc Riddick - *Sidoti & Company LLC - Analyst*

Okay. Excellent. And then there was -- I did want to touch a little bit on state and local catalysts that you're seeing. And maybe -- that was the other thing I want to ask about. While there's a lot around elections, I was wondering if there were any particular funding measures that we should be thinking about, aware of, or kind of maybe flew under the radar that you view as opportunistic for ICFI?

Anne Choate - *ICF International, Inc. - President*

I think it's early for me to provide you with some sort of definitive answer there. I know that we had -- there was something we were following in Florida, Florida Amendment 3, but we don't expect that's going to have material near-term impact on ICF. It was -- it had the potential to constrain local government spending because it was going to increase home standard deductions for certain property taxes.

But anyway, we've thought about it. We don't see -- in the last two days, we haven't come up with anything that -- so that's one that comes to mind, but I'm sure that as we unpack all of this, we'll have more to say.

Operator

I'm showing no further questions at this time. I would now like to turn it back to John Wasson for closing remarks.

John Wasson - *ICF International, Inc. - Chairman of the Board, Chief Executive Officer*

Okay. Thank you, everyone, for participating in today's call. We look forward to updating you on our progress in the future. Thank you.

Operator

Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.

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