THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

ICFI - Q1 2014 ICF International Earnings Conference Call

EVENT DATE/TIME: MAY 07, 2014 / 9:00PM GMT

CORPORATE PARTICIPANTS

Douglas Beck *ICF International, Inc. - SVP, Corporate Development*

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

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

James Morgan *ICF International, Inc. - EVP & CFO*

CONFERENCE CALL PARTICIPANTS

Tim McHugh *William Blair & Company - Analyst*

Frank Brown *SunTrust Robinson Humphrey - Analyst*

Bill Loomis *Stifel Nicolaus - Analyst*

PRESENTATION

Operator

Welcome to the ICF International first-quarter 2014 results conference call. (Operator Instructions) As a reminder, this conference is being recorded on Wednesday, May 7, 2014, and cannot be reproduced or rebroadcast without permission from the Company.

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

Douglas Beck - *ICF International, Inc. - SVP, Corporate Development*

Thank you, Operator. Good afternoon, everyone, and thank you for joining us to review ICF's first-quarter 2014 performance. With us today from ICF International are Sudhakar Kesavan, Chairman and CEO; John Wasson, President and COO; and James Morgan, CFO.

During this conference call, we will make forward-looking statements to assist you in understanding ICF Management's expectations about our future performance. These statements are subject to a number of risks that could cause actual events and results to differ materially and I refer you to our May 7, 2014 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 our CEO, Sudhakar Kesavan, to discuss the first-quarter 2014 performance. Sudhakar?

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

Thanks, Doug, and good afternoon, everyone. Thank you for participating in our review of ICF's first-quarter results and business outlook.

First-quarter results represented a solid start to the year and demonstrate the benefits of the diversification strategy we have implemented over the last three years to build out our commercial and international businesses.

Domestic commercial revenues grew 7.7% compared to last year's first quarter. International government revenues more than doubled. And together commercial and international government growth more than offset lower US federal government revenue. In the aggregate commercial and international government revenues accounted for 37% of total revenues for the quarter, up from 33% in last year's first quarter.

And, as expected, our state and local business saw positive comparisons this quarter, primarily due to the ramp-up of disaster recovery work for the State of New Jersey and the ramp-up of the large West Coast infrastructure project for which we managed the environmental assessment.

As a result, our revenue from non-US federal clients that are comprised of work with commercial, international government, and state and local clients, accounted for 47% of ICF total first-quarter 2014 revenues, up from 41% in last year's first quarter and about 50% higher than the 32% it represented three years ago.

Our federal government business declined $9.5 million, 6.8%, compared to last year's first quarter. A significant portion of the fall-off was due to the severe weather on the US East Coast, which resulted in four days of federal government office closings in the first quarter, including the well documented ice storm in Atlanta, where we had more than 200 people working for the CDC. We estimate the dollar value of the lost revenue due to weather to be approximately $4 million to $5 million, largely related to our federal business.

While we expect commercial and international government revenues to continue to outpace our federal business in terms of revenue growth, we do expect the federal business to pick up in subsequent quarters of this year. This expectation is based on our backlog and ICF's recognized domain expertise in health and energy, broadly defined, where demand is strong.

The key growth drivers in our commercial business this quarter were digital interactive, energy efficiency, healthcare consulting, and a pickup in our energy market transaction advisory work.

In digital interactive we benefited from additional assignments from existing clients and new projects thanks to our expanded suite of services and successful cross-selling efforts.

Energy efficiency remains the biggest growth driver of our commercial business, increasing 6.1% and accounting for 40% of total commercial revenue. We won a mix of add-ons and new business in this area in the first quarter and the dollar value of energy efficiency programs in our pipeline at the end of the first quarter was equal to over 60% of the total value of the commercial bids in our pipeline.

We are pleased by the positive momentum we continue to see in our commercial healthcare business, which is growing at an impressive rate year over year, reflecting our unique ability to leverage our subject matter expertise to gain traction in the payers and providers market.

And we have continued to notice a pickup in demand for advisory work around energy market transactions. This does not (inaudible) because (inaudible) work tends to be lumpier than our core commercial activity. And there is not enough visibility for quarterly results to be considered a trend. However, we see important opportunities to continue to grow both these high-margin areas, healthcare and energy, by expanding our service offerings and broadening our client base.

The first-quarter results benefited from two months of the Mostra acquisition and about two weeks of the CityTech acquisition. The integration of both companies is progressing well and we have already begun the cross-selling process.

In the first quarter we took some contact write-downs related to ECA, the small technology acquisition we made in the middle of last year, and we reduced the estimated fair value of their earn-out. We still believe that the acquired capabilities of implementing Hybris, a multichannel e-commerce software platform, is very valuable. It rounds out ICF's suite of digital interactive business capabilities that we provide to commercial and government clients. Hybris has since been acquired by SAP.

Also, since the acquisition of CityTech we have seen promising opportunities to bundle the Adobe capabilities of CityTech, Hybris, and our legacy digital interactive business to pursue new work that leverages the collective capabilities and client relationships of these now combined entities.

The weather, ECA and acquisitions affected our reported first-quarter results. Our CFO, James Morgan, will review each of these items in detail later in the call. Excluding all of these impacts, the estimated revenue would have been between $249 million and $250 million; EBITDA between $22.6 million and $23 million; and diluted EPS would have been between $0.51 and $0.52.

Acquisitions remain an important element of ICF's growth strategy and we continue to explore opportunities to extend our footprint in key business and geographic markets.

Therefore, to sum up, first-quarter results benefited from our increasingly diversified business mix.

I will now turn the call over to ICF's President and Chief Operating Officer, John Wasson, to provide a more detailed operating review.

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

Thank you, Sudhakar, and good afternoon.

Coming off a record year in 2013, sales for the first quarter were reasonably good and set the stage for continued progress in 2014. As Sudhakar noted, there were a number of positive developments in our commercial business, where sales again were strong this quarter, led by two energy efficiency contract awards.

The first was a $16 million energy efficiency contract with a southeastern utility to continue our support of a broad suite of energy-efficient programs and technologies for single and multifamily homes, and for the commercial and industrial sector as well.

The second was a series of contracts valued at more than $9 million with another southeastern utility to continue supporting its residential and C&I programs in its territory.

Both of these contracts included adding a new program to the scope and underscore ICF's leadership role in this market. We believe that ICF is the largest advisory and implementation firm in the residential part of the energy efficiency market and believe there's still significant room for growth in this market. At the same time, however, we are moving ahead to capture more business in the commercial and industrial part of the business where we are still a smaller player and there is even more growth potential.

Our commercial sales were well diversified across our major markets this quarter. The largest projects, more than 20 at over $0.5 million each, include a broad portfolio of digital interactive, commercial health, environmental management and research, energy efficiency, and energy transitions work.

Federal sales were more modest this quarter as this followed an extremely strong fourth quarter. And we are still finding that, despite a healthy pipeline, some agencies are still moving slower on the procurement side. Nevertheless, the top dozen wins covered all of our major markets, with particular strength in health, social programs, and transportation. We expect federal sales to pick up over the course of the year, based on our pipeline which has increased steadily and is well diversified and our recognized domain expertise. There remain solid opportunities in our pipeline for new federal wins, even in a flat budget environment.

At the state and local level, the largest projects concentrated on environmental management and compliance, particularly in the Western states. This includes additional work to provide the next major deliverable related to our support of a large infrastructure project in California.

Also, our state and local performance has been helped by our disaster recovery work, particularly related to Superstorm Sandy. We had previously mentioned that as result of the storm's damage we have been providing assistance to the State of New Jersey, including policy and procedural advice on implementing the array of federally-funded recovery programs.

This past quarter we were tasked with two additional projects from the State. First, the State expanded our current contract to provide staff augmentation services in nine housing recovery centers around New Jersey. Although the total value of this task order under our original contract was in excess of $30 million, much of that is pass-throughs of funds to a subcontractor. We therefore recorded the sale at a level reflecting net value to us of approximately $7 million.

Second, we were pleased to win another competitively bid contract to provide oversight of the environmental reviews required for each structure receiving reconstruction or rehabilitation funds. The new contract has a value of up to approximately $17 million.

Our international government sales performance continues to be strong. The largest projects included a EUR5 million, a nearly $7 million contact with the European Commission to support the design and implementation of a greenhouse gas emissions system, extending our work to support a program among the 28 European states to share best strategies for reducing unemployment, and providing technical assistance to urban services for the poor in India for a European aid agency.

We continue to build a growing pipeline that reflects the combined resources of legacy ICF and GHK in a mutually supportive strategy and we look forward to even greater gains with the acquisition of Mostra.

As you know, we closed two acquisitions in the first quarter. Mostra, which was closed on February 7, is a full-service, strategic communications firm that has a particularly strong position servicing the European Commission in advisory and implementation projects across its 28 member countries.

This integration with ICF's European operations has been going very well and the clients are responding positively. We already have submitted, or are preparing, bids totaling more than 20 million, using the combined qualifications of both firms. And we believe that the combination of ICF's domain expertise with ICF Mostra's marketing implementation skills will be a strong and sustainable advantage for us in the European market.

The CityTech acquisition was completed two weeks before the close of the first quarter and, as Sudhakar noted, the integration into ICF is going well. The cultural fit is excellent and we've already developed a number of joint proposals. ICF is adding its digital strategy, user experience, and Hybris e-commerce integration expertise to proposals to CityTech clients, and we are adding their Adobe and Amazon Cloud strength to ours. Of course it is early, but we are pleased with the level of cross-selling that is already occurring.

As noted in our press release, our pipeline continues to grow and reached a record $3.8 billion at the end of the quarter, 30% greater than a year ago. Moreover, our large contract pipeline continues to increase and has grown to 32 opportunities greater than $25 million and 62 greater than $10 million.

Finally, our turnover was, again, a low 2.5% and this translates into 9.9% at an annualized rate.

I'd like to turn the call over to our CFO, James Morgan. James?

James Morgan - *ICF International, Inc. - EVP & CFO*

Thanks, John. Good afternoon, everyone.

As Sudhakar mentioned, we had a few special items that affected our results for the period. The major items were weather, acquisition-related costs associated with Mostra and CityTech, contract write-downs related to ECA, and the reduction of a contingent liability associated with the ECA earn-out. I will cover the financial impact of each of these items as I walk through the major elements of our income statement.

We reported total revenue of $245.1 million, or 4.8% above last year's first quarter. The revenue growth was primarily driven by the acquisition of Mostra and CityTech. Organic revenue, which is the total revenue excluding acquisitions completed within the last 12 months, was essentially flat compared with the prior year.

We estimate that severe weather during the quarter negatively impacted 2014 Q1 revenues by $4 million to $5 million, largely attributable to our federal government business. Thus, without the weather-related office closings in the metropolitan DC area and Atlanta, we estimate revenues would have been between $249 million to $250 million.

2014 Q1 revenue gross profit margin was 37.3%. However, write-downs of contracts acquired as a part of the ECA acquisition caused a nearly 70 basis point reduction in reported gross profit margin. Contract write-downs resulted from renegotiated contractual terms, and revised estimates of the cost-to-complete work efforts. On an adjusted basis, the calendar year 2014 Q1 gross margin would have been approximately 38% compared to 38.9% in Q1 of last year.

Reported indirect and selling expenses for the first quarter were $69.6 million, up $1.4 million, or 2%, compared to the first quarter of 2013. The increase in indirect and selling expenses was primarily due to the addition of Mostra and CityTech, as well as the related acquisition costs. This increase was partially offset by the $2.8 million benefit, or a reduction in direct and selling expense, associated with the reduction in the recorded value of the ECA earn-out.

It is important to note that under the purchase arrangement with ECA we paid a modest amount upon closing. The large majority of the purchase price was tied to an earn-out to compensate the sellers for achievement of aggressive growth projections. The value of the estimated ECA earn-out was reduced from Q1 due to the current expectation that the seller's growth targets would not be achieved. As mentioned earlier, we believe that Hybris capabilities we acquired with ECA are valuable to us in our pursuit for new digital interactive work.

Reported EBITDA was $21.7 million, and EBITDA excluding the special items I discussed would have ranged from an estimated $22.6 million to $23 million, similar to the $22.8 million reported in last year's first quarter.

Depreciation and amortization expense was $3.1 million, up from $2.8 million in 2013's first quarter. Amortization of purchased intangibles was $2 million for the first quarter of 2014, down from $2.4 million in the 2013 first quarter, primarily due to the reduced amortization of intangible assets related to the acquisition of Ironworks and Macro, partially offset by our recent acquisitions of Mostra and CityTech.

The effective tax rate was 38.9% as compared to 40.4% reported in the first quarter of 2013. Reported net income was $9.7 million, or $0.48 per diluted share. Exclusive of only the acquisition costs, diluted earnings per share would have been $0.50. Adjusted for all of the special items that I noted, diluted EPS would have been $0.51 to $0.52.

This quarter we reported cash used in operating activities of $12 million compared to cash provided by operating activities in the prior year of $13.3 million.

The collection of receivables during Q1 of this year was temporarily impacted by the need to clarify administrative billing requirements on a significant new contract which ramped up during Q1, as well as timing issues associated with collections. We still expect that cash flow from operating activities for the full year 2014 will be in the range of $70 million to $80 million.

As a result of the temporary collection and timing issues and the acquisition of Mostra and CityTech, day sales outstanding for the quarter were 81 days. Excluding the two acquisitions, days sales outstanding for the first quarter of 2014 were 77 days. We anticipate that our DSO for the remaining three quarters of the year will be within the 70-to-75 day range, including the impact of deferred revenue.

Capital expenditures for the first quarter were $5.7 million.

We repurchased approximately 15,000 shares in quarter one. As stated previously, we intend to continue share repurchases in 2014 at a level to offset the dilution caused by employee incentive programs.

Consistent with our prior guidance and based on our current portfolio of business, we are currently forecasting full-year depreciation and amortization expense to be in the range of $12.5 million to $13 million; amortization of intangibles of $8.5 million to $9.5 million; full-year interest expense to range from $3 million to $3.5 million; and we expect the full-year tax rate to be no more than 38.5%.

Also consistent with prior guidance, capital expenditures are anticipated to be in the $14 million to $15 million range for the year.

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

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

Thank you, James.

On a trailing-12-month basis, our book-to-bill ratio was 1.17 at the end of the first quarter and our business development pipeline was a record $3.8 billion, up 29% year on year and 9% sequentially.

These figures underpin our confidence that full-year 2014 revenues will range from $1.025 billion to $1.065 billion. Likewise, we continue to expect earnings per diluted share to be in the range of $2.27 to $2.37 for the year, benefiting from progressive improvement in profitability, thanks to more favorable business mix and higher productivity.

And, as mentioned by James, operating cash flow is projected to be in the $70 million to $80 million range for 2014.

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

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Tim McHugh; William Blair & Company.

Tim McHugh - *William Blair & Company - Analyst*

First, just wanted to ask on the energy efficiency side -- can you help me kind of contrast the commercial energy efficiency growth rate of kind of 6% this quarter? It's a lot less than I think you've been doing, but yet your comments about the pipeline and backlog are very strong -- at least that's my impression. So can you kind of contrast those things? Is it just becoming a bigger business that's slower growth now? Or is this just timing factors?

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

Thanks, Tim. It's John Wasson. I think it's timing factors. I think we remain confident that we'll see double-digit growth in our energy efficiency business this year. The pipeline remains strong and robust. And we expect deals to be closed in Q2 and Q3 that will certainly allow -- give us the double-digit growth we expect. So I really think it's a timing issue. We remain quite confident and focused on the energy efficiency business.

Tim McHugh - *William Blair & Company - Analyst*

And you mentioned the pipeline's rather large. Are these larger types of contracts, or is just a lot of smaller ones that you're still seeing out there?

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

I think it's a mix. There's a range of smaller to larger implementation contracts. I think that, as we talked about on prior calls, we're certainly pursuing a lot of new opportunities in the commercial and industrial space. And so we're seeing a good mix of medium to large -- small, medium and large contracts in the energy efficiency space.

Tim McHugh - *William Blair & Company - Analyst*

Okay. And then, on the weather-related impact with the government, is that revenue lost? Or how do we think about it on a full-year basis? And would you expect the work that you would have been doing on those days when the office was closed to be made up? Or is it just you never quite make that up?

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

This is John Wasson again. I think it would be largely made up. I think it's obviously early in the year. I would expect us to largely make that up.

James Morgan - *ICF International, Inc. - EVP & CFO*

This is James. Let me add to that. If you look at the -- the government offices were shut down in the DC area by eight days or so and Atlanta --

---

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

Four.

James Morgan - *ICF International, Inc. - EVP & CFO*

Four days; I'm sorry. And Atlanta was impacted by roughly six to eight days, depending on the various pieces of the office. And so, overall we're estimating that we've made up most of that impact, but we still think we had about a day and a half or so of impact and we're hoping to make up some of that through the remainder of the year.

Tim McHugh - *William Blair & Company - Analyst*

Okay, great. Thanks.

Operator

Tobey Sommer; SunTrust.

Frank Brown - *SunTrust Robinson Humphrey - Analyst*

This is actually Frank in for Tobey. Wanted to ask about the international government business. Can you give us a sense of the size and margins of that business that you're seeing some nice growth there?

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

Yes. I think the size is very substantial and the fact, you know, a lot of the work we do is for the European Commission and for the UK government. The size of the business is -- run rate is around $100 million or so a year, the business.

The communications business is slightly more profitable than the traditional US government business, the 8% to 10% [fee] business which is the US government business. The communications business, so for example the Mostra business, is actually more profitable. The rest of the business is approximately the same profitability. So it's slightly better than the government business, than the US government business.

Frank Brown - *SunTrust Robinson Humphrey - Analyst*

Okay. And what is the contribution to the pipeline from the recent acquisitions? Is that meaningful at all?

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

Yes. Actually it's substantial in the sense the pipeline for our non-US public work went up quite substantially over this past quarter. Mostra added almost $200 million in the pipeline. And we are quite rigorous about making sure that the (inaudible) the pipeline before we add it.

So there's also work which we can potentially pursue now with government-type, Europe- government-type clients, which is for visibility [of revenue and earnings] projects with the European Commission. And the added advantage of the European Commission is that we have budgets which go on for seven years. They decide on seven-year segments. So we won't have the issues which we have here which is there's more uncertainty.

So I think that -- I [used a good] example of Mostra about the amount they've added to the pipeline. So today good strong revenue visibility on our business and we think that characteristics are very similar to the US federal business.

Frank Brown - *SunTrust Robinson Humphrey - Analyst*

Okay. And lastly, turnover was nice and low this quarter. What can you tell us about the hiring environment and finding good talent out there?

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

I think we've had this question before. I think that in our traditional areas we are pretty successful -- in the health, energy, broadly speaking, area. Clearly in certain technology areas it's always going to be harder. But I think we have a company which I think attracts people because of our mission orientation sort of, because we [seeking to deliver] value. And while when I say that I don't mean it in a -- I mean it really seriously. There are a lot of individuals who join us from IT companies because of the fact they like what we do. They like the fact that we are good citizens. They like the fact that we are (inaudible) [conscience,] that sort of thing.

So I think that we traditionally find that we -- we are working hard to find the people. But we have found a lot of people and I've talked to them and they've said that it's always good to work on things where there is some -- even though we're working on the technology aspect, there's some good that we're doing.

So it's tougher in the technology area. It's slightly easier because of the large footprint we have in our health, energy, infrastructure area.

Frank Brown - *SunTrust Robinson Humphrey - Analyst*

Great. Thank you very much.

Operator

(Operator Instructions) Bill Loomis; Stifel.

Bill Loomis - *Stifel Nicolaus - Analyst*

Does the $0.51 to $0.52 EPS number, when you add it back, does that also include taking out the benefit from the earn-out reversal?

James Morgan - *ICF International, Inc. - EVP & CFO*

Yes. It does take that out also.

Bill Loomis - *Stifel Nicolaus - Analyst*

Okay. And then on ECA, why did -- what was the reasons -- you talked about in terms of ECA the higher contract costs. I guess they were integrating projects where they were integrating the Hybris software and just it cost more for you to do it. What happened there? Because I know it was a fairly recent -- I guess a year ago, almost a year ago.

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

Right. Yes. This is John Wasson. I think we had a handful of major e-commerce implementation projects for new clients that we required ECA. We were in the late stages of finalizing the requirements, so the early stages of coding these projects. And I think we knew there was risks around them. And I think that some of those risks came to fruition.

I think, as we discussed, we did structure the deal so that we had a modest up-front cash payment for ECA and then tried to put all the risk on the sellers associated with the future revenues and profitability -- or much of the risk on the sellers, both for the projects that we acquired and for the future sales. And so I think that we were pretty careful to capture this risk and manage the risk through the earn-out. So I think that's what we tried to do.

Bill Loomis - *Stifel Nicolaus - Analyst*

And on the commercial healthcare business, can you give us a little more flavor on that in terms of the size and what we should expect over the last year? Because you highlighted that as a key part.

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

Sure. The commercial healthcare business is growing very nicely. And we'll give you the numbers, Bill, but we give it to you once a year at the end of the year, which (inaudible). It's growing very nicely. It is a business around $15 million to $20 million, growing at a very solid rate. And we are very pleased with that. And just like our -- I'd use the [analog] of our energy efficiency business, which four years ago was a $10 million business and now is into three digits.

So I think that we have hopes that maybe this is another little rocket ship which we have which hopefully will continue to do well by us going forward. So that's what -- is that enough flavor, you think?

Bill Loomis - *Stifel Nicolaus - Analyst*

I guess it'll have to do. And then, just looking at the commercial, excluding domestic commercial, so including international obviously, that rate was 3% instead of 8%. What was the biggest driver, if you can detail that for us?

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

90% of our commercial business, just so you know, is domestic. But we do have some (inaudible) infrastructure work which is pretty lumpy, which is international and out of the Hong Kong office. And then we also have some aviation work, which we were doing a big project last year in the first quarter for a Middle East entity, which -- where there's not been a project this year. So it's just a lumpy thing which didn't happen in those two cases and that's what reduced the -- where they didn't do enough -- (inaudible) revenues in the international commercial arena.

Bill Loomis - *Stifel Nicolaus - Analyst*

Just on that aviation work, did they complete that in the first quarter of 2013, so you're not going to compare against that in the second quarter?

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

Yes. Yes, first quarter of 2013.

James Morgan - *ICF International, Inc. - EVP & CFO*

Yes.

Bill Loomis - *Stifel Nicolaus - Analyst*

Thank you.

Operator

And we have no further questions at this time. I will now turn the call over to Management for closing comments.

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

Thank you very much for participation in today's call. We look forward to speaking with you again after release of the second-quarter results. Thanks again.

Operator

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