REFINITIV STREETEVENTS

EDITED TRANSCRIPT

Q2 2023 ICF International Inc Earnings Call

EVENT DATE/TIME: AUGUST 03, 2023 / 8:30PM GMT

CORPORATE PARTICIPANTS

Barry M. Broadus *ICF International, Inc. - Senior VP & CFO*
John M. Wasson *ICF International, Inc. - Chairman of the Board, President & CEO*

CONFERENCE CALL PARTICIPANTS

Joseph Anthony Vafi *Canaccord Genuity Corp., Research Division - Analyst*
Kevin Mark Steinke *Barrington Research Associates, Inc., Research Division - MD*
Marc Frye Riddick *Sidoti & Company, LLC - Business and Consumer Services Analyst*
Tobey O'Brien Sommer *Truist Securities, Inc., Research Division - MD*
Lynn Morgen *AdvisIRy Partners*

PRESENTATION

Operator

Welcome to the Second Quarter 2023 ICF Earnings Conference Call. My name is Tess and I will be your operator for today's call. (Operator Instructions) I will now turn the call over to Lynn Morgen of Advisory Partners. Lynn, you may begin.

Lynn Morgen ***AdvisIRy Partners***

Thank you, Tess. Good afternoon, everyone, and thank you for joining us to review ICF's second quarter 2023 performance. With us today from ICF are John Wasson, Chair and CEO; and Barry Broadus, CFO. Joining them is James Morgan, Chief Operating 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 August 3, 2023 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 second quarter 2023 performance. John?

John M. Wasson ***ICF International, Inc. - Chairman of the Board, President & CEO***

Thank you, Lynn, and thank you all for joining us to review our Q2 results, the transactions we announced this afternoon and our business outlook. As there's a lot to discuss today, I will focus on the highlights of the second quarter and then quickly move on to recent developments and comment on the growth initiatives underway at ICF.

There were key -- several key takeaways from our second quarter performance. First, this was an excellent quarter for ICF. Revenues increased 18%, indicative of how well aligned our services and capabilities are with market demand. Second quarter revenue growth was led by strong year-on-year comparisons in our key growth markets and represented 10% organic growth, together with the SemanticBits' acquisition we completed in mid-2022.

Second, contract awards were up 28% year-on-year, and we expect second half contract wins to be quite strong. Over 80% of our second quarter wins represented new business in contrast to recompetes, another indication of ICF's competitive positioning in areas of priority spending. Our trailing 12-month book-to-bill ratio of 1.3 is among the highest in the industry and supports our expectations for significant revenue growth this year and into 2024.

Third, we ended the quarter with a record business development pipeline of $10.3 billion, which represents almost 20% growth compared to year ago levels. This growth is attributable to our expanded capabilities, our ability to bid on larger contracts thanks to our increased scale and the opportunities that are emerging from the IIJA and IRA legislation.

Lastly, we executed transactions that strengthen ICF's position in key growth areas and support our long-term growth strategy.

Our Energy, Environment, Infrastructure and Disaster Recovery market, which spans our government and commercial client set, continued to be a standout performer in the second quarter. Revenues increased nearly 18%, primarily representing organic growth, and this market accounted for slightly over 40% of second quarter revenues.

Commercial Energy represents a large part of that market and includes advisory work for utilities, renewable energy developers and investors, implementation of energy efficiency and distributed energy programs for utilities, and environmental services for utilities and other energy providers. Commercial energy revenues increased 22% in the second quarter and are up 20% year-to-date. We expanded our energy efficiency programs for several large utility clients and saw greater demand for advisory expertise and our environmental and planning services, as clients plan their renewable projects in light of funds and tax credits made available through the IIJA and IRA.

This was also a strong quarter of new contract awards in the commercial nergy arena. There was particular strength in multiple innovative pilot programs, focusing on electrification, financing and energy equity. A material portion of the new work that we won is to provide services necessary to analyze, finance, permit, construct, connect, monitor and operate renewable projects across the country and offshore. The Federal Energy Regulatory Commission issued an order last week that should expedite interconnection of new wind, solar and storage resources to the grid, which should drive additional demand for our advisory work.

In today's release, we announced the acquisition of CMY Solutions, which will expand our addressable market within the electrical sector. CMY Solutions is a power and [energy] (added by company after the call) engineering firm that provides next-generation technology solutions and data analytics that drive more informed decision-making on grid modernization and investments. CMY has a team of about 50 electrical engineers who work with utilities and developers across the U.S., Europe and Asia, including investor-owned utilities, electric municipalities and electric cooperatives. We have successfully partnered with CMY on several projects and together have an excellent track record of delivering positive results for our clients, which made this a compelling transaction for us. CMY expands our addressable market by giving us the ability to support client needs for renewables interconnection, substation and distribution upgrades and grid resilience, and providing us new technology and data management capabilities that we can offer our commercial energy clients as well as our government clients.

In addition to commercial energy, we also experienced strong demand in the second quarter for our climate and environmental services, which, as you know, cut across all of our client categories. Second quarter growth in our climate business was driven by new or expanding projects at NASA, EPA, DOE, USAID and 3 large East Coast utilities. ICF has one of the leading, if not the leading climate practice in the country, and we are seeing strong demand resulting from funding for decarbonization programs, including assessment, disclosure and management of risk in the private sector and large-scale programmatic funding by government, including the IIJA and IRA.

Our environmental planning and monitoring services and disaster management account for over 80% of our state and local revenues, which in total increased over 27% in the second quarter. Pent-up demand post-COVID and the IIJA and IRA are driving significant new infrastructure planning and investment, and environmental scopes of work that are required at the front end of such projects are increasingly considering climate risk, energy equity, resilience, fire, flood and sea level rise, which is another example of the growing interconnections that play to ICF's competitive advantages.

Revenues from our disaster recovery market continued to grow at a double-digit rate in the second quarter. We continued our recovery work in Puerto Rico and just announced a new $32.1 million contract with a U.S. territory to provide disaster management consulting services to accelerate federally funded recovery efforts across the territory.

Our other large market is Health and Social Programs, which is where our public health and the majority of our IT modernization services reside. This market is primarily comprised of work for the federal government, with a small part representing services to state and local and international government clients and a minor contribution from commercial clients. In the second quarter, its revenues were up 30%, reflecting both organic growth and the acquisition of SemanticBits, and this market accounted for 41% of total second quarter revenues.

We continued to see strong year-on-year growth in public health and IT modernization in the second quarter. Public health and IT modernization are 2 areas that historically have garnered bipartisan support and have been well funded. We see significant runway to increase our market share at the Department of Health and Human Services, resulting from specific opportunities for revenue synergies tied to the SemanticBits acquisition, which we expect to bid over the next 6 to 9 months.

Also, our greater scale is opening more and larger opportunity for us at HHS and across our federal government client set. Similarly, our social programs pipeline is very strong, and we have seen material growth in this area in the past and expect to see more in the future.

Our pipeline and federal government opportunities increased 21% from the similar period last year and 6% sequentially, supporting our outlook for continued growth in the federal arena.

Further, with regard to federal government opportunities, we are seeing increased interest in the use of AI amongst our federal government clients, and ICF is well positioned to benefit from this trend. In fact, we have been deploying AI and machine learning for years with our federal clients. As a leader in the shift to low-code/no-code platforms and to open source solutions, our 1,800 technologists have been and will continue to take advantage of the AI capabilities embedded in these platforms, including developing novel generative AI approaches to automate code generation and enhance developer productivity, and leveraging AI to enable more efficient migration of technology to modern platforms.

At the same time, we see generative AI as a way to improve the productivity and experience of our own employees and streamline various corporate functions at ICF. In fact, at the beginning of this year, we established a generative AI enablement team to identify and develop use cases for how Gen AI can be utilized to increase productivity for both client-related work and efforts internally within ICF.

Lastly, in today's earnings release, we announced that ICF recently signed a definitive set of agreements to sell our Commercial Marketing Group. Included in the sale were our commercial loyalty programs and integrated communication services for consumer and financial clients. This group has brought ICF important capabilities that have provided and contributed to the growth of the engagement and communication services we provide to our government and utility clients. As we have increased our focus on key growth markets and mission-related areas within our government and commercial energy client sets, however, this group has become less core to what we do and thus the decision was made to divest the business. We are especially pleased that the group's senior leadership and staff have been offered positions by the acquirer. The transaction is expected to close in the third quarter, and Barry will provide additional details on the net effect of this divestiture and the CMY acquisition in his remarks. With that, I'll turn the call over to our CFO, Barry Broadus for a financial review. Barry?

Barry M. Broadus ***ICF International, Inc. - Senior VP & CFO***

Thank you, John, and good afternoon, everyone. I will now share additional details of our financial performance in the second quarter of 2023.

As John noted, we had strong second quarter revenue performance, which was a result of our 10% organic growth, coupled with the acquisition of SemanticBits in July of last year, and drove our year-over-year revenue increase of 18.2% to $500.1 million. Revenue growth was broad-based, reflecting double-digit increases from federal, state and local government and commercial energy clients, which together accounted for 88% of our second quarter revenue.

Subcontractor and other direct costs of $137.7 million represented 27.6% of total revenue, which is in line with last year's second quarter.

Gross margin for the second quarter was 34.9%, a decline of 150 basis points as compared to the same period last year. Several factors contributed to the decrease, including last year's acquisition of SemanticBits, which generates a lower gross margin but higher EBITDA margins, and the timing of certain projects and contract ramp-ups. We expect to see sequential progressive improvement in gross margins in the second half of this year.

Year-over-year adjusted indirect expenses declined 140 basis points to 24.6% of revenue due to greater scale and the effective management of our indirect expenses. As we continued to make investments in people and technology to support our long-term growth, our indirect and selling expenses increased 10.6% year-on-year to $126.5 million, which was at a significantly slower pace than our revenue growth.

Second quarter EBITDA increased 19.2% to $47.5 million, and adjusted EBITDA increased 15.3% to $51 million year-over-year.

Interest expense for the second quarter was $10.2 million, an increase of $6.1 million from last year's level. The second quarter acquisition of CMY, which was not embedded in our prior forecast, coupled with the increase in interest rates, drove our interest expense to be higher than we anticipated. The second quarter EPS impact of the higher interest expense was more than offset by the benefit from our tax optimization strategies we implemented. We expect this additional benefit from our tax optimization strategies to mitigate the forecasted year-over-year higher interest expense for the remainder of this year.

Net income was $20.3 million or $1.07 per diluted share in the second quarter, inclusive of $3.5 million or $0.13 per share of tax-affected M&A and severance charges. Our second quarter net income and diluted EPS included a $0.21 per share incremental tax benefit beyond the full year estimated tax rate from which our year-end ETR guidance was based upon. Second quarter of 2022 net income was $18.4 million or $0.97 per diluted share.

Non-GAAP EPS increased 18.8% to $1.57 per share, which also includes the benefit of the company's long-term tax strategies.

We're very pleased with our second quarter and year-to-date cash flow generation. Our second quarter cash flow from operations was $36.7 million and $19.9 million on a year-to-date basis, significantly ahead of our results in the first half of 2022. Our ongoing cash management initiatives were a key driver of the favorable cash generation performance and also contributed to our improved days sales outstanding of 73 days as compared to the 82 days in last year's second quarter.

Year-to-date capital expenditures primarily related to technology investments totaled $13.2 million as compared to $11 million in the first half of 2022.

Our debt at the end of June was $601.8 million, similar to our debt balance at the end of the first quarter. Our second quarter debt is inclusive of the funding of the purchase of CMY Solutions. The acquisition was largely executed through the cash flow generation from operations during Q2.

Our adjusted net leverage ratio was 3.11 at quarter end compared to 3.09 at the end of the first quarter. Assuming no additional acquisitions this year, we expect our year-end leverage ratio to be down approximately 1 turn, inclusive of the expected net proceeds from the divestiture of our Commercial Marketing Group.

In addition, during the second quarter, the company executed an additional $100 million of interest rate swaps, which increased our fixed rate debt to be approximately 60% of total debt. With the addition of these new swaps, our all-in average interest rate now stands at 5.25%.

In addition to debt reduction, our capital allocation priorities include making investments to support organic growth, paying dividends, repurchasing shares to offset the impact of employee incentive programs and continuing to consider strategic acquisitions. We used $18.1 million in the first half of this year to repurchase 180,000 shares. We have $93.7 million remaining under the current stock repurchase authorization plan. We also announced today a quarterly cash dividend of $0.14 per share, payable on October 13, 2023, to shareholders of record on September 8, 2023.

Now to help you with your financial models, I want to emphasize that our second half revenues will be essentially flat as compared to the first half due to the divestiture of our Commercial Marketing Group, which is offset in part by the revenue generated from the CMY acquisition. The net effect of the divestiture and the acquisition in the second half of this year will lower our revenue by approximately $15 million, weighted towards the latter part of this year.

As John previously stated, we are reaffirming our revenue and non-GAAP EPS guidance for 2023, which is inclusive of both the CMY acquisition and the pending divestiture of our Commercial Marketing Group. In addition, any potential gain associated with the

Commercial Marketing Group divestiture and the onetime noncash charge associated with stranded facilities will not impact our non-GAAP EPS guidance.

Now I'll move on to other key guidance metrics. Our depreciation and amortization expense is expected to be in the range of $23 million to $25 million. Amortization of intangibles is approximate -- should be approximately $36 million. Interest expense is now expected to be in the range of $37 million to $39 million compared to our previous forecast of $32 million to $34 million, resulting from higher interest rates and higher average debt balances as I previously mentioned. Our tax rate in the first half -- based on our tax rate in the first half of the year, we now expect the tax rate for this year to be approximately 17% as compared to the 23.5% we previously guided to, with the second half of this year to be in the range of 19% and more specifically, with the third quarter projected to be at approximately 12%. Operating cash flow is projected to be $150 million. We expect our fully diluted weighted average share count to be approximately $19 million and our capital expenditures are anticipated to be between $26 million and $28 million.

On a final note, we have removed the non-GAAP financial measure of service revenue as it is not in line with recently stated SEC guidelines. Service revenue will no longer be included in our public filings, investor presentations and other published reports and documents. The company will continue to provide information on our subcontractor and other direct costs.

And with that, I will now turn the call back over to John for his closing remarks.

John M. Wasson ***ICF International, Inc. - Chairman of the Board, President & CEO***

Thanks, Barry. We are pleased to reaffirm our full year guidance. We expect 2023 total revenue of $1.93 billion to $2 billion, and we anticipate subcontractor and other direct costs will be approximately 27% of total revenue. EBITDA is estimated to range from $210 million to $220 million and GAAP EPS is projected at $4.75 to $5.05, exclusive of special charges. Non-GAAP EPS is expected to range from $6.15 to $6.45. Operating cash flow is expected to be approximately $150 million in 2023.

In the second quarter, we continued to invest in people and technology that enabled ICF to execute effectively on our existing contracts while positioning us to capture an even greater share of future growth opportunities. The sale of our Commercial Marketing Group was a strategic decision to streamline our business and deploy our resources to support the key growth markets we have identified. And the acquisition of CMY fully aligns with the increased demand we anticipate from our commercial energy clients. Our industry-leading trailing 12-month book-to-bill ratio of 1.3, together with a record $10.3 billion business development pipeline point to continued growth ahead.

Additionally, we are proud of the impact that ICF and its people are having on society through the services we provide clients in support of energy saving, carbon reduction and natural resource protection programs as well as health, education, development and social justice programs. I encourage all of you to review our recently released corporate citizenship report, which highlights our impacts in these areas.

With that, operator, we'll open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will be from Joseph Vafi from Canaccord Genuity.

Joseph Anthony Vafi ***Canaccord Genuity Corp., Research Division - Analyst***

Everyone and once again, congratulations on the solid and steady results. I thought, John, I would just circle back to your -- some of your opening comments where you said that you expected a strong second half in bookings. And I know there's a lot of tailwinds out there relative to the environment and IIJA and the like. But unless the deals are signed, it's a little bit unlike you to say it's going to be solid. So just any color there, maybe perhaps some solid bookings already happened in July? And then I'll have a follow-up.

John M. Wasson ***ICF International, Inc. - Chairman of the Board, President & CEO***

Sure, Joe. I appreciate the question. Well, first of all, I'd say, obviously, as you saw and heard in the results, we have a very strong pipeline, a record pipeline. As you know, the cyclicality of our awards, Q3 is generally our far and away our strongest quarter for awards driven with the end of the government fiscal year. Q4, certainly last year and over the last couple of years has also been quite strong, again, with some wins in federal, but also across commercial and state and local.

And so I think given the size of the pipeline and the significant amount of the pipeline that is in proposals submitted, awaiting award or is in final negotiation of the opportunity, I think we do have a high degree of confidence that the wins and the sales for Q3 and Q4 will be quite strong, much like last year, where Q3 and Q4, we were quite strong and obviously these are very strong results. And so I think that's what's driving the confidence. Again, I think we have clear visibility of how those awards should play out.

Joseph Anthony Vafi ***Canaccord Genuity Corp., Research Division - Analyst***

Got it. And then I know you kind of also mentioned about having the size and scale for a bigger bid, but it kind of feels like you've had that size and scale for a while. I mean you're kind of a scale player in a lot of verticals. So just wanted to drill down into those comments too, John, relative to your size and average deal size that you're seeing these days? And then I might sneak one more in.

John M. Wasson ***ICF International, Inc. - Chairman of the Board, President & CEO***

Sure. I mean I think the area where the size and scale over the last several years is really helping us is on the IT modernization and the technology front. I mean, as you know, Joe, we've come a long way there. As I said in our remarks, we have 1,800 technologists. We have $500 million in round numbers, a $500 million revenue technology business.

And so I think that's an area where we are seeing larger opportunities, and we are increasingly able to pursue and capture larger opportunities.

I think as we also talked about, with the SemanticBits acquisition, that really has given us scale and a position within CMS to bid larger opportunities and combine the technology capabilities that legacy ICF has on the low-code and no-code with the open source and bring deeper ICF capabilities into CMS.

And then we can also leverage the SemanticBits open-source capabilities into our broader civilian client base. And so I want to emphasize the scale on certainly as with respect to technology. The only other thing I'd say is right now, I mean, I think as you saw in the second quarter results, I mean, our energy business is really coming to the fore here in terms of the growth.

I think we grew all in 22% in commercial energy. And I think we -- so I think and we obviously have scale there and see large opportunities, continue to see a lot of opportunities in the energy efficiency area. And so I think that's what I would emphasize on the scale side.

Joseph Anthony Vafi ***Canaccord Genuity Corp., Research Division - Analyst***

Got it. And then just one more. I know that there are some puts and takes coming in the P&L here in the second half with M&A and divestitures. But with EPS kind of reiterated, started to drill down a bit and ask if there was -- because you're going to lose some EPS from, I guess, the sale of marketing, the acquisition of CMY's coming in, it could be a little accretive. Maybe the core business was doing a little better, and it would have been kind of of upside to guidance without any M&A. But just I thought I'd ask if there's any more color to add on how we get to kind of reiterated EPS with those moving parts.

Barry M. Broadus ***ICF International, Inc. - Senior VP & CFO***

Joe, thanks for the question. I think, as I stated, that we are strong on reaffirming the non-GAAP EPS guidance for this year. We think that given the divestitures and all the different moving parts, including the tax strategies that we've implemented, will certainly help offset any of the lost EPS that we would have from the divestiture. So we feel like, that we're solidly there for this year.

John M. Wasson ***ICF International, Inc. - Chairman of the Board, President & CEO***

I just would add on the -- well, I think Barry gave guidance on exactly how the revenues would shift given the divestiture of the commercial marketing and the CMY acquisition on the revenue front. I would just say from a bottom line earnings and EPS perspective, how we look at it is commercial marketing business, we divested that. Its margins were at the low to mid end of our federal business. And CMY, which is a smaller business than what we're divesting with CMG and why the revenues are coming down, what did we say, $13 million to $14 million, it is acommercial energy business, the margins are at the high end of our kind of commercial energy, what we'd expect for commercial energy. So at the end of the day, from an EPS perspective, I would say, kind of more or less a wash given the relative margins and the revenues.

Operator

We have Tobey Sommer from Truist Securities.

Tobey O'Brien Sommer ***Truist Securities, Inc., Research Division - MD***

If you look at your expectation for pretty strong contract awards in the back half of this year. If you look at the composition source of those, are they related to the IIJA and/or climate bill and sort of like that -- is that what makes them strong? Or from your vantage point, is it the regular way of budget spending by your customers?

John M. Wasson ***ICF International, Inc. - Chairman of the Board, President & CEO***

Yes. I guess I'd say at a high level, Tobey, that, I mean, I think we're seeing the growth in the pipeline and the awards. I would expect to see them across the 5 growth areas. And so I would -- and so -- and the pipeline is expanding across federal, commercial, state and local. And so it's broad-based across those 5 growth drivers.

Having said that, I do think that as I said, actually I said in my remarks and I said in response to Joe's question on our commercial energy business is showing acceleration here. I think that across -- in a broad way across that business from advisory to utility programs to climate, to environment and planning.

And in the second quarter, our total pipeline, we have reported our pipeline for IIJA opportunities here and our awards. I think we're approaching about $270 million pipeline for IIJA opportunities. I think we're up to about $70 million on awards here. And so we are seeing some positive momentum on the IIJA front, which we said we thought we would see in the second half of the year.

I think the IRA, we're seeing a lot of interest and a lot of impact from that on the market, particularly around the economics of solar wind and investment activities with utilities, developers, which is a very positive sign for our pipeline. And so as I've said, I think we -- there's not a significant amount built into our contracts for 2023 from those areas. I just would say that the momentum we're seeing from IIJA and IRA remains positive.

And I think as I've said before, it's a positive indication that it's -- things are playing out in a positive way. And I think it potentially sets us up for even further growth as we go into 2024.

Tobey O'Brien Sommer ***Truist Securities, Inc., Research Division - MD***

Okay. What does your guidance assume from a fiscal federal 2024 budget or CR. I know you don't have a particular crystal ball and you can't predict it, but curious what sort of assumption you have as you get into the fourth calendar quarter.

John M. Wasson ***ICF International, Inc. - Chairman of the Board, President & CEO***

I mean I think we're -- I mean, we haven't given guidance per se for 2024 yet. Obviously, we do have our long-term goal we articulated at our Investor Day around high single-digit organic growth and the potential for double-digit growth with leveraging the balance sheet over time through 2024.

I think generally, our assumption is that we'll have a budget. Ideally, we'll have a budget. Certainly, we would expect to have a continuing resolution. And I think with either of those, I think, given the momentum in our markets, so on the federal side, the fact that public health and IT modernization has tended to be bipartisan, it's remained a very high priority that those areas will do better than the average budget increase in civilian and frankly, given the strong momentum we have with contract awards and backlog we have in place in those areas, that's what we're assuming to continue to deliver the results we've discussed through 2024.

Obviously, if there's unexpected -- I mean, obviously, a government shutdown or unexpected cuts are not what we're expecting. But generally, I think we're assuming there will either be a budget or there will be a continuing resolution.

Operator

We will have our next question from Kevin Steinke, Barrington Research Associates.

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

I just wanted to ask about with the divestiture of the commercial marketing group. You mentioned that they helped with the growth of some of your engagement and communication services that you provide to your government and utility clients. Do you still retain some of those capabilities within the company, even after the divestiture, that are going to serve you going forward to serve that -- those key client bases?

John M. Wasson ***ICF International, Inc. - Chairman of the Board, President & CEO***

Yes. Let me be very clear, Kevin. It's a good question. I mean, so within our government business, we have a separate group that provides the marketing and communication services to our federal clients. That's north of a $100 million business. That business resides within our federal business, and that business is staying with ICF. There's no-- that's going to stay a key part of ICF and our ICF Next sub brand.

We also have a core set of people that support our commercial energy business with communication in the market, in particular, our energy efficiency and other utility programs. Those people are embedded in our commercial energy business, they are all staying with ICF, and we'll continue to do that work.

And then we have an international marketing communications business out of Brussels. And that's also remaining with us. So all of those businesses remaining in the firm, they've been operating on a stand-alone basis. There's a little bit of interaction with the commercial marketing group, but it's de minimus. And so we'll keep all those capabilities and all the skills and all that -- all those people.

The thing we're selling is kind of the core commercial marketing services business, which included the hospitality, [integrated] (corrected by company after the call) marketing, some business transformation consulting we do really for retail, hospitality, travel, consumer packaged goods clients, which today are not a core part of our business, a core part of more broadly who we serve. And so that's what we're kind of divesting with this transaction.

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

Okay. Understood. That's helpful. Just also wanted to ask about service revenue, although you mentioned that it's not going to be part of your investor communications anymore. Is that going to be a metric you continue to look at internally to monitor the progress of the business and margins and overall health of the business?

Barry M. Broadus ***ICF International, Inc. - Senior VP & CFO***

Yes, Kevin, this is Barry. Thanks for the question. And the answer to that question is yes. We do think that it's an important metric. And we look at that as we think it's a very good representation of how the core business is performing. So we will continue to look at that, and we'll provide the Street information on subcontractors and ODCs so that if you'd like to be able to calculate that number, you certainly will be able to -- and you'll see that in the 10-Q when we file that, you'll see how we break that down in the MD&A section. So I appreciate the question. And yes, we do think it's important.

Operator

And I show our next question comes from the line of Marc Riddick from Sidoti.

Marc Frye Riddick ***Sidoti & Company, LLC - Business and Consumer Services Analyst***

So I wanted to jump in on to -- one of the things I wanted to circle back on in the prepared remarks that you made regarding some of the commentary around AI and some of those capabilities and some of the progress that you're making there, which is actually somewhat refreshing this season as a lot of folks are kind of -- it's a little too early for a lot of folks, but certainly, it's encouraging to see that it's an area that you're encouraged by.

I was wondering if you could spend a little time sort of discussing some of the opportunities there as well as any talent needs that may arise, not just specifically within AI, but overall for the entire enterprise as well.

John M. Wasson ***ICF International, Inc. - Chairman of the Board, President & CEO***

Sure. So I think as I said in the prepared remarks, obviously, we have a significant technology business on IT modernization. I think with that business, honestly, that business has been doing machine learning and various forms of AI for years as part of their work for clients in the federal sector. And as I also indicated, are looking and experimenting with generative AI, the potential to use generative AI for clients as we go forward.

And it's certainly our expectation that AI has been embedded in these platforms for many years and that generative AI will become part of what is embedded and used in these platforms. And so we continue to look at that, take a hard look at that, work with our clients and, and evaluate how internally how to best utilize those products to meet -- and those capabilities to meet client needs and to improve productivity.

And we've also used -- more broadly, our domain client staff over the years have used machine learning and predictive AI to support clients in things like literature searches and looking for patterns in data to understand what might -- causes of diseases, how to avoid waste fraud and abuse based on patterns and data. And so that's certainly been part of what we've done on the domain side.

We're also looking at how we can -- how come we can use generative AI to improve our product internally, in our corporate services, and have created sandboxes to test and experiment with use cases to try to improve how we do our marketing, our business development, review of contracts and then things of those -- of that nature.

In terms of the talent, I think certainly, we obviously, finding the talent in our technology business is quite important. As I say, we'll -- it's been part of our business, and we'll continue to look for that talent. It is -- that is an area where it's highly competitive and challenging to find that talent. But I think we generally -- we've made significant investments in recruiting, I think we'll be able to find the talent we need to support our business.

Marc Frye Riddick ***Sidoti & Company, LLC - Business and Consumer Services Analyst***

Great. And then the last one for me, I was want to wondering if you could talk a little bit about the pricing environment and as far as putting through price increases when rules come up? And are there any areas that are a little more price sensitive due to economic changes or given the funding environment that most areas where you play that you're not really running into that?

John M. Wasson ***ICF International, Inc. - Chairman of the Board, President & CEO***

No, I wouldn't say there's been a significant change in the pricing environment. I mean, all of our business is competitive. And with the federal business and with regulated utilities, you're writing proposals, you have to compete for the business. But I wouldn't say there's been a change. And I think as we've talked about generally in the past, certainly in our client, civilian client areas, we've not seen over the years the kind of lowest price technically acceptable (inaudible) concepts. Price is important, but the quality of your capabilities, your past performance, your people is most important.

In terms of passing costs on, I would say that like many companies, we've given significant increases in salaries and pay the tension that we stated market on the compensation side I think, and we give those raises in March each year. So we did give material increases and raises in March.

I think as we've talked about, with cost plus, you can more or less pass those on quickly. Only about 15% of our work is cost plus; 40 -- I don't know, Barry, 40% is T&M, 45% of fixed price.

Now the T&M, we can raise those rates on a yearly basis. We can move people up categories when they -- with more experience. And so those are things we do to address the cost, the challenges, and with fixed price, we have built in escalators. They're not always enough to cover the raises and there the strategies you can use over time to make sure that you pass those along as best as you can.

We'll deploy all those strategies. I think it's -- and they're (inaudible) strategies. They don't happen overnight depending on the type of contract, but we're -- we remain focused on that and managing that, I think, generally well.

Operator

I'm showing no further questions in the queue. At this time, I'd like to turn the call back over to John for closing remarks.

John M. Wasson ***ICF International, Inc. - Chairman of the Board, President & CEO***

Okay. Well, thank you for participating in today's call, and we look forward to connecting with you at future conferences and events. Have a good rest of the summer. Take care.

Operator

Thank you. This concludes today's conference call. Thank you for participating. You may now disconnect.