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PRESENTATION

Operator

Welcome to the First Quarter 2024 ICF Earnings Conference Call. My name is Liz, and I will be your operator for today's call.

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

Lynn Morgen ***AdvisIRy Partners***

Thank you, operator. Good morning, everyone, and thank you for joining us to review ICF's First Quarter 2024 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 May 2, 2024 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 first quarter 2024 performance. John?

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

Thank you, Lynn, and thank you all for joining today's call to discuss our first quarter results and review our business outlook. First quarter results represented an excellent start to 2024 and demonstrated ICF's positioning in key growth areas and the strength of our diversified business model.

There are several takeaways worth highlighting. First, revenue growth for the quarter was quite strong. Excluding divestitures, revenues increased by 8.7% from last year's levels.

Second, our margin profile continues to strengthen. Drivers such as revenue mix, high utilization and reduced facility costs continued to contribute to the consistent margin expansion that we have achieved over the last several years. And third, our forward-looking metrics point to continued growth for ICF. At the end of the first quarter, our backlog was $3.6 billion. Our trailing 12-month book-to-bill ratio was 1.23, and our business development pipeline was $9.7 billion. This speaks to how well aligned our capabilities are with the current spending priorities of our government and commercial clients.

Taking a closer look at our first quarter revenue performance, ICF's work in the Energy, Environment, Infrastructure and Disaster Recovery client market, again, was a meaningful contributor to our first quarter growth. Revenues in this client market increased 20% year-on-year to account for 45% of first quarter revenues. We are seeing very strong results across both our service offerings and our diversified client base.

ICF brings together a complement of deep domain and implementation expertise across a broad platform of interconnected subject matter areas, including energy efficiency, decarbonization, electrification, environmental and climate impacts and disaster recovery in mitigation. We combine our expertise with proven implementation skills around program management, environmental monitoring and grid engineering services, supported by cutting-edge analytic tools and proprietary energy models that have become the industry standard. Thus, we are offering unique and very customizable services and solutions, which are resonating with utility clients, renewable energy producers and others on the commercial side, while we continue to provide our government clients with research, policy and economic analysis, program design, analytics, grant management services, disaster recovery work and climate impact analysis.

Highlights in this market in the first quarter were: over 30% increase in revenues from utility programs, including energy efficiency work, reflecting continued expansion in both size and scope of programs. ICF is now serving over 75 utilities across the country. Notable contract wins in the quarter included $85 million of expanded energy efficiency work with a large utility holding company, a new $18 million electrification project for a large Midwestern utility. And in conjunction with our disaster management team, ICF was tapped to support a Western state's wildfire and natural disaster resiliency rebuild program, which provides incentives to help homeowners impacted by natural disasters rebuild all-electric homes.

We also saw strong double-digit growth in Energy Advisory revenues driven by increased demand for both our Power and Technical Advisory work. First quarter contract awards included numerous grid engineering and analytics projects for utilities and developers.

Additionally, revenues from our Environment and Planning services in the U.S. continued to show solid growth, representing continued strong demand from renewable developers, increased resilience work for utilities undergrounding power lines and environmental infrastructure-related work for state clients on projects funded under the IIJA. Contract wins in the first quarter were from a combination of utilities, developers and government clients for the full breadth of ICF's licensing, permitting and compliance services.

IRA and IIJA funds are also starting to flow at scale, including the Department of Energy's Group Resilience and Innovation Partnership program and its National Electrical Vehicle Infrastructure program and EPA's Environmental Justice awards. Funding for state energy offices is now in the process of being released, and states and other recipients are beginning to issue solicitations for planning and program support. We are actively monitoring opportunities to provide support at all levels: federal, state and local and commercial.

To date, ICF has won contracts valued at approximately $125 million related to the IIJA and IRA primarily from federal and state government clients, and our pipeline is about $200 million. This does not include all the related work that we are doing for commercial clients where it's more difficult to tie engagement to specific legislation.

In the first quarter, our revenues from federal government clients increased 2.4%, in line with expectations, primarily reflecting the $5 million reduction in pass-through revenues associated with large international public health contracts that we referred to last quarter.

Revenues from federal government clients, excluding subcontractor and other direct costs, increased 5.4% in the quarter. Our 2 growth markets in the federal government client category are public health and IT modernization. With respect to public health, our contract wins at SAMHSA last year are now fully up and running, and we expanded our clinical decision support work at the Veterans Administration. Also, our business development pipeline in public health is quite strong. There is bipartisan support to address the nation's metal health crisis. And with increased budgets, we see significant opportunities to expand our work for SAMHSA.

Also, recent funding for NIH and CDC is in specific areas that are relevant to ICF subject matter expertise and experience, including funding to end HIV and for cancer and Alzheimer's research. We continue to see a strong pipeline for global health security and low-middle income countries where we have historically worked providing demographic and health surveys, nutrition surveys and diagnostic testing. Global health security involves identifying and containing infectious disease threats wherever they occur in the world. CDC's and USAID's work on monkeypox and Ebola are 2 of the most current examples.

Additionally, we continue to see strong, steady performance on our environmental health work at EPA with a BPA recompete win for EPA's Office of Research and Development and task order wins to support EPA's Office of Pollution Prevention and Toxics. As you know, the EPA issued the final National Primary Drinking Water Standards to protect Americans from exposure to PFAS substances in mid-April. ICF supported the scientific and regulatory analyses that inform development of the new rule setting maximum levels of these chemicals for the nation's drinking water supply. Our work continues as we staff EPA laboratory contracts through which samples are tested for PFAS substances.

IT modernization and digital transformation is another area of bipartisan support. In the first quarter, we continue to execute our programs to update workflows and infrastructure and optimize data usage across our civilian agency clients, and we continue to ramp up work on the $300 million of contracts we won in the second half of 2023. Additionally, we completed several important projects within the Department of Health and Human Services that advance research efforts and support public health, including the development of dashboards to support the Medicare Diabetes Prevention program, facilitate health equity data submission and address vascular health.

Notably, in the first quarter, we combined ICF's domain expertise in energy with cutting-edge technology to stand up 3 unique grants management programs with varying complexity levels for the Department of Energy to support millions of dollars in new IIJA and IRA funding across multiple rebate programs. This project, together with the close tie-in that our IT modernization capabilities have with our public health expertise demonstrates ICF's unique ability to define subject matter expertise with substantial IT capabilities to drive growth and positive outcomes for clients.

We also have a strong active pipeline in this area, which includes a significant number of opportunities that reflect potential synergies between our open source capabilities and ICF policy-related experience. [To] sum up, this was another record quarter for ICF, which has set the stage for substantial organic growth for the company in 2024. Now I'll turn over the call to our CFO, Barry Broadus, for a financial review. Barry?

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

Thank you, John, and good morning, everyone. I'm pleased to provide you with additional details on our 2024 first quarter financial performance. Total revenues were $494.4 million, up 2.3% compared to the first quarter of 2023. After adjusting for the divestiture of our commercial marketing business lines in 2023, revenues increased 8.7%, driven by robust growth from our commercial energy clients and solid growth from our government customers. Subcontractor and other direct costs totaled $120.5 million or 24.4% of total revenue, down from 27.3% in the first quarter of 2023. The year-on-year decrease was due in part to the divestiture of the commercial marketing business lines and lower pass-through revenue in certain U.S. government contracts. First quarter gross margins expanded 190 basis points to 37.2% of total revenue, benefiting from the timing of several recently awarded energy efficiency contracts, which are estimated to pull forward approximately $0.15 to $0.20 of EPS in the first quarter. So typically, these contracts tend to be more profitable during the start-up phase of the program. As costs ramp up over time, margins will level out over the period of performance. In the second half of this year, we expect that margins from these contracts will be more closely in line with margins we typically see with our other energy efficiency programs.

Indirect and selling expenses were $129.1 million, up 4.3% year-on-year, reflecting the expansion of the business and investments in our staff and various growth initiatives. We continue to realize higher utilization and benefit from our increased scale and reduced facility costs. This, together with our favorable revenue mix and the quarter-specific upside from the energy efficiency contracts I mentioned earlier, drove a year-over-year 21.6% increase in EBITDA to $56.4 million and an 8.2% increase in adjusted EBITDA to $55.2 million. Interest expense of $8.2 million decreased from $9.5 million in the first quarter of 2023, reflecting our lower average debt balances year-to-year. Our tax rate was 20.4% as compared to 23.5% in the year ago quarter, primarily due to tax credits and the vesting of equity compensation, which largely occurs in the first quarter of each year. For the full year, our tax rate guidance remains unchanged at 23.5%. Net income was $27.3 million or $1.44 per diluted share in the first quarter compared to $16.4 million or $0.87 per diluted share reported in the comparable period last year. Non-GAAP EPS was $1.77, an increase of 24.6% from $1.42 per share reported in last year's first quarter.

First quarter EPS benefited from the margin expansion, including the profit pull-forward from our energy efficiency programs I previously mentioned and the favorable impact of our lower year-on-year interest expense and tax rate as well as greater efficiency in the business.

Shifting to cash flows and our balance sheet. In the first quarter, we used $10 million of operating cash for working capital needs, an improvement of $6.8 million as compared to the first quarter of last year. The use of operating cash flow is consistent with our typical first quarter seasonal working capital needs. Our days sales outstanding were 75 days compared to 71 days in last year's first quarter.

Capital expenditures totaled $5.2 million, down from $6.4 million in last year's first quarter.

At the end of March, our debt was $474.7 million, above the $430.4 million reported at the end of 2023. The sequential increase primarily reflects first quarter seasonal use of cash for share repurchases and year-end bonuses. On a year-over-year basis, we reduced our debt by $123 million from $598 million at the end of last year's first quarter. Our adjusted net leverage ratio was 2.29x at quarter end compared to 3.09x at the end of last year's first quarter. Approximately 58% of our debt is currently at a fixed rate.

We remain committed to a balanced approach to capital allocation. We continue to prioritize investment in organic growth initiatives, acquisitions, debt reduction share repurchases to offset the dilution of our employee incentive programs and quarterly dividend.

Today, we announced a quarterly cash dividend of $0.14 per share payable on July 12, 2024, to shareholders of record on June 7, 2024.

Now to help you with your financial models, our guidance from our last call remains unchanged. As a reminder, we expect to generate approximately 48% of our revenue guidance in the first half of the year. Our depreciation and amortization expense is expected to range from $24 million to $26 million. Amortization of intangibles should be approximately $32 million to $33 million. Interest expense will range from $32 million to $34 million. Our full year tax rate will be approximately 23.5%. We expect a fully diluted weighted average share count of approximately 19 million shares. Our operating cash flow is expected to be $155 million, and our capital expenditures are anticipated to be between $25 million and $28 million. And with that, I'll 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 very pleased with our results to date and the opportunities we see on the horizon. Our first quarter performance together with strong backlog, book-to-bill and pipeline metrics provide excellent visibility that supports our full year 2024 guidance. We're pleased to reaffirm our expectation that 2024 organic revenues from continuing operations will range from $2.03 billion to $2.1 billion, representing a year-on-year growth of 5.2% at the midpoint when compared to reported 2023 and 8.5% at the midpoint on continuing operations.

EBITDA is expected to range from $220 million to $230 million, reflecting year-on-year growth of 14.2% at the midpoint. Our guidance range for GAAP EPS is $5.25 to $5.55 excluding special charges and for non-GAAP EPS is $6.60 to $6.90. The work that I described in today's business review involves helping clients address many of the most challenging issues of the day. We are proud to participate in this work and have attracted a like-minded group of professions who are committed to making a positive impact on society. And with that, operator, I would like to open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Sam Kusswurm at William Blair.

Samuel Kusswurm ***William Blair & Company L.L.C., Research Division - Analyst***

I know you just mentioned you're still expecting 48% of full year revenue to occur in the first half. Based on your first quarter that implies sort of flat growth on the top line in the second quarter here, if we're using the midpoint of guidance, I guess I want to make sure I'm thinking about that the right way? Or maybe there is more optimism in hitting the upper range of guidance there.

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

Sam, thanks for the question. Yes, we think that the revenues will certainly uptick in the second half of the year. We have great visibility into the revenue stream. And we think that we'll have a continued strong growth, as outlined in our guidance.

Samuel Kusswurm ***William Blair & Company L.L.C., Research Division - Analyst***

Got it. Okay. Maybe pivoting here, I guess this question kind of relates to your work in commercial energy and renewables. We've heard about many of the difficulties clients are facing in that industry, such interconnection permitting and just great organization in general. I guess I'm wondering if you can help us understand how this impacts your business just limiting some of the work you can finish? Or maybe it's creating complexity you can help solve. Just want to get your thoughts around that.

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

Yes, sure. I mean I think that we certainly work on grid modernization, grid interconnection, interconnection issues related to renewable energy. And so I think those challenges in the industry are creating opportunity for us, and we're advising utility clients and power producers on those issues. And so that's certainly an area where we're supporting our clients and seeing opportunity. We continue to see significant opportunity around renewable power generation resources at the project level, both solar and wind, and are doing a significant amount of work for those clients.

And that continues to be strong, and we're quite active on that. And so I would generally say that the specific issues you mentioned, we're working with our clients intently to analyze and assess the issues and help solve them. And so it's, I think, generally been a net positive for us.

Operator

The next question is from Tobey Sommer with Truist Securities.

Jack Wilson ***Truist Securities, Inc., Research Division - Research Analyst***

This is Jack Wilson on for Toby. Maybe just to kick it off, can you maybe dig a little bit more in sort of what parts of the budget have been sort of most helpful? And if there are any sort of headwinds embedded in that other parts of the budget?

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

You did ask -- Jack, did you mean the federal budget? Or is that what you mean? Or...

Jack Wilson ***Truist Securities, Inc., Research Division - Research Analyst***

Yes, budgets.

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

I think that in the federal arena, I think we've guided to high single-digit growth for the year in our federal markets. I think in our last call, we indicated we'd have low single-digit growth in the first half as we ramp up our new IT modernization work, and we expect our USAID work, which includes the capacities to ramp-up as we go forward in the year. And so we remain quite confident at the high level on that guidance. I would say as we've discussed regularly on this call over the last couple of years, the 2 major areas of growth for us are in public health -- and in IT modernization.

And generally, the budgets there have been quite strong. They're bipartisan. They've seen very strong budgets in the last several years. And I think we're confident we'll see robust growth there for this year. Also, obviously, these are very large agencies, and we have a small share. So we're also taking market share in these agencies. But generally, I think the budget situation in our key federal growth areas remains positive, and we're -- as I say, we've guided to high single-digit growth for the year, and we're certainly confident in that.

Jack Wilson ***Truist Securities, Inc., Research Division - Research Analyst***

And then maybe just as a follow-up. When we dig into the IRA a little bit more, maybe using a baseball analogy, could you sort of describe what inning you think we're in? And if it's possible to segment that between sort of the supply and demand side of the equation, that would be helpful as well.

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

Well, I would say on the -- certainly on the IRA, I think we're still in the early innings. It's still ramping up. We're seeing that funding beginning -- has begun to flow. We're seeing it at the federal level. We're seeing it also getting to the state level, the states are turning around and starting to put out grants and move that money. And so I think we expect that will continue to ramp up for the next several years. And then from there, I think that's a 5- to 10-year money, and so it will be a long-term tailwind for us. And so I think we're in the early innings. I don't know the IRA is third inning, third or fourth inning. IIJA started a year, 1.5 years earlier. Maybe we're getting towards the middle innings there, but there's still a long tail of spend on the IIJA. And so (inaudible) we think those will be tailwinds and continue to present material growth opportunities for us over the next 5 to 10 years. In terms of supply and demand, I mean, I think I would say -- if I focus on the IRA. I think it certainly had an impact on both sides. I mean, obviously, the tax credits are providing tremendous incentives around solar wind and hydrogen and carbon cater changing the -- improving the economics of those activities.

And so we're seeing tremendous demand from that. And there's also funding available on demand side, and we're certainly supporting federal state clients, utility clients who benefiting from that around energy-related demand programs. And so we're seeing it on both sides. It is particularly strong right now on the supply side.

Operator

(Operator Instructions) Our next question comes from Marc Riddick with Sidoti.

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

So I wanted to touch a little bit on how we're feeling about what the potential acquisition pipeline might look like and maybe your current appetite and views as to maybe what you're seeing out there and valuations relative to maybe the beginning of the year, it seems like overall M&A seems to be picking up a little bit. I was wondering if you had any thoughts or views or how that might have evolved throughout the year.

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

Maybe I'll take a couple of words, and I'll let Barry speak to valuations. I think that -- I wouldn't say we've seen a material shift in the M&A market in the last couple of quarters. (inaudible) as you well know, Marc, I mean M&A has been a key part of our growth strategy over the years. We did our last material deal in July of 2022. We've obviously paid down a lot of debt. We have capacity. I think we -- so we remain in the market and continue to look at potential deals. Obviously, we're focused on areas around our key growth drivers. So around public health, data and analytics, energy. The -- I would say the market is -- has not changed in the last 6 months. Valuations are still a bit frothy. But Barry, do you want to give a little more color on that?

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

Yes. As John mentioned, we are very active in the acquisition arena. We're continuing to look at different properties as they come through the pipe. I'd say from a valuation perspective, at this point, we thought that maybe the valuations may have should tick down a little bit based on where we are with interest rates and kind of the equilibrium between the 2. But we still think that -- we still see that the valuations are still not that much change from the previous 6 months or even longer than that. We have, as John mentioned, plenty of capacity. We paid down a lot of debt. So we're certainly looking for that as we've done in the past, we certainly see the different markets that we play in. And depending upon the market, the valuations will fluctuate a little bit between some of the hotter markets versus some of the others. But we are very active and continue to look for acquisitions.

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

Great. And then I just have one quick follow-up. I was kind of wondering with the sort of shifting economic landscape, I guess, or forecasting relative to maybe where we began the year. Are you seeing any changes in the pace of RFPs? Or are there any particular client verticals that you're noticing any shift of behavior that we haven't had chance to talk about yet?

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

I mean I would say on the government side, we really haven't seen a shift. I think we continue to see opportunities there. The RFP flow, proposal flow is good. The pipeline is at or near a record. Our book-to-bill is very strong. So on the government side, I think it's business as usual. I would say in the energy climate arena, I think the results speak for themselves. I mean, we had north of 20% revenue growth in our energy environment infrastructure and disaster recovery market. our commercial energy business grew 34% in the first quarter. I mean we're seeing tremendous opportunity there. I think I've said before, we have our 5 key growth drivers, but the key drivers that are in the energy environment infrastructure area. Those 3 are certainly coming to the floor, and there's significant economic activity and significant opportunity across commercial federal government, state and local and international. So in that area, I would say that we're -- it's accelerating.

Operator

This concludes the question-and-answer session. I would now like to turn it back to CEO, John Wasson, for closing remarks.

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

Okay. Great. Thanks for participating in today's call. We look forward to connecting with you all at upcoming conferences and events. Thank you.

Operator

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