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Q2 2020 ICF International Inc Earnings Call

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## PRESENTATION

**Operator**

Welcome to the ICF International Second Quarter 2020 Earnings Conference Call. My name is Vanessa, and I will be your operator for today's call. (Operator Instructions) Please note, this conference is being recorded on Tuesday, August 4, 2020, and cannot be reproduced or rebroadcast without permission from the company.

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

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**Lynn Morgen**

Thank you, Vanessa. Good afternoon, everyone, and thank you for joining us to review ICF's second quarter 2020 performance. Hosting the call today are John Wasson, ICF's President and CEO; and Bettina Welsh, CFO. Joining them are Sudhakar Kesavan, Executive Chairman; and James Morgan, Chief of Business Operations.

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 4, 2020, 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 2020 performance. John?

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**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Thank you, Lynn, and thank you all for joining us to review our second quarter results and discuss our business outlook heading into the second half of the year. We were very pleased with ICF's strong performance in the second quarter, as it reflected considerable year-on-year and sequential growth in service revenue, which represents the work performed by ICF employees. We also achieved very strong sequential comparisons across key profitability metrics, including GAAP EPS, non-GAAP EPS and EBITDA, each of which increased substantially over first quarter levels.

These results demonstrate the resilience of ICF's diversified business model and our ability to pivot quickly to address changing business conditions. Much of the year-on-year decline in total revenues was tied to lower pass-through revenues, which were $22 million lower in this year's second quarter than in the comparable year ago quarter and $10 million below first quarter 2020 levels. This reduction was mitigated by strong revenue growth in our federal government and commercial energy businesses, with favorable business mix, lower G&A costs and higher utilization, driving higher year-on-year and sequential EBITDA.

Second quarter service revenue and profitability were above our expectations due to first-rate execution by ICF employees, who work closely with clients to meet their needs while working remotely, and to actions we have taken to reduce costs. ICF has learned to operate more efficiently in a physically distanced environment, and we will use these learnings to operate as a leaner organization in a post-COVID-19 world, particularly with respect to travel and facility expenses.

Revenue performance in the second quarter was driven by strong growth in our federal business, where the 21% year-over-year revenue increase reflected both organic growth and the ITG acquisition. In fact, the significant leverage gained from bringing together ITG's robust IT modernization capabilities and ICF's deep civilian domain expertise and client relationships has become even clearer now that the integration of this acquisition is fully complete. Nowhere is this more apparent today than in public health, where we have seen some initial contract wins by pairing our expanded IT modernization qualifications with our deep subject matter knowledge.

As an example, we recently announced a strategically important award to provide emerging technology and design acceleration support services to the Centers for Disease Control. Under this effort, we would be working with the Office of the Chief Information Officer to develop a framework to evaluate and implement emerging and modern technologies across CDC public health programs.

Also in the second quarter, we were awarded $13 million of COVID-19-related task orders to assist federal agency clients, including our largest client, the Department of Health and Human Services in collecting data as well as communicating with health care professionals and the general public.

Over the next 1 to 2 years, we expect to see a considerable increase in public health preparedness and response activities at the federal, state and local levels. With contract vehicles in all of the key agencies that are involved in handling the COVID crisis, ICF is uniquely positioned to assist clients across the 3 phases of the COVID pandemic: response, recovery and reinvention.

As I just mentioned, we are currently active in the response phase, with information dissemination and surveillance and analytics work to better understand the virus and how it spreads. In the recovery phase, we expect that modernization of disease surveillance systems and associated analytics will be a priority, and our expanded IT modernization capabilities, together with our deep domain expertise and agency relationships in public health, make ICF uniquely qualified to assist in these areas.

In the reinvention phase, we believe that government will need to reevaluate the current organizational structure to address key issues, including governance roles and responsibilities, the national stockpile of vaccines and medical equipment, and the service capacity of our hospitals and health care workers. We have been thought leaders in the public health arena for many years, and ICF is recognized for our subject matter expertise in all areas of public health, both domestically within HHS and internationally, supporting USAID programs.

Revenues from state and local clients came in better than expected. We experienced less client in-sourcing in our disaster management business than anticipated and expect this trend to continue for the remainder of the year. We also are responding to new requests for support and staff during this period. As a result, we now expect disaster management to account for over $110 million in revenue for ICF in fiscal 2020.

We also continue to expect additional opportunities for ICF stemming from disaster management work in Puerto Rico and Texas associated with the 2017 and 2018 hurricanes. In the second quarter, we saw several new RFPs related to additional HUD CDBG funding in Puerto Rico that we are expecting award decisions on in Q3, and there is an additional $8.25 billion allocated to Puerto Rico under the CDBG Mitigation Program, for which RFPs should be forthcoming either later this year or early next year. We believe we are only a handful of years into what will be 10-plus years of requirements.

Work with Texas state agency disaster management clients picked up during the second quarter, with additional revenue related to housing construction management within our existing contracts. Texas also remains an active market for mitigation work. The state led several mitigation procurements in the second quarter that should be decided in the near term, and we expect several more mitigation bids during the second half of the year. Also, more generally, the great majority of the work we do for state and local clients is either federally-funded or funded by municipal bonds that support infrastructure projects, which makes our work much more resilient to and less impacted by state budgets at the state and local levels.

As expected, international government revenue trended lower in the second quarter, primarily as a result of COVID-related lockdowns and resulting postponements of face-to-face events, conferences, meetings and surveys that we support for the European Commission. Keep in mind that 65% of the year-on-year revenue decline in this market represents pass-through revenue, on which we earn minimal fees.

Project work remains strong in energy, climate and international consulting, and we continue to win work with the European Commission to deliver programs to influence the low carbon and clean energy transition. We are also closely managing costs in this business, and we have confidence in the strength of our client relationships and the potential for the business to turn quickly once COVID-19 concerns recede.

Our commercial energy business, which works primarily for utility clients and represented 16.4% of Q2 revenues, continued to perform well in the second quarter, with revenues increasing by 5.4%. Work on our energy efficiency programs for utilities continued apace, as we've been able to handle most elements of the programs while working remotely. During the COVID-19 crisis, we have been working closely with our utility clients to virtualize portions of our field work, such as virtual audits, using photo and video inspections and transitioning to virtual account management. These responses have been well received by our utility clients who see effective communication of their customer-facing programs as a high priority.

We saw a significant pickup in our energy markets advisory business in the second quarter, where we provided services to support significant transaction activity, largely driven by renewables, storage and gas asset development. Our distributed energy resources consulting business also performed well as states and utilities address the impact of distributed resources on the grid. We believe that the utility partner programs we're working on can evolve into future utility implementation programs beyond traditional energy efficiency. We've also been assisting several utilities with resiliency planning activities, and this area is expected to grow as federal and state regulators drive additional attention to the resiliency of our key energy infrastructure.

Commercial energy ended the quarter with a robust pipeline of potential opportunities, particularly around the expansion of energy efficiency program outsourcing in California, and we expect decisions to be forthcoming later this year.

Lastly, commercial marketing services represented 10.5% of second quarter revenues. Similar for our clients in travel and tourism, hospitality and retail has been curtailed as a result of COVID-19, but we continue to do ongoing retainer work on the loyalty programs. Our activity on behalf of health clients, which represents our largest industry vertical, remains strong with increased budgets, resulting in additional assignments. For example, in the second quarter, we won several new contracts with health care clients, including a $30 million plus integrated marketing and communications contract, under which we are providing strategy, implementation, advertising, and analytics support.

We are very proud of the work we did early in the second quarter for our client, Serta. ICF Next helped Serta donate 10,000 mattresses to New York City hospitals and medical facilities fighting COVID-19, and we launched "Stay Home, Send Beds", a program allowing bed donations from anyone. In addition to doing good, the campaign earned Serta more than 300 million media impressions in outlets like Fox Business, Forbes and NBC's Early Today show.

ICF ended the second quarter with a robust pipeline, which reached a record $7.1 billion. The opportunities are diversified across our client set, with federal government accounting for about $4 billion of this $7.1 billion. Approximately $1.4 billion of this amount represents opportunities in IT modernization, where we have a greater chance of winning thanks to the ITG acquisition, and which pair our strong domain expertise with broad experience in providing cloud-based services to federal government agencies. We also have robust opportunities in the pipeline for disaster management and energy work for utilities. Over the past 6 weeks, we have received notice of awards with an aggregate value of over $250 million, which we expect to be included in our Q3 contract awards.

A robust pipeline together with our strong backlog and recent notice of awards supports our confidence in ICF's future growth prospects.

Now I'll turn the call over to our CFO, Bettina Welsh, who will provide a detailed review of the quarter. Bettina?

**Bettina Garcia Welsh** ***ICF International, Inc. - Senior VP & CFO***

Thank you, John. Good afternoon, everyone. I'm pleased to provide additional color on the company's financial performance in the second quarter of 2020, which represented strong profitability improvements over the first quarter and positive year-on-year comparisons in several key areas.

Total revenue was $354 million, 3.5% lower than last year, primarily as a result of lower pass-through revenue. Pass-through revenue accounted for 26.2% of total revenue this year compared to 31.2% in last year's second quarter.

On the other hand, service revenue increased 3.5% to $261.2 million, supported by solid performance in our federal government and commercial energy businesses. As you may recall, service revenue is the work performed by our ICF employees.

Gross profit was $130.6 million, relatively flat with the $131.7 million in the year ago quarter. Gross profit margin on total revenue, however, expanded by 100 basis points to 36.9% due to lower pass-through revenues than the second quarter of last year, on which we earned lower margins.

Indirect and selling expenses for the second quarter declined 2.2% to $99.3 million, mainly reflecting lower general and administrative expenses tied to reduced travel and other activities. This represented 28% of total revenue. As a percentage of service revenue, indirect and selling expenses declined to 38% from 40.2% in last year's second quarter.

EBITDA increased 3.7% to $31.3 million from $30.2 million last year. Adjusted EBITDA, which excludes special charges, was relatively flat at $32.5 million during the second quarter of this year compared to $32.7 million last year. Adjusted EBITDA margin on service revenue was 12.4% compared to 13% last year. Sequentially, adjusted EBITDA was up $4.5 million from the first quarter of 2020. This marked 150 basis point improvement in adjusted EBITDA as a percentage of service revenue over the first quarter, reflective of higher gross margin and lower indirect costs.

Operating income of $22.8 million was slightly ahead of the $22.5 million reported in the second quarter of 2019 and includes an increase of $1.4 million in amortization of intangibles, primarily related to the ITG acquisition, which was completed on January 31 of this year. Our tax rate was 29% compared to 26.2% in the second quarter of 2019, primarily due to certain nondeductible items in 2020.

Net income for the quarter was $13.7 million or $0.72 per diluted share. This compares to $14.6 million or $0.76 per diluted share in the second quarter of 2019. This year's second quarter results were impacted by $0.04 derived from higher acquisition-related interest expense and $0.03 from a higher tax rate.

Non-GAAP diluted EPS, which excludes the impact of amortization of intangibles and special charges, was $0.89 compared to $0.97 reported in the second quarter of 2019.

We were very pleased with our cash flow generation in the second quarter, which was a period of strong collection activity. Year-to-date operating cash flow was $10.8 million compared to $47.9 million use of cash for operating activities in last year's first half, representing a $58.7 million improvement. This performance supports our expectation for full year 2020 operating cash flow of approximately $110 million, 20% ahead of 2019.

Days sales outstanding were 88 days, or 78 days excluding the slower-paying Puerto Rico contract, compared to 95 days and 84 days, respectively, in the second quarter of 2019. By year-end, we anticipate DSOs to be in the range of 78 to 83 days.

Our bank leverage ratio at the end of June was 3.07, and we expect to use our cash flow to pay down debt and end this year with a bank leverage ratio of approximately 2.6.

Year-to-date capital expenditures were $10.7 million. Reflective of our decision to evaluate spending in light of the current economic environment, we now anticipate our full year capital expenditures to range from $23 million to $25 million, down $2 million from our previous guidance.

Our capital allocation priorities remain debt reduction and funding our dividend. To that end, today, we declared a quarterly cash dividend of $0.14 per share, payable on October 13, 2020, to shareholders of record on September 11, 2020.

For modeling purposes, our expectations for full year 2020 are as follows: depreciation and amortization expense in the range of $20.5 million to $21.5 million; amortization of intangibles of $13.3 million; interest expense between $15 million to $15.5 million; tax rate of no more than 27.5%; and fully diluted weighted average shares of approximately 19.2 million.

And with that, I'll turn the call back to John for his closing remarks.

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Thanks, Bettina. To sum up, we are pleased with our second quarter performance and expect continued improvement in the second half of this year. Based on current visibility, we are reaffirming our guidance for full year 2020 across key metrics, including cash flow, where we had a very strong showing in the first half compared to the same period last year.

We are entering the second half of this year with a substantial backlog, a record business development pipeline and a strong financial position. These attributes, together with our recession-resistant revenue drivers, support our confidence in ICF's ability to operate effectively during this period of economic uncertainty.

ICF's differentiators have long been around subject matter knowledge and culture. Our civilian agency domain expertise in the high-profile areas of IT modernization, digital transformation and public health, our qualifications in disaster management and mitigation and resilience, and our leadership in energy efficiency and advisory work, position ICF for further progress in 2020 and accelerated growth in 2021 and beyond.

Our company is comprised of people who are passionate about their work and committed to client service. In the second quarter, our personnel turnover rate was 11.4%, remaining below the industry average. The ICF culture has been a key driver of our growth thus far and has enabled us to perform well during this health crisis. A key tenet of this culture is focused on embracing diversity of all kinds. And given recent events, we've recently redoubled our efforts with respect to diversity and inclusion.

In June, we issued a public statement on social justice, which I encourage you to read. It's on icf.com. We've also taken the step to match employee donations to organizations working to enhance inclusion, build strong communities and improve economic equality, values that are central to ICF's own founding 50 years ago. And in our annual corporate citizen report issued last month, we've included race-specific diversity data for the first time in an effort to provide more transparency and focus on the diversity of our employee base.

I appreciate the hard work and dedication of the ICF employees; they give me confidence that ICF will not only continue to progress throughout this year, but will emerge from this pandemic as a leaner and stronger company, operating in an environment where our domain expertise, as well as our corporate citizenship and our values, become even more relevant.

Operator, I'd now like to open the call to questions.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) We have our first question from Joseph Vafi with Canaccord.

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

Nice quarter and nice to see the setup going into the second half. John, I was wondering if you could kind of quantify the delta on disaster management now. I know I heard your comments about a little less in-sourcing. What were you -- what was the kind of expectation, if you could remind us, on what disaster management revenue is going to be this year previously and now with less in-sourcing just to get an idea of the delta there? And then I have a follow-up.

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Sure. So I think on our past call, we had said that our disaster management revenues would be north of $100 million this year. We're now expecting them, as I said in my remarks, being north of $110 million. And so we've seen about -- our expectation is there'll be $10 million less of in-sourcing this year on the -- on our disaster management work.

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

Okay. Got it. And should we expect that to kind of be the new run rate with less in-sourcing, say, into next year or is this kind of just we're taking it a year at a time on the level of in-sourcing?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

I would say that our expectation is that we would continue on this run rate. I think we're not expecting any further in-sourcing on this work. I think this is the new normal. And as you know, Joe, we have another year to go on that contract through June of 2021.

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

That's good news. And then just real quick on commercial marketing and the retainer work going there. Is there -- I know that some of the affected clients are kind of retainer-based, but as the pandemic continues to linger on, how do you feel about that run rate on retainer work as it stands now, even in a prolonged pandemic situation?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Yes. I think we feel pretty good, Joe. And I would say that we obviously saw impacts in Q2 and have been in close contact with those clients. I think we feel that the retainer work we have, the backlog we have is pretty solid. And so I think our expectation is that we won't see further reductions there. I think that generally -- certainly, much of the work we're doing under retainers is very valuable to the clients. We're running loyalty platforms. We're helping them stay engaged with their most valuable customers. And so I think they view us as partners, and they want to make sure these programs and these efforts continue. And so I think we feel pretty confident with the retainer relationships and the backlog we have in place in terms of the best as we look forward.

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

Okay. That's helpful. And then just finally, just any more color around the large deal pipeline. It does sound like the pipeline is good. I heard what you said a little bit about IT modernization. But in particular, do you -- is there anything on the large deal front that could be percolating towards decisions or proposal submissions in the next quarter or 2?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Sure. Well, I certainly think IT modernization is an area where we're seeing significant large opportunities. I think we -- as I noted in my remarks, we were thrilled to bits with the ITG acquisition. I think we've continued to build out the pipeline there and win significant contracts. And so certainly, IT modernization is an area where we continue to see robust opportunities and certainly expect to continue to win contracts this year. As I said in my remarks also, I think there's -- there are bids that are underway on the disaster management front, both in Puerto Rico, more on the traditional housing side and then in Texas on mitigation. Those bids have been out. We do expect award decisions on those at some point in Q3. And so those, as you know, can be quite significant. And we remain quite busy on California and the opportunities there. It's a very intense period writing proposals in California. Again, I would say that we expect work there in the second half of the year. So I guess that's a long-winded way to say across federal, disaster management, energy. I think there's certainly opportunities in the second half of the year that can move the needle.

**Operator**

We have our next question from Tobey Sommer with SunTrust.

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

I wanted to see if I could tuck in and get your color on the size and duration of the opportunity that you could garner new contracts related to COVID-19 in the public. And I guess, not specifically COVID-19 because you did cite some contracts, but all-encompassing kind of a public health effort to retool and reinvent, to kind of borrow your word with prepared remarks.

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Yes. Tobey, I think it's a little early for us to put a lot of guidance or color around the total size of the contract. So the -- or the specific opportunities that could come down the pike here, as I mentioned, I mean, I think there's kind of -- there's the response and there's a recovery, and then there's the reinvention. I still think we're in the response phase. And so we've -- as I noted in my remarks that we won $14 million or $15 million, $14 million of contracts here in the second quarter. I think we are finding multimillion-dollar opportunities flowing through our existing contracts, our existing client relationships. We're certainly in the game on some very strategic work. As you know, I think as we get deeper into this response to this pandemic, more focused on being from immediate response to recovery, kind of reimagining public health, I think the opportunities could become quite sizable. As you know, the funding that's been allocated to public health agencies associated with the first stimulus bill, the first $2 trillion stimulus bill or hundreds of millions of dollars to CDC, to NIH, to other public health agencies. And so I think they can be quite significant. I think they could move the needle for us, as I've told you and others and we shared before -- I mean the types of funding here, if we look at the past, again, when Obama stimulated the economy, he had $900 billion in the TARP program. I mean we grew double-digit for 2 or 3 years in the federal government on the back of those types of projects and around infrastructure defined, I think the same potential opportunity is in front of us here over the next several years. If that funding moves into our clients in areas that fit with our expertise, which I think our view is it will, I think it can provide a very significant opportunity as we look forward. But it's hard for me to talk about specific contracts or specific ranges, at $25 million contracts, $50 million contract. I just-- it's too early for us to put a lot of color around that.

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

Okay. With respect to disaster recovery, as you look at the pipeline of RFPs in projects that you expect to either already have bid on or bidding on through the balance of this year, are they more related to the residential infrastructure of sort of the first action plans that were submitted and approved? Or do you expect to see mitigation related funds adjudicated and awarded?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

I would say that in Puerto Rico, the opportunities we're seeing for this year are more housing-related funding. So from traditional CDBG funding. And under CDBG, that funding, in addition to supporting homeowners who build their homes, that funding can also support certain types of infrastructure repair by state and local governments. It can also support economic recovery to the Puerto Rican economy. And so I think the types of opportunities we're going to see that will be adjudicated in Puerto Rico this year will be material potential opportunities around infrastructure and economic recovery with more traditional CDBG housing funding. I think in Texas, the opportunities, as I noted in my remarks, we are seeing mitigation opportunities flow there. Those contracts could be material, and I think they will be awarded in the second half of the year. So in Texas, I would say, the more significant opportunities are certainly on the mitigation side for this year.

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

Tobey, let me just go back to your original question on the whole issue of public health and how this is going to evolve. I do think that it's really quite important to understand, as John said, the response to company reinvention and the recovery and the reinvention part of the business, the response and the recovery response would certainly have been improved through the pandemic. And I think that the restructuring of the public health agencies in the federal government is going to be a major exercise going forward. I think given our understanding of the different agencies and given our skill sets in the whole response recovery arena, we do think that -- and the fact that we have these technology calls on IT modernization, we do think that if there is a new, say, public health security administration just to combat these kinds of pandemics, we think that we are well positioned to take advantage of the reorganization or possibilities associated with that sort of big huge reorganization. So we do think that there is going to be -- if you look forward the next 2 or 3 or 4 years, I think that there's going to be enormous amounts of reinvention -- reimagining of the particular (inaudible).

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

Okay. Last question for me. Within the contracts that you -- contract value that you cited as already being -- receiving quarter-to-date, do you -- are there some contracts awards within that, that play into the themes of public health and COVID-related work, disaster recovery and the commercial energy, energy efficiency project sort of broad themes that investors are looking to, to drive growth going forward?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Yes.

**Operator**

We have our next question from Sam England with Berenberg Capital.

**Samuel England** ***Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst***

Just a couple for me. So firstly, could you talk a little bit about what you've seen in terms of project postponement and cancellations in the commercial side of the business in Q2? And whether there's much that's been pushed back that we can expect to flow through in H2?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

I think as we -- I don't think we've seen a significant shift in the cancellations since we talked about this during our first quarter call in May. I mean I think, we had indicated at the time that we -- obviously, we're going to see COVID-related impacts in commercial marketing. In European businesses, I think we indicated we thought that they could be down as much as 20% for the year. And I think that's played out as expected. I don't think we see a new or different trend there. We don't see a new material risk there. I think it's playing out as we've been discussing it. And I think we don't expect any surprises there.

**Samuel England** ***Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst***

Okay. Great. And then on the acquisition side, given the success of the ITG deal, do you think more acquisitions in the IT consulting space are likely going forward? And what areas do you view as most attractive?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Well, I think we've talked broadly on the acquisition front. I mean, first, I would say that we continue to stay very focused on the success of ITG. As I said in my remarks, we've fully integrated it, but we're quite focused on continuing to build out the pipeline and make sure we achieve all the synergies there. I do think there is significant growth opportunity for us there. I mean the model of pairing their IT modernization expertise with our domain and client leadership certainly is giving us a lot of opportunity for growth. I think as we look down the road, I think our story has been consistent. I mean I think, we continue to look at opportunities potentially in the federal arena, particularly around public health and health broadly and certainly, IT modernization. I think we have scale there, but I think we -- if specific client relationships came -- firms with specific relationships that were of interest to us, we'd look at digital transformation. And so I think those would be the areas in federal. I think in energy, I think we're constantly looking for firms that could expand either our expertise or geographic reach on energy efficiency or distributed energy resources. I would say those are the primary markets that we're focused on from an M&A perspective. And I think -- for the remainder of this year, I think we're going to be quite focused on integrating and ensuring the success of ITG, but we certainly stay out in the market and continue to look for opportunities. And I mean if you take a long run view, certainly, acquisitions will continue to be part of our strategy.

**Samuel England** ***Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst***

Okay. Great. And then maybe one last one. Could you just talk a bit about headcount and hiring plans for the second half this year?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Yes, I mean, I think the headcount and hiring plans will follow the growth. I mean we're growing 3.5% in the last quarter on service revenue. And so I think there are certain markets where we are growing, IT modernization, energy efficiency. And certainly, on disaster recovery, if we win more contracts, we'll have to hire. I think we found that we can be quite successful hiring in this environment, in a virtual environment, in onboarding people. I would say, at the end of the day, you'll also note that our utilization has gone up here in the last quarter. We're -- I'm very focused on that. And as we grow, we will -- for every -- if we're going to grow 4%, we will try to hire 2.5% or 3% additional staff and leverage our existing staff to get the work done with the growth. And so I think we're being pretty careful there and really want to leverage our existing talent as best as we can.

**Operator**

We have our next question from Andrew Nicholas with William Blair.

**Andrew Owen Nicholas** ***William Blair & Company L.L.C., Research Division - Analyst***

I just wanted to ask a high-level question on the quarter. Just wondering if you could kind of speak to how the results came in relative to your expectations a couple of months back. And then relatedly, if we're thinking about medium-term demand, you've talked about a lot of different positive growth drivers across several of your businesses. Is there anything material that accelerated or decelerated versus the last time we spoke? And what would those be?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Yes. I mean I guess, in terms of the quarter, I think we certainly feel the quarter came in stronger than we expected. I think in our first quarter call, we had said that we thought the business would be flat to down marginally to slightly. Obviously, we've achieved 3.5% service revenue growth all in, which is kind of the work done by ICF employees, which is obviously the most profitable, and so we certainly outperformed our expectations. From there, I think that, as -- I believe I mentioned, I think that's due to disaster management and less in-sourcing and a very strong quarter in energy advisory. We see energy continuing to improve, and IT modernization remains very strong. I think a portion of the strength we had in the second quarter, we certainly pulled forward some project work, particularly in the energy advisory side. But having said that, those 3 markets have been quite robust. I would say, as we look forward in terms of the opportunities, in terms of our outlook vis-à-vis where we were a quarter ago, I would say that we have greater confidence that our disaster recovery and CDBG and mitigation, the housing and mitigation contracts, we'll start to see opportunities there decided in the second half of the year. We continue to feel very good about the IT modernization. And I do think we can see some awards in California on energy efficiency in the second half of the year.

So I think we're certainly more positive on the disaster recovery and continue to be positive on energy efficiency and IT modernization. In public health, I think there's a lot of opportunity. As I said in my answer to Tobey, I think we feel like we're getting our fair share of the imminent recovery work. But the real opportunity for us is the medium to long-term, and it's a little too early to kind of fully characterize those opportunities. I just -- we're obviously very pleased to have the $250 million of notice of awards in the last 6 weeks or so. That should move into contract sales for Q3. We're quite pleased to see some of that movement.

**Andrew Owen Nicholas** ***William Blair & Company L.L.C., Research Division - Analyst***

Got it. Got it. And then just a housekeeping item for me, and I apologize if I missed it. But did you mention the ITG revenue in the quarter and maybe how fast that's been growing?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

No, we haven't -- I don't think we've -- I mean we fully integrated ITG with our kind of IT modernization business, and so we kind of put those 2 together and broke it down. So I would just come back to what we told you at the time of the acquisition. I think ITG ended the year on a $90 million run rate. We told you they would grow at least 15%. They're certainly growing at least 15%. And so they're certainly achieving and, if not exceeding, expectations.

**Operator**

Our next question is from Kevin Steinke with Barrington Research.

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

I wanted to start out by asking about, John, you mentioned in your prepared comments some success with distributed energy resources, pilot projects, I believe. And can you just talk about trends in that business? Are you winning more new pilots there? And are any of those projects progressing towards what might be to the larger implementation contracts that you ultimately anticipate there?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Sure. I mean I think you've done a nice job kind of summarizing where we are there, Kevin. We are certainly -- have won and continue to win and see distributed energy pilot projects to test -- so basically work with utilities to test ideas and approaches on the distributed energy front. And so we do have a portfolio of projects there across several utilities that are in the pilot phase, and we can continue to see additional opportunities. So I think we'll continue to add to that portfolio part of the projects. And then there will be some that are successful and some that will have to be -- won't be as successful and will have to be reevaluated or changed, but there will certainly be a subset of those that will be successful and that will move into implementation phase, and that's where kind of like the analog of energy efficiency, as you point out. Those successful programs could ultimately be -- end up being utility programs across a broad swath of utilities in the country. And so that's certainly the long-term goal. I don't think we're at the point -- I mean, certainly, this year, we're not going to move these projects into implementation. I still think we're a year or 2 away from doing that with any scale. But I mean that is how the business will progress. And those opportunities are out there, and we are building a pipeline and adding to our pilot projects over time.

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

Okay, great. And I wanted to ask about how we should think about indirect and selling expenses kind of trending as we move forward here for the rest of the year. You had talked about last fall some furlough programs, et cetera. Should we expect to see some of those costs coming back as the year progresses? Or maybe conversely, do you get a full run rate of those cost savings moving into the third quarter and the back half?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

I think that -- as you point out, I mean we certainly -- with the COVID issues, we certainly reduced our indirect travel cost materially, obviously, focus on traveling, which is absolutely necessary and have reduced some of our indirect consultants and obviously, conference attendance. I think that we'll -- so I would say 2 things. One is, I think we've, we're garnering significant cost efficiencies there. As I think through the rest of this year, we've assumed that those significant savings will continue -- obviously, as the business rebounds and the world comes back, we'll need to do more travel. We can't stay at this low level, but we certainly expect that in the long run, we'll be able to reinvent our business and save a portion, spend less on indirect travel and conferences and ultimately, also save on facilities because I think we certainly learned that we don't need to have -- we can work very effectively in a virtual environment, and we don't have to have people in the office 5 days a week. And so I think over time, as we -- leases expire, we'll certainly be looking to reduce our facilities footprint, and that's our third largest cost in the company. And so I think that's another area. That won't happen overnight, but there could be material savings there. And so I think for this year, we'll continue to see the savings on indirect travel, but there will be longer-term savings across travel and facilities cost for us, too.

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

(inaudible) follow-up today.

(technical difficulty)

**Operator**

Pardon me. You're breaking up, Kevin. I'm sorry, you're breaking up. Could you repeat that?

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

Hello, can you hear me now?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Yes. Yes, we hear you now.

**Operator**

Yes. Please go ahead.

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

I'm sorry about that. I just was asking as a follow-up to that. It's obviously beneficial to get cost savings out of reduced facility space, et cetera. But just from a higher level perspective, how do you balance that out with -- as a professional services firm having interaction between your consultants in terms of brainstorming and knowledge transfer and mentoring, et cetera, so you can continue to have a strong culture and all that -- all of those things that are important to a professional services firm.

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Yes. Okay. No, yes, that's a good question, and I completely agree. I mean the culture, the brainstorming, those interactions are incredibly important, and so we're going to have to find a balance here. We've talked a lot about the importance of culture. I would say that we have been doing a lot of work on the innovation front in terms of methodologies and approaches, obviously in this COVID environment to do virtual brainstorming and using technologies to support that, whether it's MURAL or Teams or Zoom and really coming up with specific methodologies to teach our staff. And actually, our clients to have virtual brainstorming sessions that can be quite effective. And so I feel like we do have an innovation function within the firm that's very focused on that. We've managed to actually apply those methodologies, both within the company and are now doing it with clients. And actually, they're paying us to help them run virtual brainstorming sessions within their organizations. And so I think a part of this is you have to innovate and you have to figure out how to do this virtually. But please don't take my comments as that we're going to push everybody out to a pure virtual approach in the long run and let it adversely impact our culture. They'll be -- they'll have to be the right balance, absolutely the case.

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

Okay. Got it. And then lastly, can I just ask about maybe how you expect the cadence of results to play out in the back half of the year?

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

I think we would see continual improvement from Q3 to Q4. I would say that we did pull forward a little bit from Q3 into Q2, so I would say kind of -- so we would see consistent improvement. But given the pull forward, Q3 would probably show a little less improvement from Q2 to Q3 than you would expect from Q3 to Q4.

**Operator**

(Operator Instructions) And we have our next question from Marc Riddick with Sidoti.

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

Wondering if you could touch a little bit on ITG for a moment. If I remember correctly, when the acquisition was announced, the amount of their business, the percentage of their revenue that subcontracted, was higher than the company average. Also wondering if maybe you could talk a little bit about what that looks like now, especially with the orders that you have and the progress that you're making there? And then I have one last follow-up after that.

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

I think we're making some progress on that front. As we discussed at that time, ITG did subcontract a higher percentage of their revenues than ICF typically does. I think at the time of the deal, we thought that we could pull, I want to say about 10% of that revenue potentially in-house. I think we've been working through that. We've had some success. We continue to work it. Obviously, as we've said many times, and you can see in our results this quarter, it's much better and more profitable if we can have it done in-house by ICF staff than by subcontractors. And so we have strong incentives that we're working on. I think the other thing that's helped us there is as certain parts of our commercial marketing services business has slowed, we've been able to take technologies from that business and essentially transfer them onto ITG project work. And I think we're up to, I don't know, 15 or 20 people technologists that we've transferred into that business, which has helped to accelerate pulling some of the work in-house. So we're working it. There's more to do, but we're making progress on it.

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

Okay. That's certainly encouraging. And then the last one for me, you touched on the concerns that some folks have around as state and local tax revenue going forward, and you certainly kind of framed around how much of -- talking about the federal contribution being part of that and what's tied to bonds and what have you. Is there sort of a ballpark percentage of the state and local that you think is potentially vulnerable to that amount for us to think about as far as -- I mean, granted, it seems as though most is certainly covered, which should take care of most for you as well. So I'm sort of curious as to maybe what percentage is actually subject to that.

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Yes, I think it's a small percentage. I mean I think, disaster management is all federally-funded, that's over half of the business. And then the infrastructure work is primarily municipal bond rates. So I mean I haven't done the calculation exactly, but I would -- 10%, 10%, 15% might be, subject to state and local -- state budgets. It's a small -- it's not -- I mean that gives you a sense.

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

Okay. Great. And then the last thing for me, and this is probably maybe more general in nature, but I was wondering if you could sort of share some of the thoughts as to how you see the processes of California progressing. And maybe if you could give a little additional color as to your thoughts on the possibility of seeing some more activity there between now and the end of the year. Certainly, it's obviously tricky to predict, but was just sort of wondering if there were and maybe what some of those things are that give you some level of comfort going forward.

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

I mean I think, it's just the intensity of the proposal effort is certain to remain quite robust in California. I think as we've discussed on prior calls, the initial set of bids that originally came out -- the bids kind of fall into 2 buckets. One are bids that -- each individual utility is kind of running the RFP process for their service territory as mortgage as ours. Initially, the bids -- set of the bids we're focused on, each utility was running programs that were focused in each of their service territories and because they were -- for just their territory, they weren't statewide, they tended to be smaller. So we saw a smaller but a significant number of those bids earlier in the process. Early this year, we've begun to see the statewide bids come out, and those are more sizable and obviously, will apply across all the utility service territories in California. And so I think we'll certainly start to see some awards -- certainly see awards on the smaller utility specific areas. And I think there's a potential we'll see a few awards on the statewide before the end of the year. I think the bigger statewide opportunities will be -- the rest of the -- and most material number of statewide opportunities will be decided, I think, early next year or at some point next year. But there's certainly going to be awards this year, and I think if utilities move them into implementation quickly, it could certainly help us certainly in the fourth quarter. We are just very busy on our feet there. And as we talked about, it's a 2-stage process, you pitch your ideas. Hey, if your idea makes the cut to NAS, we'll form a proposal, and we've continued to have a very high percentage of our ideas to make the cut to the proposal stage.

**Operator**

At this time, we have no further questions. I will now turn the call over to management for closing comments.

**John Wasson** ***ICF International, Inc. - President, CEO & Director***

Okay. Well, thank you for participating with us today. We look forward to seeing you virtually at upcoming conferences and meetings. We certainly hope that you and your families stay safe. Thank you.

**Operator**

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