

ICF

ICF Definitive Agreement to Acquire SemanticBits Meeting

June 8, 2022 - 5 p.m.

CORPORATE PARTICIPANTS

John Wasson – *Chairman and CEO*

James Morgan – *Chief of Business Operations*

Mark Lee – *EVP and Group Lead, Public Sector*

Barry Broadus – *CFO*

Lynn Morgen – *Investor Relations*

PRESENTATION

Operator

Good afternoon and welcome to the ICF conference call to discuss a definitive agreement to acquire SemanticBits. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the * key followed by 0. After today's presentation, there will be an opportunity to ask questions.

To ask a question, you press * then 1 on a touchtone phone. To withdraw your question, please press * then 2. Please note that this conference is being recorded on Wednesday, June 8, 2022, and cannot be reproduced or rebroadcast without permission from the company. And I would now like to turn the conference over to Lynn Morgen of AdvisIRy Partners. Please go ahead.

Lynn Morgen

Thank you, operator. Good afternoon, everyone and thank you for joining us to discuss today's announcement that ICF has reached a definitive agreement to acquire SemanticBits. Today's call will be hosted by John Wasson, Chairman and CEO and we will be joined by James Morgan, Chief of Business Operations; Mark Lee, EVP and Group Lead, Public Sector; and Barry Broadus, CFO.

As noted in our release, this live webcast includes supplemental slides that we will refer to during our remarks. These slides are also posted on the ICF website, icf.com. During this conference call, we will be making 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 June 8, 2022, press release and our SEC filings for a discussion 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. In addition, and as a reminder, we may be limited in discussing certain aspects of this transaction until after closing. I will now turn the call over to ICF's CEO, John Wasson. John?

John Wasson

Thank you, Lynn. And good afternoon, everyone. Thank you for joining us on short notice to discuss our definitive agreement to acquire SemanticBits, which we announced after the market closed today. This transaction is fully aligned with our strategy of building out ICF capabilities in high-growth markets and complementing our high single-digit organic growth with acquisitions that provide significant opportunities for revenue synergies.

Moving to slide 3, you can see a snapshot of SemanticBits, a 450-person firm that provides open-source IT solutions, at scale, primarily to the Centers for Medicare and Medicaid Services, or CMS. SemanticBits has an excellent reputation, and its technologists and practitioners bring demonstrated success with large, federal health IT projects and expertise across 30 technology platforms. Their fully agile and open-source approach compliments ICF's deep, federal health domain expertise and digital modernization capabilities, builds out our health IT and analytics capabilities, and brings the run-rate of our digital modernization business to almost \$500 million, further reinforcing our leading position as a provider of these services to civilian agencies.

SemanticBits is on track to generate revenues of approximately \$135 million this year, and we expect to close the transaction mid-July. Approximately \$115 million of that revenue is expected to be recurring in 2023, reflecting the completion of several small business contracts this year and next. SemanticBits has a track record of double-digit revenue growth and is expected to generate EBITDA margins in the high teens as part of ICF.

As you can see on the left of this slide, over 90 percent of SemanticBits revenue has been derived from the Centers for Medicare and Medicaid Services, again known as CMS. In the bottom right, you can see some of the domain areas they are focused in. These are all areas of significant growth in spending at CMS and NIH and complement our existing capabilities very well.

Slide 4 highlights our strategic thinking in moving forward with this transaction. First, SemanticBits is a well-regarded service provider to the Department of Health and Human Services, which is our largest client, representing 20 percent of ICF's total revenues prior to this acquisition. Second, with the vast majority of its revenues derived from the CMS, SemanticBits opens up a large, new addressable market for us, giving ICF scale at CMS, an agency with substantial and growing budgets. Third, we will be able to leverage their large, open-source project experience to service customers both within HHS and beyond.

We are seeing a lot of large, open-source opportunities across our civilian space and adding SemanticBits makes those much more winnable for us. Fourth and fifth, we are acquiring a leader that is adept in all areas of advanced technology required to support the overhaul and maintenance of legacy systems and a team of exceptionally talented technology experts.

Slide 5 details a number of the initial growth opportunities we see for ICF at CMS. CMS spends a great deal every year on exactly the types of services we provide and their spending will continue to grow in line with the need to reduce the healthcare costs of an aging population.

We have narrowed our focus to four of the organizations that are part of CMS, shown on the left of this slide, which have profiles most similar to those agencies we have served successfully for many years. Notably, their needs align with our strategy of providing differentiated services versus the more commoditized services required in other parts of the agency. With the work that our recent ITG and ESAC acquisitions have brought us, we already have a footprint in OIT and CCSQ.

SemanticBits will add significantly to the open-source component and will give us access to the other two target organizations, namely CPI and OC. On the right, we show overall CMS spending across the five professional services contract vehicles we have identified as highly relevant to these four organizations. We currently hold three of these, indicated with asterisks, and have subcontractor positions on the other two.

The average deal size at CMS is larger than most of our other clients, so it's attractive from that perspective, as well. Importantly, both the strategic and cultural fit are excellent here. On slide 6 is a quick look at their talent base. SemanticBits has long operated under a mission-driven culture and we look forward to welcoming them to a comparable cultural environment at ICF.

At our recent investor day two weeks ago, we stressed the importance of our culture. It defines the way we do things at ICF and it's the glue that binds us. It captures the animating energy of ICF and putting our passion and mission orientation, our willingness to collaborate, and the diversity of skills and viewpoints that we can bring to solve complex problems. We see the same

elements at SemanticBits, which is why their owner sought out ICF when they were contemplating the sale of the company.

Now to review the financial details on slide 7. The \$220 million purchase price will be funded by our existing credit facility, which was recently expanded. We expect ICF's net leverage ratio, post-transaction, to be approximately 3.55, which we expect to lower by approximately 40 basis points by 2022 year-end, absent any additional acquisitions this year. When we release our second quarter results on August 3rd, we will revise our full-year guidance to reflect the SemanticBits contribution.

To sum up on slide 8, SemanticBits checks all the boxes for us. We showed the left side of this slide at our investor day to provide additional insight into our M&A criteria. The SemanticBits transaction expands our addressable market by providing access to CMS, strengthens both our technical and domain expertise, is a mission-driven, client-sector organization with great client relationships, and will be immediately accretive to our EPS. We look forward to closing this transaction and bringing our new SemanticBits colleagues on board in the near future. With that, operator, my colleagues and I would like to open the call for questions.

QUESTION AND ANSWER

Operator

Thank you. We will now begin the question-and-answer session. To ask a question, you may press * then 1 on your touchtone phone. If you are using a speaker phone, please pick up your handset before pressing the keys. If at any time, your question has been addressed and you would like to withdraw your question, please press * then 2. At this time, we will pause momentarily to assemble our roster.

Our first question comes from Tobey Sommer with Truist Securities. Please go ahead.

Jasper Bibb

Hey, good afternoon. This is actually Jasper Bibb, on for Tobey. Thanks for taking my questions. I just wanted to start with how you're thinking about the revenue synergy opportunity here. Why has SemanticBits been so concentrated with CMS historically? And how do you think bringing them onto the ICF platform would help them diversify that customer base?

John Wasson

I'll ask Mark Lee, who leads our public service practice and manages our IT modernization business, to take that question first. Mark?

Mark Lee

Yeah. Sure. I think there's two parts of that, synergies being one and the second how we might be able to leverage ICF to bring them into more markets. For the first one, I think that the synergy there, really about the past performance they bring us for the large modernization tasks, which increasingly have a large, open-source component, marries really well with our low-code expertise, which I think is most of the big deals, going forward, are going to be some blend of those likely, and I think they really help in terms of synergy sales there.

I think in terms of bringing them into our markets, that's actually the easy part. Their capabilities are really leading edge and there are some that are specific to health and CMS, though a lot of them aren't and very easily extendable to our other public-sector clients, particularly in the civilian

space. I think we're already seeing these kinds of jobs and what this brings us, really, is some larger, past-performance examples that help differentiate us on those bids.

Jasper Bibb

Thanks. And then, just wanted to ask about the small business exposure. Are you expecting that headwind from small business or set-aside programs to be complete in 2023, with revenue declining to \$115 million or would there potentially still be more work coming out in future years?

John Wasson

Yeah, I think that, as you know, our last several deals, ITG, Creative, and now SemanticBits, have included small business revenues and I think we have a pretty clear and effective playbook we follow to manage the transition of small business revenues by looking for full and open contracts to move those revenues and if we're not able to do that, we'll get means to sub or have joint ventures with other small businesses.

And so, given that playbook and our experience with it, we think we've really ring-fenced what the potential reduction in revenues is here, from '22 to '23. You've seen the same approach we have on our last couple of acquisitions. So I think we've ring-fenced the risk and fully captured it here and so, we would expect, as we say, the revenues to come down in 2023.

But then, thereafter, we would return to growth and we would expect significant growth in this market. I think, as you know, we've had quite robust double-digit growth in IT modernization and I think we're confident, in the long run, we'll achieve that with the SemanticBits. They've certainly been a growth company and this has been a growth market for ICF.

Jasper Bibb

Yeah, makes sense. Maybe following up on that, could you just comment on the backlog metrics for Semantic and their recompute profile in the next few years? How did that inform your thinking on the acquisition?

John Wasson

Yeah, I think I'll start and then I'll ask Mark Lee to add any comments. I think they're obviously in the federal market. I think they, like ICF, have a significant backlog. They start each year with strong visibility on their backlog and they've been very successful in growing this business and I think have had high win rates and have been very successful on recompetes. And so, I think all those metrics are strong. Mark, I don't know if you want to add any more color or specifics on that?

Mark Lee

No, I think you summed it up pretty well.

Jasper Bibb

Okay. Last one from me. Can you give us a bit more context on how this deal came about? Is this a company that you partnered with in the past? Was this an auction process or did that management team from Semantic come directly to you?

John Wasson

Mark, do you want to comment on that?

Mark Lee

Yeah, sure. Thanks, John. Yeah, so we had run across them a number of times, out in the market and had been really impressed by the quality of their capabilities. And we started talking with the owner probably, maybe almost a year ago, and just try to get to know them more. And the more we got to know the more we like them. And we entered into a proprietary process and that got us to where we are today.

So this wasn't an auction. It's very purposeful on both sides. I think in talking to the primary owner Ram, I think he was really looking for a really good cultural fit and a really good growth platform for his people and felt really comfortable with ICF and, obviously, we were really excited about the staff that they have, the capabilities and the clients. So I think it really seemed like a great match.

Jasper Bibb

Okay. Yeah. Appreciate the detail. Thanks for taking the questions, guys.

Operator

As a reminder, if you have a question, please press * then 1 to be joined into the queue.

The next question comes from Marc Riddick with Sidoti. Please go ahead.

Marc Riddick

Hi. Good afternoon.

John Wasson

Hey, Marc.

Marc Riddick

So a lot of the general questions are covered now. Curious as to the capacity. You made mention in the slides, as far as financials and plans, as far as debt repayment for the remainder of the year, so really appreciate that type of color. Can you talk a little bit about where this puts you, as to further acquisition capacity for the near-term?

John Wasson

Well, sure. So I'll say a few words and I'll ask Barry Broadus to add. I think as we said in the conference call remarks, and this will take us up to a net leverage ratio of about 3.55. I think as we've discussed, over the year, ICF's generally been in the range of 2 to 3.5-3.75. And over the years we've levered up and then paid down the debt quickly with our very strong cash flow.

I would say at this point, we generally are comfortable in the range of 2.5 to high 3s, and so I certainly don't see us going above a 4 leverage ratio, as a general rule. And so I think, and so, obviously, this is a significant and highly strategic acquisition for us. We'll be quite focused on integration here, certainly in the next year. I think if we were to do anything on the acquisition front, it would be small tuck-in acquisitions. I think we'll be focused on integration here for the next year. Barry, I don't know if there's anything else you'd want to add on that front?

Barry Broadus

Yeah. Thanks, John. Hi, Marc.

Marc Riddick

Hi, there.

Barry Broadus

If you look at the capacity, we'll still have plenty of room for other acquisitions, if you take into account the leverage position that John had mentioned, as well as some holdbacks that we like to have for working capital needs. And we're still in that \$200 million plus range. So we've got plenty of capacity with those two governors in place. So we certainly have room to do the things we'd like to do from an acquisition perspective.

Marc Riddick

And I know it's only been a couple of weeks, but maybe for those who weren't at the investor day or hadn't heard it, could you talk a little bit about how you're viewing the overall acquisition pipeline and what the opportunity set looks like for you, overall?

John Wasson

Well, I think, as we discussed at our investor day, we have our five key growth drivers, and I think, generally, from an acquisitions perspective, we're focused in those five key markets. I would say that the priorities certainly have been IT modernization. I think with this deal, we have the core of all the capability we need on the digital transformation and IT modernization front across the low-code and no-code platforms and the open-source platforms and across the full suite of key civilian clients.

We're really, really pleased this acquisition is going to add significant scale on the open-source side and really pleased it puts us on the map at scale at CMS. And so this is a terrific acquisition for us. In addition to that, I would say, as we talked about at investor day, the broader public health and health markets remain a priority and energy markets remain a priority. And I would say those are the three priorities. And, as you imply, we do keep a pipeline of potential acquisitions, and I think we'll certainly stay out in the market looking at opportunities, but this is obviously a significant acquisition for us and we're certainly going to make sure we do a great job of integrating, you know, the top-notch talent and the terrific capabilities within SemanticBits.

Marc Riddick

Okay, great. I appreciate the color. Congratulations, John.

John Wasson

Yep. Okay.

Operator

This concludes the question-and-answer session. I would now like to turn the conference back over to management for any closing remarks.

CONCLUSION**John Wasson**

Well, thank you for joining us today. We look forward to speaking with you at our second quarter earnings call in early August and at our upcoming investor events. Thank you.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.