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Q1 2022 ICF International Inc Earnings Call

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PRESENTATION

Operator

Welcome to the First Quarter 2022 ICF Earnings Conference Call. My name is Vanessa, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded on Wednesday, May 4, 2022, and cannot be reproduced or rebroadcast without permission from the company. And now I would like to turn the program over to David Gold, Investor Relations. Sir, you may begin.

David Gold ***AdvisIRy Partners***

Thank you, Vanessa. Good afternoon, everyone, and thank you for joining us to review ICF's first quarter 2022 performance. With us today from ICF are John Wasson, Chairman and CEO; and Barry Broadus, CFO. Joining them is James Morgan, Chief of Business Operations.

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 May 4, 2022 press release and our SEC filings for the 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 2022 performance. John?

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

Thank you, David, and thank you all for participating in today's call to review first quarter business and financial trends and discuss our business outlook. ICF's first quarter results represented a very strong start to the year, supporting outlook for considerable growth in 2022.

In terms of the key takeaways from our first quarter performance: First, we continue to build our position in high-growth markets. These markets, namely, IT modernization and digital transformation, public health, disaster management, utility consulting, together with our climate, environmental and infrastructure services are expected to account for approximately 70% of service revenue in 2022, up from around 65% at the end of 2021.

Second, we continue to drive margin improvement. Our adjusted EBITDA to service revenue expanded to 13.9%, while we continue to invest in people, technology and strategic initiatives to support our future growth.

And third, our business development results continue to support our long-term growth outlook. At the end of the first quarter, our trailing 12-month book-to-bill ratio was 1.27 and our business on the pipeline was a record $7.9 billion, pointing to ICF substantial runway for future growth.

The strongest year-on-year revenue comparisons in the first quarter were in our federal government business, which was up 25%, reflecting organic growth across our growth markets and the acquisition of Creative Systems and Consulting, which we completed at the end of 2021.

As you'll recall, Creative is an IT modernization, digital transformation solutions provider to U.S. federal agencies that expanded our addressable market in 2 ways. First, it brought substantial expertise in Salesforce and Microsoft platforms that complement our ServiceNow and Appian capabilities, strengthening our qualifications for new awards. Second, it expanded our presence in several civilian agencies, including USDA and Treasury, where we see additional growth potential. The acquisition is performing well, in line with our expectations of mid-teens revenue growth, and we see significant opportunities for revenue synergies as we now offer leading practices supporting the most -- 3 most widely adopted low-code, no-code platforms in the U.S. federal government.

The passage of Omnibus Spending Package for fiscal year 2022 increased civilian spending opportunities by 8.9%. And with only 6 months left in the year, we are experiencing a very busy bid and proposal season. Additionally, we are closely monitoring the CDC's recently announced agency-wide modernization review that is expected to include the development of new systems and processes to deliver its science to the American public as well as facilitate its public health work.

In addition to the healthy Omnibus increases for fiscal year 2022, the President submitted his fiscal '23 budget request at Congress in March. And while it is far from passage, it does reflect the administration's priorities. These include a significant increase in federal health budgets with mandatory spending to prepare for the next pandemic, focus on child care, indicated by a considerable increase in funding at the Administration for Children and Families, and $65 billion in IT spending across civilian agencies, all areas in which ICF has substantial domain expertise and cross-cutting implementation capabilities.

We also saw strong year-on-year growth of 14% in revenues from state and local government clients which represented both our work in the disaster management arena and our climate, environmental and infrastructure services. ICF continued to execute effectively on key disaster recovery contracts in Texas and Puerto Rico, as well as on recent contracts and extensions related to more recent storms. Further, ICF currently is working on mitigation efforts for over 30 clients in 14 states with first quarter wins in Washington, South Carolina, New York, Oregon and Virginia, expanding our geographic footprint.

The Department of Housing and Urban Development recently announced more than $2 billion in CDBG Disaster Recovery and Mitigation Funding for disasters that occurred during 2020. ICF is already doing disaster recovery work in 7 of the 10 states receiving funding. And during Q1, we won several small-scale preliminary assignments related to planning for these awards.

Also, we continued to provide our state and local clients with climate, environmental and infrastructure advisory services. In Q1, we won additional work helping clients identify opportunities for securing climate resilience and clean energy funding available through the Infrastructure Investment and Jobs Act, and we were awarded new permitting assignments for energy infrastructure upgrades and development initiatives.

Revenues from international government clients were lower year-on-year due to the completion of the short-term project with significant pass-through revenues that drove exceptional growth in this client category in 2021. Excluding that contract, revenues were similar to year-ago first quarter levels, even though our event work for the European Union has not fully recovered from pandemic impacts.

We continue to win new multiyear contracts with a [diverse array] of European Commission and U.K. government clients in the areas of training and capacity building, research and evaluation, and communications that address a range of subject matters, including energy and climate, water, agricultural and food systems, education, human health and social policy.

Moving to our commercial client category. Revenues declined to 6.7% year-on-year as commercial marketing services remained pressured by the impacts of the pandemic and the slower-than-expected recovery of our clients in the hospitality and travel industries. Marketing services represented approximately 7% of ICF's total first quarter revenues.

We did gain traction and delivered growth in both aviation and utility consulting in Q1 by leveraging the deep engagement expertise in these businesses to win new contracts. Notably, aviation consulting continued its year-on-year progress, winning additional work with existing clients and adding new clients. The strong policy focus in both the U.S. and European Union on decarbonization and sustainable aviation has been a business driver.

The major growth area within our commercial business is energy markets, which accounted for 60% of first quarter commercial revenues. As expected, we saw modestly lower first quarter revenue comparisons given the timing of the startup and wind down of various programs as well as our exceptional 12% growth in the first quarter of 2021. In this year's first quarter, revenue from energy efficiency programs increased 1.3% and energy markets advisory work was steady year-on-year, but the timing of projects in our environmental and infrastructure business caused lower first quarter comparisons in that client category. For the full year, we expect mid-single-digit growth -- revenue growth for our commercial energy markets business, with higher year-on-year comparisons in the second half.

Currently, ICF is executing on more than 200 energy efficiency programs for 55 utilities nationwide, and the pipeline remains strong for energy efficiency as well as our other core services to utilities, including beneficial electrification, flexible load management, and consulting. In fact, several utility clients have expanded their energy efficiency goals to include greenhouse gas reductions, and we recently won an implementation contract with utility for the remote management of thermostats.

Overall, there's been a noticeable uptick in demand for us to analyze more complex issues for utility clients, encompassing energy efficiency objectives, decarbonization goals, electric vehicle programs, and their impact on grid reliability. Additionally, as utility clients efficiently emphasize equity, disadvantaged communities, [and] workforce development, there are increasing opportunities for us to leverage ICF's global expertise in human services.

In the first quarter, ICF continued to win new environmental services work with utilities and renewable energy developers in the areas of construction and compliance monitoring for energy infrastructure projects and the environmental studies for large offshore wind projects. Also, we were awarded several climate advisory contracts in the first quarter to work for large utilities and commercial clients on projects to ensure that energy systems are resilient to extreme weather, programs that support clean energy usage, and the development of climate action plans.

To sum up, in the first quarter, we continued to expand our capabilities, backlog and pipeline in key growth areas, which we expect to progressively increase as a percentage of ICF service revenue in the periods ahead, supporting our expectations for substantial growth in 2022 and beyond.

Now I'll turn the call over to Barry Broadus, our CFO, for a financial review. Barry?

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

Thank you, John, and good afternoon, everyone. I'm very pleased to be part of the ICF team and to report on such strong financial results during my first quarter as CFO.

To start, our 2022 first quarter total revenue increased 9.2% to $413.5 million, which is inclusive of organic revenue growth of approximately 5%. Service revenue increased 8.9% to $304.6 million. These year-over-year comparisons were mainly driven by the robust performance of our federal and state and local government businesses. This quarter's pass-through revenue accounted for 26.3% of total revenue, which is in line with the first quarter of 2021 and within the range we expect for full year of 2022.

Our gross profit totaled $155.3 million, an increase of 6.1% compared to the first quarter of 2021. Gross margin on total revenue was 37.6% compared to 38.7% last year. Gross margin on service revenue was 51% compared to 52.4% a year ago. As we discussed in the first quarter of 2021, we realized significant gross margin benefits, primarily from the timing of several fixed-price energy efficiency contracts, which drove gross margin variance. This year's first quarter gross margin is consistent with what we would expect for the balance of the year.

Indirect and selling expenses, while up in dollars by 6.8%, were 180 basis points lower as a percentage of service revenue on an adjusted basis due to our increased scale and actions we have taken to reduce our non-labor expenses. We have also made investments to streamline our systems and processes that will yield cost savings in future periods.

EBITDA increased 4% to $37.9 million as compared to $36.4 million in the first quarter of 2021. Excluding special charges totaling $4.4

million related to our new headquarters, M&A and severance expense, adjusted EBITDA outpaced our revenue growth, increasing 12.1% to $42.3 million from $37.7 million in last year's first quarter.

Several factors contributed to our 13.9% adjusted EBITDA to service revenue margin, including a favorable revenue mix, high utilization levels and our increased scale, as we benefit from past action to consolidate office space and realize operating efficiencies. We are confident in our ability to progressively increase EBITDA margins over the next several years while reinvesting in our business.

Operating income was $27.7 million compared to $28.1 million in the first quarter of 2021, reflecting the same factors impacting our gross margins. Our tax rate was 27.5%, which is line with our expectations and similar to 2021.

Net income totaled $17.9 million and diluted EPS was $0.94 per share in the first quarter. This includes $0.17 per share of tax-affected special charges, of which $0.12 represented M&A and previously disclosed facility-related charges. This compares to net income of $18.4 million or $0.96 per share last year. which included $0.05 of tax-affected special charges. On a non-GAAP basis, which excludes the impact of special charges and amortization of intangibles, EPS increased 15.9% to $1.31 per share.

Moving to the cash flow statement and balance sheet, we used $7 million of cash for operations, which is comparable to our historical first quarter results. Capital expenditures were $6.5 million, which included investments in our new headquarters. Days sales outstanding for the first quarter were 79 days compared to 80 days in the similar period last year. Our debt at the end of March was $459.8 million compared to $421.6 million at the end of 2021, mainly reflecting seasonality as well as the integration of our Creative acquisition, which had a short-term impact on our billing and collections. Our net leverage ratio at the end of March was 3.15x, which reflects the acquisition of Creative on December 31, 2021.

In regards to our capital deployment strategy, we will continue to prioritize investment in organic growth initiatives, acquisitions, issue dividends and continue with our share buyback program, and use excess capital to delever the company. We will remain disciplined as we manage our capital with an eye towards ensuring capital efficiency towards optimizing the long-term intrinsic value of the company.

In the first quarter of 2022, we repurchased 176,375 shares for $17 million to offset the dilution from our employee incentive programs. Today, we declared a quarterly cash dividend of $0.14 per share payable on July 14, 2022, to the shareholders of record on June 10, 2022.

On our last earnings call, we mentioned the cadence of our financial performance this year will be largely balanced between the first and second half of 2022. After high single-digit service revenue growth achieved in the first quarter, we expect double-digit service revenue growth beginning in the second quarter.

For modeling purposes, the following metrics remain our expectations for 2022. Our depreciation and amortization expense is expected to be in the range of $20.7 million to $22.7 million for the full year 2022. Our amortization of intangibles should be in the range of $18.5 million to $19 million. Our full year interest expense will be in the range of $10 million to $12 million. And our full year tax rate will be approximately 28%. We expect a fully diluted weighted average share count of approximately 19.1 million for 2022. And capital expenditures are anticipated to be between $33 million and $37 million, including approximately $15 million of expenses related to onetime leasehold improvement costs associated with the new Reston headquarters. Our 2022 operating cash flow is forecast to be $130 million.

In closing, this is a great time to join ICF, given our unique position in the marketplace and strong growth prospects ahead. I look forward to meeting you at our upcoming Investor Day later this month in New York.

And with that, I'll turn the call back over to John. Thank you.

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

Thank you, Barry. We are looking ahead to double-digit revenue growth and strong margin performance in full year '22. And we are pleased to reaffirm the guidance we provided with our year-end 2021 results. At the midpoint of the guidance range, as noted in today's release, we expect service revenue for 2022 to increase by 12%, adjusted EBITDA margin on service revenue to be 13.9% and GAAP EPS and non-GAAP EPS to be up 15% and 10%, respectively, all compared to 2021.

Operating cash flow is expected to be approximately $130 million for the year, up 18% year-on-year. We consider this performance to represent an inflection point for ICF, demonstrating our strong position in key growth markets as well as our expanding addressable market.

Our Investor Day on May 25 in New York will feature presentations and panels that will provide greater insight into the growth drivers ahead for ICF as well as additional insight into the impact of our work. Please direct any questions to Lynn Morgen. We certainly hope to see you all there.

With that, operator, I'd like to now open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) I see we have our first question from Tobey Sommer with Truist Securities.

Jasper James Bibb ***Truist Securities, Inc., Research Division - Associate***

This is Jasper Bibb on for Tobey. Some of your federal peers with more of a defense focus described a slowdown in tasking during the first quarter. Is that something that you were seeing given your mix? And have you seen customer activity improve in April and May after we got the budget?

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

I wouldn't say that we saw a slowdown in tasking in Q1. I think we had -- the businesses remained steady. And as I said, we certainly have seen a pickup and are very busy on the business development and the proposal front. But I think our tasking and our awarding of funding has been pretty steady. I don't think we've seen a slowdown.

Jasper James Bibb ***Truist Securities, Inc., Research Division - Associate***

Then I wanted to follow up on the decline in energy market revenues during the quarter. Could you just provide a bit more color on what drove that decline? And are you expecting some of those delayed projects to pick back up again in 2Q or in the latter half of the year?

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

Yes. I think -- look, as I said in our remarks, I think we certainly expect for the year that the commercial energy business will grow at least mid-single digits for the year. I think the first quarter results was due really to the timing around kind of wind down of certain projects and the kickoff of new projects in our environment and infrastructure business. It was not unexpected. I think we knew that we would be winding down certain projects and starting up others. And so that's really what drove the Q1 results.

I think given the pipeline and backlog, as I said, we certainly expect at least mid-single-digit growth there. I think we'll have a much stronger second half of the year in our commercial energy business, given the trends and the awards.

Jasper James Bibb ***Truist Securities, Inc., Research Division - Associate***

No, that makes sense. And then last question for me is just hoping you could update us on the pace of RFP activity for disaster work in Puerto Rico. And do you think there's still a meaningful pipeline of work in that area of the bid, given more a couple of years into that funding being obligated now?

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

I think that our pipeline for disaster recovery is quite robust. And as we said in our remarks, I mean, the state and local business grew 14 -- or certain level of businesses grew 14% in Q1. Obviously, disaster recovery is a key part of that growth, driving that growth. And so -- and certainly, the pipeline there remains robust. I think we still have material opportunities in front of us in Puerto Rico.

And as I noted in my remarks, we certainly are seeing a bevy of opportunities on the mitigation front around the country. And I think that's a long-term trend that's here to stay. And so certainly, the disaster recovery remains one of our key growth markets. We have a robust pipeline. I certainly expect that we'll see material opportunities there as we look forward.

Jasper James Bibb ***Truist Securities, Inc., Research Division - Associate***

Congrats on the nice start to the year here.

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

Thank you.

Operator

We have our next question from Joe Vafi with Canaccord.

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

Nice results here in Q1. I was wondering if we could drill down a little bit into the supply side. I know you said there was higher utilization that help margins. Was that -- just get a backdrop here of hiring versus utilization going higher, how you're managing that, especially given kind of the inflationary outlook here for wages. And then I have a follow-up.

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

Well, sure. I mean, I think, Joe, we've talked in the past about recruiting and utilization. I think we certainly are pleased with the strong utilization within the company. Obviously, as we're growing nicely as we are, that certainly can help provide the work to maintain that high utilization as we go forward.

And so I think we'll be able to consistently do that. I do think, to your point, we are in a people business, we need to add the head count. We are expecting 7% organic growth here, which would imply we need to add 6%, 6.5% more staff to meet that growth. As we talked about on prior calls, we are investing significantly in recruiting and I have confidence we'll be able to recruit that staff and bring them on board in a timely way. I'm not going to kid you, it's a very competitive market, and it's a challenging market. But as we talked about in our -- I think in our fourth quarter call last year, we grew 6.4% and we'll be able to hire 5.5% or 6% more staff to meet that. So I think we're generally confident on the recruiting such that we can hire the staff.

To your point on wage inflation and those issues, I mean, we're -- like every business in America, we're experiencing wage pressures and higher wages and have had to increase our wage expense, both in terms of various aspects of profits and salaries, retention awards. As I've talked about, I mean, I think we generally believe that we'll be able to manage those, both through passing those costs through in our rates through time in a timely way. And as we've also talked about, I mean, we are continuing to have savings in travel and entertainment. We've taken steps to reduce our facility footprint. And so some of the savings there are certainly being reinvested back into the people and allowing us to stay competitive on the compensation front, but without having to impact our profitability.

And so I guess that's a long-winded answer, but I think we're managing that as well as we can and are generally doing a good job. And I think at end of the day, I'm confident we'll be able to meet our recruiting goals and find the talent we need.

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

Sure. And then just to follow-up. I mean, your IT footprint is getting bigger, which is great, I think. It would just be interesting to get a kind of a lay of the land if it's big enough now, you can kind of see some of the differences in some of the IT work versus just some of the more program management stuff with your government clients. How is attracting and retaining talent in each of those, the IT versus the non-IT segment? And then any differences you're seeing in RFP activity or changes in each of those sectors versus, say, 6 months ago?

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

Yes. I think that -- well, certainly, you're correct that IT, IT modernization is certainly becoming a more and more material portion of our business. It's certainly one of our significant key growth drivers, there's significant opportunity there. And over the last 2 to 3 years, both through our inorganic efforts to grow the business and the 2 or 3 acquisitions we've done, we certainly have scale now in IT modernization. We can go to market on each of the 3 significant platforms in civilian markets and are certainly very competitive in those markets.

Again, I would say that we've -- on the technology side, I think we've generally been quite successful in recruiting the talent. I think to your point, it's not exactly the same as recruiting domain-oriented talent. I mean I think those folks are quite interested in doing really leading-edge, interesting technology work and the training and the skill development you can provide. And so I think -- but given what we do and the platform we have, we can certainly do that. And so I think we're able to recruit and retain the talent.

And at the end of the day, I also think that they -- once they are here, they find they like the ICF culture and like the mission orientation of the work we do. And so I think we've really have become quite skilled at recruiting and retaining the technology talent we need.

In terms of the pipeline and the business development opportunities, I mean, I would say to you that right now, I mean, as we said in our first quarter results, I mean, really the federal government and state and local markets really drove our first quarter results. And on the federal side, that's really IT modernization and public health. And so we are seeing a lot of opportunity on the IT modernization and on the public health side right now. And I think we're quite bullish on those markets, and we think that those will be long-term growth drivers for us.

And so as I said, I think the proposal activity within ICF and the variety of deals we're seeing and certainly in the IT monetization, larger deals we've seen are all very positive trends for us.

Operator

Just to confirm, Joe, do you have anything further?

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

Well, that's it for now.

Operator

(Operator Instructions) And I see no further questions at this time. I will now turn the call over to John Wasson for closing remarks.

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

Thank you all for participating today. We look forward to keeping you apprised of our progress as we grow throughout 2022. And we certainly hope to see you at our Investor Day at the end of this month. Thank you, and take care.

Operator

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