

ICF International, Inc.
Form 10-Q
November 07, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission File Number: 001-33045

ICF International, Inc.

(Exact name of Registrant as Specified in its Charter)

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Delaware (State or Other Jurisdiction of Incorporation or Organization)	22-3661438 (I.R.S. Employer Identification No.)
9300 Lee Highway, Fairfax, VA (Address of Principal Executive Offices)	22031 (Zip Code)
Registrant's telephone number, including area code: (703) 934-3000	

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 1, 2008, there were 14,877,813 shares outstanding of the registrant's common stock.

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ICF INTERNATIONAL, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE

PERIOD ENDED SEPTEMBER 30, 2008

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****ICF International, Inc. and Subsidiaries****CONSOLIDATED BALANCE SHEETS AT****SEPTEMBER 30, 2008 (UNAUDITED) AND DECEMBER 31, 2007**

(in thousands)

Assets

	September 30, 2008 <i>(Unaudited)</i>	December 31, 2007
Current Assets:		
Cash and cash equivalents	\$ 2,699	\$ 2,733
Contract receivables, net	156,199	190,159
Prepaid expenses and other	4,962	3,955
Income tax receivable	1,140	1,933
Deferred income taxes	5,613	3,902
Total current assets	170,613	202,682
Total property and equipment, net	14,340	7,541
Other assets:		
Goodwill	200,061	159,491
Other intangible assets, net	19,086	17,710
Restricted cash	2,644	3,668
Other assets	3,078	1,933
Total assets	\$ 409,822	\$ 393,025

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**ICF International, Inc. and Subsidiaries****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts)

Liabilities and Stockholders' Equity

	September 30, 2008 (Unaudited)	December 31, 2007
Current Liabilities:		
Accounts payable	\$ 23,510	\$ 74,260
Accrued expenses	42,190	47,084
Accrued salaries and benefits	32,115	27,801
Deferred revenue	12,299	16,067
Total current liabilities	110,114	165,212
Long-term liabilities:		
Long-term debt	89,692	47,079
Deferred rent	2,300	1,773
Deferred income taxes	11,449	9,109
Other	1,733	5,061
Total Liabilities	215,288	228,234
Commitments and Contingencies		
Stockholders' Equity:		
Preferred stock, par value \$.001 per share; 5,000,000 shares authorized; none issued		
Common stock, \$.001 par value; 70,000,000 shares authorized; 14,854,014 and 14,593,723 issued; and 14,779,602 and 14,531,521 outstanding as of September 30, 2008, and December 31, 2007, respectively	15	15
Additional paid-in capital	117,876	109,795
Treasury stock, at cost	(1,438)	(746)
Accumulated other comprehensive income	125	361
Stockholder notes receivable	(12)	(21)
Retained earnings	77,968	55,387
Total stockholders' equity	194,534	164,791
Total liabilities and stockholders' equity	\$ 409,822	\$ 393,025

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**ICF International, Inc. and Subsidiaries****CONSOLIDATED STATEMENTS OF EARNINGS (UNAUDITED)**

(in thousands, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Gross Revenue	\$ 176,281	\$ 198,813	\$ 535,493	\$ 540,697
Direct Costs	115,421	147,468	355,138	398,260
Operating costs and expenses:				
Indirect and selling expenses	44,251	29,639	128,344	85,107
Depreciation and amortization	1,706	622	3,891	1,727
Amortization of intangible assets	2,241	1,257	6,442	2,493
Total operating costs and expenses	48,198	31,518	138,677	89,327
Operating Income	12,662	19,827	41,678	53,110
Interest expense	(785)	(654)	(3,032)	(1,392)
Other income	67	54	15	490
Income before taxes	11,944	19,227	38,661	52,208
Provision for income taxes	5,076	8,133	16,080	21,272
Net income	\$ 6,868	\$ 11,094	\$ 22,581	\$ 30,936
Earnings per Share:				
Basic	\$ 0.47	\$ 0.78	\$ 1.55	\$ 2.20
Diluted	\$ 0.45	\$ 0.74	\$ 1.48	\$ 2.09
Weighted-average Shares:				
Basic	14,631	14,299	14,570	14,060
Diluted	15,283	14,999	15,209	14,800

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**ICF International, Inc. and Subsidiaries****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(in thousands)

	Nine months ended September 30,	
	2008	2007
Cash flows from operating activities		
Net income	\$ 22,581	\$ 30,936
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,333	4,220
Non-cash compensation	4,827	2,189
Accrued interest on stockholder notes		(21)
Loss on disposal of fixed assets	122	5
Deferred income taxes	(4,736)	(1,715)
Changes in operating assets and liabilities, net of the effect of acquisitions:		
Contract receivables, net	51,932	(36,950)
Prepaid expenses and other	327	(1,506)
Accounts payable	(55,083)	17,725
Accrued expenses	(7,685)	20,833
Accrued salaries and benefits	543	7,731
Deferred revenue	(3,887)	(3,995)
Income tax payable	36	(2,706)
Deferred rent	569	1
Other liabilities	(3,738)	(1,177)
Net cash provided by operating activities	16,141	35,570
Cash flows from investing activities		
Capital expenditures	(9,257)	(2,646)
Capitalized software development costs	(245)	(300)
Payments for business acquisitions, net of cash acquired	(51,334)	(40,796)
Net cash used in investing activities	(60,836)	(43,742)
Cash flows from financing activities		
Advances from working capital facilities	227,878	216,089
Payments on working capital facilities	(185,265)	(216,089)
Restricted cash	1,024	72
Debt issue costs	(1,311)	(82)
Proceeds from exercise of options	1,200	3,851
Tax benefits of stock option exercises	2,047	2,960
Net payments for stockholder issuances and buybacks	(685)	(285)
Proceeds on stockholder notes	9	536
Net cash provided by financing activities	44,897	7,052
Effect of Exchange Rate on Cash	(236)	197
Net decrease in cash and cash equivalents	(34)	(923)
Cash and cash equivalents, beginning of period	2,733	2,997

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Cash and cash equivalents, end of period	\$ 2,699	\$ 2,074
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Supplemental disclosure of cash flow information

Cash paid during the period for:

Interest	\$ 2,714	\$ 1,135
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Income taxes	\$ 20,694	\$ 23,037
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The accompanying notes are an integral part of these consolidated financial statements.

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Notes to Consolidated Financial Statements

(Dollar amounts in tables in thousands, except per share data)

Note 1. Basis of Presentation and Nature of Operations

Interim Results

The unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). These rules and regulations permit some of the information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) to be condensed or omitted. In management 's opinion, the unaudited consolidated financial statements contain all adjustments, that are of a normal recurring nature, necessary for a fair statement of the Company 's results for the three-month and nine-month periods ended September 30, 2008, and September 30, 2007. Operating results for the three-month and nine-month periods ended September 30, 2008, are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2007, and the notes thereto included in the Company 's Annual Report on Form 10-K, filed with the SEC on March 17, 2008.

Basis of Presentation and Nature of Operations

The accompanying consolidated financial statements include the accounts of ICF International, Inc. (ICFI) and its subsidiaries (collectively, the Company). The Company provides management, technology, and policy professional services in the areas of energy and climate change, environment and infrastructure, health, human services and social programs, and homeland security and defense. The Company 's major clients are the State of Louisiana and United States (U.S.) government agencies, especially the Department of Health and Human Services (HHS), Department of Defense (DoD), Environmental Protection Agency (EPA), Department of Homeland Security (DHS), Department of Transportation (DOT), Department of Justice (DOJ), Department of Housing and Urban Development (HUD), and Department of Energy (DOE); commercial and international clients, primarily in the air transportation and energy sectors, including airlines, airports, electric and gas utilities, oil companies, and law firms; and other government organizations throughout the U.S. and the world. The Company offers a full range of services to these clients, including strategy, analysis, program management, and information technology solutions that combine experienced professional staff, industry and institutional knowledge, and analytical methods.

The Company, incorporated in Delaware, is headquartered in Fairfax, Virginia, with over 30 domestic regional offices and international offices in London, Moscow, New Delhi, Rio de Janeiro, and Toronto.

Note 2. Acquisitions

Jones & Stokes Associates, Inc. In February 2008, the Company acquired 100 percent of the outstanding common stock of Jones & Stokes Associates, Inc. (Jones & Stokes), a privately held firm that provides integrated planning and resource management services, specializing in the transportation, energy, water, and natural resource management sectors. Jones & Stokes supports a broad mix of commercial and federal, state, and local government clients on projects to plan and implement infrastructure improvements and mandated government programs. The Company undertook the acquisition to expand ICFI 's environmental and large project implementation capabilities across such strategic growth areas as transportation and infrastructure, energy, climate change, and water resources. The Company also undertook the acquisition to expand its presence in the western U.S. markets, where natural resources issues are a growing concern and where Jones & Stokes has outstanding market presence.

The acquisition was accounted for as a purchase in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* (SFAS No. 141). The aggregate purchase price was approximately \$50.4 million, including \$49.0 million of cash and \$1.4 million of transaction expenses. The Company engaged an independent valuation firm to assist management in the allocation of the purchase price to goodwill and to other acquired intangible assets. The excess of the purchase price over the estimated fair value of the net tangible assets acquired was approximately \$48.7 million. The Company has preliminarily allocated approximately \$43.7 million to goodwill and \$5.0 million to other intangible assets. The intangible assets consist of customer-related intangibles and marketing-related intangibles in the amounts of approximately \$2.9 million and \$2.1 million, respectively. The customer-related intangibles and marketing-related intangibles are being amortized over seven years and two years, respectively. Neither the goodwill nor the amortization of intangibles is deductible for tax purposes. The results of operations for Jones & Stokes have been included in the Company 's statement of operations since February 11, 2008.

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During the second and third quarters of 2008, the Company's estimated fair value of net tangible assets acquired decreased by \$1.1 million, primarily due to an increase in deferred tax liability. The aggregate purchase price increased by \$0.4 million (due to a working capital adjustment), and other intangible assets increased by \$1.9 million.

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Management's estimates of the fair values of the other acquired assets are as of the acquisition date and are based on its initial analysis of supporting information. Additionally, the purchase price for the transaction may change based upon final settlement of any pre-acquisition contingencies in accordance with SFAS No. 141.

Simat, Helliesen & Eichner, Inc. In December 2007, the Company acquired 100 percent of the outstanding common shares of Simat, Helliesen & Eichner, Inc. (SH&E), a privately held aviation transportation consulting firm that provides strategy, policy, regulatory, financial, and technical consulting services to airlines, airports, and other public and private industry stakeholders. The Company believes that the acquisition will enhance its transportation service offerings, which had been concentrated primarily on surface transportation, with federal, state, and industry clients; enhance its position in key federal markets such as the Federal Aviation Administration and Transportation Security Administration; and allow the Company to combine its climate change expertise with SH&E's strong aviation presence to be a leader in the expanding air transport and climate change market.

The acquisition was accounted for as a purchase in accordance with the provisions of SFAS No. 141. The aggregate purchase price was approximately \$53.0 million, including \$52.0 million of cash and \$1.0 million of transaction expenses. The Company engaged an independent valuation firm to assist management in the allocation of the purchase price to goodwill and to other acquired intangible assets. The excess of the purchase price over the estimated fair value of the net tangible assets acquired was approximately \$47.6 million. The Company has preliminarily allocated approximately \$38.2 million to goodwill and \$9.4 million to other intangible assets and expects to finalize this allocation by the end of 2008. The intangible assets consist of customer-related intangibles, developed technology, and marketing-related intangibles in the amounts of approximately \$6.6 million, \$2.3 million and \$0.5 million, respectively. The customer-related intangibles, developed technology, and marketing related intangibles are being amortized over seven years, six years, and one year, respectively. Neither the goodwill nor the amortization of intangibles is deductible for tax purposes. The results of operations for SH&E have been included in the Company's statement of operations since December 3, 2007.

Management's estimates of the fair values of the acquired assets are as of the acquisition date and are based on its initial analysis of supporting information. The final results of the Company's analysis may differ from the preliminary purchase price allocation. Additionally, the purchase price for the transaction may change based upon final settlement of any pre-acquisition contingencies in accordance with SFAS No. 141.

Note 3. Contract Receivables

Contract receivables consisted of the following (in thousands of dollars):

	September 30, 2008	December 31, 2007
Billed	\$ 120,513	\$ 141,484
Unbilled	40,868	52,208
Allowance for doubtful accounts	(5,182)	(3,533)
Contract receivables, net	\$ 156,199	\$ 190,159

Contract receivables, net of the established allowance, are stated at amounts expected to be realized in future periods. Unbilled receivables result from revenue that has been earned in advance of billing. The unbilled receivables can be invoiced at contractually defined intervals or milestones, as well as upon completion of the contract or U.S. federal government cost audits. The Company anticipates that the majority of unbilled receivables will be substantially billed and collected within one year. Contract receivables are classified as current assets in accordance with industry practice.

The allowance for doubtful accounts is determined based upon management's best estimate of potentially uncollectible contract receivables, taking into account management's expectations of future losses on a contract-by-contract basis. The Company writes off contract receivables when such amounts are determined to be uncollectible. Losses have historically been within management's expectations.

Note 4. Commitments and Contingencies**Litigation and Claims**

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Various lawsuits and claims and contingent liabilities arise in the ordinary course of the Company's business. The ultimate disposition of certain of these contingencies is not determinable at this time. The Company's management believes there are no current outstanding matters that will materially affect the Company's financial position or results of operations.

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Note 5. Debt

As of September 30, 2008, the Company had \$89.7 million in debt outstanding. During the nine months ended September 30, 2008, the Company incurred net borrowings of \$42.6 million on its revolving credit facility. The Company used these borrowed funds to finance acquisitions and working capital. The Company amended its credit facility on February 14, 2008, to increase the capacity of its revolving line of credit from \$115.0 million to \$125.0 million. On February 20, 2008, the Company signed the Second Amended and Restated Business Loan and Security Agreement with a syndication of nine commercial banks to allow for borrowings of up to \$350.0 million for a period of five years (until February 20, 2013). The Company borrowed funds under its revolving facility at interest rates based on both LIBOR and prime rates, at its discretion, plus their applicable margins. These interest rates ranged from 3.35% to 4.09% during the quarter. The unused credit facility as of September 30, 2008, was \$184.4 million.

Note 6. Accounting for Stock-Based Compensation**Stock Incentive Plans**

On June 25, 1999, the Company adopted the ICF Consulting Group, Inc. Management Stock Option Plan (the 1999 Plan). The 1999 Plan provides for the granting of straight and incentive awards to employees of the Company to purchase shares of the Company's common stock. A total of 1,334,027 shares of common stock were originally reserved for issuance under the 1999 Plan. In May 2002, the Company amended the 1999 Plan to reserve an additional 238,313 shares for issuance. The exercise price for straight awards granted under the 1999 Plan was not to be less than \$5.00 per share. The option price for incentive awards granted under the 1999 Plan was determined by the Compensation Committee of the Board of Directors based upon the fair market value of the Company's common stock on the date of grant. Awards are no longer being made under the 1999 Plan, and the 1999 Plan will expire in June 2009. A total of 23,692 share equivalents remain available under the 1999 Plan.

Effective with the Company's initial public offering of stock in September 2006, a long-term equity incentive plan (the 2006 Plan) was adopted. The 2006 Plan permits the grant of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, performance shares, performance units, and other incentive awards, including restricted stock units and cash incentives. Under the 2006 Plan, the Company may make awards of up to 1,000,000 shares, plus an annual increase on the first day of each of the Company's fiscal years, beginning in 2007, equal to the lesser of three percent (3%) of the number of outstanding shares of common stock outstanding as of January 1 or a lesser amount as determined by the Board of Directors (the evergreen provision). Under this evergreen provision, the Board of Directors authorized increases of (a) 217,973 shares as of January 1, 2008, which was one and one-half percent (1.5%) of its shares of common stock outstanding as of that date, and (b) 416,241 shares as of January 1, 2007, which was three percent (3%) of the number of shares outstanding as of that date. Individuals eligible to participate in the 2006 Plan include all officers and key employees of the Company, as determined by the Compensation Committee of the Board of Directors, and all non-employee directors.

Stock-Based Compensation

The Company recognized stock-based compensation expense of \$4.8 million in the nine months ended September 30, 2008, and \$2.2 million in the nine months ended September 30, 2007, which is included in indirect and selling expenses.

As of September 30, 2008, and September 30, 2007, there was \$11.7 million and \$7.0 million, respectively, of total unrecognized compensation cost related to unvested stock-based compensation agreements. Unrecognized compensation expense is being recognized over a three- to five-year period on a straight-line basis.

In accordance with SFAS No. 123(R), *Share-Based Payment*, for periods beginning on or after January 1, 2006, excess tax benefits from stock-based compensation plans are presented as financing cash flows. The excess tax benefits totaled approximately \$2.0 million and \$3.0 million for the nine months ended September 30, 2008, and September 30, 2007, respectively.

Stock Options

All stock options granted through 2006 were granted under the 1999 Plan. All stock options granted in 2007 were under the 2006 Plan. No stock options were granted during the nine months ended September 30, 2008. The aggregate intrinsic value of options outstanding and exercisable at September 30, 2008, was \$8.4 million. The aggregate intrinsic value of options outstanding but unvested at September 30, 2008, was \$0.2 million.

Compensation expense related to options under the fair value method was \$0.4 million for the nine months ended September 30, 2008, and \$0.3 million for the nine months ended September 30, 2007. Unrecognized expense related to options was \$0.8 million and \$1.3 million for the nine

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months ended September 30, 2008, and September 30, 2007, respectively.

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The following table depicts stock option activity for the nine months ended September 30, 2008:

	Options Outstanding	
	Shares	Weighted-Average Exercise Price
As of December 31, 2007	1,043,561	\$ 8.48
Options forfeited or cancelled	(1,000)	5.00
Options exercised	(216,882)	5.53
As of September 30, 2008	825,679	\$ 9.25

Information regarding stock options outstanding as of September 30, 2008, is summarized below:

OPTIONS OUTSTANDING				OPTIONS EXERCISABLE		
Range of Options		Number of Options Outstanding As of 09/30/08	Weighted Average Remaining Contractual Term (yrs)	Weighted Average Option Exercise Price	Number of Options Exercisable As of 09/30/08	Weighted Average Exercise Price
Exercise Prices						
\$ 5.00	\$ 5.00	195,986	1.69	\$ 5.00	195,986	\$ 5.00
\$ 6.00	\$ 6.00	29,265	2.25	\$ 6.00	29,265	\$ 6.00
\$ 6.10	\$ 6.10	233,223	3.78	\$ 6.10	233,223	\$ 6.10
\$ 7.34	\$ 7.34	119,705	5.92	\$ 7.34	119,705	\$ 7.34
\$ 9.05	\$ 9.05	37,500	7.46	\$ 9.05	37,500	\$ 9.05
\$ 18.31	\$ 18.31	210,000	8.48	\$ 18.31	70,001	\$ 18.31
\$ 5.00	\$ 18.31	825,679	4.90	\$ 9.25	685,680	\$ 7.41

Restricted Stock Awards

Pursuant to the 2006 Plan, the Company issued 10,192 shares of restricted stock to two directors on March 14, 2008, which vest over three years on a straight-line basis. The grant date fair value of these restricted stock awards was \$21.19 per share.

Compensation expense computed under the fair value method was \$0.4 million for both the nine months ended September 30, 2008, and September 30, 2007. Unrecognized compensation expense related to restricted stock awards was approximately \$0.6 million and \$1.1 million for the nine months ended September 30, 2008, and September 30, 2007, respectively.

Restricted Stock Units

Pursuant to the 2006 Plan, the Company awarded 44,757 restricted stock units (RSUs) to employees during the nine months ended September 30, 2008. The RSUs vest over three years and are being expensed on a straight-line basis. When an RSU vests, one share of stock is issued to the employee for each RSU he or she holds. The RSUs were valued based on the grant date value of a share of the Company's common stock. The weighted-average grant date fair value of the RSUs was \$21.23 per share.

Compensation expense related to RSUs computed under the fair value method was \$4.0 million and \$1.5 million for the nine months ended September 30, 2008, and September 30, 2007, respectively. Unrecognized expense related to RSUs was \$10.4 million and \$4.6 million for the nine months ended September 30, 2008, and September 30, 2007, respectively.

The activity related to RSUs during the nine months ended September 30, 2008, was as follows:

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	Shares
Outstanding December 31, 2007	889,165
Granted	44,757
Vested	(53,507)
Forfeited	(31,300)
Outstanding September 30, 2008	849,115

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On January 1, 2007, the Company adopted the provision of Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48).

For the nine months ended September 30, 2008, the Company reduced the \$2.2 million of unrecognized tax benefits at December 31, 2007, by \$1.3 million. Of this reduction, \$1.1 million was predominantly related to filing of amended tax returns to report unrecognized tax benefits from prior acquisitions and \$0.4 million was related to the expiration of the federal statute of limitations for the 2004 tax year, both of which were partially offset by a \$0.2 million addition for new unrecognized tax benefits. The unrecognized tax benefits as of September 30, 2008, were \$0.9 million. Of this total, \$0.7 million would affect the effective tax rate if recognized and the remaining \$0.2 million related to acquisitions would not affect the effective tax rate if recognized, but would be a decrease to goodwill.

The Company files income tax returns in the U.S. and various state and foreign jurisdictions. The 2005 through 2007 tax years remain subject to examination by the Internal Revenue Service and the 2004 through 2007 tax years generally remain subject to examination by state authorities. The Company does not anticipate a significant increase or decrease to the total unrecognized tax benefits during the next 12 months.

The Company reports interest and penalties related to non-acquisition unrecognized tax benefits in net income before tax. For the nine months ended September 30, 2008, the Company reversed approximately \$0.4 million of penalty and interest. This reversal was predominantly related to the expiration of the federal statute of limitations for the 2004 tax year and the filing of amended returns for previous unrecognized tax benefits, of which \$0.3 million related to prior acquisitions and was recorded through goodwill. The Company has not yet determined the effect, if any, that the acquisition of Jones and Stokes will have on the amount of unrecognized tax benefits, but expects to make this determination by the end of 2008.

Note 8. Earnings Per Share

Basic earnings per share (EPS) is computed by dividing reported net income by the weighted-average number of shares outstanding. Diluted EPS considers the potential dilution that could occur if common stock equivalents were exercised or converted into stock. The difference between the basic and diluted weighted-average equivalent shares with respect to the Company's EPS calculation is due entirely to the assumed exercise of stock options and the vesting of restricted stock and RSUs. The dilutive effect of stock options, restricted stock, and RSUs for each period reported is summarized below:

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Net Income	\$ 6,868	\$ 11,094	\$ 22,581	\$ 30,936
Weighted-average number of basic shares outstanding during the period	14,631	14,299	14,570	14,060
Dilutive effect of stock options, restricted stock and RSUs	652	700	639	740
Weighted-average number of diluted shares outstanding during the period	15,283	14,999	15,209	14,800
Basic earnings per share	\$ 0.47	\$ 0.78	\$ 1.55	\$ 2.20
Diluted earnings per share	\$ 0.45	\$ 0.74	\$ 1.48	\$ 2.09

Note 9. Recent Pronouncements

In December 2007, the FASB issued SFAS Statement No. 141(R), *Business Combinations* (SFAS No. 141(R)). SFAS No. 141(R) amends SFAS 141 and provides revised guidance for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed, and any noncontrolling interest in the acquiree. It also provides disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. It is effective for the Company beginning January 1, 2009, and will be applied prospectively. To the extent the Company continues to make acquisitions, SFAS No. 141(R) could impact its future financial statements and related disclosures.

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In December 2007, the FASB issued SFAS Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin No. 51* (SFAS No. 160). SFAS No. 160 requires that ownership interests in subsidiaries held by parties other than the parent, and the amount of consolidated net income, be clearly identified, labeled, and presented in the consolidated financial statements. It also requires that once a subsidiary is deconsolidated, any retained

noncontrolling equity

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investment in the former subsidiary be initially measured at fair value. Sufficient disclosures are required to identify and distinguish clearly between the interests of the parent and the interests of the noncontrolling owners. It is effective for the Company beginning January 1, 2009, and requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements shall be applied prospectively. The Company has no material existing minority interests; therefore, the Company does not expect that the adoption of SFAS No. 160 will have a material effect on its future financial statements and related disclosures.

In May 2008, the FASB issued SFAS Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). SFAS No. 162 identifies a hierarchy for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. GAAP for nongovernmental entities. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The adoption of SFAS No. 162 is not expected to have a material impact on the Company's consolidated financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
FORWARD-LOOKING STATEMENTS

Some of the statements in this Quarterly Report on Form 10-Q constitute forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, plan, potential, should, will, would or similar words. You should read these statements carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. The factors described in our filings with the SEC, as well as any cautionary language in this Quarterly Report on Form 10-Q, provide examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements, including but not limited to:

changes in the spending priorities of our clients;

failure by Congress or other governmental bodies to approve budgets in a timely fashion;

our dependence on contracts with state and federal government agencies and departments for the majority of our revenue;

performance by us and our subcontractors under a major contract with the State of Louisiana, Office of Community Development (The Road Home contract);

acceleration of performance and revenues under The Road Home contract, on the one hand, and significant audit risks associated with, and possible termination of, The Road Home contract, on the other hand;

uncertainty as to what extent we will be able to replace the revenue generated by The Road Home contract as activity under that contract decreases;

results of government audits and investigations;

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an economic downturn in the air transportation or energy sectors;

failure to receive the full amount of our backlog;

loss of members of management or other key employees;

difficulties implementing our acquisition strategy; and

difficulties expanding our service offerings and client base.

Additional factors that may affect our results are discussed in our Annual Report on Form 10-K for the year ended December 31, 2007, in Part I, Item 1A, entitled Risk Factors. Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to update these forward-looking statements, even if our situation changes in the future.

The terms we, our and us as used throughout this Quarterly Report on Form 10-Q refer to ICF International, Inc. and its consolidated subsidiaries, unless otherwise indicated.

OVERVIEW

We provide management, technology and policy consulting and implementation services to government, commercial and international clients. We help our clients conceive, develop, implement and improve solutions that address complex economic, social and national

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security issues. Our services primarily address four key markets: energy and climate change; environment and infrastructure; health, human services and social programs; and homeland security and defense. Increased government involvement in virtually all aspects of our lives has created opportunities for us to resolve issues at the intersection of the public and private sectors. We believe that demand for our services will continue to grow as government, industry and other stakeholders seek to understand and respond to geopolitical and demographic changes, budgetary constraints, heightened environmental and social concerns, rapid technological changes, and increasing globalization. Our clients utilize our services because we combine diverse institutional knowledge and experience in their activities with the deep subject matter expertise of our highly educated staff, which we deploy in multi-disciplinary teams. Our federal government clients have included every cabinet-level department, including HHS, DoD, EPA, DHS, DOT, DOJ, HUD, and DOE. U.S. federal government clients generated approximately 35% of our revenue for the nine months ended September 30, 2008, and approximately 27% of our revenue in the full year 2007. Our largest state and local government client is the state of Louisiana. State and local government clients generated approximately 48% of our revenue for the nine months ended September 30, 2008, and approximately 65% of our revenue in the full year 2007. The Road Home contract with the State of Louisiana accounted for approximately 40% of our revenue for the nine months ended September 30, 2008, and approximately 63% of our revenue in the full year 2007. We also serve commercial and international clients, primarily in the air transportation and energy sectors, including airlines, airports, electric and gas utilities, oil companies, and law firms. Our commercial and international clients, including government clients outside the United States, generated approximately 17% of our revenue for the nine months ended September 30, 2008, and 8% of our revenue in the full year 2007. We have successfully worked with many of our clients for decades, with the result that we have a unique and knowledgeable perspective on their needs.

We partner with our clients to solve complex problems and produce mission-critical results. Across our markets, we provide end-to-end services that deliver value throughout the entire life of a policy, program, project or initiative:

Advisory Services. We help our clients analyze the policy, regulatory, technology, and other challenges facing them and develop strategies and plans for responding. Our advisory and management consulting services include needs and markets assessment, policy analysis, strategy and concept development, change management strategy, enterprise architecture, and program design.

Implementation Services. We implement and manage technological, organizational, and management solutions for our clients, often based on the results of our advisory services. Our implementation services include information technology solutions, project and program management, project delivery, strategic communications, and training.

Evaluation and Improvement Services. In support of advisory and implementation services, we provide evaluation and improvement services to help our clients increase the future efficiency and effectiveness of their programs. These services include program evaluation, continuous improvement initiatives, performance management, benchmarking, and return-on-investment analyses.

We have more than 3,000 employees, including many who are recognized thought leaders in their respective fields. We serve clients globally from our headquarters in the metropolitan Washington, D.C. area, our domestic regional offices throughout the United States, and our international offices in London, Moscow, New Delhi, Rio de Janeiro, and Toronto.

OUTLOOK

In June 2006, our subsidiary, ICF Emergency Management Services, LLC, was awarded The Road Home contract. As discussed below, The Road Home contract has had a significant impact on our results of operations beginning in the third quarter of 2006, accounting for approximately 63% of our revenue for all of 2007 and approximately 40% of our revenue for the nine months ended September 30, 2008. The contract has a stated term of three years. However, due to the acceleration of the program, we expect the program may be substantially concluded during 2008, accelerating to earlier periods our need to win new business to replace the revenues from the contract. The acceleration of the program has also accelerated the pace at which we have earned fees compared to anticipated fee earnings over what had been expected to be a three-year program. This factor, together with the challenges of predicting the future timing of work by our numerous subcontractors, makes it especially difficult for us to forecast the revenues and earnings associated with the contract.

We do not expect to be able to replace the revenues derived from The Road Home contract solely with organic growth in our existing businesses or from different services, clients, practice areas, offices, geographic focus, or otherwise. As a result, our future results will depend in part on the success of our strategy to continue to make acquisitions and to integrate them successfully. We announced the purchase of Z-Tech Corporation (Z-Tech) on June 28, 2007, SH&E on November 12, 2007, and Jones & Stokes on February 13, 2008. We are continuing to evaluate other acquisition opportunities, and at any given point in time we may be evaluating several such opportunities. There is no assurance that we will be

able to complete or successfully integrate additional acquisitions.

DESCRIPTION OF CRITICAL ACCOUNTING POLICIES

The preparation of our financial statements in accordance with US GAAP requires that we make estimates and judgments that affect the reported amount of assets, liabilities, revenue, and expenses, as well as the disclosure of contingent assets and liabilities. If any of

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these estimates or judgments proves to be incorrect, our reported results could be materially affected. Actual results may differ significantly from our estimates under different assumptions or conditions. We believe that the estimates, assumptions and judgments involved in the accounting practices described below have the greatest potential impact on our financial statements and therefore consider them to be critical accounting policies.

Revenue Recognition

We recognize revenue when persuasive evidence of an arrangement exists, services have been rendered, the contract price is fixed or determinable, and collectibility is reasonably assured. We enter into contracts that are time-and-materials contracts, cost-based contracts, fixed-price contracts, or a combination of these.

Time-and-Materials Contracts. Revenue under time-and-materials contracts is recognized as costs are incurred. Revenue for time-and-materials contracts is recorded on the basis of allowable labor hours worked multiplied by the contract-defined billing rates, plus the costs of other items used in the performance of the contract. Profit and losses on time-and-materials contracts result from the difference between the cost of services performed and the contract-defined billing rates for these services.

Cost-Based Contracts. Revenue under cost-based contracts is recognized as costs are incurred. Applicable estimated profit, if any, is included in earnings in the proportion that incurred costs bear to total estimated costs. Incentives, award fees, or penalties related to performance are also considered in estimating revenue and profit rates based on actual and anticipated awards.

Fixed-Price Contracts. Revenue for fixed-price contracts is recognized when earned, generally as work is performed in accordance with the provisions of SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*. Services performed vary from contract to contract and are not uniformly performed over the term of the arrangement. We recognize revenue in a number of different ways on fixed-price contracts, including:

revenue on certain fixed-price contracts is recorded each period based on contract costs incurred to date compared with total estimated costs at completion (cost-to-cost method). Performance is based on the ratio of costs incurred to total estimated costs where the costs incurred represent a reasonable surrogate for output measures of contract performance, including the presentation of deliverables to the client. Progress on a contract is matched against project costs and costs to complete on a periodic basis. Clients are obligated to pay as services are performed, and in the event that a client cancels the contract, payment for services performed through the date of cancellation is negotiated with the client;

revenue on certain other fixed-price contracts is recognized ratably over the period benefited; and

revenue on certain other fixed-price contracts is recorded based on units delivered to the customer multiplied by the contract-defined unit price.

Revenue recognition requires us to use judgment relative to assessing risks, estimating contract revenue and costs, and making assumptions for schedule and technical issues. Due to the size and nature of many of our contracts, the estimation of revenue and cost at completion can be complicated and is subject to many variables. Contract costs include labor, subcontracting costs, and other direct costs, as well as allocation of allowable indirect costs. We must also make assumptions regarding the length of time to complete the contract because costs also include expected increases in wages, prices for subcontractors, and other direct costs. From time to time, facts develop that require us to revise our estimated total costs and revenue on a contract. To the extent that a revised estimate affects contract profit or revenue previously recognized, we record the cumulative effect of the revision in the period in which the facts requiring the revision become known. Provision for the full amount of an anticipated loss on any type of contract is recognized in the period in which it becomes probable and can be reasonably estimated. As a result, operating results could be affected by revisions to prior accounting estimates.

We generate invoices to clients in accordance with the terms of the applicable contract, which may not be directly related to the performance of services. Unbilled receivables are invoiced based upon the achievement of specific events as defined by each contract including deliverables,

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timetables, and incurrence of certain costs. Unbilled receivables are classified as a current asset. Advanced billings to clients in excess of revenue earned are recorded as deferred revenue until the revenue recognition criteria are met. Reimbursements of out-of-pocket expenses are included in revenue with corresponding costs incurred by us included in cost of revenue.

From time to time, we may proceed with work based on client direction prior to the completion and signing of formal contract documents. We have a formal review process for approving any such work. Revenue associated with such work is recognized only when it can reliably be estimated and realization is probable. We base our estimates on a variety of factors, including previous experiences with the client, communications with the client regarding funding status, and our knowledge of available funding for the contract.

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Goodwill and the Amortization of Intangible Assets

Costs in excess of the fair value of tangible and identifiable intangible assets acquired and liabilities assumed in a business combination are recorded as goodwill, in accordance with SFAS No. 141, *Business Combinations*. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but are instead reviewed annually (or more frequently if impairment indicators arise) for impairment in accordance with the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142). SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-lived Assets* (SFAS No. 144).

We have elected to perform the annual goodwill impairment review, as of September 30 of each year, during the fourth quarter. Based upon management's most recent review, including a valuation report issued by an investment bank, we determined that no goodwill impairment charge was required for 2007. Historically, there have been no goodwill impairment charges recorded by the Company.

We follow the provisions of SFAS No. 144 in accounting for impairment or disposal of long-lived assets. SFAS No. 144 requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset might not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less cost to sell. To date, there have been no impairment charges recorded by the Company.

New Accounting Standards

In December 2007, the FASB issued SFAS No. 141(R), which amends SFAS 141 and provides revised guidance for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed, and any noncontrolling interest in the acquiree. It also provides disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. It is effective for the Company beginning January 1, 2009, and will be applied prospectively. To the extent we continue to make acquisitions, SFAS No. 141(R) could impact our future financial statements and related disclosures.

In December 2007, the FASB issued SFAS No. 160, which requires that ownership interests in subsidiaries held by parties other than the parent, and the amount of consolidated net income, be clearly identified, labeled, and presented in the consolidated financial statements. It also requires that once a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value. Sufficient disclosures are required to identify and distinguish clearly between the interests of the parent and the interests of the noncontrolling owners. It is effective for us beginning January 1, 2009, and requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements shall be applied prospectively. We have no material existing minority interests; therefore, we do not expect that the adoption of SFAS No. 160 will have a material effect on our future financial statements and related disclosures.

In May 2008, the FASB issued SFAS No. 162, which identifies a hierarchy for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. GAAP for nongovernmental entities. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The adoption of SFAS No. 162 is not expected to have a material impact on our consolidated financial statements.

DIRECT COSTS

Direct costs consist primarily of costs incurred to provide services to clients, the most significant of which include employee salaries and wages, plus associated fringe benefits, relating to specific client engagements. Direct costs also include the costs of subcontractors and outside consultants, third-party materials, and any other related direct costs, such as travel expenses.

We generally expect the ratio of direct costs as a percentage of revenue to decline when our own labor increases relative to subcontracted labor or outside consultants. Conversely, as subcontracted labor or outside consultants for clients increase relative to our own labor, we expect the ratio to increase.

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Changes in the mix of services and other direct costs provided under our contracts can result in variability in our direct costs as a percentage of revenue. For example, if we are successful in our strategy to increase the proportion of our work in the area of implementation (as in the case of The Road Home contract), we expect that more of our services will be performed in client-provided facilities and/or with dedicated staff. Such work generally has a higher proportion of direct costs than much of our current advisory work, and we anticipate that higher utilization of such staff will decrease the amount of indirect expenses. In addition, to the extent we are successful in winning larger contracts, our own labor services component could decrease because larger contracts typically are broader in scope and require more diverse capabilities, potentially resulting in more subcontracted labor, increased other direct costs,

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and lower margins. Although these factors could lead to a higher ratio of direct costs as a percentage of revenue, the economics of these larger jobs are nonetheless generally favorable because they increase income, broaden our revenue base, and have a favorable return on invested capital.

OPERATING COSTS AND EXPENSES

Our operating costs and expenses consist of indirect and selling expenses, including non-cash compensation, and depreciation and amortization.

Indirect and Selling Expenses

Indirect and selling expenses include our management, facilities, and infrastructure costs for all employees, as well as salaries and wages, plus associated fringe benefits, not directly related to client engagements. Among the functions covered by these expenses are marketing, business and corporate development, bids and proposals, facilities, information technology and systems, contracts administration, accounting, treasury, human resources, legal, corporate governance, and executive and senior management. We include all of the incentive compensation paid to all of our employees in this item, including cash and non-cash incentive compensation (such as stock-based compensation) regardless of whether the other compensation and benefit costs of these employees are included in direct costs or indirect and selling expenses.

Non-Cash Compensation

The Company recognized stock-based compensation expense of \$1.5 million and \$4.8 million in the three months and nine months ended September 30, 2008, respectively, which is included in indirect and selling expenses. By comparison, the Company recognized stock-based compensation expense of \$0.8 million and \$2.2 million in the three months and nine months ended September 30, 2007, respectively. The expense was significantly greater in 2008 because approximately 61% of the awards made in 2007 were made in the fourth quarter.

As of September 30, 2008, there was \$11.7 million of total unrecognized compensation expense related to unvested stock-based compensation. Such unrecognized compensation expense is being recognized over a three- to five-year period on a straight-line basis.

Depreciation and Amortization

Depreciation and amortization include the depreciation of computers, furniture, and other equipment; the amortization of the costs of internal software; leasehold improvements; and the amortization of intangible assets arising from acquisitions.

INCOME TAX EXPENSE

Our effective tax rate of 41.6% for the nine months ended September 30, 2008, was higher than the statutory tax rate primarily due to permanent tax differences related to expenses not deductible for tax purposes.

RESULTS OF OPERATIONS

Three Months ended September 30, 2008, compared to Three Months ended September 30, 2007

The following table sets forth certain items from our unaudited consolidated statements of operations and the period-over-period rate of change in each of them and expresses these items as a percentage of revenue for the periods indicated.

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	Three Months Ended September 30,				Year-to-Year Change	
	2008	2007	2008	2007	Three Months Ended September 30, 2007 to 2008	
	Dollars (In Thousands)		Percentages		Dollars (In Thousands)	Percent
Revenue	\$ 176,281	\$ 198,813	100.0%	100.0%	\$ (22,532)	(11.3)%
Direct Costs	115,421	147,468	65.5%	74.2%	(32,047)	(21.7)%
Operating Expenses						
Indirect and selling expenses	44,251	29,639	25.0%	14.9%	14,612	49.3%
Depreciation and amortization	1,706	622	1.0%	0.3%	1,084	174.3%
Amortization of intangible assets	2,241	1,257	1.3%	0.6%	984	78.3%
Total Operating Expenses	48,198	31,518	27.3%	15.8%	16,680	52.9%