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HURN - Q2 2017 Huron Consulting Group Inc Earnings Call

EVENT DATE/TIME: JULY 27, 2017 / 9:00PM GMT

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to Huron Consulting Group's webcast to discuss financial results for the second quarter 2017. (Operator Instructions) As a reminder, this conference call is being recorded.

Before we begin, I would like to point all of you to the disclosure at the end of the company's news release for information about any forward-looking statements that may be made or discussed on this call. The news release is posted on Huron's website. Please review that information along with the filings with the SEC for a disclosure of factors that may impact subjects discussed in this morning's webcast.

The company will be discussing one or more non-GAAP financial measures. Please look at the earnings release and on Huron's website for all of the disclosures required by the SEC, including reconciliation to the most comparable GAAP numbers.

And now I would like to turn the call over to Jim Roth, Chief Executive Officer and President of Huron Consulting Group. Mr. Roth, please go ahead.

James H. Roth *- Huron Consulting Group Inc. - Co-Founder, CEO, President & Director*

Good afternoon, and welcome to Huron Consulting Group's Second Quarter 2017 Earnings Call. With me today are John Kelly, our Chief Financial Officer; and Mark Hussey, our Chief Operating Officer.

Our Business Advisory and Education segments continued to meet our expectations during the second quarter while our Healthcare segment remained challenged. Let me provide some perspective on each of our segments and then turn it over to John so he can walk you through the financials.

I'll begin with Healthcare. During the second quarter, Healthcare segment revenues declined 22% compared to the prior year quarter. On an organic basis, Healthcare revenues decreased approximately 27% over the second quarter of 2016. The quarter-over-quarter decline, was primarily attributable to the roll off of a large engagement in the first quarter of 2017 and, to a lesser extent, continued softness in our revenue cycle offering within the performance improvement solutions.

Excluding the impact of a large engagement in the first quarter of 2017, Healthcare segment revenues declined 10% sequentially in the second quarter. From a revenue perspective, the Healthcare segment is nearly evenly split between the performance improvement business, which includes our revenue cycle and cost and clinical offerings, and the advancing solutions business, which comprises our Studer Group, technology services, medical group and strategy offerings.

Within performance improvement, we believe we are nearing a point of stabilization in this business inclusive of our revenue cycle offering after a nearly 2-year decline. We have recently seen some positive indications related to demand for these services and anticipate a steadier run rate for the remainder of the year. Many health care providers are facing increased pressure on margins due to rising expenses that continue to outpace reimbursement. This scenario has created a stronger sense of urgency for our performance improvement services.

While our performance improvement business appears to be stabilizing, we see some signs of softness in our advancing solutions business, of which the Studer Group offering is the largest component. In Studer Group, we have recently experienced an unanticipated slowdown in demand that we expect will impact our revenue for the remainder of the year. The reasons for the revenue shortfall are the early termination of contracts among certain national health systems and slower-than-expected new business sales. While renewals from expiring contracts continue, we believe the primary cause for the recent cancellations was the need by clients to reduce discretionary spending amidst continuing margin pressures.

Studer Group's core regional and community hospital base is currently stable and the business' Net Promoter Scores remain high. Although some of the large clients have terminated some of the coaching services, many of these clients still have an ongoing relationships with Studer Group as they continue to use our software products to enable and sustain performance in key clinical and administrative processes.

We continue to enhance our offerings within our Healthcare practice to address evolving market needs and align with client buying preferences. As we discussed at our Investor Day in February, we see the health care market purchasing services in a more discrete and flexible manner.

Within the broader Healthcare segment, we continue to integrate our offerings to create a unified value proposition for our clients consistent with the way they are viewing the transformation of their businesses. Our core performance improvement offerings are well along the way to being more effectively aligned with the market. We are innovating new offerings within Studer Group while also unbundling some of their current offerings to enable us to better integrate Studer Group's leadership, change management and cultural transformation services with our performance improvement solutions to further sustain our results.

There are indications that the changes we have made to respond in the market needs and its preference for greater flexibility in how they engage with us are resonating. We are successfully broadening our client base, creating a stronger foundation from which we can grow. In 2017, we are on pace to work with 30% more clients than in 2016, although with smaller engagements as we have discussed on prior calls. And we are increasingly winning follow-on work across our breadth of services as we shift to more of an ongoing trusted advisor relationship with our clients.

Although demand appears to be improving for most of our Healthcare Services, the significant shift in how the health care market has been buying our services has caused disruption to revenues and margins over the past couple of years. As we have disclosed in prior quarters, if the financial performance of our Healthcare segment continued to decline and did not meet our expectations, we could be required to perform an interim impairment analysis with respect to our carrying value of goodwill for the Healthcare reporting unit prior to our usual annual test.

Due to our second quarter results and our revised forecast for the remainder of 2017, coupled with the revenue and margin trends for the Healthcare segment over the past 2 years, we performed such an interim impairment analysis as part of our second quarter closed process, and have recorded a goodwill impairment charge for our Healthcare segment. There is no impact to ongoing operations, revenues, cash flows or financial covenant compliance due to the goodwill impairment charge.

While the impairment charge reflects current visibility, we believe we have a strong set of capabilities that will continue to differentiate Huron in the market, and we are aggressively pursuing strategic initiatives that will position us to return to long-term growth.

Some of the initiatives we discussed during our Investor Day are beginning to yield some positive results in our business. The addition of Innosight further adds to our opportunities to differentiate our comprehensive strategic, operational, analytic and technology offerings in the market as many of our clients are ongoing disruption that requires transformation of their businesses.

In summary, although we have recently seen some softness in our Studer Group offering, we believe we are nearing a point of stabilization in performance improvement. We believe the changes we have made are taking hold in the market, and we have the right pieces in place to address our clients' most pressing challenges. They are facing significant and rapid change, and with our broad set of capabilities and deep industry expertise, we are uniquely positioned to help our hospital and health system clients transform their organizations.

Turning now to the Education segment. As of June 1, we realigned the Life Sciences practice with the Business Advisory segment, which I will discuss in more detail shortly. In Education, the segment achieved strong performance in the quarter, growing revenues nearly 18% year-over-year. The segment had exceptional performance in the first half of the year led by our strategy in operations and technology offerings.

Over the past several years, we have made investments in our cloud-related businesses and today, we have nearly 100 people supporting our cloud efforts within Education. Within the past few weeks, we have had 2 significant go-lives for large research universities, bringing in resources from many service lines across the Education business to support these successes. We will continue to invest in these businesses to grow our resources and expand our presence, as clients are increasingly turning to the cloud to modernize their systems and improve their performance.

The Education segment is on a path to have its third consecutive year of double-digit growth. Higher Education institutions are under considerable stress, and we remain well positioned to meet the evolving demands of this sector.

Our Business Advisory segment now includes 4 businesses: Enterprise Solutions and Analytics, or ES&A, legacy Business Advisory, strategy and innovation and Life Sciences. This segment continued to perform in line with our expectations during the second quarter.

Given the realignment of the Life Sciences business, the makeup of the Business Advisory segment is now approximately 45% ES&A; 20% legacy Business Advisory; 20% strategy and innovation; and 15% Life Sciences. These practices within the Business Advisory segment have some common characteristics. First, their clients predominantly have for-profit objectives; and second, many of their clients serve global markets. This is in contrast to our Healthcare and Education businesses, which today primarily serve not-for-profit and domestic clients.

The addition of Life Sciences to the Business Advisory segment better aligns our largest strategy capabilities and global operations under one segment, driving increased collaboration and improved efficiencies across these businesses.

Now let me turn to the individual businesses within this segment beginning with ES&A. The ES&A business performed well during the second quarter of 2017, achieving organic revenue growth in the mid-teen range. In the first half, revenue growth was primarily driven by our business intelligence and sales force solutions. Cloud-based platforms have accelerated pace at which our clients are adopting new technologies. As our clients look to thrive in the digital economy, they are leveraging our broad, functional and technical capabilities to gain operational efficiencies, improve customer experiences and unlock valuable insights to better manage their business. Our talented team of consultants bring the best of process and technical expertise together across our portfolio of services to deliver the results of our clients' desire.

The performance of our legacy Business Advisory practice declined year-over-year due to tough comparisons that were driven by a large contingent fee earned in the second quarter of 2016. Excluding this contingent fee, the Business Advisory practice has grown in the mid-single-digit range for the first half of 2017. This business continues to broaden its client base to serve not only distressed clients but also nondistressed clients looking to improve their financial and operational performance. With a diversified client base and service offering, we are able to support the needs of our clients at the different stages in their evolution which provides us more opportunities to growth -- to drive growth in this business.

The strategy and innovation practice, which we acquired in the first quarter with Innosight continued its strong momentum in the second quarter. With the combination of our strategy and operations capabilities and deep industry expertise, we are uniquely positioned to help our clients transform as they strive to strengthen their businesses today while creating growth opportunities for the future. When we acquired this business in March, there was a strong sense that Innosight and Huron would be far better off together than apart. This has proven true in multiple collaborative engagements we have won during that second quarter by bringing Huron's collective competencies and industry expertise to market together with the strategy and innovation team to present an approach and depth of capabilities unmatched by competitors.

In a short time, we have successfully gone to market together with major clients in the Healthcare and Life Sciences industries, and we are aggressively expanding our collaborative approach into other industries and client relationships.

Now turning to Life Sciences. The Life Sciences business continued to perform in line with our expectations in the second quarter. In addition to the segment realignment during the quarter, we also made some organizational changes to accelerate our growth in the Life Sciences business. First, we decided to focus our investments on growing the Life Sciences strategy business and exited the compliance and operations, or C&O, business during the second quarter. This action allows us to optimize investments in our people and preserve our ability to invest more quickly and effectively in the global Life Sciences strategy business, where we see our greatest growth opportunities. Taking into account the divestiture of the C&O business and the acquisition of Pope Woodhead, we expect the Life Sciences practice to grow revenues in the upper single-digit range on a full year basis.

Second, we welcomed John Westwood to Huron as the leader of the Life Sciences practice. John most recently served as Senior Partner and Managing Director at L.E.K. Consulting, where he cofounded and led the firm's Life Sciences practice. Working with our experienced team, John will help to broaden our services and accelerate Huron's global growth in the pharmaceutical, biotech and medical device industries. He will also work closely with the practice to expand its collaborative efforts with other Huron businesses, to enhance our competitive advantage across the broader health care spectrum. I firmly believe that under John's leadership, working together with our very talented Life Sciences team, this business will continue to grow, building upon our strong reputation in the Life Sciences industry.

During our Investor Day in February, we discussed our vision for building stronger, strategic advantage through a deeper collaboration within Huron, and we continue to make progress. Excluding the Life Sciences practice, in the first half of 2017, the Business Advisory segment generated approximately 21% of their total revenues in the Healthcare, Education and Life Sciences industries. Also during the first half of 2017, nearly 50% of our top 15 clients worked with at least 2 practices within Huron. We believe our clients are best supported and achieve the most valuable outcomes when we bring the right solutions to bear from across the firm. Our ability to meaningfully collaborate brings a unique value proposition to our clients, strengthening our client relationships and competitive advantage and building the foundation for future growth.

Let me now turn to our 2017 guidance. As our press release indicates, we are updating our annual revenue guidance to $730 million to $750 million, and our GAAP earnings per share guidance to a loss of $6.25 to $6.15, which includes the $7.05 goodwill impairment charge. And on a non-GAAP adjusted basis, our updated EPS guidance is now income of $2.20 to $2.30. We updated our revenue guidance due to 2 primary factors. First, our Healthcare expectations for the remainder of the year have changed. This change is driven by the softness in Studer Group and slower-than-anticipated growth in the first half of the year in our performance improvement solution despite recent signs of stabilization. Second, as a result of the sale of the C&O business, revenues within our Life Sciences practice will be lower than contemplated in our original guidance. Excluding the impact of the C&O sale, we expect our Education and Business Advisory segments will continue to be in line with our original full year revenue expectations with anticipated organic growth in the low double-digit range.

We also updated our adjusted EPS guidance primarily reflecting the reductions in revenue I just discussed. Finally, we are updating our Healthcare performance-based fee guidance to $25 million to $30 million.

Although there is no question that this has been a challenging period for the health care practice, let me share a final perspective about why I'm excited about Huron's future. The pace of change in the health care industry has led us to make significant changes in the way we operate our business and our go-to-market strategy. We have made considerable progress in transforming this business, enhancing the depth and breadth of our service offerings, broadening our client base and more deeply integrating complementary offerings within the practice and across the firm.

We are one of the largest and most well-regarded health care management consulting firms, and we have aligned our competencies to be responsive to our clients' need to strategically and operationally navigate in uncertain and rapidly changing health care environment.

We have a broad range and depth of capabilities to support our Healthcare clients. We are unifying the practice to leverage the breadth and depth of our capabilities and repositioning how we engage with the market in order to capitalize on our growing base of clients. We have made significant progress in executing a major transformation of our Healthcare practice, and we are far better prepared for growth today than we were even 3 months ago. Our management focus for the remainder of the year will be to continue to position us for future growth by executing on our plans to unify the Healthcare business.

Our Education and Business Advisory segments, which comprise over half of our business, continue to perform well. And both segments are seeing market opportunities that are well suited for future growth. Our focus will also be to continue enhancing the strong market-facing platform that has enabled these segments to achieve solid growth over the past few years.

Our people are our most important asset and are the driving force that is executing our vision of a more integrated company and creating opportunities in new areas where we can grow. We see a lot of change and disruption in all of the industries that we serve, including our own, and I am proud and confident that our nearly 3,000 employees are prepared and energized to achieve new levels of success in Huron's future.

Now let me turn it over to John for a more detailed discussion of our financial results. John?

John D. Kelly - *Huron Consulting Group Inc. - CFO, EVP and Treasurer*

Thank you, Jim, and good afternoon, everyone. Before I begin, please note that I will be discussing non-GAAP financial measures, such as EBITDA, adjusted EBITDA, adjusted net income, adjusted EPS and free cash flow. Our press release, 10-Q, Investor Relations page on the Huron's website have reconciliations of these non-GAAP measures to the most comparable GAAP measures, along with the discussion of why management uses these non-GAAP measures and why management believes they provide useful information to investors regarding our financial condition and operating results.

Effective as of the second quarter of 2017, we reorganized our internal reporting structure by moving our Life Sciences practice from the Education Life Sciences segment, which is now the Education segment, to the Business Advisory segment. The historical results of our Life Sciences practice have been reclassified to the Business Advisory segment for all periods presented in our 10-Q and in today's discussion. The supplemental 8-K, with the recast historical segment results for the 2016 quarters and full year 2015 reflecting this reorganization, will be provided later this afternoon. Also, our acquisition of the international business of ADI Strategies, which closed in April, is included in our second quarter financial results in the Business Advisory segment.

Now let me walk you through some of the key financial results for the quarter. Revenues for the second quarter of 2017 declined 1.5% to $181.4 million compared to $184.3 million in the same quarter of 2016. Second quarter 2017 revenues include $19.8 million from our acquisitions of HSM Consulting, Pope Woodhead and Innosight, all of which closed after the second quarter of 2016.

Second quarter 2017 revenues also included: incremental revenues due to the full quarter impact of our acquisitions of the U.S. business of ADI Strategies completed in May 2016; and revenues from our recent acquisition of the international business of ADI Strategies, both of which have been fully integrated into our business.

Net loss from continuing operations was $150.5 million or $7 per share in the second quarter of 2017, compared to income of $16.1 million or $0.76 per diluted share in the same quarter last year. The decline in net income over the prior period -- prior year period reflects the goodwill impairment charge related to the Healthcare segment.

As Jim noted, we have aggressively made changes to reposition the Healthcare business for growth, and we see positive indicators for demand in our performance improvement solution. However, as we have previously disclosed could be required, based on our second quarter performance and revised forecast for the remainder of 2017 and reflective of the revenue and margin trends over the past 2 years, as part of our second quarter close, we determined that we should perform an interim impairment analysis relating to the Healthcare reporting unit. And as a result, we concluded that the carrying value of the unit exceeded its fair value.

As such, we recorded a $209.6 million noncash pretax goodwill impairment charge in the second quarter of 2017. The charge was related to goodwill recorded in conjunction with all of our Healthcare segment acquisitions over the past 12 years, including the Wellspring stock and Studer Group acquisition. As Jim noted, there is no impact to ongoing operations, revenues, cash flows or financial covenant compliance due to the goodwill impairment charge.

Our effective tax rate in the second quarter 2017 was 26.2% compared to 33.8% a year ago. Excluding the impact of the goodwill impairment charge, our effective income tax rate was 44%, which is higher than our statutory rate inclusive of state income taxes due to certain nondeductible business expenses and estate tax true-up, partially offset by certain credits and deductions.

Adjusted EBITDA was $24.5 million in Q2 2017 or 13.5% of revenues compared to $41.6 million in Q2 2016 or 22.6% of revenues. The year-over-year decrease in adjusted EBITDA was primarily attributable to lower operating income in our Healthcare segment.

Adjusted non-GAAP net income from continuing operations was $10.6 million or $0.49 per diluted share in the second quarter of 2017 compared to $23.3 million or $1.09 per diluted share in the same period 2016.

Now I'll make a few comments about the performance of each of our operating segments. The Healthcare segment generated 46% of total company revenues during the second quarter of 2017. This segment posted revenues of $83.2 million for the second quarter of 2017, down $22.9 million or 21.5% from the second quarter of 2016. Revenues for the second quarter of 2017 included $6.4 million from our acquisition of HSM Consulting, which closed during the third quarter of 2016. Excluding this incremental amount, revenue on an organic basis decreased 27% compared to the second quarter of 2016. As Jim mentioned, the decline in revenue was primarily driven by the wind down of a large engagement (inaudible) softness in our performance improvement business, in particular, our revenue cycle offering.

Performance-based fees in Q2 2017 were $4.5 million compared to $14.8 million in the same quarter last year. Our full year expectations for the range of performance-based fees is now $25 million to $30 million.

Operating income margin for Healthcare was 28.4% for Q2 2017 compared to 39% for the same quarter in 2016. The year-over-year decrease in operating margin is primarily attributable to an increase in salaries, bonuses and related expense as a percentage of revenues.

The second quarter of 2016 also included a bonus adjustment, which improved segment operating margin during that quarter. We continue to execute on smaller projects during the second quarter 2017, which offer less contingency upside and resource efficiencies and large engagements, driving reduced margins for this business.

The Education segment generated 24% of total company revenues during the second quarter 2017. The segment posted record quarterly revenues of $43.9 million this second quarter, an organic increase of 17.7% compared to revenues for Q2 2016 of $37.3 million. The operating income margin for the Education segment was 28.4% for Q2 2017 compared to 30.8% for the same quarter in 2016. The decrease in operating income margin in the quarter was primarily attributable to an increase in salaries, bonus and related expenses, as a percentage of revenues as we continue to invest in our cloud offerings. As Jim noted, our cloud solutions performed well during the second quarter.

The Business Advisory segment, which now includes the ES&A, legacy Business Advisory, strategy and innovation and Life Sciences practices, generated 30% of total company revenues in the second quarter. The segment posted revenues of $54.3 million for the second quarter of 2017, an increase of 32.8% compared to $40.8 million in Q2 2016. Revenues for the second quarter of 2017 included $13.3 million of revenues from our acquisitions of Pope Woodhead and Innosight.

Second quarter 2017 revenues also included: incremental revenues due to the full quarter impact of our acquisition of the U.S. business of ADI Strategies completed in May of 2016, and revenues from our recent acquisition of the international business of ADI Strategies, over which has since been fully integrated into our Business Advisory segment.

The operating income margin for business advisory was 22.5% for Q2 2017 compared to 26.6% for the same quarter in 2016. The decrease in operating income margin in the quarter is primarily attributable to the favorable impact of a large success fee from our broker-dealer during the second quarter of 2016.

Other corporate expenses not allocated to second level is $30.7 million in Q2 2017, compared with $28 million in Q2 2016. The quarter included approximately $1.4 million of restructuring charges. In addition, approximately $3.1 million of Pope Woodhead and Innosight's costs are included in the unallocated G&A, as these activities are consistent with other corporate activities within Huron.

As our business mix continue to shift, we are actively managing our cost structure across the enterprise.

Now turning to the balance sheet and cash flows. DSO came in at 59 days for the second quarter 2017 compared to 61 days for the first quarter of 2017. So all that includes the $250 million face value of convertible notes; $167 million of senior bank debt; and a $5 million promissory note, for a total debt of $422 million. We finished the quarter with cash of $13 million for net debt of $409 million, a decrease of approximately $24 million compared to net debt of $433 million as of the end of the first quarter.

We ended Q2 2017 with a leverage ratio, as defined in our senior secured credit agreement, of approximately 3.2x adjusted EBITDA. We expect our leverage ratio to increase by 10 to 20 basis points in the third quarter before decreasing below 3.0x by the end of the year.

Cash provided by operating activities for the first 6 months of 2017 was $23 million. We expect cash flows from operating activities for the year of $95 million to $105 million. We still expect capital expenditures for the year to be approximately $25 million.

Net of capital expenditures. We expect free cash flow for the year of approximately $70 million to $80 million net of cash taxes and interest and excluding noncash stock compensation. As Jim mentioned, we are updating our annual revenue guidance to $730 million to $750 million. We're also reducing our annual earnings guidance for GAAP EPS to a loss of $6.25 to $6.15 per share, and non-GAAP adjusted EBITDA to income of $2.20 to $2.30 per share.

We expect our effective tax rate, exclusive of the impact of the goodwill impairment charge, to be in the range of 44% to 45%, reflective of the impact of the new share-based compensation accounting rules.

I would like to highlight the following key assumptions related to our updated guidance. Regarding the Healthcare segment, our expectation is that revenue will be flat sequentially in the third and fourth quarters compared to the second quarter results. We now expect the full year Healthcare segment operating margin to be around 33%.

Regarding the Education segment, we expect the full year revenue growth percentage to be in the low double-digit range compared to 2016. This revenue growth is entirely organic. We now expect full year Education segment operating margin to be between 24% and 25%.

With regards to the Business Advisory segment, excluding strategy and innovation and Life Sciences, we expect the full year organic revenue growth percentage to be in the low double-digit range compared to 2016. For this portion of the business, excluding the impact of a significant success fee recognized during the second quarter of 2016, organic revenue growth was in the upper single-digit range during the first half of the year.

Our strategy and innovation practice remains on track with our initial expectations. After factoring in both the acquisition of Pope Woodhead and the divestiture of our C&O practice, we expect our Life Sciences practice to grow in the upper single-digit range in 2017. We now expect overall Business Advisory segment margins to be in the 23% to 24% range.

Finally, with regard to unallocated corporate SG&A, we should expect a quarterly run rate between $28 million and $30 million for the remainder of 2017. Please note that this run rate includes an estimated incremental $3 million per quarter related to the ongoing operations of our Innosight and Pope Woodhead acquisitions.

As a closing reminder, with respect to adjusted EBITDA, adjusted net income and adjusted EPS, there are several items that you will need to consider when reconciling these non-GAAP measures to comparable GAAP measures. The reconciliation schedules that we included in our press release will help walk you through these reconciliations.

With that, I would now like to open the call up to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Tim McHugh with William Blair & Company.

Timothy John McHugh - *William Blair & Company L.L.C., Research Division - Partner and Global Services Analyst*

First, just to ask about Studer. I guess can you elaborate on what you're hearing and -- is one question on that. Second, maybe, can you kind of quantify how meaningful, I guess, the slowdown is there?

C. Mark Hussey - *Huron Consulting Group Inc. - COO and EVP*

Hey, Tim, it's Mark. Yes, so with Studer, I think it was pretty descriptive in the comments. We had some larger national systems that have been under margin pressure and have had directives to reduce spending across the system, and that's been something that's been a change. I think it's reflective of the increased margin pressure within the group. And I'll let John quantify what that means for the year.

John D. Kelly - *Huron Consulting Group Inc. - CFO, EVP and Treasurer*

Tim, we're now expecting Studor to be down in the upper single-digit percent range full year 2017 as compared to 2016. We don't have guidance yet on 2018 until we go through our budgeting process at the end of Q4. However, the full year impact of the 2017 cancellations will be a headwind to that 2018 growth. To get the complete picture, you need to factor in assumptions about new business development, renewals of existing contracts and we won't be in a position to do that until later in the year.

Timothy John McHugh - *William Blair & Company L.L.C., Research Division - Partner and Global Services Analyst*

I guess what was Studor down -- or what was the performance in the first half, if you expect it down high-single digits for the full year?

C. Mark Hussey - *Huron Consulting Group Inc. - COO and EVP*

I think it was relatively flat year-on-year. John, just double check.

John D. Kelly - *Huron Consulting Group Inc. - CFO, EVP and Treasurer*

Yes, I'm looking. It was relatively flat for the first 6 months, Tim.

Timothy John McHugh - *William Blair & Company L.L.C., Research Division - Partner and Global Services Analyst*

Okay. And I guess just, Mark, to follow up on that. Not to, I guess, question it but a little bit -- there's been pressure, I guess, so. And I guess it seems a little unusual for someone to cancel -- it sounds like early before their contract period was up. So I guess is it just as you say, the pressure got that much worse, and I guess -- it sounds like this is a couple of hospitals, I guess. So is that right to think of it that way? It's not just one entity that did this?

C. Mark Hussey - *Huron Consulting Group Inc. - COO and EVP*

Right, right, Tim. It was more than one entity. And I think you're right. It's been unusual in the cadence for Studer to see cancellation out of sequence. And candidly, some of the cancellations, as we said, actually they've had very high Net Promoter Scores. We've done a lot of work with our clients just to really make sure that we accurately understand the rationale for that. In some areas, they have retained certain of the services that are provided with Studer. And I think there was a comment that Jim had made about the direction that we're unbundling some of the services. So historically, Studor has gone to market with a very -- one single contract that brought all the services together and was for a 3-year period of time. And I think that's in some respects, the market wants more flexibility, no different than we've seen in some of our PI offerings in terms of how they are buying their services. So we still think we have very, very high levels of service delivery, high satisfaction. And we think it really is truly a financial issue with respect to the decisions that came through.

Timothy John McHugh - *William Blair & Company L.L.C., Research Division - Partner and Global Services Analyst*

Okay. Was this reflected in the second quarter results? Or more something that is an incremental as we look forward?

C. Mark Hussey - *Huron Consulting Group Inc. - COO and EVP*

Yes. It's really reflected, Tim, in the second half outlook because with the cancellation, there's normally a notice period. And so that really bridges you into -- largely out of Q2, for the most part into Q3 and 4.

Operator

And our next question is from Kevin Steinke with Barrington Research.

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

So was the Studer impact to guidance only cancellations? I believe you also said just kind of delayed sales cycles as well. Is that part of the guidance reduction, too?

C. Mark Hussey - *Huron Consulting Group Inc. - COO and EVP*

Yes, Tim -- I'm sorry, Kevin, it's actually a little bit of both. The cancellations was probably the precipitating factor. And the slower new business sales, I think has been a factor that's been out there a little bit that we've been watching for a while but predominantly it's the impact of the cancellations.

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

Okay. And taking the revenue guidance at the midpoint, has gone down by $30 million, you talked about Studer and both slower-than-expected performance improvement, can you divide that up in terms of the guidance reduction into those 2 buckets at all?

John D. Kelly - *Huron Consulting Group Inc. - CFO, EVP and Treasurer*

I would say, Kevin, it's probably -- out of that, the factor that Jim cited related to the total decline in the midpoint revenue guidance were really the Healthcare factors and also the fact that we have C&O dropping off, the C&O practice within our Life Sciences segment dropping off in the back half of the year. So I'd say, I think the Healthcare piece is about 2/3 of that $30 million and the Life Sciences piece being the other component. So as far as that Healthcare piece goes, I'd describe it is about 3/4 Studer Group and then about 1/4 related to changing expectations for the performance improvement practice.

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

Okay, that's helpful. And just -- you talked about -- you think performance improvement is stabilizing although it's been softer than expected and that's part of the guidance reduction. So can you just talk a little bit more about why you believe that's stabilizing, and what gives you confidence that it's doing that?

James H. Roth - *Huron Consulting Group Inc. - Co-Founder, CEO, President & Director*

Yes, Kevin. This is Jim. I guess there's a couple of factors. First of all, we've been, like everybody else, we've been looking and hearing in the market about pressures. I think we've seen a buildup in urgency among some of our clients to take -- to make cost reductions, in particular, but also [reducing] the revenue cycle, just trying to get better performance. I think the margins, they're really getting squeezed right now. As we talked about for a long time, there was a lot of uncertainty. I think the fact is that right now people are recognizing there's probably going to be uncertainty for a long time, and are now focused on addressing what I think, for many places, has been reduced margins. And so I think that's what -- we've seen it in the work that we've won. We've seen it in work that appears to be up for bid or up for RFPs. And so our sense is both across the board and some of the larger hospitals and economic medical centers, but also for some of the more small and mid-sized hospitals, the margin pressures is getting increasingly difficult. I mean it's really simple to explain that. The labor costs are simply increasing significantly more than the reimbursements.

C. Mark Hussey - *Huron Consulting Group Inc. - COO and EVP*

And the thing I'd add to that is that we have made changes in how we're going to market that I think are resonating. And we're seeing, as Jim mentioned, an expansion in the client base. And we had initially started changing things that are causing clinical solutions probably over a year ago. And we had good success in terms of how that resonated in the market. And we have pursued, really, the same thing in our revenue cycle offering, and that is also resonating. So what it's doing is helping us just essentially increase the addressable market that really will be interested in the services and how they want to consume them. And I think collectively, increased margin pressures with our repositioning is coming together that gives us more confidence in the outlook being stable.

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

Okay. And on Education, the restated Education segment, 18% growth there you're talking about. So was that -- you talked about in the first quarter some projects with some unusually high intensity, did that continue in the second quarter? And then does that kind of fall off in the second half and get you more down to that low double-digit range for the full year?

James H. Roth - *Huron Consulting Group Inc. - Co-Founder, CEO, President & Director*

I think we're -- I think our guidance kind of anticipates lower double-digit range there. They're -- I think not that dissimilar to Healthcare, there are a lot of changes going on in higher education and we're very well prepared to meet those. But I think it is pretty -- we've been talking about this now for probably the better part of 2 years, and our progress and our growth in higher ed is really across all of our practices within that. But I think in most recent quarter, and actually probably the most recent first half of the year, we've had considerable strength in our technology, cloud-based solutions and our strategy and operations solutions. So we feel that we should be able to hit the lower double-digit growth range for the remainder of the year.

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

Okay. Does that imply, though, that maybe the growth just slows a little bit in the second half, just from that 18% level? Just trying to parse, I guess, low double digit, what the definition of that is, and if we drop them more like high single digits or low teens in the second half.

John D. Kelly - *Huron Consulting Group Inc. - CFO, EVP and Treasurer*

Kevin, we're looking at high single digits right now for the second half.

Operator

Our next question comes from Tobey Sommer with SunTrust.

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

I wonder if you could size the different pieces in businesses within the Healthcare segment, just so I can understand how the differing trends, kind of, blend together time to move the overall segment.

John D. Kelly - *Huron Consulting Group Inc. - CFO, EVP and Treasurer*

Hey, Toby, this is John. When we look at the Healthcare segment, it's really about a 50-50 split now between the performance improvement side of the business and the advancing solution side. So within performance improvement, it's probably about a 60-40 split between rev cycle and cost in clinical on that half of the business. And then within advancing solutions, the majority is Studer Group with the rest being our technology, strategy and medical group practices.

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

Okay. So when you talked about the performance improvement, signs getting better, a little more urgency, just trying to understand is that a reflection of sentiment in conversations or contracts and billing?

C. Mark Hussey - *Huron Consulting Group Inc. - COO and EVP*

It's expectations in pipeline, Tobey.

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

Okay, got it. And then I think you described, in your prepared remarks, collaborative engagements that you seem pretty excited about with respect to Innosight, and I was hoping you could give some more color around that and what you see as an opportunity in that area.

James H. Roth - *Huron Consulting Group Inc. - Co-Founder, CEO, President & Director*

Well, Tobey, this is Jim. The collaborative efforts we talked about really come in a couple of ways. I mean, number one, first of all Innosight in and of itself was obviously very strong across a lot of commercial sectors, and actually had done some work in the health care sector both on the provider side and the payer side. And what we've been able to do, in the short period of time that they've been under our umbrella, is we have bid with them together using our industry competence, in one case Life Sciences, in another case, Healthcare, where we had pretty significant competition and we were able to win because of our collective knowledge of the industry and their approach to strategy and looking at the future. And the approach and our industry competencies really resonated well with the clients. And I think that's why we won against a very formidable set of competitors. So we take a lot of pride in the way that, that's worked out over a really short period of time to which we've been together. And I think we're only now just beginning to see some of the opportunities that are ahead of us as we continue to go to market together. So these early successes has really helped our confidence that we're onto something that others really aren't able to combine. And I think that's why we're going to be, obviously, very aggressive at taking that combined approach and delivering it across our Health, Education and Life Sciences segments in addition to the normal commercial segments that they've gone to.

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

Okay. In recent quarters, you've been active, reshaping the offering, in part, via acquisition. Are you -- not to say you'll do more acquisitions but is that flurry of activity in reshaping -- or do we have more of that behind us than we have in front of us over the near term? Or are you going to need to continue to fuel your positioning with acquisitions near term?

James H. Roth - *Huron Consulting Group Inc. - Co-Founder, CEO, President & Director*

We actually feel, Tobey, very good about our current positioning and we don't expect to be heavy into M&A in the near future.

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

Okay. And so from a -- could you maybe describe for me what that implies from a capital allocation and balance sheet perspective then?

John D. Kelly - *Huron Consulting Group Inc. - CFO, EVP and Treasurer*

Tobey, I'd say the focus right now is going to be on debt paydown as we -- as I talked about in my remarks. And from a bank definition perspective, we're at 3.2x leveraged at the end of the quarter. Our preference is to be more, I'd say, in the mid 2s. So the priority right now will be paying down debt.

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

Okay. And then could you just repeat, if you could, the expectations for growth in the Education segment? I missed that detail.

John D. Kelly - *Huron Consulting Group Inc. - CFO, EVP and Treasurer*

Hey, Tobey, so for full year '16 versus '17, we expect Education to grow in the low double-digit range. And so through the first half of the year, they're up 18%. And the application for the back half of the year is that will be in the upper single digits.

Operator

And our next question comes from Bill Sutherland with Benchmark.

William Sutherland - *The Benchmark Company, LLC, Research Division - Equity Analyst*

Just a couple left at this point. Within performance improvement, where you characterize a steadier run rate in the second half, is that like a mix of cost in clinical, seeing forward momentum and lesser declines in the revenue cycle?

C. Mark Hussey - *Huron Consulting Group Inc. - COO and EVP*

Hey, Bill, it's Mark. It's actually remarkably balanced. I think we've seen, with the changes in how we're going to market in terms of delivery, really a stabilization that I would just say is very, very well balanced across all the service offerings that we have right now. So that's also been a very nice development in terms of just the outlook, in terms of how the evolution is happening. It's a more diverse client base than we've seen. It's a balanced offering. Our sales model, the way that we've gone to market, has involved a lot broader number versus the more concentrated engagements. So that gives us just a good feeling about the trajectory of the business.

William Sutherland - *The Benchmark Company, LLC, Research Division - Equity Analyst*

And then as far as any remaining large-scale revenue cycle deals that are ongoing, do they have -- do you have any sense of their longevity at this point in the, kind of, just the magnitude that they represent at this point?

C. Mark Hussey - *Huron Consulting Group Inc. - COO and EVP*

Yes. Bill, we wouldn't comment on any individual one but I would just say that when you look at the impact of larger engagements on the mix of the overall business, I would say having followed off this tough comparison from the Q1, I think we'll start to see a much more balanced mix. There are some decent-sized engagements, I don't want to say they're all small. I mean I think that's always been the historic mix. And perhaps with the recovery in margin pressures in the business, it's what I would characterize as very healthy. It gives us the ability to deploy people and gain efficiencies and have impact, at the same time it's not so overwhelming that we feel like we're creating a future hole for ourselves in terms of comparisons.

William Sutherland - *The Benchmark Company, LLC, Research Division - Equity Analyst*

And then one last one on a performance fees. Are they going to be ratable Q3 and Q4 as far as the...

John D. Kelly - *Huron Consulting Group Inc. - CFO, EVP and Treasurer*

I think so, Bill. Yes.

Operator

Mr. Roth, we have concluded the allotted time for this call. I'd like to turn the conference back over to you.

James H. Roth - *Huron Consulting Group Inc. - Co-Founder, CEO, President & Director*

Thank you for spending time with us this afternoon. We look forward to speaking with you again when we announce our third quarter results. Good evening.

Operator

That concludes today's conference call. Thank you, everyone, for your participation.
