THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

HURN - Q4 2017 Huron Consulting Group Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 27, 2018 / 10:00PM GMT

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

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

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

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to Huron Consulting Group's webcast to discuss financial results for the fourth quarter and full year 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 afternoon'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 Fourth Quarter and Full Year 2017 Earnings call. With me today are John Kelly, our Chief Financial Officer, and Mark Hussey, our Chief Operating Officer.

Our fourth quarter results were slightly below our expectations, with mixed results across segments.

We've made significant progress in the operational turnaround of our Healthcare business. And the Education segment performed well throughout the year and finished the fourth quarter consistent with our expectations. Finally, the Business Advisory segment had a softer fourth quarter.

I will now share some additional insight into our fourth quarter and full year performance and our expectations for 2018.

On a full year basis, Healthcare segment revenues declined 16% over 2016. The year-over-year decline was primarily attributable to a reduction in performance improvement revenue, stemming in part from the roll-off of some larger engagements and, to a lesser extent, softness in our Studer Group business, primarily in the middle of the year.

Healthcare revenues in Q4 2017 declined approximately 6% over the same period in 2016, but grew 20% sequentially over Q3 2017.

The sequential growth was driven by our performance improvement business, where demand strengthened due to the ongoing financial pressures impacting our clients and a broader disruption taking place across the Healthcare provider industry.

Utilization increased in the fourth quarter to 84%, achieving the highest rate in 4 years.

The changes we made during 2017 to accelerate the operational turnaround of our Healthcare business have positioned us to be more responsive to changing market conditions. Among other initiatives, this includes efforts to better equip the Healthcare business to compete across a wider spectrum of engagement sizes and durations as we have developed more flexible delivery models. In addition, we have enhanced the level of collaboration across all of our service lines, while also expanding our client base. Essentially, we have removed the historical silos that existed within our business in order to improve the execution of an organic growth strategy.

Our professionals are leveraging our core competencies and deep expertise in new and creative ways that are resonating with our current and new clients, as they confront the challenges of their own rapidly-changing and highly-competitive environment. As the Healthcare market further evolves in a direction that, we believe, will be favorable to our business, given the current market uncertainties and continued limited visibility into our pipeline, we remain cautious about predicting the rate of growth for this business in 2018.

Turning now to the Education segment. The Education segment achieved organic growth of 12% in 2017 over 2016, driven by strong performance in our technology and strategy and operations businesses. Our cloud-based technology services, where we've been investing for long-term growth in recent years, performed well. We continue to increase our scale in our cloud offerings and demand for our services remains strong. Higher Education institutions continue to face significant challenges, and many are focused on enhancing their academic and administrative functions to improve their ability to respond to cost pressures, in light of increased competition and broader disruption across the Education industry.

Turning to the Business Advisory segment. On a full year basis, the Business Advisory segment grew 37% year-over-year. Given the impact of the divestiture of the Life Sciences compliance and operations business in Q2, organic growth, excluding Life Sciences, grew in the mid- to upper single-digit range, year-over-year, driven by growth in Enterprise Solutions and Analytics, or ES&A business.

Within ES&A, the business has grown from approximately $30 million in revenues to nearly $100 million in a little over 4 years, through both organic growth and acquisitions. Although the practice experienced approximately 20% revenue growth in 2017 over 2016, in the fourth quarter of 2017, the pace of growth slowed. And we now expect more conservative growth in 2018, as reflected in our guidance. We recorded a goodwill impairment charge in the fourth quarter of 2017, which John will discuss shortly. While the impairment charge reflects current visibility, we believe the ES&A practice will continue to grow in 2018, albeit at lower levels than in recent years.

Technology and Analytics is playing an increasingly important role at our clients, and we believe we have the right set of competencies and team in place to differentiate us in the market as we continue to grow our client base. This business also continues to deliver significant value to clients in our core Education and Healthcare verticals.

The legacy Business Advisory practice was down slightly year-over-year, primarily driven by softness in the broker-dealer business. We believe the overall market for our services remains strong, and we are anticipating better performance for this practice in 2018.

Our strategy and innovation practice had a soft fourth quarter. This business tends to be fairly lumpy, given the nature and size of some of its engagements. We continue to be impressed with the array of Fortune 100 clients, as well as those in our core industry verticals that increasingly turn to Innosight for strategic support amidst challenging and disruptive environments.

And finally, our Life Sciences practice had a solid fourth quarter. Excluding the impact of the divestiture of its -- of the compliance and operations business in the second quarter. This practice continues to broaden its reach in providing strategic and market access services to an array of pharmaceutical and medical device manufacturers in the U.S. and in Europe.

We continue to strengthen our collaborative efforts across the entire firm to capitalize on our competitive advantage. In 2017, the Business Advisory segment generated approximately 21% of its total revenues in the Healthcare and Education industries. In addition, collaboration among and between the practices within the Business Advisory segment has increased, applying our strategy, operations and technology competencies in commercial industries such as life sciences, financial services, energy, oil and gas and retail.

Let me turn to our expectations and guidance for 2018. Our revenue guidance for the year is $720 million to $760 million, and adjusted diluted earnings per share guidance is $2.10 to $2.40.

I will now provide a few thoughts regarding our expectations for each segment as well as overall company profitability.

I'll begin with Healthcare. While we are encouraged by the strengthening in demand in the Healthcare market in the fourth quarter, we remain cautious about extrapolating recent market trends in predicting our near-term performance until we have more confidence that these trends are sustainable. As such, at the midpoint of our guidance, we anticipate Healthcare segment revenues will decline in the low single-digit range in 2018, partly as a result of the roll-off of a large engagement in the first quarter of 2017.

We have made significant progress in the operational turnaround of our Healthcare business, focusing on the initiatives we outlined at last year's Investor Day. We have unified our sales and marketing team structures as well as our sales models to capitalize on opportunities to better penetrate our expanding client base. We have effectively unified our prior acquisitions to enhance the practice's ability to go-to-market in a fully collaborative manner, with aligned incentives supporting a comprehensive set of offerings. We have also increased the flexibility of our delivery models, in an environment of smaller engagements with variable duration that frequently lead to opportunities for follow-on work.

We still have more work to do to unlock the full potential of our unified healthcare platform, but I am pleased with the progress we have made to-date and am proud of the way the practice under Mark Hussey's leadership has responded to a very challenging environment.

Our 2018 guidance reflects mid- to upper single-digit organic revenue growth for our Education segment. Higher education institutions continue to face significant cost pressures, while at the same time, trying to transform their organizations in response to changing market dynamics. These issues bode well for the demand for our services, and we believe the Education segment is well-positioned to continue its solid organic growth performance in 2018.

In our Business Advisory segment, we anticipate mid-single-digit total revenue growth, or low single-digit organic growth. In the second quarter of 2017, we made the decision to focus our investments on growing the Life Sciences strategy and market access businesses, and exited the compliance and operations business. This decision created some headwinds for our 2018 revenue growth expectations for the segment. Absent this headwind, we expect the segment to grow in the mid-single-digit range organically in 2018.

In summary, we expect nearly flat total company revenues in 2018, given our continued caution in the Healthcare business.

In 2017, we embarked on our own strategic transformation, which I'll come back to in a few minutes, but I want to note that a core piece of our strategy is focused on accelerating organic growth.

Let me now provide some color on our margins in 2018. We expect adjusted earnings per share to increase 5% at the midpoint of our 2018 guidance.

At the same time, we expect adjusted EBITDA to decline 12% at the midpoint of our 2018 guidance. This reduction is primarily attributable to 2 factors; first, we are expecting a decline in our Healthcare segment margins as we continue to deliver smaller engagements with variable duration and fewer opportunities to leverage resources. We also anticipate a continued lower level of contingent fees. In this regard, the first quarter of 2017 creates a challenging comparison, given the significant contingent fees that were recognized in that quarter at the end of a very large project.

Finally, we have also made modest investments to support the operational turnaround in this business, which will have an impact on 2018 margins. As I mentioned earlier, we continue to believe we are nearing a point of stabilization in margins for this business.

Second, for several years, we have had low bonus payouts that have served to offset margin pressure, due to below expectation performance, primarily in the Healthcare segment. Given that our compensation structure is highly weighted toward incentive compensation, we believe it is prudent to provide our revenue-generating professionals with an opportunity to achieve target, competitive bonuses in 2018 if they achieve their annual plan, which is based on goals that are achievable and reflective of current market conditions.

While the cost of restoring bonuses, if 2018 goals are met, impacts our current year margins, we strongly believe that this action benefits our shareholders in the long term by retaining our high-performing people at a time where we perceive the market to be recovering.

As you know, the U.S. economy is growing at a faster rate than in the past decade, and the competitive -- the competition for talent is intensifying. As a result, we need to ensure that our compensation programs are competitive in the market and designed to both retain our great professionals and to attract the next generation of talent we will need to support our organic growth strategy.

After careful consideration, we believe this year it is important to strategically retain those employees who deliver on our growth and profitability objectives. We believe that our commitment to restore bonuses will create long-term value for our shareholders. We are highly focused on improving our margins, and believe 2018 will be a baseline from which we can sustainably grow our margins in the future, without the benefit of bonus adjustments, consistent with our long-term financial objectives.

Finally, I'd like to make a few comments about the strategic transformation we are embarking on as a company.

I recognize that the past few years have been challenging for Huron and our shareholders. We are, by no means, accepting our recent performance as the new normal. Since the sale of Huron Legal in 2015, we have been shaping this company into a more integrated, more competitive operating business, and in 2017, we took the next step in this evolution.

With the support of our board and in collaboration with practice leadership, we have carefully defined a plan to achieve our vision in a new, 5-year enterprise-level strategy. We believe we have the portfolio of services and collaborative competitive spirit we need to become the premier transformation partner to our clients.

As I look ahead, we do not anticipate any material acquisitions for the foreseeable future, as our strategy sets out to further unlock the value that we believe exists across our company.

I believe our shareholders will ultimately be rewarded for their patience, as our leadership embraces our new vision, a well-defined strategic roadmap and we drive long-term shareholder value through our focus on a sustainable, organic growth strategy that we believe will lead to increased profitability.

In addition to stabilizing our Healthcare business, I view 2017 as an important transition year, where we redefined our strategic direction, created a unified sense of purpose and secured the commitment of our employees through a new vision, mission, set of values and modified brand positioning, all designed to align with our strategy.

Having a strong purpose and values-driven culture, our teams have rallied around our new unifying strategic foundation and are clearly excited by the opportunities that lie ahead, as am I.

Our market presence and brand reputation remain strong, as well as our cash flow. And we are focused on returning this company to sustainable organic growth and increased profitability, consistent with the high expectations that all of us at Huron share with each of you.

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-K and Investor Relations page on the Huron website have reconciliations of these non-GAAP measures to the most comparable GAAP measures, along with a 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.

Also, unless otherwise stated, my comments today are all on a continuing operations basis.

Now let me walk you through some of the key financial results for the quarter.

Revenues for the fourth quarter of 2017 were $185.9 million, up 4.4% from $178.1 million in the same quarter of 2016.

Revenues for the fourth quarter of 2017 reflect our acquisitions of Pope Woodhead and Innosight, which in aggregate, generated $9.8 million of revenues during the quarter.

Fourth quarter 2017 revenues also included revenues from our acquisition of the international business of ADI Strategies, which has been fully integrated into our business.

Net loss was $29.3 million or $1.36 per diluted share in the fourth quarter of 2017 compared to net income of $4.2 million or $0.19 per diluted share in the same quarter in the prior year.

The decline in net income over the prior-year period reflects the goodwill impairment charge related to the ES&A business, which I'll come back to in a few minutes.

On a full year basis, net loss was $170.5 million or $7.95 per diluted share in 2017 compared to net income of $39.5 million or $1.84 per diluted share in 2016. The decline in net income over the prior-year period reflects the goodwill impairment charges related to the Healthcare and ES&A businesses taken over the course of the year.

Our effective income tax rate in the fourth quarter of 2017 was 7.2%, as we recognized the income tax benefit of $2.3 million on a loss of $31.5 million.

The quarterly effective rate was less favorable than the statutory rate, inclusive of state income taxes, primarily due to the impact of the December 22, 2017, passage of the Tax Cuts and Jobs Act, commonly referred to as tax reform. As a result of tax reform, in Q4, we recognized discrete tax expense of $7.9 million for the remeasurement of our deferred tax assets and liabilities, discrete tax expense of $600,000 net of credits related to the total charge on deemed repatriation of foreign earnings, and $300,000 in accrued withholding tax for future cash repatriation.

On a full year basis, our effective income tax rate for 2017 was 23.4%, as we recognized income tax benefit of $52 million on a loss of $222.5 million. The effective tax rate for 2017 was less favorable than the statutory rate, inclusive of state income taxes, primarily due to the $65 million nondeductible portions of our goodwill impairment charges, $8.8 million of discrete income tax expense related to tax reform in the fourth quarter of 2017, and $1.8 million of discrete tax expense related to the new share-based accounting rules that went into effect the beginning of 2017.

These unfavorable discrete items were partially offset by a $2.7 million tax benefit recorded in the third quarter of 2017 related to a previously unrecognized tax benefit from our 2014 check the box election.

Adjusted EBITDA was $31.5 million in Q4 2017 or 16.9% of revenues, compared to $23.9 million in Q4 2016 or 13.4% of revenues. On a full year basis, adjusted EBITDA as a percentage of revenues decreased to 14.3% compared to 17.9% in 2016.

Adjusted non-GAAP net income was $14.9 million or $0.68 per diluted share in the fourth quarter of 2017 compared to $12.5 million or $0.58 per diluted share in the same period of 2016.

For the full year 2017, adjusted non-GAAP net income was $46.6 million or $2.15 per share compared with $68.7 million or $3.21 per share in 2016.

Now I'll make a few comments about the performance of each of our operating segments.

The Healthcare segment generated 51.4% of total company revenues during the fourth quarter of 2017. This segment posted revenues of $95.6 million for the fourth quarter of 2017, down $5.7 million or 5.7% from the fourth quarter of 2016. The decline in revenue was primarily driven by our performance improvement business, stemming in part from the roll-off of some larger engagements, and to a lesser extent, our Studer Group business. However, on a sequential basis, as Jim noted, Healthcare segment revenues grew 20% over Q3 2017. The sequential growth was driven by our performance improvement business, where demand strengthened due to the ongoing financial pressures impacting our clients and a repositioning of our offerings to meet this demand. Performance-based fees in Q4 of 2017 were $9.3 million compared to $14.7 million in the same quarter last year. On a full year basis, Healthcare revenue decreased 16%. Performance-based fees for the full year 2017 were $30.9 million compared to $57.2 million in 2016. Operating income margin for Healthcare was 36.8% for Q4, 2017 compared to 28.3% for the same quarter in 2016. The year-over-year increase in margin was primarily due to higher utilization. Utilization for the fourth quarter of 2017 was 84.5% compared to 72.4% reported in Q4 2016.

The Education segment generated 21.7% of total company revenues during the fourth quarter of 2017. The segment posted revenues of $40.3 million in Q4 2017, up $2.3 million or 6% from the fourth quarter of 2016. On a full year basis, Education segment revenue increased 12.1% versus the prior year. As Jim noted, our Education business performed well in 2017 driven by strong performance in our technology and strategy and operations businesses. The operating income margin for Education was 21.2% for Q4 2017, compared to 18% for the same quarter in 2016. Utilization for the fourth quarter of 2017 was 70.6% compared to 68.7% reported in Q4 2016. On a full year basis, operating margin was 24% compared to 25.6% in 2016.

The Business Advisory segment generated 26.9% of total company revenues during the fourth quarter of 2017. The segment posted revenues of $50 million in Q4 2017, up $11.3 million or 29.1% from the fourth quarter of 2016. Revenues for the fourth quarter of 2017 included $9.8 million from our acquisitions of Pope Woodhead and Innosight. On a full year basis, the Business Advisory segment revenues grew 37.1% year-over-year, and included the acquisitions of Pope Woodhead, Innosight, the international business of ADI Strategies and the full year impact of the acquisition of the U.S. business of ADI Strategies. Given the impact of the divestiture of the Life Sciences compliance and operations business in Q2, organic growth, excluding Life Sciences, grew in the mid- to upper single-digit range year-over-year. The operating income margin for Business Advisory segment was 23.4%, Q4 2017, compared to 15.8% for the same quarter in 2016. On a full year basis, operating margin was 22.4% compared to 19.4% in 2016.

As Jim noted, during the fourth quarter of 2017, we recorded a goodwill impairment charge related to the ES&A reporting unit. We had previously disclosed that a goodwill impairment charge could be required, given the narrow headroom in this reporting unit, as the result of the series of acquisitions over the past 4 years. We performed our annual goodwill impairment analysis as part of our year-end close process, and as a result, based on our fourth quarter performance and 2018 revenue and margin expectations for this business, we concluded that the carrying value of the reporting unit exceeded its fair value. As such, we recorded a $45 million noncash, pretax, goodwill impairment charge for the fourth quarter of 2017. The charge was related to goodwill recorded in conjunction with all of our ES&A reporting unit acquisitions over the past 4 years. There is no impact to ongoing operations, revenues, cash flows or financial covenant compliance due to the goodwill impairment charge. Other corporate expenses not allocated at the segment level, were $28.1 million in Q4 2017 compared with $27.3 million in Q4 2016.

Now turning to the balance sheet and cash flows.

DSO came in at 59 days for the fourth quarter of 2017 compared to 63 days for the third quarter of 2017.

Total debt includes the $250 million face value of convertible notes, $105 million in senior bank debt and a $5 million promissory note, for total debt of $360 million.

We finished the year with cash of $17 million from net debt of $343 million. This was a $42 million decrease compared to Q3 2017 and an increase of $42 million compared to year-end 2016.

Our leverage ratio, as defined in our senior bank agreement, was approximately 3.0x adjusted EBITDA as of December 31, 2017.

Cash flows from operations for the year was $100 million. In 2017, we used $107 million of our cash to invest in acquisitions and $25 million in capital expenditures.

Finally, let me turn to our expectations and guidance for 2018.

For the full year of 2018, we anticipate revenues before reimbursable expenses in a range of $720 million to $760 million. EBITDA and adjusted EBITDA in a range of $86.5 million to $98.5 million. Net income in a range of $23 million to $29.5 million. Adjusted non-GAAP net income in the range of $47 million to $53.5 million. And finally, GAAP EPS between $1.05 to $1.35, and adjusted non-GAAP EPS in a range of $2.10 to $2.40.

Assuming the midpoint of our guidance range, we expect cash flows from operations to be in a range of $95 million to $105 million. Capital expenditures are expected to be approximately $15 million, and free cash flows are expected to be in a range of $80 million to $90 million, net of cash taxes and interest and excluding non-stock -- noncash stock compensation.

Weighted average diluted share counts for 2018 are expected to be 22 million. The guidance assumes no share repurchases, but we do have $35.1 million remaining on the $125 million authorization.

Finally with respect to taxes, you should assume an effective tax rate in a range of 30% to 32%, which comprises the lower federal tax rate of 21%; a blended state rate, net of federal benefit, of 5% to 6%; and incremental tax expense related to nondeductible expense items.

Our analysis regarding the deductibility of certain expenses, subsequent to tax reform, is not yet complete, and our actual effective tax rate in 2018 may change as we finalize our understanding of the new tax rules.

Let me add some color to our guidance. Starting with revenue. The midpoint of the revenue range reflects nearly flat organic revenue from 2017 revenue of $733 million, after consideration of the incremental 2 months of Innosight revenue.

As a reminder, the Innosight acquisition closed on March 1, 2017. Embedded in the guidance range are expected performance-based fees in the Healthcare segment in a range of $25 million to $35 million.

Our outlook for the Healthcare segment is for revenues to decline in the low single-digit range at the midpoint of our guidance. This projected decline reflects a tough comparison to 2017 in Q1, when we recorded approximately $6 million in contingent fees achieved before the wind-down of a large project, and limited visibility in the pipeline for our Healthcare offerings in the back half of 2018 in an environment of smaller engagements. We expect 2018 Healthcare operating margins to be approximately 32% to 33%, as we continue to deliver smaller engagements, anticipate a lower level of contingent fees and plan for a return to normalized bonus funding, if the Healthcare team achieves its financial targets in 2018. Healthcare operating margins are expected to include $6 million less of direct intangible asset amortization during 2018, as certain intangible assets became fully amortized in 2017 or are expected to become fully amortized in early 2018.

In the Education segment, we expect mid- to upper single-digit revenue growth in 2018. We expect operating margins will be approximately 25% to 26%.

In Business Advisory, we expect to see mid-single-digit revenue growth for 2018, and we expect our operating margins in this segment to be in a range of approximately 22% to 23%.

We expect unallocated corporate SG&A to remain relatively flat on a full year basis in 2018 compared to 2017.

Turning to the total company. Huron's adjusted EBITDA margin is expected to be in a range of 12% to 13%, a decrease of 130 basis points to 230 basis points compared to 2017. This primarily reflects the decline in projected Healthcare segment margins, as the business stabilizes in the evolving market environment, and as Jim described, a return to normalized bonus funding for our revenue generating professionals.

At the midpoint of our guidance range, we anticipate adjusted EPS of $2.25, an increase of approximately 5%, reflecting the lower effective tax rate, partially offset by the decline in adjusted EBITDA.

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.

Thanks, everyone. And now I'd like to open the call to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question is from the line of Tim McHugh with William Blair & Company.

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

Can you just elaborate on the bonus increase, as it relates to margins? Can you quantify how much of the margin drag is that? And I guess, give us some context for what level of performance is assumed, I guess, by that bonus increase? I'm kind of trying to understand, if revenue growth does continue to improve in Healthcare, do shareholders see that or do we need to see bonus accruals continue to go up, I guess.

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

Hey, Tim. This is John. I'll start by saying, I don't think we're going to get into specifically quantifying the dollar amounts. But a significant majority of the decline in EBITDA margin from the 2017 EBITDA margin rate to the 2018 EBITDA margin is related to those bonus adjustments. And I think the context to think about it then is, we don't expect it to increase going into the future. And we don't expect it to be a headwind on margins beyond 2018. Rather, over the past couple of years, some of our teams, particularly within the Healthcare practice, due to not hitting their financial targets, had lower than expected bonus funding, or lower than their target bonus funding. And the decision was that going into 2018, the right long-term move was to make sure that their plan was attainable, and they could get back to full bonus funding in 2018. And that's what the lower margins in 2018 reflect.

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

Okay. And then, just on Healthcare, I guess, obviously the fourth quarter showed improvement. But can you elaborate a little bit more on what you saw kind of exiting the quarter and here in early 2018? As maybe, I guess the guidance, I understand you don't have visibility to the second half. But it would imply maybe the strength you didn't see in the fourth quarter, you haven't seen that continue as we move into 2018. So any more color there would be helpful.

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

Hey, Tim. It's Mark. So let me offer that, I think, we've seen a continuation, at least a stabilization. Perhaps some things in the fourth quarter helped a little bit. I think we had talked about on our third quarter called a little bit of contingent slipping from Q3 into Q4. But I would just say, in general, we're seeing continued pressures within the market. And while I think the predictability is perhaps the bigger factor, I think that there's nothing that's changed that has made the environment easier to operate in from a Healthcare provider standpoint.

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

Tim, this is Jim. I want to make one other comment, just back on your other question about bonuses. And just to be clear that when we say that the bonuses would be paid out if the plan -- if their 2018 plans are achieved. And I just want to remind you that our plans are higher than guidance.

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

Okay. And then lastly, on -- the kind of the Business Advisory segment, were there turnovers? Sorry, [assignment] turnover within the staff or other market trends? You seemed to kind of just say, it was kind of a soft quarter, lumpiness that we may see from time to time. But are there any other kind of structural changes in terms of the workforce, the demand environment and so forth that makes you kind of question the performance of that business?

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

Tim, we don't see anything structural like that. The softness in the fourth quarter is really driven by the legacy Business Advisory practice, Innosight and ES&A. It's a little bit of a different story in each. I'd say, within the legacy Business Advisory practice, there was some contingent fees that we had hoped to hit in the fourth quarter that we didn't. And that was part of the issue there. From an Innosight perspective, that business can be lumpy and we knew that going in. It turned out that the fourth quarter was a softer quarter than what they expected. But as we turned the corner into the first quarter, we think that they're going to rebound from that level in the fourth quarter. And then really, from an ES&A practice perspective, they had a softer quarter. We don't think it's anything structural in the market. But they had been growing at a rapid pace. They had a slowdown in revenue during the fourth quarter. And that hit them from a margins perspective as well.

Operator

Our next question comes from the line of Tobey Sommer with SunTrust.

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

The -- from a balance sheet perspective, what would leverage look like kind of when it seasonally peaks after the bonus payout? And then, given the cash from Ops and debt pay-down, what would you expect it to be towards year end?

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

Tobey, we'd expect, in the first quarter, to peak somewhere around 3.5x to 3.6x. And then we expect it to come down below 3x, likely to the mid- to upper 2s by the time we get to the fourth quarter

---

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

Okay. I think, Jim, you alluded to a 5-year plan. Is there any thought about sharing some of the details of that eventually, externally with investors?

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

We may at some point, Tobey. I think we're still at the point where we're -- we've got some -- we've got a corporate-wide strategic framework that we've put together. And we're now kind of bringing that down to the practices. We will have more to say on this as time goes on. It's a very -- it has been a very significant part of what we've been working on, really since the early summer of 2017. And I suspect that we will have more to share at some point in time. Part of it will be, of course, competitively sensitive. Other parts will be appropriate for discussion. But we have internal, both strategic expectations for where the strategy can take us, and we also have our own financial expectations where it will take us between now and

2022. And we've been spending a lot of time building it with our teams. This wasn't just something that was top-down. It was very, very much involved with all the practices. And now we're just -- we're continuing to refine it and put some more detail around some of the practice-related issues. And then it'll be complete from our end. But we're already executing against the essence of it right now. And we feel very good about it as do our people.

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

Could you comment on your plans for headcounts in the segments in '18? And anything you can see at this point regarding bill rates and bill rate increase realizations?

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

Tobey, from a headcount perspective, we do expect headcount to grow modestly across all the businesses next year. If you look at the first quarter results in Healthcare, 84.5% utilization for the fourth quarter of 2017. That's running really hot at 84.5%. So we certainly think we can run that business north of 80%. But 84.5% might be high, so we expect to have some modest increase in headcount there. Education, we still expect to grow heading next year into the mid- to upper single digits. So we expect there to be headcount growth there. And really, it's the same in Business Advisory. Probably at a slower pace than what we've seen over the past few years in Business Advisory, as headcount has grown significantly via both acquisition and some stronger organic growth. But we still expect headcount to grow. And then, from a bill rate perspective, our expectations are that bill rates will be relatively consistent with what we saw in 2017.

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

Last question for me. Could you describe the sales funnel for Healthcare? You already made a comment kind of on where we sit, I guess, relative to the back half visibility or lack thereof. But curious about, particularly in the performance improvement area, what that looks like.

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

Sure, Tobey. I think the best way to describe it is, it continues to be, I would say, generally robust. I'd say some of the areas of strength right now have shifted a little bit more toward the revenue cycle side and away from some of the cost in clinical. Just which had been relatively hot the other way around, if you look back 3 or 4 or 5 quarters ago. We continue to see lots of demand in the technology optimization side of the needs of the market. And I would say, with Studer Group, we have a fairly normal-looking pipeline, consistent with really the kinds of things that we saw in the latter half of 2017.

Operator

Our next question comes from the line of Bill Sutherland with Benchmark.

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

Really, I'm just down to one question. And I might have missed the prepared comment on this. But the impairment that you're taking in ES&A, I think it's all related to ES&A. Could we get a -- could I get a little more color on -- I'm sure it's in the K, but just the necessity and what it's for?

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

Sure, Bill. Yes, and to confirm it, it is all within ES&A. That, if you think about the evolution of the ES&A practice, it's been through a series of 5 acquisitions over the past 4 years. And so from an accounting perspective, and this has been disclosed in our 10-Ks all along, it's always had very narrow headroom, just the way the accounting works. When you do the acquisition, the majority of the purchase price goes on the balance sheet as goodwill. And it's always been very tight.

During the fourth quarter, as we've commented, results were softer in ES&A practice. And we lowered, in the 2018 plan, our growth expectations. Though we do still expect the practice to grow organically in 2018. So really, as a result of a combination of those factors, when we went and we did the accounting test that was required during the fourth quarter, we came to the conclusion that the goodwill was impaired.

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

Okay. And then, so if the forecasts don't -- obviously don't drop another notch in latter periods, you won't be at risk of further impairments?

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

That's right. In fact, the goodwill impairment charge eliminated the goodwill in that business unit. So there will not be a risk of additional impairments in ES&A.

Operator

Our next question is from the line of Kevin Steinke with Barrington Research.

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

Just following up on Healthcare discussion a little bit here. The sequential strength you saw in the fourth quarter, combined with the lower visibility heading into 2018, is that, I guess, somewhat a function of just the fact that you're working on smaller, shorter projects? And so, therefore, some of the strength in the fourth quarter is maybe going to roll off fairly quickly? I'm just trying to get a sense if that's part of the dynamic there.

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

Kevin, I would characterize it that, when we start projects, and this is really what Jim was alluding to in terms of some of the smaller engagements. Often, we're starting with a little bit smaller scope, and they're leading to additional opportunities for work. And those are things that you just don't call out of the gate as confidently. We think that's really a dynamic of how the market is buying. They have been less focused on some of the integrated engagements, a little bit more starting with one solution and potentially going to the next, on a more sequential basis. So the good news is that ultimately, I think we've got longer touch points with our clients and opportunities to expand into other areas of work. But if you look at historically versus when we had large integrating engagements with lots of backlog, there is just inherently less visibility. And so, in that context, we're tending to be just more cautious about our outlook.

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

Kevin, this is Jim. I'm just going to add a little bit of color to Mark's comments. The lack of visibility doesn't -- it's just different than what we've had before. And there is the cautiousness. But the reality is, if you look at our Education practice, which really doesn't have great visibility either and never has, still it has solid organic growth expectations and has been doing well for a while. It's just, I think the nature of that business has always been the same where you're going to have smaller projects but there tend to be much longer durations. We've got some projects in Education that we never left the client in 10 years, 11 years, in one case I think 14 years. So I'm not predicting that for Healthcare, but I don't think that the lack of visibility is necessarily bad, it's just different than what we've had before. And as we continue to go through this transition in Healthcare, where we've gone from that small number of large engagements to a large number of small engagements, we're just being cautious in terms of extrapolating what we see as kind of real near term strength as we saw in the fourth quarter and taking that too far out until we begin to see these trends develop more -- further and we get convinced that they're sustainable.

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

Okay, that makes a lot of sense. And you, I think, mentioned that the sequential improvement in Healthcare was driven by performance improvements. So is it possible to segment that further between say, cost in clinical and revenue cycle relative to how they both perform?

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

Kevin, we're actually increasingly managing them collectively as a team in a performance improvement overall approach. And so it really is -- it's perhaps a little bit less meaningful. But I'd say directionally, we did see revenue cycle in general starting to strengthen in the fourth quarter of last year. But I would not really be able to quantify it for you.

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

Okay, that's fair enough. In terms of Innosight, you mentioned the softer quarter, but you expect them to rebound in 2018. Do you have specific growth expectations for that Innosight practice itself? I mean is that expected to kind of grow in line with the rest of the segment? Or how are you thinking about that?

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

I think for 2018, we expect our growth rate in Innosight to probably be in the lower double-digit range. So we are expecting some solid growth from them. I think the part that -- again, they've been now with us for 10 months, 11 months. And I think we've been really encouraged by the way that their strategic approach resonates with some clients and some really interesting projects. And I think that they're -- competitively they've been doing very well. So we feel they'll have a good '18. And I think we'll have some solid organic growth from that practice this year.

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

Okay, great. And then on the Education practice, I believe you said that the outlook for 2018 is 25% to 26% operating margin, which implies some pretty good margin expansion versus '17. So I'm just wondering what you're factoring in there in terms of the margin improvement?

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

Kevin, we called out a couple of years ago when we made the cloud resources investment. And so initially that was in net cost. And then we had a period in 2016 when that business was growing fast but basically at breakeven. And we're at a point now where the margins from the cloud business are expanding as we expected them to when we initially invested in the business. So I think that's really what you're seeing. It's net positive at this point, the expansion that we see in the margins. First is the fact that it's going fast and still blends in at a little bit lower rate than the rest of the practice.

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

Okay, good. Do you expect the growth in Education to be fairly broad based across your various practices? Or do you expect that to be led by technology? Or just how are you viewing that?

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

Kevin, this is Jim. I think it'll be pretty broad based. Really the growth in this business has been pretty broad based over the last 2 or 3 years and I expect that to continue in 2018.

Operator

And this concludes our Q&A session. I would like to turn the call back to Mr. Jim Roth.

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

Thanks for spending time with us this afternoon. We look forward to speaking with you again in May when we announce our first quarter results. Have a good evening.

Operator

And ladies and gentlemen, that concludes today's conference call. Thank you, everyone, for your participation.
