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HURN.OQ - Q3 2023 Huron Consulting Group Inc Earnings Call

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## CORPORATE PARTICIPANTS

**C. Mark Hussey** *Huron Consulting Group Inc. - President, CEO & Director*

**John D. Kelly** *Huron Consulting Group Inc. - Executive VP, CFO & Treasurer*

## CONFERENCE CALL PARTICIPANTS

**Andrew Owen Nicholas** *William Blair & Company L.L.C., Research Division - Analyst*

**Jack Wilson** *Truist Securities, Inc., Research Division - Research Analyst*

## PRESENTATION

**Operator**

Good afternoon, and welcome to Huron Consulting Group's webcast to discuss financial results for the Third Quarter of 2023. (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 Mark Hussey, Chief Executive Officer and President of Huron Consulting Group. Mr. Hussey, please go ahead.

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**C. Mark Hussey** - *Huron Consulting Group Inc. - President, CEO & Director*

Good afternoon, and welcome to Huron Consulting Group's third quarter 2023 earnings call. With me today are John Kelly, our Chief Financial Officer; and Ronnie Dail, our Chief Operating Officer.

Huron's strong performance continued in the third quarter, with revenues growing 26% over the prior year quarter and a 9th consecutive quarter of year-over-year margin expansion. Compared to the same period 2 years ago, the third quarter of 2021, our revenues have grown 60%, reflecting sustained strength across our industry segments and capabilities.

In the first 9 months of 2023, revenues grew organically across all 3 operating segments, led by 32% growth in the Healthcare segment, our largest business. Our financial results and increased guidance reflect ongoing solid demand for a broad portfolio of offerings, our deep industry and capability expertise, our highly talented team and our strong collaborative culture. Our third quarter results continue our solid momentum toward our investor goals of achieving double-digit revenue growth, expanding our adjusted EBITDA margins to mid-teen levels and accelerating adjusted EPS growth.

I'll now share some additional insights into our third quarter performance. In the Healthcare segment, third quarter revenues grew 36% over the prior year quarter, achieving record quarterly revenues. Market demand was strongest for our performance improvement and financial advisory offerings, reflective of ongoing challenges among our provider clients. Our strategy and innovation and our digital offerings also continued to perform very well. While the operating environment for healthcare providers has improved slightly in 2023, the healthcare industry continues to be challenged by reimbursement rates that are not keeping pace with inflation-driven labor and supply costs, competitive market dynamics and a less favorable payer mix are challenging the financial and operating models of many providers.

The financial headwinds created by these market conditions are significant and continue to challenge the efforts of hospitals and health systems to sustainably close the gaps without degrading the quality of care. Our comprehensive set of strategy, operations and financial-focused offerings makes Huron a unique and trusted partner throughout the healthcare industry. We help our clients solve issues such as driving higher yield in the revenue cycle, expanding access to care, transforming their cost structures and clinical operations and deploying digital solutions to improve care and the patient experience.

We are also uniquely positioned to address their highly complex challenges, including situations that require integrating our strategy, performance improvement, digital and financial advisory offerings. We're proud of our broad and deep capabilities to help our clients redefine their strategies and transform their businesses for long-term growth and financial stability. We believe the persistent market headwinds facing our clients, coupled with our distinct and broad offerings positions our Healthcare segment very well for continued growth.

Education segment revenues grew 18% in the third quarter of 2023 over the prior year quarter, driven by strong demand for our digital offerings, which grew 23% as well as our strategy and operations and research offerings within our consulting and managed services capability. The education industry also faces significant financial challenges as costs are increasing faster than revenue for many institutions. The demographic cliff reflecting a declining population of college age students has been well anticipated and studied for many years. Since the pandemic, the enrollment challenges have worsened. An increasing number of college age students are electing not to pursue a college degree due in part to a lack of affordability.

Enrollment challenges are increasing the competition for students while rising costs and the need to streamline administrative operations and rationalize academic portfolios is pressuring the higher education business model. We believe these market trends will create tailwinds for all the offerings in our Education segment for the foreseeable future. Our ability to help an institution deliver on its academic and research missions is unmatched in the industry and we'll continue to deepen our industry expertise, broaden our portfolio of offerings and strengthening our competitive advantage to remain the leading partner in the higher education industry.

In the third quarter of 2023, Commercial segment revenues grew 14% over the prior year quarter, driven by strong demand for our distressed financial advisory offerings, partially offset by declines in our strategy and innovation and digital offerings in the commercial industries. Higher interest rates, challenging capital markets and economic headwinds have created a solid demand environment for our distressed financial advisory offerings. Our strategy and innovation and digital offerings have seen solid growth within healthcare and education, we have seen some delayed project starts for our commercial clients as we continue to manage through the uncertainties in the broader economic environment. We continue to believe the commercial industries create new avenues of growth for Huron and as part of our strategy, we'll continue to invest in growing our industry expertise across certain industries, while continuing to mature and align our advisory and digital capabilities across the segment.

Now let me turn to our outlook for the year. So press release indicates we're increasing and narrowing our annual revenue guidance to $1.35 billion to $1.37 billion, an increase of $40 million at the midpoint. We continue to expect our adjusted EBITDA margin to be in the range of 12% to 12.5% of revenues and we're raising and narrowing our full-year adjusted diluted earnings per share to a range of $4.70 to $4.90, an increase of $0.30 per share at the midpoint. Our performance through the first 9 months of 2023 reflects the market tailwinds for our offerings and the benefits of our operating model changes and our ability to deliver greater value to our clients.

When we outlined the realignment of our businesses under a new operating model in our Q4 2021 earnings call, we believe these changes would accelerate our growth by strengthening our go-to-market strategy and competitive advantage, drive greater efficiencies across our business and enhance transparency for investors into the core drivers of our business. We're pleased with the progress we've made in the execution of our operating model and its demonstrated benefits. Since making the initial changes at the beginning of 2022, we've achieved quarterly revenue growth ranging from high-teens to mid-20% growth, which exceeds our expectations for our stated medium-term revenue target.

We've benefited from strong demand for our offerings in the market and the changes we made to our operating model have created a more enduring and sustainable business. Our ability to deliver revenue growth and margin expansion, including the solid increase in utilization in the first 9 months of 2023 over the same prior year period is only possible because of our outstanding team, which is now better aligned to serve the comprehensive needs of our clients in their markets. I'm pleased with our progress to deliver strong growth, drive greater efficiencies across our business and advance our competitive advantage. And while we're pleased with our 2023 performance to date, we remain focused on advancing our growth strategy and delivering upon our long-term financial goals in 2024 and beyond.

And with that, let me now turn it over to John for a more detailed discussion of our financial results. John?

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**John D. Kelly** - *Huron Consulting Group Inc. - Executive VP, CFO & Treasurer*

Thank you, Mark, 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 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.

Now I will share some of the key financial results for the quarter. Revenues for the third quarter of 2023 were $358.2 million, up 25.5% from $285.4 million in the same quarter of 2022, highlighted by 36.4% growth in the Healthcare segment, along with continued strong growth in the Education and Commercial segments. From a capability perspective, consulting and managed services revenues grew 37.7% and digital revenues grew 10.8% when compared to the same quarter in 2022.

Net income for the third quarter of 2023 was $21.5 million or $1.10 per diluted share compared to net income of $17.7 million or $0.86 per diluted share in the third quarter of 2022. Our effective income tax rate in the third quarter of 2023 was 31.2% compared to 30.2% in the same prior year period. Our effective tax rate for Q3 of 2023 was less favorable than the statutory rate, inclusive of state income taxes, primarily due to tax expense related to nondeductible losses on our investments used to fund our deferred compensation liability and certain nondeductible expense items.

Adjusted EBITDA was $48 million in Q3 2023 or 13.4% of revenues compared to $36.5 million in Q3 2022 or 12.8% of revenues. The increase in adjusted EBITDA in the quarter was primarily attributable to the increase in segment operating income, excluding the impact of segment restructuring charges, partially offset by an increase in corporate expenses. As Mark noted, with our performance in the third quarter of 2023, we've achieved 9 consecutive quarters of year-over-year margin expansion, reflecting progress toward our stated financial goal of achieving mid-teen adjusted EBITDA margins by 2025.

Adjusted net income was $27.2 million or $1.39 per diluted share compared to $20.7 million or $1.01 per diluted share in the third quarter of 2022. Adjusted diluted earnings per share grew 37.6% over Q3 2022.

Now I'll make a few comments about the performance of each of our operating segments. The Healthcare segment generated 50% of total company revenues during the third quarter of 2023. This segment posted record quarterly revenues of $179.2 million, up $47.9 million or 36.4% from the third quarter of 2022. The increase in revenues in the quarter reflects strong demand for our performance improvement, strategy and innovation and financial advisory offerings within our consulting and managed services capability as well as continued strong demand for our digital offerings. Our Healthcare segment is on track to achieve record full-year revenue growth in 2023, driven by the strong demand for our broad portfolio of offerings across the industry, in particular, the consulting and managed services capability, which has grown nearly 40% through the first 9 months of 2023 compared to the same prior year period.

Operating income margin for Healthcare was 26.2% for Q3 2023 compared to 25.2% for the same quarter in 2022. The quarter-over-quarter increase in margin was primarily due to a decrease in practice administration and meeting expense and revenue growth to outpace an increase in salaries and related expenses for our revenue-generating professionals, partially offset by increases in performance bonus expense for our revenue-generating professionals and contractor expenses, both as percentages of revenues.

The Education segment generated 31% of total company revenues during the third quarter of 2023. The Education segment posted revenues of $111 million, up $16.7 million or 17.7% from the third quarter of 2022. The increase in revenues in the quarter was driven by broad-based demand across the segment, including for our digital offerings as well as our strategy and operations and research offerings within our consulting and managed services capability.

Operating income margin for Education was 23.9% for Q3 2023 compared to 24.2% for the same quarter in 2022. The quarter-over-quarter decrease in margin was primarily due to increases in compensation costs for our revenue-generating professionals and technology expenses as percentages of revenue, partially offset by a decrease in contractor expenses.

The Commercial segment generated 19% of total company revenues during the third quarter of 2023 and posted revenues of $68 million, up $8.3 million or 13.8% from the third quarter of 2022. The quarter-over-quarter increase in revenue was primarily attributable to strong demand for our distressed focused financial advisory offerings, partially offset by declines in our strategy and innovation and digital offerings. With regard to our strategy and digital offerings, we experienced some project delays and a longer sales cycle for some of our commercial clients during the quarter, reflecting the uncertainty in the broader macro environment.

Operating income margin for the Commercial segment was 22.7% for Q3 2023 compared to 23.7% for the same quarter in 2022. The quarter-over-quarter decrease was primarily driven by increases in compensation costs for our revenue-generating professionals and support personnel as percentages of revenues, partially offset by a decrease in contractor expenses.

Corporate expenses not allocated at the segment level and excluding restructuring charges, were $43.1 million in Q3 2023 compared to $34.9 million in Q3 2022. The $8.2 million increase in unallocated corporate expenses was primarily driven by increases in salaries and related expenses, performance bonus expense and performance-based stock compensation expense for our support personnel. Corporate restructuring charges were $4.1 million for the third quarter of 2023 compared to $800,000 for the same quarter last year. The corporate restructuring charge in Q3 2023 primarily consisted of a non-cash charge related to office space that we exited during the quarter.

Now turning to the balance sheet and cash flows. We finished the quarter with total debt of $358 million, consisting entirely of our senior bank debt and cash of $9.4 million from net debt of $348.6 million. Our leverage ratio as defined in our senior bank agreement, was 1.8x adjusted EBITDA as of September 30, 2023, compared to 2.1x adjusted EBITDA at the end of Q3 2022. Cash flow generated from operations in the third quarter of 2023 was $68.8 million. We used $8 million of our cash to invest in capital expenditures, inclusive of internally developed software costs and purchases of property and equipment, resulting in free cash flow of $60.7 million.

DSO came in at 83 days for the second quarter of 2023 compared to 77 days for the second quarter of 2023 and 85 days for the third quarter of 2022. The increase in DSO over the second quarter of 2023 is primarily driven by certain large healthcare and education industry projects with extending billing and payment terms.

During the third quarter, we repurchased approximately 290,000 shares for $28.8 million under our share repurchase program. In October, our Board of Directors increased the authorized amount under the share repurchase program by an additional $100 million for a total authorization since 2020 of $400 million, which expires in December 2024. Since November 2020 and through September 30, 2023, we purchased 4.5 million shares at a total purchase price of $279.6 million at an average share price of $61.70. The shares repurchased since 2020 represent an approximate 20% reduction in our shares outstanding.

Consistent with the capital allocation strategy communicated at our 2022 Investor Day, we remain committed to balancing growth, flexibility and return of capital to shareholders through strategic tuck-in acquisitions, debt paydown and continued share repurchases.

Finally, let me turn to our expectations and guidance for 2023. As Mark noted, we are raising our full-year 2023 revenue guidance to be in the range of $1.35 billion to $1.37 billion. In addition, we are maintaining our adjusted EBITDA guidance range of 12% to 12.5% of revenues and raising and narrowing our full-year adjusted non-GAAP diluted earnings per share guidance to be in a range of $4.70 to $4.90. Finally, we continue to expect our full-year effective tax rate to be in a range of 28% to 30%.

Thanks, everyone. I would now like to open the call to questions. Operator?

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from the line of Tobey Sommer of Truist Securities.

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**Jack Wilson** - *Truist Securities, Inc., Research Division - Research Analyst*

This is Jack Wilson on for Tobey. So my first question, can you talk a little bit about sort of demand by capability across segments?

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**John D. Kelly** - *Huron Consulting Group Inc. - Executive VP, CFO & Treasurer*

So overall, the pipeline remains robust. And even with the 2023 guidance that we provided, we're seeing similar pipeline and backlog coverage ratios as in recent quarters, which gives us a lot of confidence in our guidance range. In healthcare, we have seen continued robust broad-based demand for our services. In particular, performance improvement in financial advisory demand has been strong as many of our healthcare provider clients continue to face significant financial pressures. There's been strong demand for our healthcare digital offerings as our clients try to capture returns on the investments in technology and drive operating efficiencies in a high labor cost environment, improved care outcomes and enhanced access and consumer experience.

We've also seen increased demand for our revenue cycle managed services and strategy offerings. Increasingly, we're seeing situations where our clients are looking for help across multiple of these capabilities within the scope of a single project. We're seeing continued broad-based demand in the education industry, inclusive of our digital offerings. And similar to healthcare, this demand is reflective of a financially strained environment and higher ed characterized by student enrollment volume and mix pressures, tuition pricing pressure and escalating costs.

We're also seeing strong pipeline and sales conversion in our distressed advisory business in the Commercial segment. Our Commercial digital business is an area where we -- as Mark and I both alluded to in our prepared remarks, that's an area where we have overall solid pipeline, but we've seen some project deferrals in longer sales cycles, which I don't think is a surprise just given some of the macro conditions that we see going on in the environment right now.

And our strategy business has experienced some softness in demand in the commercial industry, which is due to similar reasons probably to the commercial digital pipeline, but they've seen increasing demand in the healthcare industry. And so that's actually an area that we're pretty excited about the growth prospects moving forward.

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**Jack Wilson** - *Truist Securities, Inc., Research Division - Research Analyst*

So as a follow-up, how would you describe sort of the hiring environment across both consulting and digital? It seems like you made impressive gains in the headcount in both of those capabilities.

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**John D. Kelly** - *Huron Consulting Group Inc. - Executive VP, CFO & Treasurer*

So we're -- from a hiring perspective, I guess, maybe I'll start actually with the attrition side of the equation and we continue to experience very low attrition compared to historical periods. I'd say at this point, across the business, and it's fairly consistent across the different parts of the business. We're looking at full-year attrition rate, it's probably going to be the low-double digits from an annualized perspective. And so that is good news for us given the growth that we've seen and the demand that we're seeing across the business and the pipeline that we just talked about. With all that said, given the pace of the growth and given the pipeline that we see as we head into next year, we've been continuing to hire.

And I think in terms of finding talent, I think it's been a good environment for us. I don't think we've had any challenges finding the talent that we need and it's been pretty well balanced across different parts of the portfolio, really focusing, though, on the areas where we see the most demand right now.

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**Operator**

Our next question comes from the line of Andrew Nicholas of William Blair and Company.

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**Andrew Owen Nicholas** - *William Blair & Company L.L.C., Research Division - Analyst*

Wanted to ask -- I appreciate all the commentary on the pipeline, but maybe specific to kind of '24 outlook, I know it's early, I know you'll give the official guidance next year. But obviously, the last 2 years now, you posted growth that well in excess of those medium-term targets. So I just kind of want to get your sense for -- that's something certainly maybe not '23 rates or '22 rates, but if you're still kind of operating under the assumption that you can run out of those -- of that target next year? Or I just don't want us to get out of ourselves after 7 or 8 quarters of 20% plus type growth?

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**John D. Kelly** - *Huron Consulting Group Inc. - Executive VP, CFO & Treasurer*

I think the good news from our perspective and the way we framed it at our Investor Day towards the beginning of last year was that we anticipated double -- low double-digit growth on an annual basis. And to your point, we're really pleased that we've been able to exceed that rate of growth in 2022 and 2023. And I think the good news from our perspective is even with the bigger base of revenue, that implies based on the growth that we've had in the past 2 years that's exceeded those targets, we still feel good about our ability to grow at a double-digit pace moving forward.

To your point, to the extent that our teams will be working to beat that, and we'll be looking for ways to drive growth as high as we can. But -- and to your other point, we're not through our planning cycle yet, and we're still -- we'll give guidance at the end of February. But I think going back to those Investor Day targets off of kind of the revised base that we have here at 2023 is a good way of looking at it.

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**C. Mark Hussey** - *Huron Consulting Group Inc. - President, CEO & Director*

Andrew, this is Mark. I'll add a couple of comments. One is, the end markets that we have in healthcare and education, we have very strong market positions, which in the Healthcare segment has been obviously great momentum this year. And coming into next year, we feel good about the early part of the year. But over time, the other thing we've been very active working on over the last several years has been adding capabilities that will be in demand in the positive cycle when hospitals and health systems are going to be investing more, whether it's in digital capabilities, getting back to more in their people and patient experience in the areas of financial advisory and then strategy as well.

So we've balanced out some of the variability that we knew was kind of inherent in some of the cycle. I don't think we feel that we're through the cycle. As I said, we have seen signs of softening demand, but it's something we watch carefully but with an eye toward making sure that we have less cyclicality around that particular business.

Education is one also that I think you've got just very strong tailwinds across the needs of the industry and we're very well positioned in the base. And underlying both of those in tying into our commercial markets is really the ongoing transformation to the cloud and the ability to use technology to deliver whether it's on the growth side of the business or whether it's more efficient operations. It's a nice combination of that industry expertise and capability that's working well together. As we look in the commercial markets as well, we think we certainly have capital to continue to put to work where we think we can strengthen our businesses even outside of healthcare and education.

So we feel like we've made great progress, as we said, ahead of where we expected to be in our medium-term financial targets. But by no means do we see ourselves shrinking away from changes in the environment, our model, we think is robust enough and our business continues to evolve in ways that we feel attaining those targets is quite reasonable for us.

**Andrew Owen Nicholas** - *William Blair & Company L.L.C., Research Division - Analyst*

And then I wanted to ask on restructuring or distressed financial advisory in commercial. I think it's a hard environment to maybe manage headcount in that space, a long overdue restructuring cycle at least in my opinion, I'm just kind of wondering how much you're leaning into headcount growth there because it's been a couple of quarters now of that being what I think is an outperformer. So if you could just kind of speak to momentum there and hiring plans?

And then also from a profitability perspective, and I realize any single quarter can be lumpy. But over any kind of longer-term time frame, is restructuring going to be a positive kind of mix component of margin expansion there? Is that higher margins than the strategy and digital businesses there? Or how should we think about that evolving mix impacting margins?

**C. Mark Hussey** - *Huron Consulting Group Inc. - President, CEO & Director*

Andrew, it's Mark. In terms of the hiring environment, you're absolutely right. The cycle right now is hot. You see that across all the competitors in the space. And so there is a strong demand for headcount that is qualified in those skill sets across the industry. Having said that, the size and scale of our business, and really, I would characterize the kind of culture that we have and the kind of people that are attracted to work in our environment is a differentiator for us. So we've been able to continue to add people at the levels that have enabled us to sustain what is a right now, very hot sales cycle. And so we feel good about what that trajectory looks like over time just because it's a smaller part of our business, but it's done really, really well.

And I would just add in terms of your question to margins, I'll let John add commentary, but just in general, it is definitely a contributor to profitability. And for us, obviously, the kind of rates that you realize in this part of the cycle and the environment when things are really troubled and there's need for very rapid actions puts us in a very strong position within the marketplace. And the range of capabilities we have in that business, which is not just consulting and advisory, but the investment banking capabilities that we have in special situations also positions us very well to be able to capitalize on the full range of opportunities in the market. But John, why don't you speak to mix and its contribution as well.

**John D. Kelly** - *Huron Consulting Group Inc. - Executive VP, CFO & Treasurer*

Yes. No, Mark, I agree with what you said. It's definitely one of our stronger margin businesses in the entire portfolio across segments. So when that business is performing well, that's a positive contributor from a margin perspective. So as Mark said, we'll continue to see robust demand there, continue to kind of lean into that demand with headcount growth. So we're excited about the prospects for that part of the business.

**Andrew Owen Nicholas** - *William Blair & Company L.L.C., Research Division - Analyst*

And maybe just one quick follow-up if I could squeeze in. I think last quarter, you called out a favorable adjustment of I think it was $16 million in healthcare. Was there anything kind of lumpy or one-time in results that is worth calling out or that I might have missed in the prepared remarks?

**C. Mark Hussey** - *Huron Consulting Group Inc. - President, CEO & Director*

No, Andrew. There really wasn't this quarter anything significant to note in that regard. There was mid-single digit million dollars of performance-based fee adjustments in healthcare, but I probably -- particularly at the scale that we're at now, I'd probably consider that to be more of a normal course thing. But other than that, there really wasn't anything [we'd be] able to call out.

**Operator**

(Operator Instructions) Our next question comes from the line of Kevin Steinke of Barrington Research Associates. (Operator Instructions) Seeing no more questions in queue, I'd like to turn the call back to Mr. Hussey.

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**C. Mark Hussey** - *Huron Consulting Group Inc. - President, CEO & Director*

Thank you so much for spending time with us this afternoon. We look forward to speaking with you again in February when we announce our fourth quarter results and announce our 2024 earnings guidance. Have a good afternoon.

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**Operator**

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

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