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HURN - Q1 2016 Huron Consulting Group Inc Earnings Call

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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 first quarter 2016. 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 the 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.

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

Good afternoon, and welcome to the Huron Consulting Group's first quarter 2016 earnings call. With me today is Mark Hussey, our Chief Operating Officer and Chief Financial Officer.

Revenue from continuing operations grew 17% over the prior-year quarter, and our first quarter results were in line with our expectations and consistent with our full-year guidance.

The Education and Life Sciences and Business Advisory segments both achieved strong results in the quarter. Our Healthcare business also grew, albeit at a more modest level, as expected.

I will now provide a brief overview of the performance for each segment, and then Mark will add color to the financials. On our earnings call in February, we commented that we were cautiously optimistic about the overall growth of the Healthcare segment in 2016. During the first quarter, our Healthcare segment revenue grew 16% compared to the prior-year quarter. This included an incremental $11 million of revenue from Studer Group, which we acquired in mid-February 2015.

On an organic basis, growth in our Cost and Clinical solution enabled Healthcare segment revenue to increase modestly over easier Q1 2015 comparisons.

Within our Healthcare business, we have seen some softness in the pipeline from what we call fully-integrated projects - those that require our collective set of solutions to be deployed in one comprehensive project. We've also seen a shift in our clients' buying patterns toward the procurement of more solution-specific engagements. But in many instances, these solution-specific engagements have positioned us well for additional follow-on projects.

As the market continues to evolve, a portfolio of solution-specific engagements, while limiting some of the visibility to which we have grown accustomed, creates opportunities to be working with our clients over a longer period of time. We consider partnering with clients on a series of related engagements to be an important contributor to the long-term growth and future success of our Healthcare business. And we are comfortable with the market-driven evolution and buying patterns that we have witnessed over the past year.

While we have not seen a discernible change in our market position, we have made and will continue to make changes within our Healthcare business to respond to the demand for services in the market. Like any business that sees a change in its market, we will continue to improve and adjust our go-to-market strategy and resources to address our clients' needs and to maintain our expected profitability.

Our Revenue Cycle offering remains the premier solution for delivering sustainable revenue cycle improvement. And we expect to see continued demand for this part of the business. We anticipate our Studer Group solution will meet full-year expectations, and we believe the repositioning of our Cost and Clinical solution will result in a stronger business.

We continue to be somewhat cautious about the growth rate of our overall Healthcare segment. But the many factors we have discussed on prior calls that are driving the need for change among healthcare providers remain, and we believe we have the strongest set of credentials, reputation for delivering value, and depth of experienced personnel to position us for growth as the provider market continues its evolution.

Moving to our Education and Life Sciences, or ELS, segment, the segment turned in another quarter of solid performance. Our Education practice continued to see strong demand in the first quarter across each of its service lines. The higher education industry faces tremendous pressure to reduce costs while improving quality, particularly student outcomes, and our services are well-aligned to help our clients as they face these issues, driving demand and growth in the practice.

In addition to our current offerings, we continue to make progress on building new solutions, including our cloud-based ERP initiatives, where we obtained several key wins during the quarter. Having been close to the higher education sector for much of my career, it is both interesting and difficult to witness the array of change taking place in this industry. Economic pressures play a major role, including the fact that most institutions are significantly challenged to grow revenues, while their cost base continues to increase.

But the pressures are not just economic. Technology continues to play a substantive role in changing the way education is delivered and administered. The need to efficiently and effectively manage a complicated decentralized educational institution, while facing extensive financial strain, is driving demand across our full spectrum of administrative research and academic offerings.

Our highly experienced team is well-prepared to help our clients address the challenges that are endemic in the higher education industry, especially in the management of complex research universities and academic medical centers.

Turning to our Life Sciences business, the practice turned the corner into 2016 at a slower pace than was seen at the end of 2015, but gained momentum throughout the quarter. Within the practice, our strategy offerings have been highly successful in helping clients optimize the value of their existing product portfolio, including through strategic acquisitions.

Our compliance and operation solutions continue to address our clients' government pricing and process management needs to ensure sales, marketing, R&D, and clinical activities are aligned to the appropriate reimbursement and regulatory requirements.

Our Business Advisory segment continues to perform well. Both our legacy Business Advisory and Enterprise Performance Management and Analytics, or EPM&A, practices achieved strong performance in the quarter. The legacy Business Advisory practice had a solid first quarter. The uneven economic recovery that we are seeing across multiple industries has contributed to the strength of this business. Most of our success has been with middle market companies across an array of industries where we have strong operational knowledge and a deep set of relationships, including industries such as healthcare, life sciences, oil and gas, and manufacturing.

The EPM&A practice continued its high-growth momentum from 2015 into the first quarter. Our deep Oracle, Salesforce, and business intelligence and analytics expertise, coupled with our team's diverse financial and operational backgrounds, uniquely position us to assist clients in optimizing their technologies and processes, whether using an on premise, cloud, or hybrid approach.

While this practice has achieved strong organic growth over the past several years, acquisition opportunities have helped solidify our leading position within the market, including this week's announcement of Huron's intent to acquire ADI Strategies. ADI is an enterprise performance management, risk management and business intelligence firm, focused on implementing the Oracle enterprise application suite.

The acquisition will enhance and broaden our Oracle solutions and industry expertise, while strengthening the depth of our domestic and international offerings. As an Oracle Platinum Partner, ADI has developed a market-leading position in the most heavily regulated and data-dependent industries, including financial services, engineering, construction, and technology.

We look forward to bringing our businesses together, as we will be uniquely positioned to capitalize on the market opportunities presented by the rapidly-evolving technology landscape.

Turning now to our thoughts on the rest of the year, given our solid first-quarter performance and the ongoing demand for our services, today we affirm our companywide guidance for revenue, performance-based revenue, and earnings.

Huron is differentiated among our competitors by our highly collaborative culture and a unique portfolio of industry-specific expertise and complementary business advisory services. Our corporate objective is to create an environment where our businesses and our employees can thrive, driving innovation and growth in and across our practice boundaries to increase shareholder value.

While we remain cautiously optimistic about our near-term healthcare growth rate, we believe we have fostered an environment where companywide growth will continue at our mid to upper-single digit growth targets.

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

Mark Hussey - *Huron Consulting Group Inc. - COO, EVP, CFO and Treasurer*

Thank you, Jim. And good afternoon, everyone. Before I begin, please note that I'll be discussing non-GAAP financial measures, such as EBITDA, adjusted EBITDA, adjusted net income, and adjusted EPS. Our press release website and 10-Q each 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.

Also, our acquisition of MyRounding, which closed on February 1st, is included in our first quarter financial results within our Healthcare segment. In addition, our recently announced acquisition of ADI Strategies, which has not closed, is not included in our first quarter financial results or in our 2016 full-year guidance. ADI Strategies will be included within our Business Advisory segment upon closing, which we anticipate will occur during the second quarter of 2016.

Now let me walk you through some of the key financial results for the quarter. Revenues from continuing operations for the first quarter of 2016 were $180.5 million, up 16.9% from $154.4 million in the same quarter of 2015. Revenues for the first quarter of 2016 reflect our acquisitions of Rittman Mead India, Cloud62, and MyRounding, all of which closed after the first quarter of 2015, and in the aggregate generated $2.8 million of revenues during the quarter.

The quarter also included $10.7 million of incremental revenues due to the full quarter impact of our acquisition of Studer Group, which we completed mid-first quarter 2015. The year-over-year increase in revenue is primarily attributable to the acquisition of Studer Group and strong performances in our Education and Life Sciences and Business Advisory segments.

Operating income from continuing operations increased $6.4 million, or 81% to $14.4 million in Q1 2016, from $7.9 million in Q1 2015. Operating income margin was 8% in Q1 2016 compared to 5.1% in Q1 of 2015. The increase in operating income margin was primarily due to lower salaries and related expenses as a percentage of revenues.

Adjusted EBITDA from continuing operations was $26.5 million in Q1 2016, or 14.7% of revenues, compared to $16.1 million in Q1 of 2015, for 10.4% of revenues.

Net income from continuing operations was $6.9 million or $0.32 per diluted share in the first quarter of 2016, compared to $1 million or $0.04 per diluted share in the same quarter last year.

Adjusted non-GAAP net income from continuing operations was $13.3 million, or $0.62 per diluted share in the first quarter of 2016, compared to $5.1 million or $0.23 per diluted share in the same period of 2015.

Our effective income tax rate in the first quarter of 2016 was 36.9%, compared to 66.2% a year ago. Our effective tax rate for Q1 of this year was lower than the statutory rate, primarily due to tax credits and certain tax incentives. The prior-year tax rate was higher than the statutory rate, primarily due to losses in foreign jurisdictions with no tax benefits, and certain non-deductible expenses.

Now I'll make a few comments about the performance of each of our operating segments. The Healthcare segment generated 63% of total company revenues during the first quarter of 2016. This segment posted revenues of $114 million for the first quarter of 2016, up $16 million or 16.3% from the first quarter of 2015.

Revenues for the first quarter of 2016 included $11 million from our acquisition of MyRounding and the incremental revenue associated with the full-quarter impact of our acquisition of Studer Group. Excluding these incremental amounts, revenue organically increased 5.2% compared to the year-ago quarter, primarily driven by our Cost and Clinical solution, which faced easier comparisons over weak Q1 2015 results. Performance-based fees were $13.9 million, compared to $13.5 million in the same quarter last year.

Operating income margin for Huron Healthcare was 34.2% for Q1 2016, compared to 29.6% for the same quarter in 2015. The increase in operating income margin is primarily due to increased consultant utilization.

The Education and Life Sciences segment generated 24% of total company revenues during the first quarter of 2016. The segment posted revenues of $43.2 million in Q1 2016, an increase of 8.4% compared to revenues for Q1 2015 of $39.9 million. As Jim noted, the increase in revenue during the quarter was driven by strong demand in our Higher Education practice.

The operating income margin for Huron Education and Life Sciences was 23.6% for Q1 2016, compared to 29.5% for the same quarter in 2015. The decline in margin is primarily attributable to our cloud-based ERP investment and lower consultant utilization, which was particularly strong in the year-ago quarter.

The Business Advisory segment generated revenues of $23.2 million for the first quarter of 2016, an increase of 47.6% compared to $15.7 million in Q1 of 2015. Our legacy Business Advisory practice delivered solid growth while the EPM&A practice experienced very strong growth in the quarter.

The operating income margin for Huron Business Advisory was 11.6% for Q1 2016, compared to 10.2% for the same quarter in 2015. The improvement in margin is primarily due to revenue growth that outpaced increases in salaries and expenses.

Other corporate expenses not allocated at the segment level were $30.1 million in Q1 2016, compared with $28.1 million in Q1 2015. The increase in expenses was primarily driven by a full quarter of corporate SG&A expenses related to Studer Group, along with restructuring expenses and higher bonus funding for our corporate resources. Included in corporate expenses were $2.4 million of Studer Group's costs, as these activities are consistent with other corporate activities. In Q1, we incurred a restructuring charge of $1.3 million, primarily related to workforce reductions to align our corporate infrastructure following the divestiture of the Huron Legal segment.

Now, turning to the balance sheet and cash flows, DSO came in at 58 days for the first quarter of 2016, an increase of two days compared to 56 days for the fourth quarter of 2015. Total debt includes both the $250 million face value of convertible notes, and $132.5 million in senior bank debt, for a total debt of $382.5 million.

We finished the quarter with cash of $13.5 million for a net debt of $369 million, compared to $284 million at the end of last year. The increase in net debt reflects payments of our annual bonuses, share repurchases of $55 million, and the acquisition of MyRounding.

We ended the quarter with a leverage ratio defined as total debt, net of cash, of approximately 2.4x adjusted EBITDA. Cash used in operations for the quarter was $9.9 million, as we funded approximately $46 million in bonus payments. We continue to expect free cash flow for the year of approximately $125 million.

Finally, as Jim mentioned, we are affirming the annual revenue and earnings guidance that we provided during our February earnings call. With that, I would now like to open up the call to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Tim McHugh, William Blair

Tim McHugh - *William Blair & Company - Analyst*

Thanks, guys. Just on healthcare to start with, I guess. The commentary about the soft pipeline, I guess, for essentially what you're calling large engagements; is it getting-- is the comment that it has gotten worse, I guess, as you've gone into 2016? Or is this a continuation, I guess, of what you talked about last fall?

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

Tim, I'm sorry. I missed that word. What's gotten worse?

Tim McHugh - *William Blair & Company - Analyst*

You talked about the pipeline for healthcare, and in particular the large engagements.

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

Yes. No, I think the pipeline is really the same. The nature of the pipeline is what's changed. And this is really a continuation of what we've had before. I mean what we've been talking about for a while is that we have not had these fully-integrated projects that were providing a lot more visibility in the past. I think in terms of the total number of opportunities that we see, I think they're relatively similar to what we've seen in the past, Tim. I think the difference is that the size of some of them has come down.

And as we said, that's something we've anticipated for a while. We believe that the opportunity-- that our ability to have more opportunities in the marketplace, perhaps having smaller projects, perhaps having less visibility, but it certainly gives us an opportunity to be working with our clients for a longer period of time. And so as we indicated in the call, we're actually comfortable with that trade-off, even though it does come with a little bit less visibility.

Tim McHugh - *William Blair & Company - Analyst*

But is the-- so you made a comment there that you have the same number of projects in the pipeline, but they're smaller. So I guess the value of the pipeline would be smaller in that case. Or am I cutting your words too closely there?

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

No. I think that's probably accurate, Tim.

Mark Hussey - *Huron Consulting Group Inc. - COO, EVP, CFO and Treasurer*

I think Tim, the other aspect of it that we're seeing is just the way the clients are buying, as opposed to up front. We're seeing them buy more transformationally, where they'll start in phases. And so the value of the pipeline is a little bit of apples and orange for that reason, where we've seen some extensions into other phases of the project.

So, what we're saying is that the value has, if you look strictly at a snapshot, but we're seeing those follow-on engagements as another part of just the change in the buying patterns of customers.

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

Yes, or maybe putting it more simply, what I think used to be fully-integrated projects are now coming to us in smaller chunks. And they're buying individual projects, as opposed to one more comprehensive project. That's actually reasonably similar to the way we've had-- we've experienced things in the education practice for a long period of time, where we have a larger number of smaller engagements. And we tend to work with clients over a long period of time.

Whether this is going to be a pattern that evolves forever in healthcare, we don't know. We're comfortable with the pipeline. It's just has a different set of characteristics than it typically has.

Tim McHugh - *William Blair & Company - Analyst*

And is that a-- you've had some large projects last year, the integrated projects. I guess, what the timing risk around those rolling off given the change you described, I guess, in the future work?

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

I think that's all factored into our guidance assumptions, Tim. I mean those projects are evolving just fine. And I think it's important to say also that I think the things that drove the need for those projects, I think, will continue to evolve. We just don't want to predict when. But I think if you look at the nature of those larger-- or the fully integrated projects-- I think you're really going to see that the rationale for the clients wanting those projects; that same rationale exists at a lot of other-- particular the AMCs and some of the larger systems, where there's a lot of more recently consolidated hospitals.

So, I don't want to say that we don't think those fully-integrated projects are ever going to come back. Because I think they well. And they haven't really disappeared. They're just not coming at the pace that we once thought. And what's coming instead is our clients just simply taking a more concise view of which projects they want to do within a sequence, as opposed to doing them all together.

And as I said, we're totally fine with that cadence. And that's something that we think we can certainly factor into the way we're approaching the market. So we're comfortable with where we're at right now. It's just going to have different characteristics than we've been experiencing in, say, over the past three to four years.

Tim McHugh - *William Blair & Company - Analyst*

Okay. And then Mark, just two numbers. One was Studer. If I just add the revenue to what the organic contribution was last year, you said the incremental, I guess it implies it didn't grow a lot year over year, I guess. Or the $10.7 million, is that just not including growth, I guess, on a year-over-year basis for Studer? That's a long way of asking what Studer's revenue was.

Mark Hussey - *Huron Consulting Group Inc. - COO, EVP, CFO and Treasurer*

Yes. So Studer actually, we expected their sequential revenue to be-- I don't have the year-ago number at the top of my head. But I think the sequential growth was flattish, as we expected. What happens with Studer is they get to the end of their contracts, and the unrecognized revenue tends to come in, and kind of pop up the number.

So I would say, going back to the comments that we made in the script here, I think we're comfortable on a full-year basis with them meeting their expectations. And I guess looking now at a year-on-year basis, I think Tim, they probably would have grown somewhere in the high single digits for the quarter year on year.

Tim McHugh - *William Blair & Company - Analyst*

Okay. And one last one then; the ADI, can you give us any sense of what's the size, purchase price and revenue contribution?

Mark Hussey - *Huron Consulting Group Inc. - COO, EVP, CFO and Treasurer*

Yes. Absolutely. So with ADI again, which we're excited about because of the complementary aspects. When you look at it from an economics standpoint, if you back into their revenue per head and the number of consultants we ultimately expect to come over, you're looking at roughly $230,000 to $250,000 per head at 150. So roughly speaking, it's a mid-$30 million-$36 million, roughly US business, as an example; probably a little bit more once the international piece of it would close.

And in terms of economics, the purchase price is just under 1 times revenue. And from a margin standpoint, you're looking at probably low teens, but lots of efficiencies as we bring these practices together. So multiple-wise, you're looking at something in the mid-7 range of EBITDA multiple.

Tim McHugh - *William Blair & Company - Analyst*

Okay. And with international, is it approaching $50 million then?

Mark Hussey - *Huron Consulting Group Inc. - COO, EVP, CFO and Treasurer*

No. The international piece is quite a bit smaller. It's probably, I would say, between 10% and 15% of the US business. We had moved more quickly on the US piece of this transaction, because of Oracle's yearend at the end of May is just-- the timing is very important. And we just have a little bit more work to get done on the international side.

Tim McHugh - *William Blair & Company - Analyst*

Okay. Thanks.

Operator

Tobey Sommer, SunTrust

Kwan Kim - *SunTrust Robinson Humphrey - Analyst*

This is Kwan Kim on for Tobey. Thank you for taking my questions. I've got a follow-up question on ADI Strategies. After the acquisition, would there be opportunities to cross sell ADI Strategy services through the Education and Life Sciences segment to higher institutions? What is your thinking on that?

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

Well, we're actually-- we've been doing that quite nicely since we-- prior to ADI, within the EPM&A practice already, I would say close to 30% of the revenue within that part of our business has actually been done in our health and education areas. So they're with our health and education clients. And I think what's happened is really the purchase of ADI enables us to broaden our capabilities to do that. So I think those kind of statistics are going to probably continue to be the case.

We've had a huge amount of success in taking the competencies around budgeting and planning and business intelligence, and applying them into our education and healthcare and life sciences clients. So we expect that to continue. So those revenues have all been in EPM&A, even though they're-- we've been very successful at cross selling into our industry areas.

Kwan Kim - *SunTrust Robinson Humphrey - Analyst*

Got it. And I've got a question on Workday implementations. Has the progress been better than your prior expectations once again? How would you characterize the momentum on that side of the business?

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

We're very pleased with the way that that's progressing. We've had some nice wins. And our focus is probably in terms of hiring people and getting people into the market that are trained. And working at clients is probably ahead of where we thought we would be at this point in time.

We're very pleased with the way it's going, and we're pleased with what we believe is going to be a very strong future really for all of our cloud-based technologies across all of our practices.

Kwan Kim. Got it. Thank you.

Operator

(Operator Instructions) Randy Reece, Avondale

Randy Reece - *Avondale Partners - Analyst*

Good afternoon. First of all, I was wondering how you evaluate end market conditions for the group of companies in your Business Advisory segment. How does demand and the competitive dynamics, how do they feel now versus the last time you forged guidance?

Mark Hussey - *Huron Consulting Group Inc. - COO, EVP, CFO and Treasurer*

Randy, I don't know that there's been any material change in the end market conditions. I mean we continue to see more pressure than we've seen in the last couple of years. We've seen opportunities, again, as we described. And certainly oil and gas has been one that we see increasing opportunities. But we've also seen them in other-- manufacturing-related industrials and commodities. And so you've got just any place that there is a little bit of dislocation and pressure where there might have been more leverage, is creating good opportunities for us.

Randy Reece - *Avondale Partners - Analyst*

And on the-- just the recruiting side of the healthcare business. Is there any change in your-- let's say, human capital acquisition strategy this year compared with the past couple years, in terms of talent mix or seniority mix, or anything like that?

Mark Hussey - *Huron Consulting Group Inc. - COO, EVP, CFO and Treasurer*

Nothing has really changed in terms of our views of the leverage model. I think that's there's always just some evolution, as we've talked about cost and clinical, and looking at really how that business is evolving. But it's really largely not had any impact on the talent acquisition process.

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

Yes. The only thing I would add to that would be that as we-- as our clients continue to go and take on risk in this value-based environment, having some added skills in that area certainly is something that we've already been (inaudible) on getting some additional people on. So some new competencies that a company-- the [transition] that's taking place in healthcare. And we've been fortunate to be able to get some really talented people to help us-- to add to our competencies in that area.

Randy Reece - *Avondale Partners - Analyst*

Is there a customer segment though in the healthcare market that you would characterize as atypically stronger or weaker than the rest of the mix?

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

Are you saying in terms of financially?

Mark Hussey - *Huron Consulting Group Inc. - COO, EVP, CFO and Treasurer*

From what perspective?

Randy Reece - *Avondale Partners - Analyst*

No. I mean in terms of demand.

Mark Hussey - *Huron Consulting Group Inc. - COO, EVP, CFO and Treasurer*

AMCs versus integrated systems; is that what you're getting at Randy?

Randy Reece - *Avondale Partners - Analyst*

Yes. (multiple speakers) and standalones.

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

Yes. The reality is that I think we're seeing-- we're still seeing demand across the board. There's just different economic pressures. The whole market is just changing quite a bit. And it's still-- many of the providers tend to still be influenced heavily by geographic concerns, rather than national concerns, from a financial perspective. But we've had success, really, across the board, everywhere from the large health systems, even into the community-- the smaller hospital community markets.

We continue to believe that the academic medical centers are going be very stressed for a long period of time. And we fully expect a fair amount of our work in that area to continue as well.

Randy Reece - *Avondale Partners - Analyst*

Thank you very much.

Operator

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

Jim Roth - *Huron Consulting Group Inc. - CEO and President*

Okay. Thank you very much for spending time with us this afternoon. We look forward to speaking with you again in July when we announce our second quarter results. Good evening.

Operator

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