



Healthcare Services Group (HCSG)

Updated October 21st, 2022, by Tiago Dias

Key Metrics

Current Price:	\$13	5 Year CAGR Estimate:	10.1%	Market Cap:	\$1 B
Fair Value Price:	\$15	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	11/17/2022
% Fair Value:	87%	5 Year Valuation Multiple Estimate:	2.9%	Dividend Payment Date:	12/22/2022
Dividend Yield:	6.6%	5 Year Price Target	\$17	Years Of Dividend Growth:	19
Dividend Risk Score:	C	Retirement Suitability Score:	B	Rating:	Hold

Overview & Current Events

Healthcare Services Group (HCSG), founded in 1976, is a Pennsylvania corporation that provides management, administrative and operating expertise and services to the housekeeping, laundry, linen, facility maintenance and dietary service departments of healthcare facilities throughout the United States. With a dividend that has grown on a yearly basis since 2003, this \$1 billion market cap company generates approximately \$1.7 billion in annual revenue.

The company reported Q3 2022 earnings on October 19th, 2022, and declared a quarterly dividend of \$0.215 per share, the 77th consecutive increase since 2003. With earnings of \$0.00 per share, compared to \$0.13 in last year's quarter, this dividend is not well covered by the company's earnings. Revenue equaled \$414 million versus \$415 million in the year ago period. The third quarter results reflect the ongoing and expected choppiness that was referenced in the second quarter call, and while the management team has conviction in its ability to manage the controllable components of the business, they are also realistic about the ongoing challenges in the industry and broader economy.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$0.65	\$0.67	\$0.31	\$0.80	\$1.05	\$1.19	\$1.12	\$0.87	\$1.32	\$0.61	\$1.00	\$1.10
DPS	\$0.65	\$0.67	\$0.69	\$0.71	\$0.73	\$0.75	\$0.77	\$0.79	\$0.81	\$0.83	\$0.86	\$0.90
Shares	68	70	71	73	73	74	75	75	75	75	76	80

Earnings per share have followed revenue throughout the period, with somewhat steady growth up until 2018. The 2019 numbers suffered as a result of decreased revenue and margins due to business model changes. These changes have continued since and resulted in noticeably lower revenue and profit margins.

The company is a low margin services business, and as a result their business is heavily affected by the impact that wages and inflation have on their profit margins. This is particularly noticeable when comparing a low inflation year like 2020, with high inflation years like 2021 and 2022.

The service agreements the company holds with its clients can be modified, and the management team is confident that doing so would help the company bring back its operational margins to its historical averages. As such, we expect earnings-per-share to rise to around \$1 in late 2022.

This should provide some favorable tailwinds to an otherwise unremarkable business, though it is not likely that earnings-per-share will come back to 2017/2018/2020 highs without some yet unseen catalyst to increase revenue. It's this lack of a revenue growth catalyst that means our estimates for 2027 are a conservative \$1.10 earnings per share, in line with our 5-year growth estimate of 2% annually.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	29.2	32.8	83.9	37.5	32.4	41.2	34.8	27.6	23.5	29.5	13.0	15.0
Avg. Yld.	3.4%	3.1%	2.7%	2.4%	2.2%	1.5%	2.0%	3.3%	2.6%	4.6%	6.6%	5.5%

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Investors have historically been willing to pay a premium for Healthcare Services Group, likely as a result of historically high revenue growth. However, with revenue growth, and subsequent earnings and margin compression since 2018 it's clear that investors have re-rated the company to an earnings multiple that is more in line with its lackluster prospects. This has resulted in a historically low P/E multiple of 13, below the market average.

While we believe the company can maintain its dividend growth policy, we are forecasting just 1% annual dividend increases from this point. In turn, we expect the payout ratio to remain around 80% of earnings.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	100%	100%	223%	89%	70%	63%	69%	91%	62%	136%	86%	82%

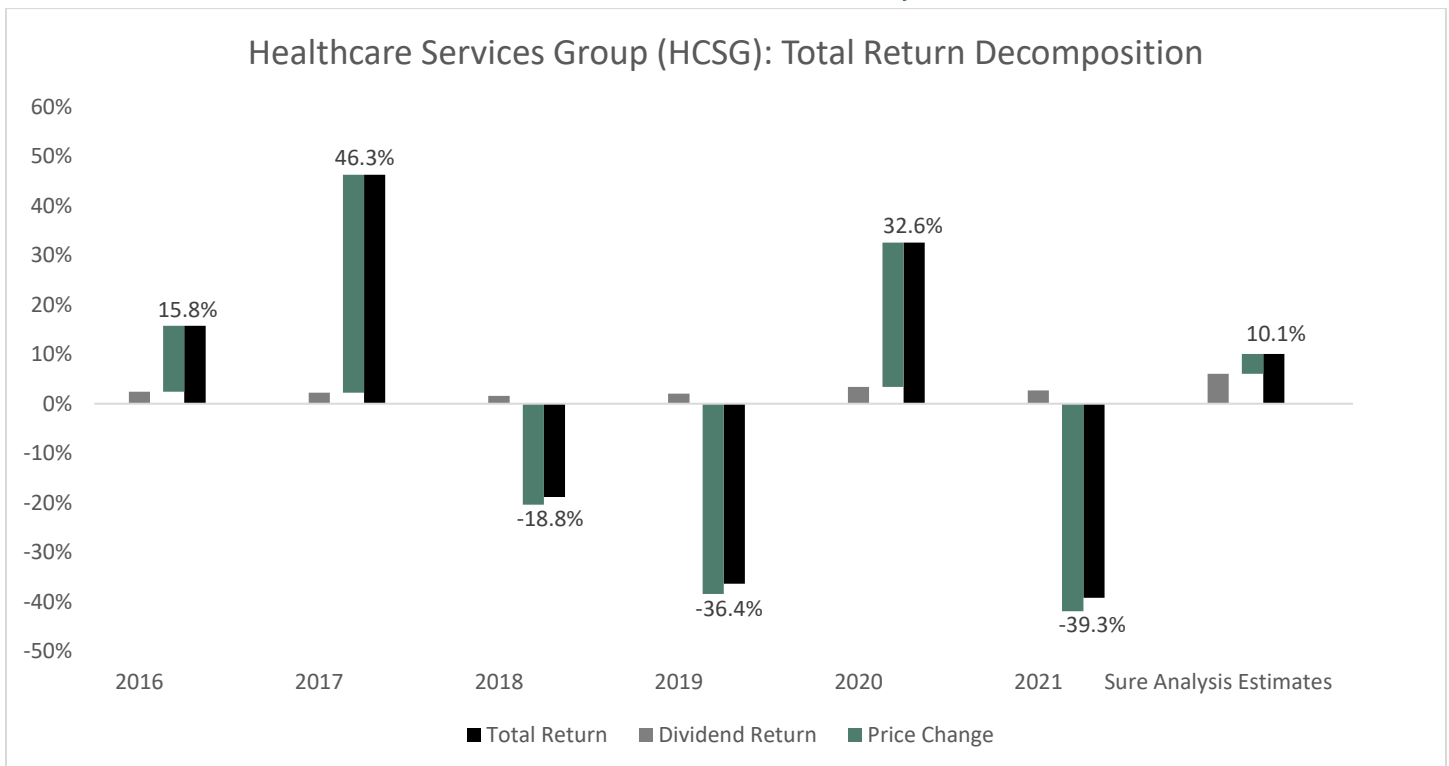
Operationally speaking, the company is a low margin services business in a highly competitive industry without any significant competitive advantage against other similar businesses, or even their clients inhouse housekeeping departments.

The almost total lack of debt as part of their capital structure means that its accounts receivable is more than enough to pay off all its liabilities and is a good indication of the quality of the management team. This lack of debt provides the company with enough stability to survive almost any recession, and is an encouraging sign for the company's dividend, particularly given that it has regularly issued higher dividends than its earnings would be able to support.

Final Thoughts & Recommendation

Healthcare Services Group's five year estimated total return comes in at 10.1% per year, driven by a 6.6% dividend yield, a 2.9% valuation expansion and 2% expected earnings growth rate. It's clear that the company is priced fairly, and not highly undervalued. Due to the lack of a significant margin of safety, the company's shares earn a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	1,077	1,150	1,293	1,437	1,563	1,861	2,003	1,841	1,760	1,642
Gross Profit	147	155	138	201	223	251	234	228	268	227
Gross Margin	13.6%	13.5%	10.7%	14.0%	14.3%	13.5%	11.7%	12.4%	15.2%	13.8%
SG&A Exp.	78	89	107	112	104	127	137	150	142	166
D&A Exp.	5	6	7	8	7	9	9	14	14	15
Operating Profit	69	66	31	89	119	124	98	78	126	60
Op. Margin	6.4%	5.7%	2.4%	6.2%	7.6%	6.7%	4.9%	4.2%	7.2%	3.7%
Net Profit	44	47	22	58	77	88	84	65	99	46
Net Margin	4.1%	4.1%	1.7%	4.0%	5.0%	4.7%	4.2%	3.5%	5.6%	2.8%
Free Cash Flow	57	28	52	58	36	2	75	89	213	31
Income Tax	26	19	10	32	43	45	16	21	31	16

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	331	425	470	481	528	676	693	723	785	778
Cash & Equivalents	69	64	75	33	24	10	26	27	139	71
Acc. Receivable	140	189	198	215	271	379	342	341	255	293
Inventories	29	32	35	36	38	42	41	37	32	26
Goodwill & Int.	22	64	65	62	59	82	78	73	69	96
Total Liabilities	102	140	194	184	190	276	252	262	305	325
Accounts Payable	23	44	44	41	43	74	61	54	52	64
Long-Term Debt	---	---	---	---	---	35	30	10	---	---
Total Equity	230	285	276	296	339	400	441	460	480	453
LTD/E Ratio	---	---	---	---	---	0.09	0.07	0.02	---	---

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	14.2%	12.5%	4.9%	12.2%	15.3%	14.7%	12.2%	9.1%	13.1%	5.9%
Return on Equity	19.8%	18.3%	7.8%	20.3%	24.4%	23.9%	19.9%	14.3%	21.0%	9.8%
ROIC	19.8%	18.3%	7.8%	20.3%	24.4%	22.8%	18.4%	13.7%	20.8%	9.8%
Shares Out.	68	70	71	73	73	74	75	75	75	75
Revenue/Share	15.73	16.42	18.13	19.82	21.27	25.03	26.84	24.68	23.54	21.90
FCF/Share	0.83	0.41	0.73	0.80	0.49	0.03	1.01	1.20	2.85	0.42

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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