



Healthcare Services Group (HCSG)

Updated February 19th, 2023, by Tiago Dias

Key Metrics

Current Price:	\$14	5 Year CAGR Estimate:	-18.7%	Market Cap:	\$1 B
Fair Value Price:	\$5	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	N/A
% Fair Value:	311%	5 Year Valuation Multiple Estimate:	-20.3%	Dividend Payment Date:	N/A
Dividend Yield:	0.0%	5 Year Price Target	\$5	Years Of Dividend Growth:	0
Dividend Risk Score:	N/A	Retirement Suitability Score:	N/A	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. This \$1 billion market cap company generates approximately \$1.7 billion in annual revenue.

The company reported Q4 and full year 2022 earnings on February 15th, 2022. The company has modified its capital allocation strategy and as a result they have suspended its regular quarterly dividend and instead authorized the repurchase of up to 7.5 million shares of its stock.

With full year GAAP earnings of \$0.47 versus the \$0.61 the company reported in FY 2021, the company's \$0.85 dividend was unsustainable, particularly given the increased pressures the company is facing due to workforce availability, inflation and supply chain constraints. The company did not provide any guidance for 2023.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$0.67	\$0.31	\$0.80	\$1.05	\$1.19	\$1.12	\$0.87	\$1.32	\$0.61	\$0.47	\$0.30	\$0.33
DPS	\$0.67	\$0.69	\$0.71	\$0.73	\$0.75	\$0.77	\$0.79	\$0.81	\$0.83	\$0.85	\$0.00	\$0.00
Shares	70	71	73	73	74	75	75	75	75	74	74.0	74.0

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, but the results so far have been mixed.

If successful 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 2028 are a conservative \$0.33 earnings per share, in line with our 5-year growth estimate of 2% annually.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Avg. P/E	71.0	32.5	28.6	28.6	43.8	44.8	18.2	50.8	29.5	27.5	46.7	15.0
Avg. Yld.	3.1%	2.7%	2.4%	2.2%	1.6%	2.0%	3.4%	2.7%	4.6%	6.5%	0.0%	0.0%

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.

The company's substantial earnings decrease has resulted in an unusually high current PE ratio, and one that it is unlikely to maintain given the lackluster growth rate. As such we expect this ratio to decrease to the general market average of 15 by 2028.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	100%	223%	89%	70%	63%	69%	91%	62%	136%	181%	0%	0%

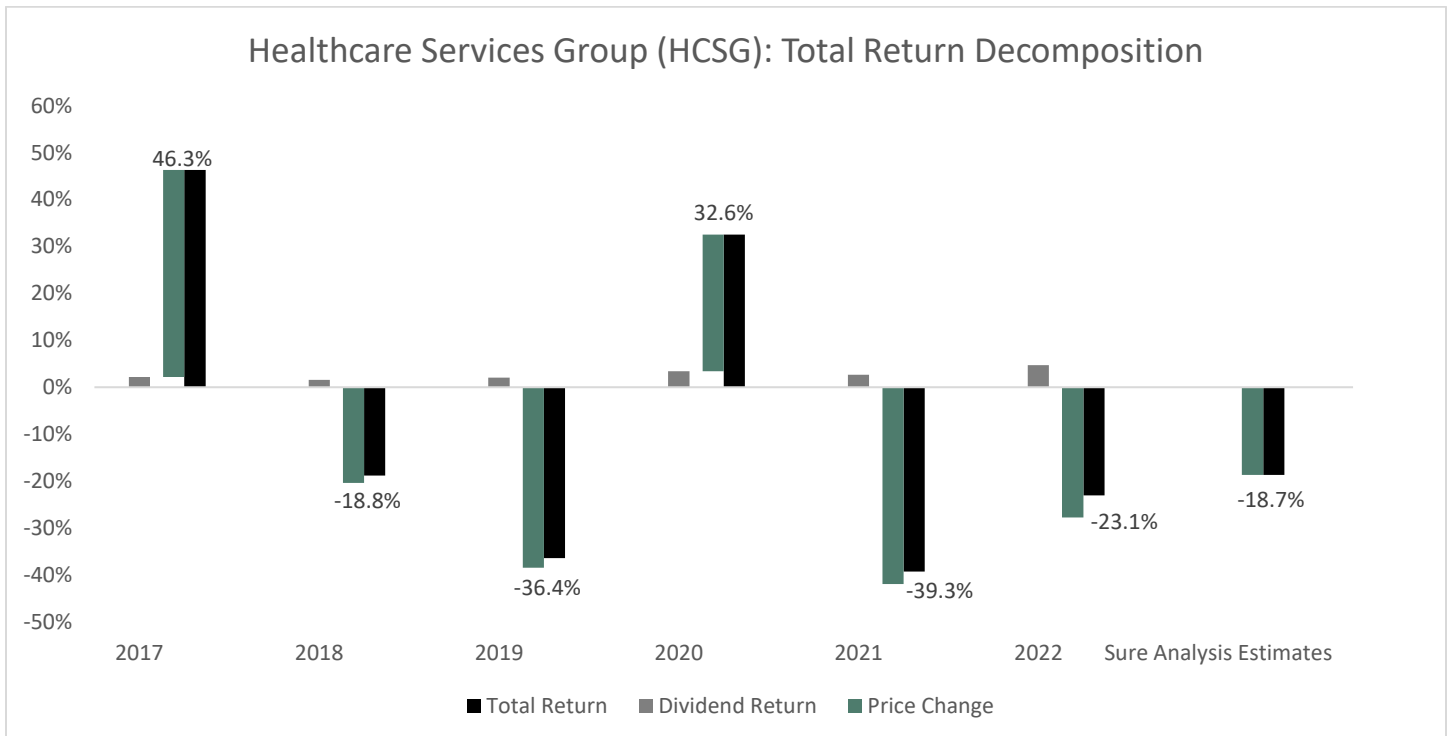
Operationally speaking, the company is a low margin services business in a highly competitive industry without any significant competitive advantage against other similar businesses, or even their clients inhouse housekeeping departments.

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 usually a good indication of the quality of the management team. That said, its consistently unsustainable payout ratio has taken its toll and forced the company to suspend its dividend payments going forward. While it is possible that they will return to paying a dividend in the future, at this point no such thing can be assumed, and the trust that investors put in the company's dividend streak has been broken.

Final Thoughts & Recommendation

Healthcare Services Group's five year estimated total return comes in at -18.7% per year, driven by a -20.3% valuation re-rating and the 2% expected earnings growth rate. It's clear that the company has suffered extensively over the past 2 years, and it's unclear as to what its prospects will be going forward.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	1,150	1,293	1,437	1,563	1,861	2,003	1,841	1,760	1,642	1,690
Gross Profit	155	138	201	223	251	234	228	268	227	194
Gross Margin	13.5%	10.7%	14.0%	14.3%	13.5%	11.7%	12.4%	15.2%	13.8%	11.5%
SG&A Exp.	89	107	112	104	127	137	150	142	166	150
D&A Exp.	6	7	8	7	9	9	14	14	15	15
Operating Profit	66	31	89	119	124	98	78	126	60	44
Op. Margin	5.7%	2.4%	6.2%	7.6%	6.7%	4.9%	4.2%	7.2%	3.7%	2.6%
Net Profit	47	22	58	77	88	84	65	99	46	35
Net Margin	4.1%	1.7%	4.0%	5.0%	4.7%	4.2%	3.5%	5.6%	2.8%	2.1%
Free Cash Flow	28	52	58	36	2	75	89	213	31	-13
Income Tax	19	10	32	43	45	16	21	31	16	10

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	425	470	481	528	676	693	723	785	778	718
Cash & Equivalents	64	75	33	24	10	26	27	139	71	26
Acc. Receivable	189	198	215	271	379	342	341	255	293	337
Inventories	32	35	36	38	42	41	37	32	26	21
Goodwill & Int.	64	65	62	59	82	78	73	69	96	91
Total Liabilities	140	194	184	190	276	252	262	305	325	292
Accounts Payable	44	44	41	43	74	61	54	52	64	68
Long-Term Debt	---	---	---	---	35	30	10	---	---	25
Total Equity	285	276	296	339	400	441	460	480	453	426
LTD/E Ratio	---	---	---	---	0.09	0.07	0.02	---	---	0.06

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	12.5%	4.9%	12.2%	15.3%	14.7%	12.2%	9.1%	13.1%	5.9%	4.6%
Return on Equity	18.3%	7.8%	20.3%	24.4%	23.9%	19.9%	14.3%	21.0%	9.8%	7.9%
ROIC	18.3%	7.8%	20.3%	24.4%	22.8%	18.4%	13.7%	20.8%	9.8%	7.7%
Shares Out.	70	71	73	73	74	75	75	75	75	74
Revenue/Share	16.42	18.13	19.82	21.27	25.03	26.84	24.68	23.54	21.90	22.73
FCF/Share	0.41	0.73	0.80	0.49	0.03	1.01	1.20	2.85	0.42	-0.18

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

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