

Healthcare Services Group HCSG (NAS)

Last Close	Industry	Sector
19.63 USD	Business Services	Business Services

Profile

Pricing data through 14 Jun 2010

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Healthcare Services Group, Inc. is a Pennsylvania corporation, incorporated on November 22, 1976. The Company provides housekeeping, laundry, linen, facility maintenance and dietary services to the health care industry, including nursing homes, retirement complexes, rehabilitation centers and hospitals located throughout the United States. The Company operates a wholly-owned subsidiary, Huntingdon Holdings, Inc., which invests its cash and cash equivalents as well as managing the portfolio of marketable securities. Based on the nature and similarities of the services provided, its business operations consist of two business segments, namely, Housekeeping and Dietary. The Company provides its Housekeeping services to essentially all the approximately 2,300 facilities and provide Dietary services to approximately 350 of such facilities. Housekeeping consists mainly of the cleaning, disinfecting and sanitizing of patient rooms and common areas of a client's facility, as well as the laundering and processing of the personal clothing belonging to the facility's patients. Dietary consists of providing dietician consulting professional services, the development of a menu that meets the patient's dietary needs, and the purchasing and preparing of the food for delivery to the patients. Both segments provide its services mainly with respect to full service agreements with its clients. In such agreements, the Company is responsible for the management and hourly employees located at its clients' facilities. The Company also provides services on the basis of a management-only agreement for a very limited number of housekeeping clients. Additionally, it also provides, individually or as a combination thereof, the specialized services of Dietary on a stand-alone basis to certain clients. The Company's agreements with clients typically provide for a one year service term, cancelable by either party upon 30 to 90 days notice after the initial 90-day period. The Company competes mainly with the in-house support service departments of its potential clients. It also competes for new agreements, as well as renewals of existing agreements, based upon the quality and dependability of its services and the cost savings. The Company's clients are subject to government regulation.

Healthcare Services Group HCSG

Sales USD Mil 716 **Mkt Cap USD Mil** 859 **Industry** Business Services **Sector** Business Services

Healthcare Services Group is the largest provider of contractual housekeeping, laundry, and linen services for the long-term care industry in the U.S. The company's services are provided to more than 1,500 nursing homes, rehabilitation facilities, and retirement centers in 40 states and Canada. Its housekeeping services consist of cleaning, disinfecting, and sanitizing the facility. The laundry and linen services consist of laundering and processing the personal clothing of residents and patients.

3220 Tillman Drive Suite 300
Bensalem, PA 19020
Phone: 1 215 639-4274
Website: <http://www.hcsg.com>

Employees: 4900

Morningstar Rating **Last Price** 19.63 **Fair Value** **Uncertainty** **Economic Moat™** **Stewardship Grade**



Growth Rates	Compound Annual				
	1 Yr	3 Yr	5 Yr	10 Yr	
Revenue %	14.9	10.6	9.4	11.5	
Operating Income %	6.6	7.7	14.9	18.9	
Earnings/Share %	15.0	5.2	14.2	16.9	
Dividends %	27.6	34.1	41.5	—	
Book Value/Share %	2.1	6.0	8.6	7.6	
Stock Total Return %	13.5	5.7	10.1	33.5	
+/- Industry	—	—	—	—	
+/- Market	—	—	—	—	

Profitability Analysis	Current			
	5 Yr Avg	Ind	Mkt	
Return on Equity %	14.5	14.9	11.5	20.9
Return on Assets %	11.6	11.8	4.8	7.9
Fixed Asset Turns	168.9	128.6	6.6	7.0
Inventory Turns	37.6	35.4	25.9	13.8
Revenue/Employee USD K	146.1	137.1*	—	805.4
Gross Margin %	13.6	13.8	39.8	40.9
Operating Margin %	6.2	6.8	14.7	13.2
Net Margin %	4.2	4.6	8.1	8.7
Free Cash Flow/Rev %	2.3	3.9	10.5	0.1
R&D/Rev %	—	—	—	10.2

Financial Position	12-09 USD Mil		03-10 USD Mil	
Cash	31	29		
Inventories	17	17		
Receivables	104	105		
Current Assets	212	201		
Fixed Assets	4	5		
Intangibles	26	26		
Total Assets	266	257		
Payables	9	9		
Short-Term Debt	—	—		
Current Liabilities	35	23		
Long-Term Debt	—	—		
Total Liabilities	57	47		
Total Equity	209	210		

Valuation Analysis	Current			
	5 Yr Avg	Ind	Mkt	
Price/Earnings	29.1	30.5	9.6	15.7
Forward P/E	20.0	—	—	12.8
Price/Cash Flow	45.7	35.6	14.9	7.0
Price/Free Cash Flow	52.1	39.0	20.1	14.6
Dividend Yield %	4.2	—	0.5	1.9
Price/Book	4.1	4.2	2.5	2.1
Price/Sales	1.2	1.4	2.1	1.2
PEG Ratio	1.1	—	—	1.4

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	YTD	Stock Performance
-8.9	61.6	26.6	48.5	64.8	51.5	42.1	11.9	-22.1	39.4	-6.5	Total Return %
1.2	74.6	50.0	22.1	55.8	48.5	28.5	8.4	16.4	16.0	-4.2	+/- Market
-10.4	62.0	49.6	24.9	61.6	48.9	24.9	9.5	1.2	1.1	-6.7	+/- Industry
—	—	—	0.7	1.4	1.6	1.6	2.0	3.6	3.5	4.2	Dividend Yield %
70	112	149	220	384	557	795	901	685	935	859	Market Cap USD Mil

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Financials
255	284	329	380	443	466	512	578	603	693	716	Revenue USD Mil
10.9	11.3	11.8	11.9	12.2	12.9	14.3	14.6	13.5	13.7	13.6	Gross Margin %
8	10	13	16	22	28	36	44	42	45	44	Oper Income USD Mil
3.2	3.6	4.1	4.2	5.0	5.9	7.0	7.6	7.0	6.5	6.2	Operating Margin %
6	7	9	11	15	19	25	30	27	30	30	Net Income USD Mil
0.15	0.19	0.22	0.27	0.36	0.45	0.59	0.67	0.60	0.69	0.68	Earnings Per Share USD
0.00	0.00	0.00	0.04	0.13	0.22	0.31	0.42	0.58	0.74	0.78	Dividends USD
37	37	39	40	41	42	43	44	44	44	44	Shares Mil
2.46	2.69	2.80	3.15	3.17	3.67	4.02	4.58	4.69	4.79	4.80	Book Value Per Share USD
8	13	16	17	19	25	16	26	17	38	19	Oper Cash Flow USD Mil
-2	-2	-2	-2	-2	-2	-2	-2	-2	-2	-2	Cap Spending USD Mil
6	10	14	14	17	23	14	24	15	36	17	Free Cash Flow USD Mil

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Profitability
5.4	6.1	6.8	7.4	9.0	10.8	12.6	12.9	10.8	11.8	11.6	Return on Assets %
6.3	7.4	8.3	9.5	11.6	13.7	16.2	16.4	13.4	14.8	14.5	Return on Equity %
2.2	2.5	2.6	2.9	3.3	4.1	5.0	5.1	4.4	4.4	4.2	Net Margin %
2.47	2.48	2.58	2.60	2.72	2.62	2.53	2.52	2.45	2.69	2.77	Asset Turnover
1.2	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.2	1.3	1.2	Financial Leverage

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	03-10	Financial Health
74	83	94	113	125	143	141	167	178	177	178	Working Capital USD Mil
—	—	—	—	—	—	—	—	—	—	—	Long-Term Debt USD Mil
91	99	108	121	131	148	165	195	202	209	210	Total Equity USD Mil
—	—	—	—	—	—	—	—	—	—	—	Debt/Equity

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Valuation
12.5	16.1	17.6	20.9	26.0	30.9	32.6	31.6	26.5	31.1	29.1	Price/Earnings
—	0.7	0.9	1.0	1.4	1.8	1.9	1.9	2.4	1.7	1.9	P/E vs. Market
0.3	0.4	0.5	0.6	0.9	1.3	1.6	1.6	1.2	1.4	1.2	Price/Sales
0.8	1.1	1.4	1.8	2.9	3.8	4.8	4.6	3.4	4.5	4.1	Price/Book
9.0	9.1	9.4	13.6	19.8	23.8	51.5	36.0	42.0	24.8	45.7	Price/Cash Flow

Quarterly Results						
Revenue USD Mil	Jun 09	Sep 09	Dec 09	Mar 10		
Most Recent Period	170.9	178.8	182.6	183.8		
Prior Year Period	147.9	153.0	154.6	160.4		
Rev Growth %	Jun 09	Sep 09	Dec 09	Mar 10		
Most Recent Period	15.5	16.9	18.1	14.6		
Prior Year Period	3.9	4.7	4.0	8.9		
Earnings Per Share USD	Jun 09	Sep 09	Dec 09	Mar 10		
Most Recent Period	0.18	0.19	0.15	0.17		
Prior Year Period	0.16	0.13	0.16	0.18		

Industry Peers by Market Cap				
	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Healthcare Services	859	716	29.1	14.5
Visa, Inc.	61958	7444	27.8	11.8
G4S Plc	—	—	—	—

Major Fund Holders			% of shares
Neuberger Berman Genesis Inv			8.51
Sentinel Small Company A			2.30
Vanguard Explorer Inv			2.14

*3Yr Avg data is displayed in place of 5Yr Avg

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
DANIEL P. MCCARTNEY	Director	2,431,171	09 Dec 2009	-
BARTON D. WEISMAN		206,367	01 Jul 2009	-
JOSEPH F. MCCARTNEY	Director/Vice President, Divisional, Director	58,344	20 Apr 2010	-
ROBERT L. FROME	Director	33,769	04 Dec 2009	-
THOMAS A. COOK	President/Director, Director	30,395	29 Oct 2009	-
JOHN M. BRIGGS	Director	25,180	28 Apr 2010	-
THEODORE WAHL	Executive VP	1,600	12 Jan 2009	-
RICHARD W. HUDSON	Secretary/CFO	224	19 May 2010	1,200
ROBERT J. MOSS	Director	0	19 Feb 2010	-

*Report date represents the date on which the owner's common shares held was audited.

Fund Ownership

Top Owners	Morningstar Rating	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Neuberger Berman Genesis Inv	QQQQQ	8.51	0.83	54	31 Dec 2009
Sentinel Small Company A	QQQQ	2.30	1.12	0	31 Mar 2010
Vanguard Explorer Inv	QQQQ	2.14	0.23	66	31 Dec 2009
Columbia Acorn Z	QQQQ	1.98	0.13	0	28 Feb 2010
Wells Fargo Advantage Small Cap Val Inv	QQQQQ	1.70	0.46	-43	31 Jan 2010

Concentrated Holders

Franklin MicroCap Value A	QQQQ	1.35	3.46	-5	31 Mar 2010
Nicholas Equity Income I	QQQQ	0.19	2.41	10	30 Apr 2010
Neuberger Berman Small Cap Growth Inv	QQ	0.43	1.66	0	28 Feb 2010
Goldman Sachs Small/Mid Cap Growth A	QQQQ	0.71	1.63	87	31 Dec 2009

Institutional Transactions

Top 5 Buyers	Morningstar Rating	% of Shares Held	% of Fund Assets	Shares Bought/Sold (k)	Portfolio Date
JNL/Mellon Cap Mgmt JNL 5 A	QQ	0.82	0.23	355	31 Dec 2009
Nicholas	QQQ	0.69	0.41	295	30 Apr 2010
Goldman Sachs Small/Mid Cap Growth A	QQQQ	0.71	1.63	87	31 Dec 2009
Vanguard Explorer Inv	QQQQ	2.14	0.23	66	31 Dec 2009
Neuberger Berman Genesis Inv	QQQQQ	8.51	0.83	54	31 Dec 2009

Top 5 Sellers

Wells Fargo Advantage Small Cap Val Inv	QQQQQ	1.70	0.46	-43	31 Jan 2010
Putnam Small Cap Growth A	QQ	0.06	0.40	-28	31 Mar 2010
Wells Fargo Diversified Small Cap Admin	QQQ	0.14	0.21	-18	30 Sep 2009
Vanguard Small Cap Growth Index	QQQQ	0.77	0.14	-9	31 Dec 2009

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Industry Focus: Business Services

A Safer Play on the Banking Industry

23 April 2010

Brett Horn
Associate Director

Core processors
are insulated from
banks' woes.

The term "business services" covers an array of companies serving different industries and having different dynamics. In this article, we'll focus on a relatively obscure but attractive area under this broad umbrella: core processors. These companies are also commonly referred to as bank technology companies. We cover three such firms: Fiserv FISV, Fidelity National Information Services FIS, and Jack Henry JKHY.

Before we go on to discuss the core processors' current situation and outlook, it would probably be helpful to describe their business and what is attractive about the industry. These companies serve banks and other financial institutions, such as credit unions. Core processing is the nuts-and-bolts system that banks need to maintain their deposit and loan accounts and to post daily transactions. Core processing is a very stable, almost annuitylike, business that churns out a reliable amount of free cash flow, and we think a moat surrounds these businesses due to the high switching costs involved. Given the integral nature of core processing to their operations, banks almost never switch systems. Besides the potential for interruptions, converting to a new system would require the banks to retrain employees. Customers typically sign multiyear contracts, and customer retention is about 99% annually, excluding customers lost because of acquisitions by another bank. Actual retention rates are typically only a few percentage points lower, depending on the level of M&A activity.

However, core processing typically accounts for only a portion of the revenue generated by core processors. These firms leverage their essentially captive relationships to cross-sell a variety of products to their bank customers, such as electronic bill payment, Internet banking, check processing, and remote deposit capture. Simply put, if a

bank has a technology need related to its day-to-day operations, these companies have a product to address it. While they compete with each other, they also compete with in-house systems developed by the banks themselves. According to *Automation in Banking 2009*, 49% of financial institutions use an outsourced core processing system. The core processors' customer base skews heavily towards small and medium-sized banks, which usually lack the resources necessary to develop credible in-house solutions.

Core processors have two types of revenue streams: recurring fees under processing contracts and one-time license or event fees, with the former making up the bulk of revenue. Fiserv estimates it derives only about 5% of its revenue from license fees, while 8% of Jack Henry's revenue in fiscal 2009 was from license fees. Because the vast majority of revenue is recurring under long-term contracts and relates to systems that are necessary for the bank to remain in operation, the core processors have felt little impact from the unprecedented stress their bank customers have faced throughout the financial crisis. In 2009, both Fiserv's (stripping out a divestiture) and Jack Henry's revenue held basically flat (because FIS completed a large merger in 2009, its year-over-year growth was high, but its organic results were roughly in line with its peers). While the core processors may not have lost revenue, it's been difficult for them to grow, as struggling banks have been deferring new technology purchases while they attempt to put their own houses back in order.

Looking forward, we think it will take a while for this situation to improve. The big banks were hit hard at the front of the financial crisis due to their involvement in exotic asset-backed securities, while the small banks largely avoided this problem. The headlines currently focus on the rebound in the big banks' profitability, but the small banks are still struggling as the recession has led to higher charge-offs in their loan books, particularly due to small banks' concentration in commercial real estate loans. Fiserv noted in its fourth-quarter earnings call that there were 158 regulatory actions in 2009 and they expect this number to

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rise to a range of 200-250 in 2010. Given this, we expect a fairly flat year again in 2010 for the core processors but would expect FIS to see a top-line recovery first, due to its relatively high percentage of business with large banks, followed by Fiserv and then Jack Henry, which concentrates more heavily on the small bank and credit union space.

Over the longer term, though, we see some benefits for the core processors on the back end of the financial crisis. As banks stabilize and take a harder look at their cost structures, we think there could be an incremental increase in their willingness to outsource, both to reduce costs and to make their cost structures more flexible. Core processors typically tie their pricing to the size of the institution, so their growth over long periods tends to track the growth in bank deposits, which have grown at a 6% compound annual growth rate over the last fifteen years. We think this is the most realistic peg for industry growth over a long period, but we could see higher levels for a time when the financial crisis is fully resolved. An eventual bounceback in license fees would also be a positive. While these fees account for only a small portion of revenue, they drop almost completely to the bottom line, so they can affect profitability materially.

Right now, we don't see any great bargains in the space. Fiserv looks somewhat undervalued to us, but the margin of safety isn't large enough for us to recommend the stock. Still, we think these companies are worth keeping on your radar as they could be a relatively safe way to play any further uncertainty in the banking industry.