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Healthcare Services Group (HCSG)- 4Q18 Update

HCSG reported another quarter where it missed on revenues and announced that it beat on EPS. As usual, the company does not give enough details in its 2-page press release to fully see everything going on and we will need to wait for the 10-K to more accurately review the period. We are extremely skeptical of the beat because they announced a $15 million catch-up benefit adjustment for worker's compensation in the quarter. Without that, they missed handily.

The company also reported another $9 million bad debt charge and a $3 million expense for training managers. On top of all that, there remains no growth in revenue:

HCSG	4Q18	3Q18	2Q18	1Q18	4Q17	3Q17
Revenue	$496.4	$506.9	$503.7	$501.8	$499.4	$491.4

During the quarter, its contract with Genesis was changed where Genesis will pay the food company directly and then pay HCSG to prepare food and operate the dietary program for the client. This is expected to cost $20 million in quarterly revenue with about $7 million hitting in 4Q18. Going forward, revenue will fall more.

Also, we still do not believe that the company is collecting receivables in any meaningfully faster way. It stated again this quarter that has moved 40% of clients to a much faster payment plan. Instead of 30 days, it's now 14 days or even 7 days for some. Receivables should be plummeting, and they are not. Here is what they report in the press releases:

HCSG	4Q18	3Q18	2Q18	1Q18	4Q17
Reported Net A/R	$341.8	$353.5	$343.7	$335.0	$378.7
LT Notes Rec.	$43.0	$45.9	$37.4	$38.8	$15.5
Total	$384.8	$399.4	$381.1	$373.8	$394.2

Already that looks to be showing little improvement, but it's even worse. The company is ramping up bad debt reserves that reduces those figures:

HCSG	4Q18	3Q18	2Q18	1Q18	4Q17
Reported Net A/R	$341.8	$353.5	$343.7	$335.0	$378.7
LT Notes Rec.	$43.0	$45.9	$37.4	$38.8	$15.5
Total	$384.8	$399.4	$381.1	$373.8	$394.2
Reserves	n/a	$48.6	$49.7	$48.9	$12.0
Total A/R	n/a	$448.0	$430.8	$422.7	$406.2

We need the SEC documents to see the bad debt reserves. They do say that there was a $9 million charge to bad debt in the 4Q18, so that at least has been added to reserves. We need the 10-K to see the rest. But if HCSG is now getting paid weekly or bi-weekly by 40% of its customers, then receivables should be lower than 90% of quarterly sales. Receivables have risen since this faster collection process started.

Something happened in 4Q too – perhaps more of the receivables have been written off? We say that because the company also reports an investment and interest income line on the income statement. This is largely interest earned on cash and notes receivable. This line went negative in 4Q:

HCSG	4Q18	3Q18	2Q18	1Q18	4Q17
Interest Income	-$4.2	$2.0	$1.3	$0.5	$1.6

We won't know until we see the 10-K, but that looks like non-cash income being accrued that was written off.

On expenses, HCSG has been touting that it will get to a 14% margin on direct costs. It posted 14.3% for 4Q18. However, adjusting for the $15 million benefit from worker's comp and the $9 million charge for bad debt expense – the margin becomes 13.2% - still below forecast - ($5.6 million in lower pretax earnings).

SG&A came in at 6.4% but had a $4.1 million benefit from deferred comp and $1 million in one-time banking fees. That makes it 7.1% vs. last year's 6.7%. Guidance is for 7%. (The adjusted 7.1% vs. reported 6.4% is $3.25 million in pretax earnings.)

The tax rate was abnormally low due to Worker Opportunity Tax Credits. Instead of 21%-23%, HCSG had a 9.9% tax rate for 4Q.

Add that all up, EPS came in at 28-cents vs. the reported 42-cents. Plus, that gives HCSG credit for adding back the bad debt expense as though that is a one-time item, which it clearly is not.

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