HEALTHCARE SERVICES GROUP INC
Form 10-Q
July 25, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2013

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 0-12015

HEALTHCARE SERVICES GROUP, INC.
(Exact name of registrant as specified in its charter)

Pennsylvania	23-2018365
(State or other jurisdiction of incorporated or organization)	(IRS Employer Identification No.)
3220 Tillman Drive, Suite 300, Bensalem, PA	19020
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code:
(215) 639-4274

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES þ NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer ¨	Non-accelerated filer ¨	Smaller reporting company ¨
		(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
YES ¨ NO þ

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.
Common Stock, $.01 par value: 69,785,000 shares outstanding as of July 22, 2013.

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Healthcare Services Group, Inc.
Quarterly Report on Form 10-Q
For the Period Ended June 30, 2013

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This report and documents incorporated by reference into this report may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”), as amended, which are not historical facts but rather are based on current expectations, estimates and projections about our business and industry, our beliefs and assumptions. Words such as “believes,” “anticipates,” “plans,” “expects,” “will,” “goal,” and similar expressions are intended to identify forward-looking statements. The inclusion of forward-looking statements should not be regarded as a representation by us that any of our plans will be achieved. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Such forward-looking information is also subject to various risks and uncertainties. Such risks and uncertainties include, but are not limited to, risks arising from our providing services exclusively to the health care industry, primarily providers of long-term care; credit and collection risks associated with this industry; from having several significant clients who each individually contributed at least 3% to 5% of our total consolidated revenues for the three and six months ended June 30, 2013; risks associated with our acquisition of Platinum Health Services, LLC; our claims experience related to workers’ compensation and general liability insurance; the effects of changes in, or interpretations of laws and regulations governing the industry, our workforce and services provided, including state and local regulations pertaining to the taxability of our services; and the risk factors described in Part I of our Form 10-K for the fiscal year ended December 31, 2012 under “Government Regulation of Clients,” “Competition” and “Service Agreements/Collections,” and under Item IA “Risk Factors” in our Form 10-K for the fiscal year ended December 31, 2012. Many of our clients’ revenues are highly contingent on Medicare, Medicaid and other payors’ reimbursement funding rates, which Congress and related agencies have affected through the enactment of a number of major laws and regulations during the past decade, including the March 2010 enactment of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010. In July 2011, the United States Center for Medicare Services (“CMS”) issued final rulings which, among other things, reduced (effective October 1, 2011) Medicare payments to nursing centers by 11.1% and changed the reimbursement for the provision of group rehabilitation therapy services to Medicare beneficiaries. In January 2013, the U.S. Congress enacted the American Taxpayer Relief Act of 2012, which delayed automatic spending cuts of $1.2 trillion, including reduced Medicare payments to plans and providers up to 2%. These discretionary spending caps were originally enacted under provisions in the Budget Control Act of 2011, an initiative to reduce the federal deficit through the year 2021, also known as “sequestration.” The sequestration went into effect starting March 2013. Currently, the U.S. Congress is considering further changes or revising legislation relating to health care in the United States which, among other initiatives, may impose cost containment measures impacting our clients. These enacted laws, proposed laws and forthcoming regulations have significantly altered, or threaten to alter, overall government reimbursement funding rates and mechanisms. The overall effect of these laws and trends in the long-term care industry has affected and could adversely affect the liquidity of our clients, resulting in their inability to make payments to us on agreed upon payment terms. These factors, in addition to delays in payments from clients, have resulted in, and could continue to result in, significant additional bad debts in the near future. Additionally, our operating results would be adversely affected if unexpected increases in the costs of labor and labor-related costs, materials, supplies and equipment used in performing services could not be passed on to our clients.

In addition, we believe that to improve our financial performance we must continue to obtain service agreements with new clients, provide new services to existing clients, achieve modest price increases on current service agreements with existing clients and maintain internal cost reduction strategies at our various operational levels. Furthermore, we believe that our ability to sustain the internal development of managerial personnel is an important factor impacting future operating results and successfully executing projected growth strategies.

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PART I — FINANCIAL INFORMATION.
Item 1. Financial Statements (Unaudited).
Healthcare Services Group, Inc.
Consolidated Balance Sheets

	(Unaudited) June 30, 2013	December 31, 2012
ASSETS:		
Current assets:		
Cash and cash equivalents	$63,160,000	$68,949,000
Marketable securities, at fair value	22,026,000	21,322,000
Accounts and notes receivable, less allowance for doubtful accounts of $3,671,000 in 2013 and $3,970,000 in 2012	165,700,000	140,218,000
Inventories and supplies	28,648,000	28,675,000
Prepaid expenses and other	9,767,000	8,682,000
Total current assets	289,301,000	267,846,000
Property and equipment:		
Laundry and linen equipment installations	2,441,000	2,336,000
Housekeeping and office equipment and furniture	26,879,000	26,098,000
Autos and trucks	310,000	315,000
	29,630,000	28,749,000
Less accumulated depreciation	19,427,000	18,477,000
	10,203,000	10,272,000
Goodwill	16,955,000	16,955,000
Other intangible assets, less accumulated amortization of $11,162,000 in 2013 and $10,078,000 in 2012	4,119,000	5,203,000
Notes receivable — long term portion, net of discount	2,502,000	1,823,000
Deferred compensation funding, at fair value	19,757,000	17,831,000
Deferred income taxes — long term portion	12,535,000	11,215,000
Other noncurrent assets	38,000	38,000
Total Assets	$355,410,000	$331,183,000
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$31,238,000	$22,810,000
Accrued payroll, accrued and withheld payroll taxes	28,823,000	31,997,000
Other accrued expenses	3,081,000	3,526,000
Income taxes payable	4,479,000	1,906,000
Deferred income taxes	537,000	575,000
Accrued insurance claims	7,110,000	6,850,000
Total current liabilities	75,268,000	67,664,000
Accrued insurance claims — long term portion	16,589,000	15,712,000
Deferred compensation liability	20,033,000	18,237,000
Commitments and contingencies		
STOCKHOLDERS' EQUITY:		
Common stock, $.01 par value; 100,000,000 shares authorized; 70,407,000 shares issued and outstanding in 2013 and 70,036,000 shares in 2012	704,000	700,000
Additional paid-in capital	122,148,000	113,495,000

Retained earnings	131,998,000	127,042,000
Accumulated other comprehensive income, net of taxes	44,000	127,000
Common stock in treasury, at cost, 1,899,000 shares in 2013 and 1,983,000 shares in 2012	(11,374,000)	(11,794,000)
Total stockholders' equity	243,520,000	229,570,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$355,410,000	$331,183,000

See accompanying notes.

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Healthcare Services Group, Inc.
Consolidated Statements of Comprehensive Income
(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues	$273,604,000	$267,108,000	$547,508,000	$527,715,000
Operating costs and expenses:				
Costs of services provided	234,602,000	230,206,000	469,793,000	457,701,000
Selling, general and administrative	19,363,000	18,524,000	40,153,000	39,506,000
Other income:				
Investment and interest	219,000	(95,000)	1,253,000	1,558,000
Income before income taxes	19,858,000	18,283,000	38,815,000	32,066,000
Income taxes	6,925,000	6,963,000	10,928,000	12,167,000
Net income	$12,933,000	$11,320,000	$27,887,000	$19,899,000
Per share data:				
Basic earnings per common share	$0.19	$0.17	$0.41	$0.30
Diluted earnings per common share	$0.19	$0.17	$0.40	$0.29
Weighted average number of common shares outstanding:				
Basic	68,599,000	67,296,000	68,531,000	67,189,000
Diluted	69,370,000	68,228,000	69,366,000	68,155,000
Comprehensive income:				
Net income	$12,933,000	$11,320,000	$27,887,000	$19,899,000
Other comprehensive income:				
Unrealized loss on available for sale marketable securities, net of taxes	(106,000)	(17,000)	(83,000)	(190,000)
Total comprehensive income	$12,827,000	$11,303,000	$27,804,000	$19,709,000

See accompanying notes.

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Healthcare Services Group, Inc.
Consolidated Statements of Cash Flows
(Unaudited)

	For the Six Months Ended June 30, 2013	2012
Cash flows from operating activities:		
Net income	$27,887,000	$19,899,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,707,000	2,528,000
Bad debt provision	650,000	1,350,000
Deferred income benefits	(1,305,000)	(2,405,000)
Stock-based compensation expense	1,196,000	1,144,000
Amortization of premium on marketable securities	303,000	346,000
Unrealized loss on marketable securities	—	82,000
Unrealized gain on deferred compensation fund investments	(759,000)	(937,000)
Changes in operating assets and liabilities:		
Accounts and notes receivable	(26,812,000)	(7,891,000)
Prepaid income taxes	—	3,740,000
Inventories and supplies	27,000	(1,906,000)
Deferred compensation funding	(1,926,000)	(1,078,000)
Accounts payable and other accrued expenses	8,454,000	10,759,000
Accrued payroll, accrued and withheld payroll taxes	(1,989,000)	536,000
Accrued insurance claims	1,137,000	3,485,000
Deferred compensation liability	2,922,000	2,360,000
Income taxes payable	2,573,000	—
Prepaid expenses and other assets	(1,085,000)	(4,630,000)
Net cash provided by operating activities	13,980,000	27,382,000
Cash flows from investing activities:		
Disposals of fixed assets	150,000	10,000
Additions to property and equipment	(1,702,000)	(1,825,000)
Purchases of marketable securities	(4,597,000)	(6,362,000)
Sales of marketable securities	3,450,000	15,784,000
Net cash (used in) provided by investing activities	(2,699,000)	7,607,000
Cash flows from financing activities:		
Dividends paid	(22,931,000)	(21,803,000)
Reissuance of treasury stock pursuant to Dividend Reinvestment Plan	53,000	59,000
Tax benefit from equity compensation plans	1,128,000	1,051,000
Proceeds from the exercise of stock options	4,680,000	2,664,000
Net cash used in financing activities	(17,070,000)	(18,029,000)
Net (decrease) increase in cash and cash equivalents	(5,789,000)	16,960,000
Cash and cash equivalents at beginning of the period	68,949,000	38,639,000
Cash and cash equivalents at end of the period	$63,160,000	$55,599,000

Supplementary Cash Flow Information:

Income taxes cash payments, net of refunds	$8,531,000	$9,782,000
Issuance of Common Stock in 2013 and 2012, respectively, pursuant to Employee Stock Plans	$1,842,000	$1,250,000

See accompanying notes.

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Healthcare Services Group, Inc.
Consolidated Statement of Stockholders' Equity
(Unaudited)

	For the Six Months Ended June 30, 2013						
	Common Stock			Accumulated			
	Shares	Amount	Additional Paid-in Capital	Other Comprehensive Income, net of taxes	Retained Earnings	Treasury Stock	Stockholders' Equity
Balance — December 31, 2012	70,036,000	$700,000	$113,495,000	$127,000	$127,042,000	$(11,794,000)	$229,570,000
Comprehensive income:							
Net income for the period					27,887,000		27,887,000
Unrealized loss on available for sale marketable securities, net of taxes				(83,000)			(83,000)
Comprehensive income							27,804,000
Exercise of stock options and other stock-based compensation, net of shares tendered for payment	371,000	4,000	4,636,000			40,000	4,680,000
Tax benefit from equity compensation plans			1,128,000				1,128,000
Share-based compensation expense — stock options and restricted stock			1,011,000				1,011,000
Treasury shares issued for Deferred Compensation Plan funding and redemptions			352,000			11,000	363,000
Shares issued pursuant to Employee Stock Plans			1,370,000			472,000	1,842,000
Cash dividends					(22,931,000)		(22,931,000)

Shares issued pursuant to Dividend Reinvestment Plan			156,000			(103,000)	53,000
Balance — June 30, 2013	70,407,000	$704,000	$122,148,000	$44,000	$131,998,000	$(11,374,000)	$243,520,000

See accompanying notes.

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Healthcare Services Group, Inc.
Notes to Consolidated Financial Statements
(Unaudited)

Note 1— Description of Business and Significant Accounting Policies

Unaudited Interim Financial Data

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP") for interim financial information and the requirements of Form 10-Q and Article 10 of Regulation S-X. Accordingly, these consolidated financial statements do not include all of the information and footnotes necessary for a complete presentation of financial position, results of operations and cash flows. However, in our opinion, all adjustments which are of a normal recurring nature and necessary for a fair presentation have been reflected in these consolidated financial statements. The balance sheet shown in this report as of December 31, 2012 has been derived from, and does not include, all the disclosures contained in the financial statements for the year ended December 31, 2012. The financial statements should be read in conjunction with the financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012. The results of operations for the three and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for any future period.

Nature of Operations

We provide management, administrative and operating expertise and services to the housekeeping, laundry, linen, facility maintenance and dietary service departments of the health care industry, including nursing homes, retirement complexes, rehabilitation centers and hospitals located throughout the United States. Although we do not directly participate in any government reimbursement programs, our clients' reimbursements are subject to government regulation. Therefore, they are directly affected by any legislation relating to Medicare and Medicaid reimbursement programs.

We provide our services primarily pursuant to full service agreements with our clients. In such agreements, we are responsible for the day-to-day management of the managers and hourly employees located at our clients' facilities. We also provide services on the basis of a management-only agreement for a very limited number of clients. Our 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.

We are organized into two reportable segments; housekeeping, laundry, linen and other services ("Housekeeping"), and dietary department services ("Dietary").

Housekeeping consists of the managing of the client's housekeeping department which is principally responsible for 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. Also within the scope of this segment's service is the responsibility for laundering and processing of the bed linens, uniforms and other assorted linen items utilized by a client facility.

Dietary consists of managing the client's dietary department which is principally responsible for food purchasing, meal preparation and providing dietitian consulting professional services, which includes the development of a menu that meets the patient's dietary needs. We began Dietary operations in 1997.

As of June 30, 2013, we operate two wholly-owned subsidiaries, Huntingdon Holdings, Inc. (“Huntingdon”) and Healthcare Staff Leasing Solutions, LLC (“Staff Leasing”). Huntingdon invests our cash and cash equivalents and manages our portfolio of marketable securities. Staff Leasing is an entity formed in 2011 to offer professional employer organization (“PEO”) services to potential clients in the health care industry. As of June 30, 2013, we have PEO service contracts in two states. During the three and six months ended June 30, 2013 and 2012, operating results from our PEO service contracts were not material.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Healthcare Services Group, Inc. and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

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Cash and Cash Equivalents

Cash and cash equivalents are held in U.S. financial institutions or in custodial accounts with U.S. financial institutions. Cash and cash equivalents are defined as short-term, highly liquid investments with a maturity of three months or less at time of purchase that are readily convertible into cash and have insignificant interest rate risk.

Inventories and Supplies

Inventories and supplies include housekeeping, linen and laundry supplies, as well as food provisions and supplies. Inventories and supplies are stated at cost to approximate a first-in, first-out (FIFO) basis. Linen supplies are amortized on a straight-line basis over their estimated useful life of 24 months.

Revenue Recognition

Revenues from our service agreements with clients are recognized as services are performed.

As a distributor of laundry equipment, we occasionally sell laundry installations to certain clients. The sales in most cases represent the construction and installation of a turn-key operation and are for payment terms ranging from 24 to 60 months. Our accounting policy for these sales is to recognize the gross profit over the life of the payments associated with our financing of the transactions. During the three and six months ended June 30, 2013 and 2012, laundry installation sales were not material.

Income Taxes

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current period. We accrue for probable tax obligations as required by facts and circumstances in the various regulatory environments. In addition, deferred tax assets and liabilities are recognized for expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities. If appropriate, we would record a valuation allowance to reduce deferred tax assets to an amount for which realization is more likely than not.

In accordance with U.S. GAAP, we account for uncertain income tax positions reflected within our financial statements based on a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Earnings per Common Share

Basic earnings per common share are computed by dividing income available to common shareholders by the weighted-average common shares outstanding for the period. Diluted earnings per common share reflect the weighted-average common shares outstanding and dilutive common shares, such as those issuable upon exercise of stock options.

Share-Based Compensation

U.S. GAAP addresses the accounting for share-based compensation, specifically, the measurement and recognition of compensation expense, based on estimated fair values, for all share-based awards made to employees and directors, including stock options and participation in the Company’s employee stock purchase plan. We estimate the fair value of share-based awards on the date of grant using the Black-Scholes option valuation model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense in the Company’s consolidated statements of income over the requisite service periods. We use the straight-line single option method of expensing share-based awards in our consolidated financial statements of income. Because share-based compensation expense is based on awards that are ultimately expected to vest, share-based compensation expense will be reduced to account for estimated forfeitures. Forfeitures are to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

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Use of Estimates in Financial Statements

In preparing financial statements in conformity with U.S. GAAP, we make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are used for, but not limited to, our allowance for doubtful accounts, accrued insurance claims, asset valuations and review for potential impairment, and deferred taxes. The estimates are based upon various factors including current and historical trends, as well as other pertinent industry and regulatory authority information. We regularly evaluate this information to determine if it is necessary to update the basis for our estimates and to compensate for known changes.

Concentrations of Credit Risk

Financial instruments, as defined by U.S. GAAP, which potentially subject us to concentrations of credit risk, consist principally of cash and cash equivalents, marketable securities, deferred compensation funding and accounts and notes receivable. We define our marketable securities as fixed income investments which are highly liquid investments that can be readily purchased or sold using established markets. At June 30, 2013 and December 31, 2012, substantially all of our cash and cash equivalents, and marketable securities were held in one large financial institution located in the United States.

Our clients are concentrated in the health care industry, primarily providers of long-term care. Many of our clients' revenues are highly contingent on Medicare, Medicaid and third party payors' reimbursement funding rates. Congress has enacted a number of major laws during the past decade that have significantly altered, or threatened to alter, overall government reimbursement for nursing home services. These changes and lack of substantive reimbursement funding rate reform legislation, as well as other trends in the long-term care industry have affected and could adversely affect the liquidity of our clients, resulting in their inability to make payments to us on agreed upon payment terms. These factors, in addition to delays in payments from clients, could result in significant additional bad debts in the future.

Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This ASU requires an entity to include additional disclosures about significant amounts reclassified out of accumulated other comprehensive income by component. An entity has the option to present this information, either on the face of the statement where net income is presented or in the accompanying notes. This ASU does not change current requirements for reporting net income or other comprehensive income under current accounting guidance. This ASU is effective for reporting periods beginning after December 15, 2012. The adoption of this standard in 2013 did not have a material impact on the Company's consolidated results of operations, cash flows, or financial position.

Note 2—Changes in Accumulated Other Comprehensive Income by Component

U.S. GAAP establishes standards for presenting information about significant items reclassified out of accumulated other comprehensive income by component. As of June 30, 2013 and December 31, 2012, respectively, we generated other comprehensive income from one component. This component relates to the unrealized gains and losses from our available for sale marketable securities during a given reporting period. Effective January 1, 2013, we elected to present this information in a separate disclosure.

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The following table provides a summary of changes in accumulated other comprehensive income for the six months ended June 30, 2013:

	Unrealized Gains and Losses on Available for Sale Securities (1)
Accumulated other comprehensive income — December 31, 2012	$127,000
Other comprehensive income before reclassifications	(72,000)
Amounts reclassified from accumulated other comprehensive income (2)(3)	(11,000)
Net current period change in other comprehensive income	(83,000)
Accumulated other comprehensive income — June 30, 2013	$44,000

(1) All amounts are net of tax.

(2) Realized gains and losses are recorded pre-tax in the other income - investment and interest caption on our consolidated statements of comprehensive income.

(3) For the six months ended June 30, 2013, the Company recorded $16,000 of realized gains from the sale of available for sale securities. Refer to Note 4 herein for further information.

Note 3—Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of net assets acquired of businesses and is not amortized. Goodwill is evaluated for impairment on an annual basis, or more frequently if impairment indicators arise, using a fair-value-based test that compares the fair value of the reporting unit to its carrying value.

Goodwill by reportable operating segment, as described in Note 9 herein, was approximately $14,894,000 and $2,061,000 for Housekeeping and Dietary as of June 30, 2013 and December 31, 2012, respectively.

The cost of intangible assets is based on fair values at the date of acquisition. Intangible assets with determinable lives are amortized on a straight-line basis over their estimated useful life (between 7 and 8 years).

The following table sets forth the amounts of our identifiable intangible assets subject to amortization, which were acquired in acquisitions.

	June 30, 2013	December 31, 2012
Customer relationships	$14,481,000	$14,481,000
Non-compete agreements	800,000	800,000
Total other intangibles, gross	15,281,000	15,281,000
Less accumulated amortization	11,162,000	10,078,000
Other intangibles, net	$4,119,000	$5,203,000

The customer relationships have a weighted-average amortization period of seven years and the non-compete agreements have a weighted-average amortization period of eight years. The following table sets forth the estimated amortization expense for intangibles subject to amortization for the following five fiscal years:

Period/Year	Customer Relationships	Non-Compete Agreements	Total
July 1 to December 31, 2013	$715,000	$50,000	$765,000
2014	1,112,000	67,000	1,179,000
2015	1,112,000	—	1,112,000

2016	569,000	—	569,000
2017	297,000	—	297,000
2018	197,000	—	197,000
Thereafter	—	—	—

Amortization expense for the three months ended June 30, 2013 and 2012 was $542,000 and $542,000, respectively. Amortization expense for the six months ended June 30, 2013 and 2012 was $1,084,000 and $1,084,000, respectively.

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Note 4—Fair Value Measurements

We, in accordance with U.S. GAAP, define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). Effective January 1, 2008, we elected the fair value option for certain of our marketable securities purchased since such adoption. Management initially elected the fair value option for certain of our marketable securities because it views such investment securities as highly liquid and available to be drawn upon for working capital purposes making them similar to cash and cash equivalents. Accordingly, we recorded the net unrealized gain or loss in the other income, investment and interest caption in our consolidated income statements. We have not elected the fair value option for marketable securities acquired after December 31, 2009. Although these assets continue to be highly liquid and available, we believe these assets are more representative of our investing activities, and they will be available for future needs of the Company to support its projected growth.

The carrying value of certain assets and liabilities is considered to be representative of their fair value, due to the short term nature of these instruments. Such assets and liabilities include cash and cash equivalents, marketable securities, accounts and notes receivable, prepaid expenses and other, and accounts payable (including income taxes payable and accrued expenses).

The following tables provide fair value measurement information for our marketable securities and deferred compensation fund investment assets as of June 30, 2013 and December 31, 2012:

	As of June 30, 2013				
			Fair Value Measurement Using:		
	Carrying Amount	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:					
Marketable securities					
Municipal bonds	$22,026,000	$22,026,000	$—	$22,026,000	$—
Deferred compensation fund					
Money Market	$3,808,000	$3,808,000	$—	$3,808,000	$—
Balanced and Lifestyle	3,324,000	3,324,000	3,324,000	—	—
Large Cap Growth	1,706,000	1,706,000	1,706,000	—	—
Small Cap Value	2,172,000	2,172,000	2,172,000	—	—
Fixed Income	7,126,000	7,126,000	7,126,000	—	—
International	887,000	887,000	887,000	—	—
Mid Cap Growth	734,000	734,000	734,000	—	—
Deferred compensation fund	$19,757,000	$19,757,000	$15,949,000	$3,808,000	$—

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	As of December 31, 2012				
			Fair Value Measurement Using:		
	Carrying Amount	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:					
Marketable securities					
Municipal bonds	$21,322,000	$21,322,000	$—	$21,322,000	$—
Deferred compensation fund					
Money Market	$4,114,000	$4,114,000	$—	$4,114,000	$—
Balanced and Lifestyle	6,311,000	6,311,000	6,311,000	—	—
Large Cap Growth	2,724,000	2,724,000	2,724,000	—	—
Small Cap Value	1,936,000	1,936,000	1,936,000	—	—
Fixed Income	1,461,000	1,461,000	1,461,000	—	—
International	785,000	785,000	785,000	—	—
Mid Cap Growth	500,000	500,000	500,000	—	—
Deferred compensation fund	$17,831,000	$17,831,000	$13,717,000	$4,114,000	$—

The fair value of the municipal bonds is measured using pricing service data using third party pricing data. The fair value of equity investments in the funded deferred compensation plan are valued (Level 1) based on quoted market prices. The money market fund in the funded deferred compensation plan is valued (Level 2) at the net asset value ("NAV") of the shares held by the plan at the end of the period. As a practical expedient, fair value of our money market fund is valued at the NAV as determined by the custodian of the fund. The money market fund includes short-term United States dollar denominated money-market instruments. The money market fund can be redeemed at its NAV at its measurement date as there are no significant restrictions on the ability of participants to sell this investment. These assets will be redeemed by the plan participants on an as needed basis.

Unrealized gains and losses from marketable securities for investments recorded under the fair value option are recorded in the other income – investment and interest caption on our consolidated statements of comprehensive income. For the three and six months ended June 30, 2013, there were no unrealized gains or losses recorded. For the three and six months ended June 30, 2012, we recorded unrealized losses from marketable securities of $26,000 and $82,000, respectively.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Other-than-temporary Impairments
June 30, 2013					
Type of security:					
Municipal bonds — available for sale	21,953,000	130,000	(57,000)	22,026,000	—
Total debt securities	$21,953,000	$130,000	$(57,000)	$22,026,000	$ —
December 31, 2012					
Type of security:					
Municipal bonds — available for sale	21,111,000	220,000	(9,000)	21,322,000	—
Total debt securities	$21,111,000	$220,000	$(9,000)	$21,322,000	$ —

For the three and six months ended June 30, 2013, we received total proceeds of $3,000,000 and $3,000,000 respectively, from sales of available for sale municipal bonds. These sales resulted in realized gains of $16,000 and $16,000 recorded in other income – investment and interest caption on our statement of comprehensive income for the three and six months ended June 30, 2013, respectively. The basis for the sale of these securities was a specific identification of each bond sold during this period.

For the three and six months ended June 30, 2012, we received total proceeds of $4,274,000 and $14,871,000 respectively, from sales of available for sale municipal bonds. These sales resulted in realized gains of $41,000 and $224,000 recorded in other income – investment and interest caption on our statement of comprehensive income for the three and six months ended June 30, 2012, respectively. The basis for the sale of these securities was a specific identification of each bond sold during this period.

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The following tables include contractual maturities of debt securities held at June 30, 2013 and December 31, 2012, which are classified as marketable securities in the consolidated Balance Sheet.

	Municipal Bonds — Available for Sale	
Contractual maturity:	June 30, 2013	December 31, 2012
Maturing in one year or less	$7,284,000	$5,164,000
Maturing after one year through three years	8,000,000	12,134,000
Maturing after three years	6,742,000	4,024,000
Total debt securities	$22,026,000	$21,322,000

Note 5— Share-Based Compensation

2012 Equity Incentive Plan

On May 29, 2012, the Company's shareholders adopted and approved the 2012 Equity Incentive Plan (the "2012 Plan"), under which current or prospective officers, employees, non-employee directors and advisors can receive share-based awards such as stock options, restricted stock and other stock awards. The 2012 Plan seeks to promote the highest level of performance by providing an economic interest in the long-term success of the Company. As of this date, no further grants were permitted under any previously existing stock plans (the "Pre-existing Plans"). Additionally, all remaining shares available for future grants under the Pre-existing Plans became available for issuance under the 2012 Plan.

The Nominating, Compensation and Stock Option Committee of the Board of Directors is responsible for determining the individuals who will be granted stock awards, the number of stock awards each individual will receive, the price per share (in accordance with the terms of our 2012 Plan), and the exercise period of each stock award.

A summary of stock-based compensation expense for the six months ended June 30, 2013 and 2012 is as follows:

	For the Six Months Ended June 30,	
	2013	2012
Stock Options	$997,000	$949,000
Restricted Stock	14,000	—
Employee Stock Purchase Plan (ESPP)	185,000	195,000
Total pre-tax stock-based compensation expense charged against income (1)	$1,196,000	$1,144,000

(1) Stock-based compensation expense is recorded in the selling, general and administrative caption in our consolidated statements of comprehensive income.

We have outstanding stock awards that were granted under the Pre-existing Plans to non-employee directors, officers and employees of the Company and other specified groups, depending on the Pre-existing Plan. No further grants are allowed under the Pre-existing Plans. As of June 30, 2013, 5,550,000 shares of common stock were reserved for issuance under our 2012 Plan, including 2,781,000 shares which are available for future grant. The stock price will not be less than the fair market value of the common stock on the date the award is granted. No stock grant will have a term in excess of ten years. Since 2008, all awards granted become vested and exercisable ratably over a five year period on each yearly anniversary date of the option grant.

A summary of our stock option activity is as follows:

	Stock Options Outstanding	
	Number of Shares	Weighted Average Exercise Price
December 31, 2012	2,632,000	$13.18
Granted	564,000	23.50
Cancelled	(49,000)	18.21
Exercised	(378,000)	12.46
June 30, 2013	2,769,000	$15.29

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The weighted average grant-date fair value of stock options granted during the six months ended June 30, 2013 and 2012 was $6.81 and $4.74 per common share, respectively.

During the six months ended June 30, 2013, the Company granted 6,000 shares of restricted stock with a weighted average grant date fair value of $23.50.

The following table summarizes other information about stock options at June 30, 2013.

	Stock Options
Range of exercise prices	$3.68 - 23.50
Outstanding:	
Weighted average remaining contractual life (years)	6.60
Aggregate intrinsic value	$25,566,000
Exercisable:	
Number of shares	1,174,000
Weighted average remaining contractual life (years)	4.50
Aggregate intrinsic value	$15,846,000

Fair Value Estimates

The fair value of stock awards granted in 2013 and 2012 was estimated on the date of grant using the Black-Scholes option valuation model based on the following assumptions:

	June 30, 2013	June 30, 2012
Risk-free interest rate	1.5%	1.3%
Weighted average expected life in years	6.0 years	6.8 years
Expected volatility	38.9%	39.2%
Dividend yield	2.8%	3.6%

Other Information

Other information pertaining to activity of our stock awards during the six months ended June 30, 2013 and 2012 was as follows:

	June 30, 2013	June 30, 2012
Total grant-date fair value of stock awards granted	$3,412,000	$2,438,000
Total fair value of stock awards vested during period	$1,897,000	$1,870,000
Total unrecognized compensation expense related to non-vested stock awards	$5,982,000	$4,948,000

At June 30, 2013, the unrecognized compensation cost related to stock awards granted but not yet vested, as reported above, was expected to be recognized through the fourth quarter of 2017 for the 2013 grants and the fourth quarter of 2016 for the 2012 grants.

Employee Stock Purchase Plan

Since January 1, 2000, we have had an ESPP for all eligible employees. All full-time and certain part-time employees who have completed two years of continuous service with us are eligible to participate. The ESPP was implemented through five annual offerings. On January 1, 2000, the first annual offering commenced. On February 12, 2004 (effective January 1, 2004), our Board of Directors extended the ESPP for an additional eight annual offerings. On April 12, 2011, the Board of Directors extended the ESPP for an additional five offerings through 2016. Annual offerings commence and terminate on the respective year's first and last calendar day.

Under the ESPP, we are authorized to issue up to 4,050,000 shares of our common stock to our employees. Pursuant to such authorization, we have 2,541,000 shares available for future grant at June 30, 2013.

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The stock-based compensation expense associated with our ESPP was estimated on the date of grant using the Black-Scholes option valuation model based on the following assumptions:

	June 30, 2013	June 30, 2012
Risk-free interest rate	0.24%	0.19%
Weighted average expected life in years	1.0 year	1.0 year
Expected volatility	27.6%	36.5%
Dividend yield	2.8%	3.6%

Note 6— Dividends

During the six months ended June 30, 2013, we paid regular quarterly cash dividends approximating $22,931,000 as follows:

	Quarter Ended	
	March 31, 2013	June 30, 2013
Cash dividend per common share	$0.16625	$0.16750
Total cash dividends paid	$11,415,000	$11,516,000
Record date	February 22, 2013	May 10, 2013
Payment date	March 15, 2013	June 14, 2013

Additionally, on July 9, 2013, our Board of Directors declared a regular quarterly cash dividend of $0.16875 per common share, which will be paid on September 20, 2013, to shareholders of record as of the close of business on August 16, 2013.

Cash dividends on our outstanding weighted average number of basic common shares for the three and six months ended June 30, 2013 and 2012 was as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
Cash dividends per common share	$0.17	$0.16	$0.33	$0.32

Our Board of Directors reviews our dividend policy on a quarterly basis. Although there can be no assurance that we will continue to pay dividends or the amount of the dividend, we expect to continue to pay a regular quarterly cash dividend. In connection with the establishment of our dividend policy, we adopted a Dividend Reinvestment Plan in 2003.

Note 7— Income Taxes

For the six months ended June 30, 2013, our effective tax rate was approximately 28%, a decrease from the 38% effective tax rate for the comparable 2012 period. Such differences between the effective tax rates and the applicable U.S. federal statutory rate arise primarily from the effect of state and local income taxes and tax credits available to the Company. The decrease in the effective tax rate is primarily due to an increase in expected tax credits realized in 2013 for 2012 and 2013 as compared to previous fiscal periods. The Company receives credits related to the Work Opportunity Tax Credit ("WOTC") program but this program initially expired at December 31, 2011. The WOTC was subsequently renewed, but not until January 2, 2013, as part of The American Taxpayer Relief Act of 2012. Since the WOTC was renewed during the three month period ended March 31, 2013, the total tax effect of additional expected credits for 2012 was included in this period. As such, the effective tax rate is expected to increase in subsequent periods during 2013 and currently is expected to be approximately 32% for the entire year if there are no significant changes.

We account for income taxes using the asset and liability method, which results in recognizing income tax expense based on the amount of income taxes payable or refundable for the current year. Additionally, we evaluate regularly the tax positions taken or expected to be taken resulting from financial statement recognition of certain items. Based on our evaluation, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements. Our evaluation was performed for the tax years ended December 31, 2009 through 2012 (with regard to U.S. federal income tax returns) and December 31, 2008 through 2012 (with regard to various state and local income tax returns), the tax years which remain subject to examination by major tax jurisdictions as of June 30, 2013.

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We may from time to time be assessed interest or penalties by taxing jurisdictions, although any such assessments historically have been minimal and immaterial to our financial results. When we have received an assessment for interest and/or penalties, it has been classified in the financial statements as selling, general and administrative expense.

Note 8—Related Party Transactions

A director is a member of a law firm which was retained by us. In each of the six months ended June 30, 2013 and 2012, fees received from us by such firm did not exceed $120,000 in any period. Additionally, such fees did not exceed, in either period, 5% of such firm's revenues.

Note 9—Segment Information

Reportable Operating Segments

U.S. GAAP establishes standards for reporting information regarding operating segments in annual financial statements. Operating segments are identified as components of an enterprise for which separate discrete financial information is available for evaluation by the chief operating decision-maker, or decision-making group in making decisions on how to allocate resources and assess performance.

We manage and evaluate our operations in two reportable segments: Housekeeping (housekeeping, laundry, linen and other services), and Dietary (dietary department services). Although both segments serve the same client base and share many operational similarities, they are managed separately due to distinct differences in the type of service provided, as well as the specialized expertise required of the professional management personnel responsible for delivering the respective segment's services. We consider the various services provided within each reportable segment to comprise an identifiable reportable operating segment since such services are rendered pursuant to a single service agreement, specific to that reportable segment, as well as the fact that the delivery of the respective reportable segment's services are managed by the same management personnel of the particular reportable segment.

The Company's accounting policies for the segments are generally the same as the Company's significant accounting policies. Differences between the reportable segments' operating results and other disclosed data and our consolidated financial statements relate primarily to corporate level transactions and recording of transactions at the reportable segment level which use methods other than generally accepted accounting principles. There are certain inventories and supplies that are primarily expensed when incurred within the operating segments, while they are capitalized for the consolidated financial statements. As discussed, most corporate expense is not allocated to the operating segments, and such expenses include corporate salary and benefit costs, bad debt expense, certain legal costs, information technology costs, depreciation, amortization of finite lived intangibles, share based compensation costs and other corporate specific costs. Additionally, there are allocations for workers' compensation and general liability expense within the operating segments that differ from our actual expense recorded for U.S. GAAP. Additionally, included in the differences between the reportable segments' operating results and other disclosed data are amounts attributable to Huntingdon, our investment holding company subsidiary. Huntingdon does not transact any business with the reportable segments. Segment amounts disclosed are prior to any elimination entries made in consolidation.

Housekeeping provides services in Canada, although essentially all of its revenues and net income, 99% in both categories, are earned in one geographic area, the United States. Dietary provides services solely in the United States.

	Housekeeping Services	Dietary Services	Corporate and Eliminations	Total
Three Months Ended June 30, 2013				

Revenues	$183,754,000	$89,850,000	$—	$273,604,000
Income before income taxes	17,632,000	5,341,000	(3,115,000) [1]	19,858,000
Three Months Ended June 30, 2012				
Revenues	$183,215,000	$83,891,000	$2,000 [1]	$267,108,000
Income before income taxes	17,671,000	4,620,000	(4,008,000) [1]	18,283,000

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	Housekeeping Services	Dietary Services	Corporate and Eliminations		Total
Six Months Ended June 30, 2013					
Revenues	$371,384,000	$176,124,000	$—		$547,508,000
Income before income taxes	36,438,000	10,465,000	(8,088,000)	(1)	38,815,000
Six Months Ended June 30, 2012					
Revenues	$364,397,000	$163,281,000	$37,000	(1)	$527,715,000
Income before income taxes	35,127,000	8,674,000	(11,735,000)	(1)	32,066,000

(1) Represents primarily corporate office cost and related overhead, recording of transactions at the reportable segment level which use methods other than U.S. GAAP, as well as consolidated subsidiaries' operating expenses that are not allocated to the reportable segments, net of investment and interest income.

Total Revenues from Clients