Hercules Site Services

3rd June 2024

Excellent H1 performance, well on track for full year

Hercules' H1 results confirm another excellent performance culminating in record revenues, EBITDA and PBT. The Group is on track to meet market expectations for the full year. All three businesses reported double-digit growth for H1, benefiting from underlying market demand, Hercules' investment in new service lines and technology, as well as a maiden contribution from the Future Build acquisition.

With scope for outperformance in the second half, we reiterate our 55p Fair Value estimate, whilst noting the attraction of a 4.7% dividend yield.

Impressive H1 performance

Hercules' interims confirm another period of strong growth, continuing its excellent track record. Revenue for the six months to 31st March increased by 32% year-on-year to £48.8m, comfortably ahead of recent guidance (10th May: "over £47m"). Adjusted EBITDA increased by 91% to £2.1m. Contract momentum continues, with over £5m in civil projects and new framework agreements signed with Costain and Hill Group. The integration of Future Build is progressing well, and the Hercules Construction Academy is already developing a reputation for first class training. Importantly, H1 was a period of strong operational cash generation, supporting an interim dividend of 0.6p per share. All three divisions delivered strong double digit % growth in the period (see page 3).

In-line outlook, seasonality underpins confidence in H2

The outlook statement indicates that Hercules is on track to meet market expectations and anticipates further strong demand for the Group's services. We note the Group's traditional H2 weighting and believe our forecasts look prudently positioned with 52% of our FY'24 revenue already delivered in H1 (versus prior year weighting of 44:56). We also take confidence from recent market indicators with April's PMI survey highlighting the strongest pace of expansion since February '23 (see page 4).

Reiterating 55p Fair Value estimate

In our view, Hercules is a business with good trading momentum, an ambitious management team and a focus on the most attractive segment of the construction market. Notwithstanding the uncertainties that a General Election can bring, we see scope for forecast outperformance in the second half and reiterate our 55p / share Fair Value estimate. We also note the attraction of a 4.7% dividend yield, unusually high for a smaller company with Hercules' growth profile.

Key Financials & Valuation metrics

Year-end Sept, £m	2020A	2021A	2022A	2023A	2024E	2025E
Sales	23.0	32.8	49.5	84.7	94.7	100.1
Adjusted EBITDA	1.4	2.4	2.3	4.1	4.4	4.8
Adjusted PBT	1.0	1.4	0.7	0.9	0.7	1.1
FD Adj. EPS (p)	N/A	N/A	1.5	1.7	0.9	1.6
DPS (p)	N/A	N/A	1.7	1.7	1.7	1.7
Net Cash/(Debt)*	-4.0	-9.2	-18.2	-22.8	-22.8	-20.9
Net Cash/(Debt)**	1.7	-1.7	-5.3	-5.8	-8.9	-9.2
Net Debt**/EBITDA	N/A	0.7x	2.4x	1.4x	2.0x	1.9x
P/E	N/A	N/A	24.4x	21.6x	40.6x	23.5x
EV/EBITDA	19.8x	13.5x	18.4x	11.2x	10.5x	9.1x
EV/Sales	1.2x	1.0x	0.8x	0.5x	0.5x	0.4x
Dividend yield	N/A	N/A	4.7%	4.7%	4.7%	4.7%

*Source: ED analysis, all numbers IFRS 16 basis * including leases ** excluding leases*

Company Data

EPIC	HERC.L
Price (last close)	36.5p
52 weeks Hi/Lo	37p/24p
Market cap	£23m
ED Fair Value / share	55p
Proforma net cash/ (debt)	(£22.8m)
Avg. daily volume	36,500

Share Price, p

Source: ADVFN

Description

Hercules Site Services is a leading supplier of labour to the Construction industry in the UK. The business was founded in 2008 by CEO Brusk Korkmaz, and has achieved significant growth since then, reporting revenue of £84.7m in FY23.

The business floated on AIM in 2022 to provide access to capital to support the next stage in the Group's growth plans.

Next news: Trading update post September year-end

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H1'24 overview – building on impressive track record

Hercules' interims confirm another period of strong growth, in line with expectations. Revenue for the six months to 31st March was £48.8m, representing **growth of 32% year on year**. This was comfortably ahead of recent guidance (10th May RNS indicated "*over £47m*").

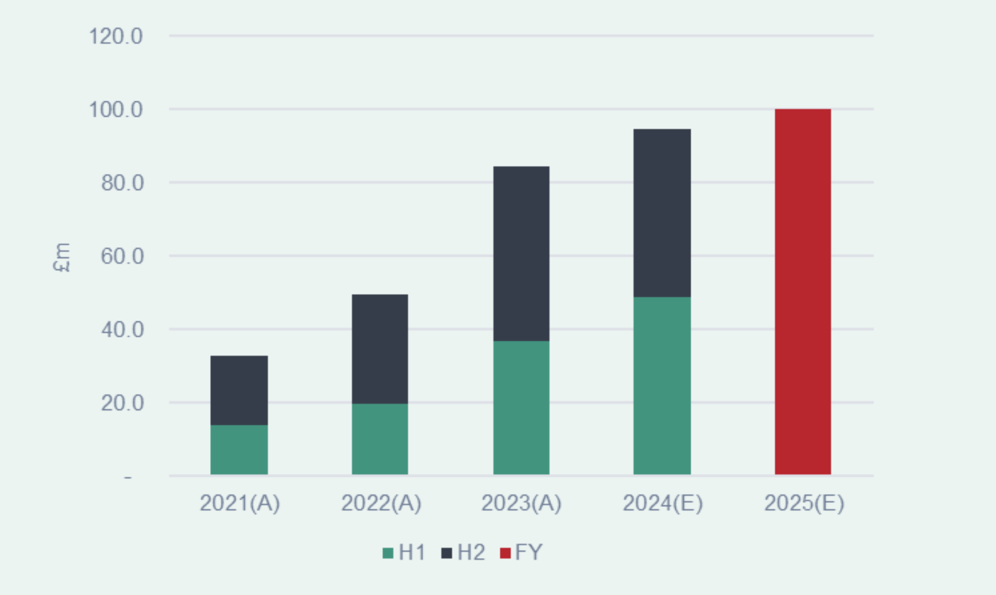
Contract momentum was a key feature of H1 progress, including over £5m in Civil Projects and new framework agreements with Costain and Hill Group (a Future Build client).

Labour supply, the Group's largest business, continues to deliver strong growth in the number of operatives supplied to HS2 and other construction/ infrastructure sites.

The integration of Future Build is said to be progressing well and the Hercules Construction Academy is already developing a reputation for first class training.

The chart below demonstrates the Group's excellent track record of growth, as well as its customary H2 weighting (seasonality due in part to the weather). In this context, we believe our forecasts look prudently positioned with 52% of our forecast delivered in H1 (versus prior year weighting of 44:56).

Continuing an impressive track record of revenue growth



Source: Company, ED estimates

Financial highlights

- Revenue increased by 32% to £48.8m, driven by strong growth in all three businesses
- Gross margin reduced slightly to 16.6% (H1'23: 18.1%) reflecting a change in mix and rebuilding utilisation of the new suction excavator fleet.
- Gross profit increased by 21% to £8.1m and Adjusted EBITDA by 91% to £2.1m. Adjusted EBITDA Is stated prior to a £0.2m loss on disposal of older suction excavators.
- Adjusted PBT increased from a loss of £0.2m in H1'23 to a profit of £0.4m, whilst reported PBT of £0.2m compared favourably to a loss of £0.2m in H1'23.
- Adjusted EPS of 0.6p is consistent with the prior year (0.6p), which benefited from a tax credit. Reported EPS for H1'24 was 0.3p (after the £0.2m adjusting item). An interim dividend of 0.6p has been declared, also in line with H1'23, as expected.

Double-digit % growth and investment in new initiatives

Group revenue growth of 32% in the period was driven by strong double-digit growth in all three divisions.

Divisional highlights

Labour Supply, Hercules' largest business, reported 25% growth on H1'23. A key driver of this has been the multi-year HS2 Phase 1 (Northern Section) contract. Labour supplied by Hercules under this contract increased to 450 operatives at 31st March (H1'23: 400) and increased further to 550 by the end of May (31st May '23: 400), which bodes well for the second half of the year and beyond. Hercules is providing additional labour every week in response to increasing demand, leveraging the Group's digital platform as a source of labour supply.

Away from HS2, 550 operatives were active on other sites as of 31st March (H1'23: 500), again representing good growth year on year. Initial growth in the new Rail business (launched Oct '23) is in line with expectations, having started well with the previously announced Balfour Beatty Rail contract. Hercules has also established a new, small office in Saxmundham in anticipation of a significant number of years' work in the Ipswich area around the Sizewell C nuclear site.

Suction excavator revenues were up 41% year-on-year. The focus is on profitability and utilisation of the 28-vehicle fleet. After acquiring 14 new suction excavators just over a year ago, utilisation dipped during H2'23. In H1'24, the team has focused on identifying opportunities with new customers, as well as increasing supply to existing customers. Hercules disposed of two older suction excavators during the period and the fleet is expected to remain at its current level for the foreseeable future.

Civil Projects enjoyed a very successful H1 with revenues +61% year-on-year. The business has benefited from increased demand relating to the well-documented issues in the water-treatment sector. This level of growth is unusual in the final year of the AMP investment cycle. AMP7 comes to an end in March '25, with a significant uplift in regulatory spending planned for AMP8.

Growth initiatives

Hercules Construction Academy in Nuneaton launched at the end of January '24. The academy has already started to obtain significant interest and initial revenues from colleges, clients, and industry in general.

The **Future Build** acquisition was completed on 30th November '23. Future Build operates mostly in the white-collar construction sector and was acquired to the broaden the Group's offering in this area, complementing Hercules' strength in blue-collar recruitment.

Key market indicators picking up

Hercules' consistently strong growth is even more impressive in the context of a subdued general construction market. In part, this is due to the Group's focus on the more attractive segments of the market, notably infrastructure, which is underpinned by regulated spending commitments in rail and water, for instance. The charts below (from ONS data) highlight weakness in UK construction output over the past year or more, particularly as a result of the depressed housing market (which Hercules does not supply).

ONS construction output (volume % change versus prior year)

Source: ONS

More encouragingly, the S&P Global UK Construction Purchasing Managers' Index (PMI) has given cause for cautious optimism recently. The PMI is a seasonally adjusted index tracking changes in industry activity, derived from a monthly survey of 170 construction companies.

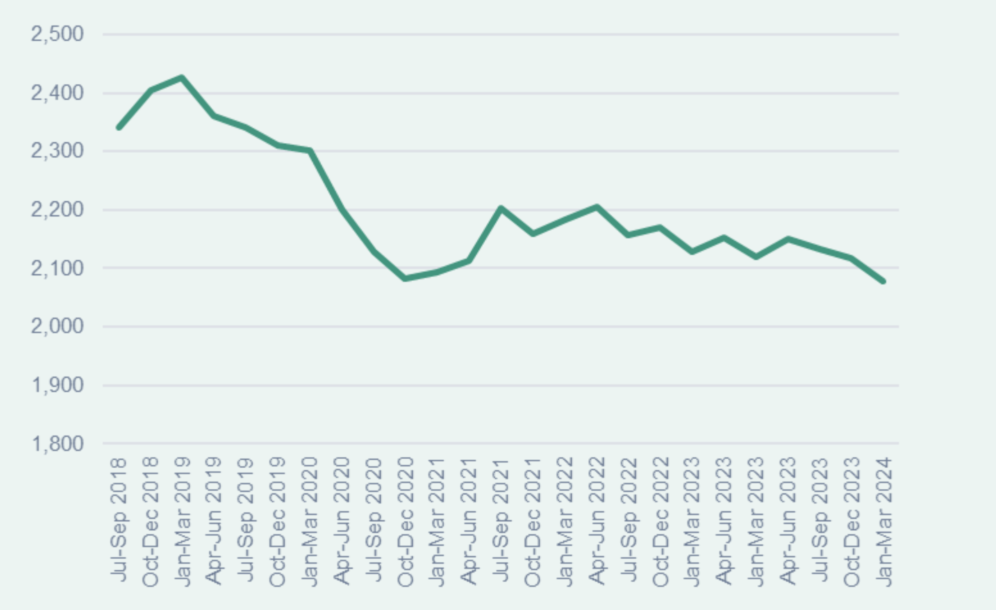
The PMI registered **53.0 in April, up from 50.2 in March** (>50 represents expansion). This is the strongest pace of expansion since February 2023. Commercial building was the fastest-growing area of activity, whilst civil engineering activity expanded at its strongest pace for nine months.

UK Construction PMI (latest data to Apr '24)

Source: S&P/ CIPS Construction PMI

Whilst overall employment in the construction industry has plateaued or declined for a number of years, vacancies remain elevated, having risen sharply in the years since the COVID pandemic. The charts below highlight the ongoing challenge in filling vacancies, whether the result of skills gaps, departure of EU workers post Brexit etc.

Total employed in construction industry ('000s) – to Mar'24



Source: S&P/ CIPS Construction PMI

It is widely acknowledged that there is a skills shortage in the construction industry, but this has not impacted Hercules' ability to recruit the operatives its clients require. Hercules' growth has benefited from investment in digital tools (see our initiation note), which easily match client vacancies to operatives with the right skills and accreditation in the right location.

The Group is also seeing the benefits of its increasing scale and reputation, as well as key relationships with some of the UK's largest contractors.

All vacancies in construction industry ('000s) – latest data to Mar'24

Source: ONS

Financials

Income statement						
Year-end Sept, £m	**2020A**	**2021A**	**2022A**	**2023A**	**2024E**	**2025E**
Group revenue	**23.0**	**32.8**	**49.5**	**84.7**	**94.7**	**100.1**
% growth	*-*	*43%*	*51%*	*71%*	*12%*	*6%*
% 2 Year CAGR	*-*	*-*	*47%*	*61%*	*38%*	*9%*
COGS	-18.6	-26.1	-39.8	-68.8	-77.9	-81.7
% growth	*-*	*40%*	*53%*	*73%*	*13%*	*5%*
% of revenue	*81%*	*80%*	*80%*	*81%*	*82%*	*82%*
Gross profit	**4.3**	**6.7**	**9.8**	**15.8**	**16.8**	**18.4**
% growth	*-*	*55%*	*46%*	*62%*	*6%*	*9%*
% margin	*19%*	*20%*	*20%*	*19%*	*18%*	*18%*
Other operating income	0.4	0.2	0.0	0.0	0.0	0.0
% of revenue	*-*	*1%*	*0%*	*-18%*	*0%*	*0%*
Segmental admin expenses	-0.9	-1.5	-3.2	-4.8	-4.4	-5.6
% of revenue	*4%*	*5%*	*6%*	*6%*	*5%*	*6%*
Central admin expenses	-2.8	-3.7	-5.4	-8.8	-10.0	-9.7
% of revenue	*12%*	*11%*	*11%*	*10%*	*11%*	*10%*
Add back D&A	0.4	0.7	1.0	1.8	2.0	1.8
% of revenue	*2%*	*2%*	*2%*	*2%*	*2%*	*2%*
Adj. EBITDA	**1.4**	**2.4**	**2.3**	**4.1**	**4.4**	**4.8**
% growth	*-*	*75%*	*-7%*	*82%*	*7%*	*10%*
% margin	*6%*	*7%*	*5%*	*4.8%*	*4.6%*	*5%*
Depreciation owned assets	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2
Depreciation right of use assets	-0.3	-0.6	-0.9	-1.6	-1.8	-1.6
Amortisation		0.0	0.0	0.0	0.0	0.0
Adj. EBITA	**1.0**	**1.7**	**1.2**	**2.3**	**2.4**	**3.0**
% growth	*-*	*69%*	*-28%*	*91%*	*3%*	*27%*
% conversion rate (EBITA/GM%)	*23%*	*25%*	*12%*	*15%*	*14%*	*17%*
% margin	*4%*	*5%*	*2%*	*3%*	*3%*	*3%*
Fair value gains/ other	0.1	0.0	0.0	0.0	0.0	0.0
Net interest	-0.1	-0.2	-0.5	-1.4	-1.7	-1.9
Adj. PBT	**1.0**	**1.4**	**0.7**	**0.9**	**0.7**	**1.1**
% growth	*-*	*40%*	*-52%*	*34%*	*-23%*	*65%*
% margin	*4%*	*4%*	*1%*	*1%*	*1%*	*1%*
Other Items/Exceptionals	0.0	-0.9	-0.5	-0.3	-0.2	0.0
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0	0.0
Reported PBT	**1.0**	**0.5**	**0.2**	**0.6**	**0.5**	**1.1**

Source: Company historic data, ED estimates

Cashflow statement					
Year-end Sept, £m	**2021A**	**2022A**	**2023A**	**2024E**	**2025E**
Adj. EBITA	1.7	1.2	2.3	2.4	3.0
Depreciation owned assets	0.1	0.1	0.2	0.2	0.2
Depreciation right of use assets	0.6	0.9	1.6	1.8	1.6
Gain on disposal of PPE	0.0	0.0	0.0	0.0	0.0
Exceptionals (inc IPO costs)	-0.9	-0.5	-0.3	-0.2	0.0
Other non-cash	0.0	0.1	0.1	0.0	0.0
Working Capital Movement	-3.1	-7.1	-0.1	0.6	0.5
Operating Cash Flow	**-1.6**	**-5.3**	**3.8**	**4.8**	**5.3**
Net Interest	-0.1	-0.2	-0.7	-1.7	-1.9
Tax	0.0	0.0	0.0	0.0	0.0
Net Operating Cash Flow	**-1.7**	**-5.6**	**3.1**	**3.1**	**3.4**
Purchase of PPE	-0.4	-0.2	-0.4	-1.8	-0.4
Proceeds from sale of PPE	0.0	0.5	0.2	0.8	0.0
Total Net Capex	-0.3	0.3	-0.2	-1.0	-0.4
Equity Free Cash Flow	**-2.1**	**-5.3**	**2.9**	**2.1**	**3.0**
M&A	0.0	0.0	0.0	-1.0	0.0
Dividend	0.0	-0.4	-0.6	-1.1	-1.1
Share Issue	0.0	3.4	1.6	0.0	0.0
Leases	-3.0	-6.5	-8.5	0.0	0.0
FX/Other	-0.1	-0.3	0.0	0.0	0.0
Net Change in Net Debt	**-5.2**	-9.0	-4.6	0.0	1.9
Net Debt - BOP	**-4.0**	**-9.2**	**-18.2**	**-22.8**	**-22.8**
Net Debt - EOP	**-9.2**	**-18.2**	**-22.8**	**-22.8**	**-20.9**

Source: Company historic data, ED estimates

Balance sheet

Year-end Sept, £m	2020A	2021A	2022A	2023A	2024E	2025E
Non-Current assets						
PPE	6.6	9.2	14.6	20.8	20.6	19.2
Goodwill/ Other intangibles	0.1	0.0	0.0	0.0	0.0	0.0
Sub-total NCAs	6.7	9.2	14.6	20.8	20.6	19.2
Current Assets						
Inventories	0.0	0.0	0.1	0.1	0.1	0.1
Trade and other receivables	8.6	8.3	17.9	22.6	23.0	24.0
Current tax receivable	0.1	0.1	0.1	0.1	0.1	0.1
Assets at fair value through profit or loss	0.3	0.3	0.0	0.0	0.0	0.0
Cash and cash equivalents	2.0	1.5	1.2	4.2	2.1	2.8
Sub-total CAs	11.0	10.1	19.3	26.9	25.2	27.0
Total Assets	**17.7**	**19.4**	**33.9**	**47.7**	**45.8**	**46.2**
Current Liabilities						
Trade and other payables	-4.8	-4.5	-7.0	-11.9	-12.9	-14.4
Provisions	-0.1	-0.3	-0.3	0.0	0.0	0.0
Loans and borrowings	-0.3	-3.1	-6.5	-10.0	-11.0	-12.0
Lease liabilities	-0.6	-0.8	-2.1	-3.5	-3.9	-3.2
Other	0.0	0.0	0.0	0.0	0.0	0.0
Sub-total CLs	-5.8	-8.7	-15.9	-25.4	-27.8	-29.6
Non-current liabilities						
Deferred tax liabilities	0.0	-0.4	-0.3	-0.2	-0.1	-0.1
Lease liabilities	-5.1	-6.7	-10.9	-13.5	-10.0	-8.5
Other	0.0	0.0	0.0	0.0	0.0	0.0
Sub-total NCLs	-5.1	-7.2	-11.2	-13.7	-10.1	-8.6
Total Liabilities	**-10.9**	**-15.9**	**-27.1**	**-39.0**	**-37.9**	**-38.2**
NET ASSETS	**6.8**	**3.4**	6.8	8.7	7.9	7.9

Source: Company historic data, ED estimates

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