Hercules Site Services

Strong conclusion to FY23, positive start to FY24

16th January 2024

Hercules has reported strong full year results, with profits well ahead of our expectations. Against a supportive backdrop for infrastructure investment, we believe momentum is building. A positive outlook statement anticipates another year of growth in FY24. We reflect this in our revenue forecasts, whilst noting that an increasing interest charge will reduce profits in the short term. We see a number of potential positive catalysts in FY24, including the launch of the training academy, a maiden contribution from the Future Build acquisition and the full year benefit of the March '23 investment in the suction excavator fleet.

In our view, Hercules' share price performance does not reflect recent strong progress. Hercules is trading on an FY25 P/E rating of c.16x and a dividend yield of 7% with scope for good earnings growth over the medium term. Our new Fair Value / share estimate is 55p (from 60p), representing an FY25 EV/EBITDA rating of c.11.5x.

A year of significant growth and strategic progress

Hercules' results confirm a successful conclusion to FY23, the Group's first full year as a listed company. The results are comfortably ahead of our expectations (adjusted EBITDA 11% ahead of forecast), even though we upgraded at the time of October's full year trading update. Revenue growth of 71% (all organic) is highly impressive, sustaining the momentum of recent years.

Core Labour Supply business leading the way

All three divisions contributed to the strong growth in FY23, but Labour Supply remains, by some distance, the largest element of the Group. This division accounted for 75% of Group revenue and 65% of gross profit whilst also delivering the strongest revenue growth in FY23 (+92%). This was driven in particular by additional demand under the Balfour Vinci JV contract on HS2 (London to Birmingham), which still has several years to run.

Positive outlook for FY24

The outlook statement strikes a positive tone, highlighting new revenue streams which should make a positive impact in FY24. These include the training academy in Nuneaton (now operational and formally opening this month) and the new "live track" rail offering, which was announced right at the start of the new year in early October. Further organic progress therefore looks well underpinned and November's Future Build acquisition (Hercules' first deal) adds another leg to the growth story.

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
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	16.5x	14.6x	27.5x	15.9x
EV/EBITDA	14.3x	10.3x	15.1x	9.4x	8.8x	7.6x
EV/Sales	0.9x	0.8x	0.7x	0.5x	0.4x	0.4x
Dividend yield	N/A	N/A	7.0%	7.0%	7.0%	7.0%

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

Company Data

EPIC	HERC.L
Price (last close)	25p
52 weeks Hi/Lo	72p/24p
Market cap	£16m
ED Fair Value / share	55p
Proforma net cash/ (debt)	(£22.8m)
Avg. daily volume	32,000

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: Launch event for Training Academy, 31st January

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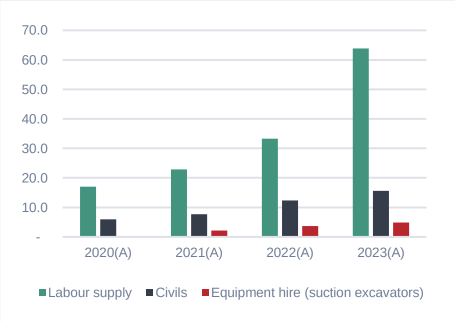
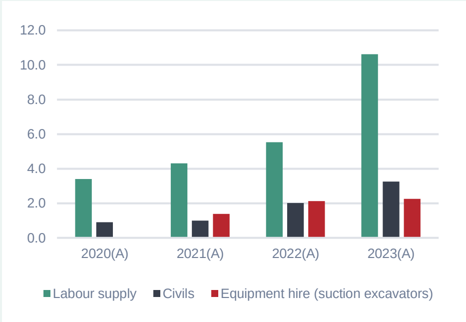
A year of significant growth and strategic progress

FY23 was another year of significant growth for Hercules Site Services. Revenue growth of 71% outperformed expectations and the strong growth delivered in the previous two years (51% in FY22 and 43% in FY21) to give **a three years CAGR of 55%**. All three divisions contributed, benefiting from good contract momentum, a supportive environment for infrastructure investment and organic growth initiatives.

Revenue by division (£m) **Gross profit by division (£m)**





Source: Company

Financial highlights

- Revenue rose by 71% to £84.7m, all organic, with Labour Supply making the key growth contribution.
- Gross margin was slightly lower than the prior year at 19.3% (FY22: 19.7%) but slightly better than we had forecast (19.2%). The modest decline year on year reflects the time taken to build utilisation of the new suction excavator fleet.
- Operating margin was similar to the prior year at 13.1% (FY22: 13.3%), despite the heightened inflationary environment and the impact of the fleet investment.
- Adjusted PBT increased by 34% to £0.9m, whilst reported PBT trebled to £0.6m from £0.2m.
- Adjusted EPS of 1.7p was in line with our expectations (13% growth year on year), as was the final dividend of 1.12p, taking the full year dividend to 1.7p. Brusk Korkmaz, CEO, via his company Hercules Real Estate Ltd, will be taking a dividend this year for the first time since the IPO. Reported EPS increased by more than 100% to 1.3p (FY22: 0.6p).
- Net debt, including lease liabilities of £22.8m, came in below expectations (£25.4m), increasing year on year (FY22: £18.2m) to fund the new suction excavators.
- Net debt excluding lease liabilities was £5.8m, similar to that of the prior year (FY22: £5.3m).
- A new replacement invoice discounting facility was entered into in November 2023, with IGF Business Credit Limited and provides a facility up to £15m to support Hercules' growth plans.

Positive outlook for FY24

The outlook statement strikes a confident tone, pointing to continuing growth potential, bolstered by the recently announced Future Build acquisition and the new training academy at Nuneaton.

"We enter 2024 with an excellent foundation for further growth, having exceeded market expectations and developed an array of accretive commercial workstreams which will expand our business and deliver additional revenue and profits. The first quarter of FY 2024 has been successful, with our first acquisition completed and strong pipeline of new business across our divisions, and the outlook for the infrastructure sector remains buoyant."

Divisional performance

Labour Supply

Labour Supply remains the Group's core business, representing 75% of Group revenue in the year (FY22: 67%). Divisional revenue increased by 92% to £63.8m, a significant acceleration on the already impressive growth of recent years.

Key drivers of ongoing demand include Network Rail's CP7 investment programme (£44bn investment in the rail network from 2024 to 2029); the AMP7 (2020-2025) and AMP8 (2025-2030) water industry investment plans, with AMP8 expected to see a significant step-up in spending.

HS2 (London to Birmingham) has been a major growth driver over the past two years. Hercules is working with the Beatty Vinci JV as the leading labour supplier on the six-supplier labour desk. Hercules now has 425 operatives on site. Strong demand is expected to continue for the next 5-7 years with FY24 requirements expected to be greater than FY23.

Other contract successes include the A47 with Galliford Try and the A428 with Skanska. In the last 12 months, on average, the Company has been supplying between 625 and 980 personnel to projects each day (average of around 850).

Specialist Plant Services

Hercules has built one of the largest fleets of suction excavators in the UK, almost doubling the size of the fleet to 30 vehicles during the year. Divisional revenue increased by 34% to £4.9m. Post year-end Hercules sold its two oldest suction excavators, taking the fleet size to 28.

Following the delivery of new vehicles in March 2023, utilisation reduced temporarily from its previous high of c.85% to c.66%, before increasing again to c.75% and rising. This inevitably impacted margins in the division in the short term in the interests of longer-term returns. The team is said to have worked well on business development and a new approach to recruitment to source operators for the vehicles. New clients for the division in the year include Amey, Keltbray, RSK and Tideway, whilst utilisation has increased through several existing clients, including M&J Evans, Anglian Water, Costain, Skanska, Milestone, Tilbury Douglas and Kier.

Civil Projects

FY23 was also another strong year of growth for the Civils division. Divisional revenue increased by 27% to £15.7m.

As in previous years, the division successfully supported clients in the water industry with repeat work under the AMP7 programme. The division also reported an increase in the size of its projects. Eight projects with a value over £1m were started or completed at various sites for clients such as Galliford Try and Mott Macdonald Bentley. In addition to this, the division also completed two projects in the gas industry for TGE and SGN.

Recent acquisition confirms strategic ambitions

On 30th November, Hercules announced its first acquisition, acquiring 60% of Future Build Recruitment, a specialist white-collar recruitment company operating in the UK construction sector. Total consideration was £1.25m and the deal was immediately earnings accretive, as well as looking strategically sensible. For more detail, see our note on the deal here: Building for the Future.

We expect targeted M&A to be a recurring element of Group strategy over the medium term.

Updating forecasts to reflect growth and margin outlook

FY23 outturn ahead of expectations

We upgraded our FY23 forecasts in October on the back of a positive year-end trading update, which highlighted good organic progress in all three divisions. Hercules continues to benefit from the strength of UK infrastructure activity (see following page), despite the more challenging economic backdrop, and we expect this to continue.

In this context, the outperformance in today's results is all the more impressive, with revenue 5% ahead of our expectations (reported revenue was £84.7m versus previous guidance of at least £80m), adjusted EBITDA was 11% ahead of our forecast and adjusted PBT 83% ahead of forecast.

Net debt also came in lower than expected at £22.8m.

Forecast review – comfortably outperforming in FY23

Year-end Sept	2023(A)	2023(E)		2024(E)	2024(E)		2025(E)	2025(E)	
	Actual	Forecast	Change	Revised	Old	Change	Revised	Old	Change
Revenue £m	84.7	80.5	5.2%	94.7	83.7	13.2%	100.1	90.2	11.0%
EBITDA £m	4.1	3.7	10.9%	4.4	4.7	-6.4%	4.8	5.9	-17.4%
PBT (underlying) £m	0.9	0.5	83.5%	0.7	1.3	-46.7%	1.1	2.5	-54.2%
EPS fully diluted p	1.7	1.7	-1.5%	0.9	1.9	-51.6%	1.6	2.7	-42.4%
Dividend	1.7	1.7	0.0%	1.7	1.8	-1.7%	1.7	1.8	-4.4%
Net cash/ (debt) £m	-22.8	-25.4	-10.2%	-22.8	-25.3	-9.8%	-20.9	-23.1	-9.7%

Source: Equity Development estimates

FY24/FY25 revenue upgrades, PBT reflects higher interest charge

The strong conclusion to FY23 supports double digit upgrades to FY24 and FY25 revenue forecasts, although it is still relatively early in the new year.

We do, however, temper our profit forecasts to reflect ongoing investment (e.g. in the new training academy) and, particularly, an increase in our net interest assumptions. Overall, our FY24 net interest forecast has increased by £0.5m to reflect the cost of funding the suction excavator fleet as well as the recent Future Build acquisition.

Taken together, this reduces our FY24 PBT forecast by £0.6m or 47%. At this stage, we prudently assume a similar percentage impact in FY25.

We assume a consistent dividend is paid across the forecast period. On current estimates the dividend is not fully covered by forecast earnings, but we fully expect earnings to rebuild over time, ultimately exceeding the FY23 outturn.

In our view, Hercules' share price performance does not reflect recent strong progress. Hercules is trading on an FY25 P/E rating of c.16x and a dividend yield of 7% with scope for good earnings growth over the medium term.

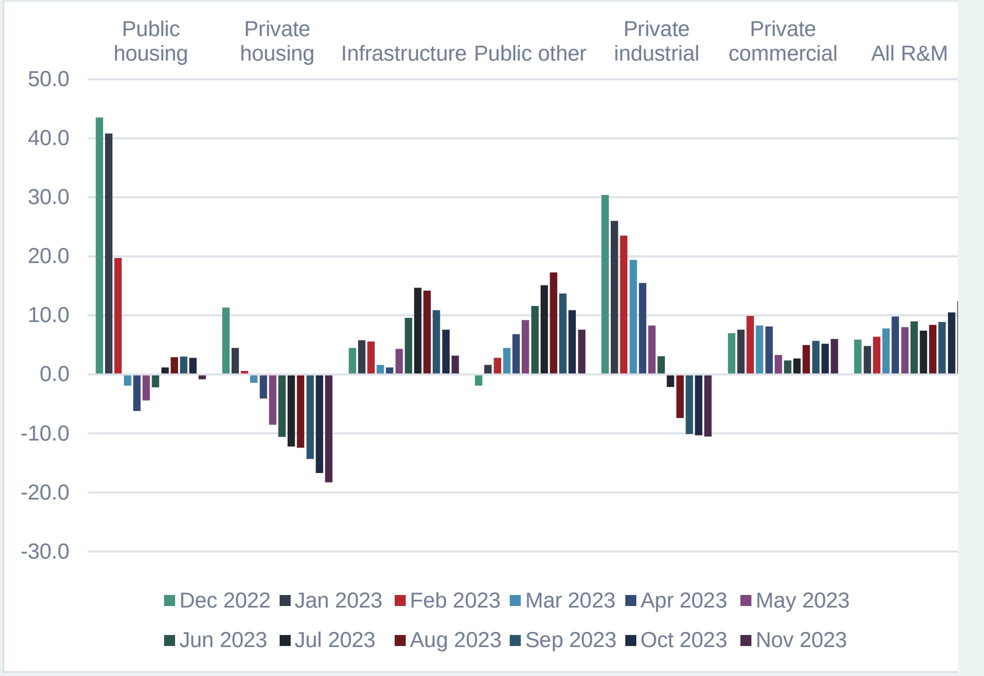
Our new Fair Value / share estimate is 55p (from 60p), representing an FY25 EV/EBITDA rating of c.11.5x.

Key market indicators remain supportive

As highlighted in our initiation note, two of the most important market indicators for Hercules are the ONS construction data (infrastructure) and construction employment vacancies.

Whilst construction output is being held back by weakness in private housing construction, infrastructure remains supportive, with a positive reading over every month for the past year (table below shows output for a three-month period versus prior year).

ONS construction output (volume % change versus prior year)



Source: ONS

Construction vacancies remain relatively high by historic standards, albeit they have fallen from their recent peak.

All vacancies in construction industry ('000s)

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	-68.3	-77.9	-81.7
% growth	-	*40%*	*53%*	*72%*	*14%*	*5%*
% of revenue	*81%*	*80%*	*80%*	*81%*	*82%*	*82%*
Gross profit	**4.3**	**6.7**	**9.8**	**16.3**	**16.8**	**18.4**
% growth	-	*55%*	*46%*	*67%*	*3%*	*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	-5.3	-5.5	-5.6
% of revenue	*4%*	*5%*	*6%*	*6%*	*6%*	*6%*
Central admin expenses	-2.8	-3.7	-5.4	-8.8	-8.9	-9.7
% of revenue	*12%*	*11%*	*11%*	*10%*	*9%*	*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%*	*5%*	*5%*	*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%*	*14%*	*14%*	*17%*
% margin	*4%*	*5%*	*2%*	*3%*	*3%*	*3%*
Fair value gains	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	0.0	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**	**0.7**	**1.1**

Source: Company historic data, ED estimates

Note that we reflect a change in the way Hercules presents its CITB levy* between FY23 and FY24 (effectively moving this cost from admin expenses in FY23 to cost of goods sold (COGS) in FY24). This is the principal reason for the apparent reduction in gross margin between FY23 and FY24.

*The CITB levy is imposed by the Construction Industry Training Board on all employers ‘engaged wholly or mainly in construction industry activities’ at a rate of 0.35% for PAYE and 1.25% for CIS contractors.

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	0.0	0.0
Other non-cash	0.0	0.1	0.1	0.0	0.0
Working Capital Movement	-3.1	-7.1	-0.1	-0.2	0.5
Operating Cash Flow	**-1.6**	**-5.3**	**3.8**	**4.2**	**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**	**2.5**	**3.4**
Purchase of PPE	-0.4	-0.2	-0.4	-0.4	-0.4
Proceeds from sale of PPE	0.0	0.5	0.2	0.0	0.0
Total Net Capex	-0.3	0.3	-0.2	-0.4	-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	19.2	17.8
Goodwill/ Other intangibles	0.1	0.0	0.0	0.0	1.0	1.0
Sub-total NCAs	6.7	9.2	14.6	20.8	20.2	18.8
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	23.8	24.8
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	4.6	5.0
Sub-total CAs	11.0	10.1	19.3	26.9	28.5	30.0
Total Assets	**17.7**	**19.4**	**33.9**	**47.7**	**48.7**	**48.8**
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	-13.5	-14.2
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	-30.3	-31.8
Non-current liabilities						
Deferred tax liabilities	0.0	-0.4	-0.3	-0.2	-0.3	-0.3
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	-10.3	-8.8
Total Liabilities	**-10.9**	**-15.9**	**-27.1**	**-39.0**	**-40.6**	**-40.6**
NET ASSETS	**6.8**	**3.4**	**6.8**	**8.7**	**8.1**	**8.1**

Source: Company historic data, ED estimates

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