Hercules Site Services

Driving growth through innovation

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Driving growth through innovation

Hercules Site Services is an innovative, entrepreneurial and high-growth business with a focus on the UK Infrastructure market. The core business is labour supply, where Hercules has built a reputation as a trusted partner to an impressive blue-chip client list. Hercules has also expanded its offering in recent years into complementary construction services, namely civil projects and specialist equipment hire. Growth to date has been highly impressive (three-year revenue CAGR 50%) and demand is underpinned by a favourable outlook for infrastructure spending, a structural undersupply of skilled labour and recent organic investment in technology and fleet expansion. We believe full year earnings forecasts are conservatively positioned and see Fair Value at 60p per share. We initiate coverage with firm conviction.

Excellent track record of growth

Hercules was founded in 2008 and has grown to become a trusted partner to blue-chip clients in the UK construction sector. Revenue growth is running at 50% per annum, all organic, and momentum has been sustained in the current year (interims reported 5th June).

Infrastructure investment underpinning demand

Infrastructure investment has been a key driver of the recovery of the construction industry post COVID and the medium-term outlook is well underpinned by major projects, not least HS2, with Phase One (London to Birmingham) approaching peak activity over the next three to five years.

Addressing a structural skills shortage

The construction industry is facing a structural skills shortage and job vacancies have risen sharply over the past two years. This has created robust demand for Hercules' core services and the business has responded by investing in workforce training to address the supply/ demand imbalance.

Innovation and investment in technology

Hercules' innovation and investment in digital (including the Construction Jobs app) is a differentiator in the industry, increasing employee engagement and helping to secure major labour supply projects.

Growth trajectory and forecast cash flow point to 60p Fair Value

Following the sizeable investment of the past two years, the FCF yield is, on our forecasts, set to increase significantly from next year to 10%. In our view, this gives a good indication of the value in the shares. **We apply a 7.5% FCF yield to FY25E to establish our Fair Value per share of 60p**.

Key Financials & Valuation metrics

Year-end Sept, £m	2020A	2021A	2022A	2023E	2024E	2025E
Sales	23.0	32.8	49.5	74.1	82.4	88.8
EBITDA	1.4	2.4	2.3	3.4	4.5	5.5
Adjusted PBT	1.0	1.4	0.7	0.2	1.0	2.0
FD Adj. EPS (p)	N/A	N/A	1.5	1.4	1.6	2.4
DPS (p)	N/A	N/A	1.7	1.7	1.8	1.8
Net Cash/(Debt)*	(4.0)	(9.2)	(18.2)	(25.6)	(24.8)	(23.0)
Net Cash/(Debt)**	1.7	(1.7)	(5.3)	(6.6)	(6.6)	(6.0)
Net Debt**/EBITDA	N/A	0.7x	2.4x	1.9x	1.5x	1.1x
P/E	N/A	N/A	21.4x	23.5x	19.5x	13.4x
EV/EBITDA	17.4x	12.1x	17.0x	13.3x	9.9x	7.8x
EV/Sales	1.0x	0.9x	0.8x	0.6x	0.5x	0.5x
Dividend yield	N/A	N/A	5.4%	5.4%	5.5%	5.6%
FCF yield	N/A	N/A	(29.6%)	(2.5%)	9.6%	14.5%

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

Company Data

EPIC	HERC.L
Price (last close)	32p
52 weeks Hi/Lo	73p/32p
Market cap	£20.0m
ED Fair Value/ share	60p
Proforma net cash/ (debt)	(£25.6m)
Avg. daily volume	32,198

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 £49.5m in FY22. The business floated on AIM in 2022 to provide access to capital to support the next stage in the Group's growth plans.

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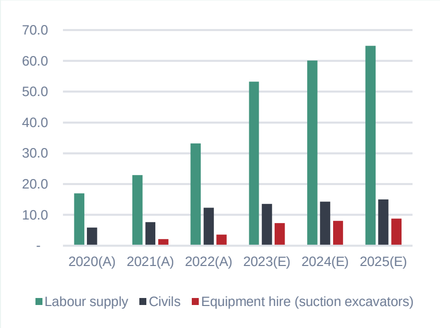
herculesplc

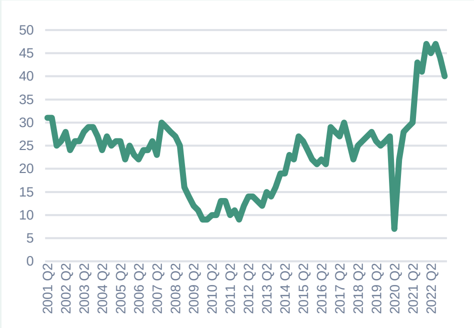
Introduction to Hercules Site Services

Hercules Site Services is a leading supplier of skilled labour to the UK construction industry. It is delivering excellent growth as a result of its industry-leading technology and service levels. Whilst still quite a young business, Hercules has added significant scale over recent years, investing in senior hires, technology and equipment to sustain growth momentum. It has established a reputation for working collaboratively with customers to improve working practices and promote the health and wellbeing of the workforce.

Revenue by division (Labour the key driver)



All UK construction vacancies ('000s)



Source: Company, ED forecasts, ONS data

After reporting strong interims (5th June '23), Hercules looks well placed to deliver another year of 50% revenue growth (or more) driven by activity on some of its larger projects, notably labour supply for HS2 Phase One, where work is now well underway. Hercules is increasing its market share with some of the UK's largest construction companies, whilst benefiting from significant government commitments to infrastructure investment to maintain and upgrade rail and road networks and water systems. At the same time, Hercules is addressing a structural undersupply of skilled labour, using technology to identify the best people in the right location and tackling the underlying issues through a new training academy (to improve the skills and knowledge base) and health screening (to identify issues and support the existing workforce).

Investment Highlights	Risk Factors
• Excellent track record of revenue growth • Attractive focus on infrastructure sector • Record demand for construction workers • Strong reputation in the market • Highly entrepreneurial culture • Leading the industry in digital innovation • Increasing presence on larger projects • Strong ESG positioning	• Cyclical nature of construction industry • Limited track record as listed company • Client concentration • Attraction and retention of key personnel • Availability and pricing of materials • Civils contract performance and dispute • Relatively low operating margins
Forecast Drivers	**Valuation Overview**
• Revenue growth running at c.50% p.a. • Consistent gross margins of c.20% • Operating margins strengthening with scale • Strong cash generation over FY24E/FY25E • H2'23 expectations prudently positioned • Progressive dividend policy	• Growth profile unique amongst listed peers • Sector ratings reflect concerns over economic outlook • Dividend yield of 5% is an attractive level • 60p Fair Value implies FCF yield of 7.5% (FY25E) • Earnings multiples will become more relevant as business matures

Company strapline:

'Together with our clients and our workforce, one vision, one team, one solution'

Company Overview

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 £49.5m in FY22 (with a further 50% forecast for FY23). The business floated on AIM in 2022 to provide access to capital to support the next stage in the Group's growth plans, whilst improving the company's profile with all stakeholders.

Hercules has a highly entrepreneurial culture and an ambitious management team. This has seen the Group's services expand into complementary areas over recent years. As well as adding new, profitable revenue streams and new clients, this has strengthened existing client relationships, enabling the Group to participate in increasingly large projects.

Hercules' Head Office is in South Cerney, near Cirencester in Gloucestershire and the Group has a national focus in terms of the projects delivered.

The Group listed on the AIM market in February 2022, raising £4m (£2.7m net) at a price of 50.5p per share to support investment in the Group's growth, alongside a modest sell-down by the main shareholder (7.9m shares). This made Hercules one of a small number of companies to list successfully in 2022, a more challenging year for capital markets.

The IPO proceeds have been used to part-fund capital investment, to provide working capital for the HS2 project, including labour ramp-up, as well as training and upskilling costs and investment in the digital offering.

A follow on fundraise in February 2023 raised a further £1.7M at a price of 45p to support further working capital investment. The net proceeds of the placing are to be used to provide working capital to support organic growth in the labour supply business. The placing received support from new and existing investors.

Strategy delivering strong organic growth in Labour Supply

The strategy is to continue to grow the core Labour Supply business at pace, to capitalise on the significant investment in infrastructure in the UK over the next decade. Hercules has established a strong, blue-chip client base and has potential to grow with its existing clients, whilst also adding new clients as its reputation and profile increase.

Growth to date has been entirely organic and there is no shortage of opportunities to sustain this momentum. That said, management has ambitions to supplement organic growth with selective M&A to accelerate the growth of Labour Supply into new areas, whether geographical or sectoral.

Broadening the service offering

The strategy for the complementary Construction Services businesses (civil projects and specialist equipment hire) is one of consolidation and carefully managed growth. The next 18 months will see an increasing contribution from the hire fleet of suction excavators (see page 8), following a period of significant investment, with the final 10 suction excavators received in March '23.

Growing with an impressive client list

Hercules has numerous framework agreements with some of the largest construction companies operating in the UK including Balfour Beatty, Costain, Kier, Skanska, Dyer & Butler and Volker Fitzpatrick. The framework agreements enable Hercules to collaborate with clients on multiple projects with good visibility of its clients' project pipeline.

Typically, the Company will go through a tender process involving numerous rounds of interviews, assessments, presentations and submissions before securing a strategic partnership or an individual project contract.

The relationship with Balfour Beatty is an excellent case study in the Group's ability to grow with its key clients. In 2015, Hercules was awarded a £3.4m labour supply contract for the M3 Smart Motorways project with Balfour Beatty, later becoming a strategic partner to Balfour Beatty Highways. In 2018, the Company began working for the Balfour Beatty Vinci JV on the M4 Smart Motorways scheme, the UK's largest infrastructure projects at the time.

In August 2021, the Company was selected as one of six labour supply partners for the Balfour Beatty Vinci JV constructing the northern section of HS2 from London to Birmingham (Phase One). The Directors believe the Company's use of digital technology in the recruitment and on-boarding of workers was a key factor in securing this business. This has been a major driver of revenue growth in the current year to date, which should continue over at least the next four years. At the recent (5th June '23) interim results, Hercules reported that it currently has 400 operatives on site (H1'22: 180) and that it is providing additional labour every week in response to increasing demand, leveraging the digital platform. Hercules is one of the six companies making up the labour desk, which it is anticipated will collectively provide at least 4,000 workers during the project.

Roads remain a very important area of activity and Hercules is a key supplier on National Highways Regional Development Projects across the A63, A57, A30, A2 and A12 as well as motorway upgrades including the M3 and M4. Future client projects of note include the A66 Trans-Pennine route, A303 Stonehenge, the New Tees Crossing and the Lower Thames Crossing.

For the Water industry, Hercules is now working on AMP7 projects for Thames Water, Southern Water and Anglian Water as activity on this phase of the regulated spending programme increases.

Selection of Hercules clients

COSTAIN	BLACK & VEATCH	anglianwater	GallifordTry
GRUNDFOS	Thames Water	HS2 Balfour Beatty VINCI	SKANSKA
HOCHTIEF	KIER	BLACKWELL Earthmoving	VolkerFitzpatrick

Source: Company

Labour Supply Division

Overview and recent performance

Labour Supply is the Group's core business. Hercules is a trusted provider of skilled and qualified labour to a growing blue-chip client base working on infrastructure, civil engineering, utilities, groundworks, highway and rail projects. This is the original Hercules business and it has grown consistently, winning market share through a reputation for excellent service, its highly regarded and experienced management team and its leading technology platform. Access to skilled labour is a longstanding industry challenge, which is showing no signs of abating and Hercules is trusted to provide its clients with skilled and qualified local labour, quickly and efficiently.

Hercules' pool of labour comprises diverse skills and experience such as ground workers, carpenters, bricklayers and site engineers in order to meet the requirements of its clients. The majority of the operatives placed are temporary workers, although many are directly employed by Hercules and in many cases operatives will be working on longer term projects.

Hercules is constantly looking to enhance its offering and has introduced two fledgling income streams in the past year, namely the supply of security personnel and white-collar workers (placing permanent job roles such as section engineers and site managers). Both of these offerings have seen early success with security personnel placed on the M42 and the provision of white-collar workers to Galliford Try. Experienced managers have been hired in both business areas to drive growth.

In the 12 months pre-IPO, Hercules supplied on average between 400 and 500 operatives to projects each day, ranging from only a handful of staff through to 140 operatives deployed on the M4 project with Balfour Beatty Highways. The HS2 project has taken this up another notch, with 400 operatives working on this project alone during H1'23. Management estimates that the Group is supplying up to 25% of the workforce on this project.

As of March '23, the division was supplying 875 operatives (approximately 46:54 directly employed: contract labour). In addition to the operatives within the Labour Supply division, Hercules employed 91 Head Office professionals across client relations, recruitment and onboarding, health and safety, site management etc.

Hercules operatives working on HS2

Source: Company website

Construction Services

At the same time as driving excellent organic growth in the Labour Supply business, **Hercules has expanded into complementary construction services**, namely Civil Projects and Specialist Plant (having identified an opportunity to modernise certain construction techniques in partnership with Hercules' clients). These businesses are smaller than the Labour Supply business but are important in terms of supporting Group revenue and margin growth, and in adding greater depth and stickiness to key client relationships.

Civils – overview and recent performance

The Civils division provides end-to-end project delivery for civil engineering contracts. The business is highly selective in the work it takes on and has a particular focus on the water industry, which is backed by multi-year government spending programmes. The business has grown through new client acquisition including an 18% increase in new clients in 2022. The strategy is for cautious growth and driving cross selling opportunities with other areas of the Group.

Contracts follow a competitive tender process and are typically fixed fee in nature. Risk is mitigated by the experience of the Hercules team, the focus on repeat work with existing clients and on sectors - such as water - in which Hercules has a very strong reputation and track record. The package of work may include site scoping, planning, the provision of labour (using the Labour Supply division to supplement the existing Hercules workforce), plant and materials, engineering support and site supervision. There is a dedicated team of project managers/ supervisors, numbering 13 at the end of March '23. This core team manages an onsite workforce in the Civils division of just over 100 CIS contracted workers.

The business has seen a very high level of demand from the water treatment sector in the first half of the current year, resulting in a very successful H1'23 and a 30% increase in revenue. New clients secured during the period include Amey and SGN. The outlook for the second half looks to be similarly busy and the business has also recently commenced working in Kent and the Midlands laying fibre broadband.

Civils project – Groundworks, Avonmouth

Source: Company

Specialist Plant – overview and recent performance

Hercules has built one of the largest fleets of suction excavators in the UK. These are available for clients to hire on their construction projects across any of Hercules' main sectors.

Operated by Hercules' own crews, the suction excavators are vehicles that can safely remove significant quantities of materials or debris from an excavation site, while reducing the risk of striking existing gas or water pipes. Using high powered suction fans, the operator sucks up materials up to 100mm in diameter through the air intake suction nozzle, operated safely by remote control. Excavated materials are deposited directly into the collection chamber on-board the vehicle, and the air deflected through the air outlet chambers to clean, dry and remove finer particles. The collection chamber can then be discharged. As well as reducing the risk of utility and cable strikes (and therefore reducing the risk of expensive project delays), the excavators have significant benefits in terms of health and safety of the workforce (lower manual input), environmental impact (fewer vehicle movements, improved waste management) and overall efficiency.

Working closely with one of its clients, Hercules has also developed the novel "Zero-Trim" method for clearing the excess concrete from a concrete pile while still wet using a suction excavator. This innovation is attracting significant interest as a much neater alternative to the established (but inefficient and messy) technique of pile cropping. Traditionally, the concrete is overpoured and then site teams have to trim the excess concrete with jack hammers, which can cause health problems, including hand-arm vibration syndrome, hearing loss and silicosis. The 'Zero-Trim' method has been successfully rolled out onto the HS2 project and, in conjunction with Hercules' partners, has won three industry awards (including for health, safety and wellbeing initiative of the year at The British Construction Industry Awards 2021).

Utilisation of the fleet has typically been an impressive c.80% and Hercules has bult a strong team to manage growth in this area. At IPO in February 2022, Hercules owned nine suction excavators and this has now increased to 30 (as of March '23) including a number of state of the art "triple fan" excavators.

After a period of rapid growth and investment, the fleet is considered to be at an optimal level to service clients and we expect utilisation of the new suction excavators to build over coming months. The strategy here is to focus on increasing utilisation and, again, to deepen existing client relationships through a breadth of service offering. There is no intention to broaden out to other areas of specialist equipment hire.

Suction excavators on site ("Zero-Trim" works)

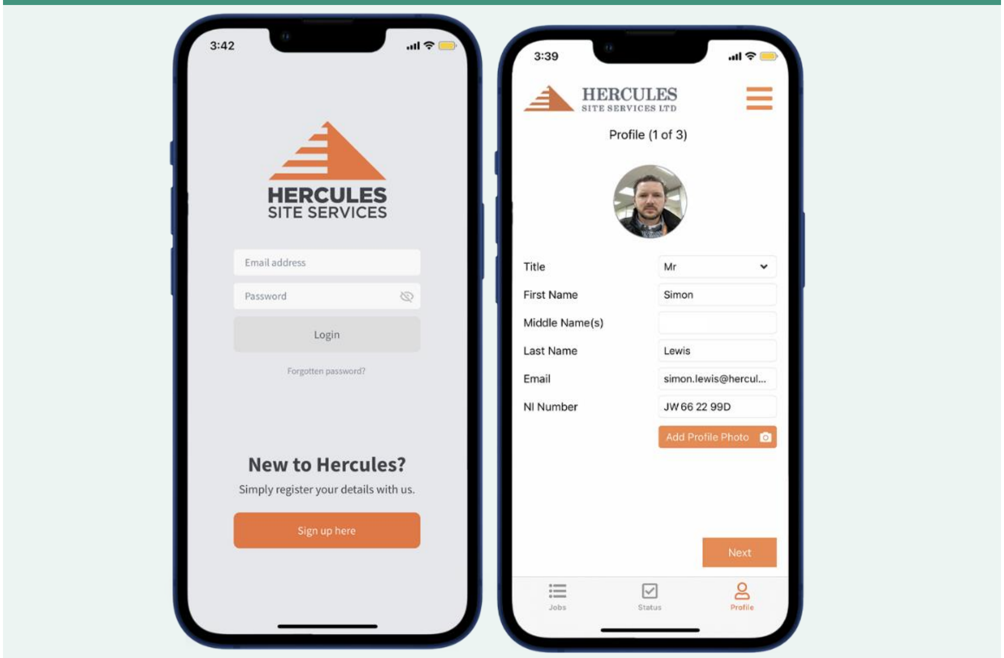
Source: Company website

Leading the industry in digital innovation

Hercules' innovation and investment in digital solutions is a clear differentiator in the industry, supporting strong employee engagement and helping the Group to secure major labour supply projects. The initial focus has been on developing software and apps to drive activity through the business and improve employee and client experience by migrating cumbersome paper-based processes to apps on workers' mobile phones. The business is now moving into a second phase in identifying opportunities to monetise its IP through licensing its software to clients. The first of these is the SEE Everything Portal, which we discuss in more detail on page 11.

Hercules is vigilant to cyber security threats. The company is Cyber Essentials accredited and is working towards ISO 27001, the leading international standard focused on information security.

User-friendly mobile solutions



Source: Company website

Hercules Construction Jobs – mobile recruitment app

Hercules' Construction Jobs app can be downloaded from the Apple App Store or Google Play. It is a user-friendly recruitment tool, where construction workers can log their skills and qualifications and search for tailored opportunities in their local area in real time. Employment opportunities are uploaded to the app together with qualification requirements, timing and location of the opportunity and hourly pay rate, while workers can filter the jobs on offer to find a suitable role.

The app improves the efficiency of the recruitment process compared to traditional methods, enabling users to quickly complete their registration, upload their credentials and find appropriate work. Other benefits for employers include increasing the number of local hires, providing accurate information on a project-by-project basis and helping with the induction process. Local job creation and recruitment is becoming increasingly important to Hercules' clients as part of their ESG commitments.

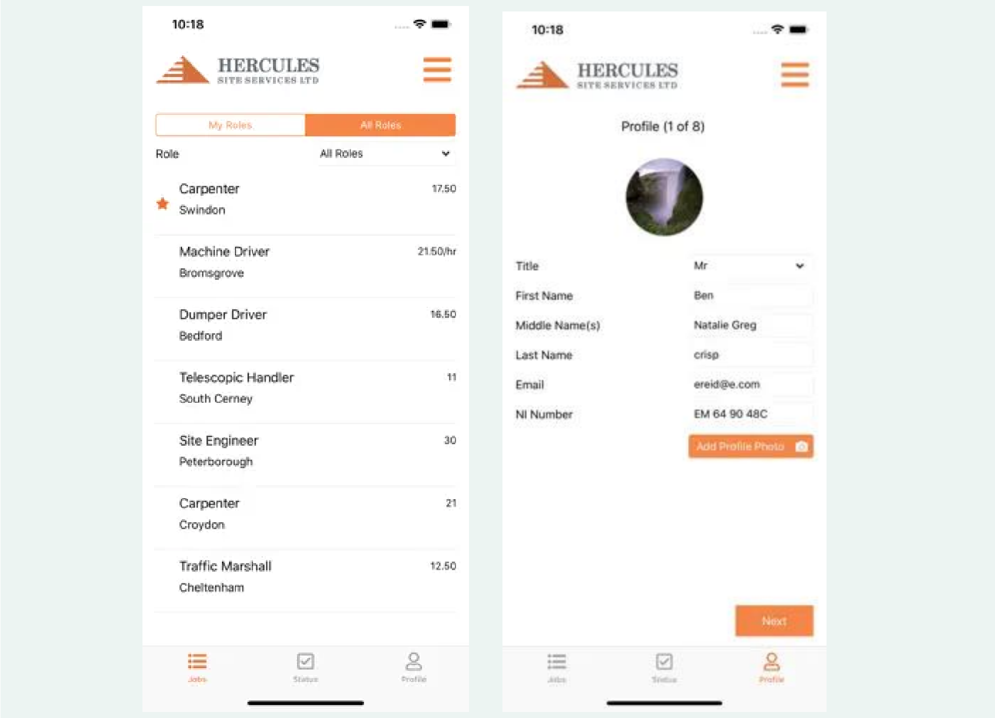
Alerts can be set, so that users receive a notification when job opportunities aligned to their requirements are posted. The in-app messaging platform enables users to be contacted directly, enabling flexible direct communication between users and recruitment teams.

Engagement with the app has been excellent and it has won numerous awards for innovation in the industry including from "Constructing Excellence" and O2 and has been recognised by the Considerate Constructors

Scheme as an example of best practice. In particular, the app has been recognised for engaging employees through better digital connectivity and for its excellent uptake and engagement by target users.

At the time of the FY'22 results last December, the app had more than 8,100 downloads and more than 4,700 registered users.

Hercules Construction Jobs app - screenshots



Source: Hercules app

Hercules One Team (Onboarding) app

Once an individual has been placed in a particular role, Hercules "One Team" app handles the complete onboarding of new workers, using digital signatures and online handbooks to avoid lengthy and cumbersome paper trails. This saves time and money in the onboarding process and ensures full compliance in terms of right to work documentation. The integrated e-sign solution ensures that workers have all the necessary documentation before they begin work on site and ultimately means workers can get on site earlier as a result of the streamlined process.

One Team was launched in 2021 and was developed in conjunction with Hercules' workforce, operations and HR teams to bring the onboarding experience in line with the increasingly online/ mobile lives of the workforce. Using the data collected during the registration and recruitment phase (within the Construction Jobs app), the One Team app allows users to upload copies of their right to work documentation, training certification and other relevant documentation. This saves time and avoids duplication and allows the recruitment team to carry out verification checks earlier and more efficiently, whilst reducing the risk of human error.

Since its launch, 95% of individuals recruited through Hercules Construction Jobs have been onboarded through Hercules One Team.

Bringing it all together: Proprietary management portal

All of the data and activity on the apps is brought together and administered by the Hercules recruitment team through a web-based management portal. This allows real time monitoring of all open roles, the availability of the workforce and the status of individual clients/ projects. There are large screens in the control room at Head Office tracking live roles and the workforce on an interactive map of the UK,

The management portal is integrated with both apps, allowing real-time updates to a user's information which can be viewed immediately by the recruitment team. This provides a live overview of all activity as well as building a valuable database of hours worked by project, broken down by trade and by cost to support effective review of project performance.

The portal is integrated with financial systems, and automatically produces accurate timesheets, payroll reports and invoicing.

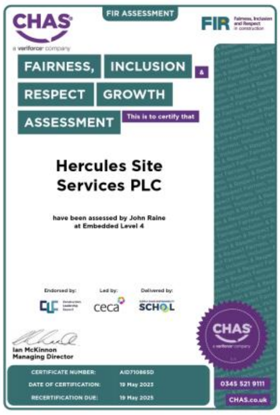
Skills, Employment and Education ("SEE") Everything Portal

Early in the current financial year (FY'23), Hercules launched its Skills, Employment and Education ("SEE") Everything Portal, which has been developed in conjunction with the Balfour Beatty Vinci joint venture for HS2. This in an industry-leading innovation, collecting accurate data to measure and evidence benefits to the wider community from large-scale construction projects. This is increasingly important to Hercules' clients as a key part of their ESG commitment.

The SEE Everything Portal allows clients to monitor their Social Value and community activity and easily report on progress. This can include upskilling the local workforce, providing careers advice and education in local schools, as well as directly creating jobs for the duration of the construction project.

Following successful trials, Hercules has now entered into a licence agreement for the implementation of the SEE Everything Portal at the Old Oak Common regeneration project in West London. Management considers this licensing agreement a significant milestone in Hercules' strategy to monetise its digital tools for major projects.

Selected Accreditations



Strong ESG Positioning

Hercules has a keen focus on ESG, which is particularly visible in the Group's charitable and community projects with a focus on areas where clients are working on major construction projects. This is regularly well documented across the Group's social media channels. Hercules also helps its clients to promote their own Social Value via the SEE Everything Portal, as covered on the previous page.

Hercules' Environmental target is to achieve net zero by 2050 in line with Construction Leadership Council industry targets. The Group has mechanisms in place to record scope 1 and 2 emissions and aims to further develop data collection for scope 3 emissions as it targets substantial carbon reductions year on year.

More fundamentally, as a labour supply business, Hercules is helping to provide employment and education to a diverse workforce. Hercules actively seeks to source candidates from diverse channels such as ex-military, ex-offenders, BAME and other hard to reach communities. Hercules has won awards for its success in hiring from the ex-military community including the Employer Recognition Scheme (ERS) Gold Award for its work with the Armed Forces community and veterans.

Hercules' Mobile Health Screening trailer is a great example of its commitment to the health and wellbeing of its workforce. It can be deployed across the country and is staffed by certified healthcare professionals to assist on-site in a variety of health and wellbeing areas (vision and hearing tests, safety critical medicals, heart and blood pressure testing and lung function testing, mental health support). The trailer is made available more widely to Hercules' clients. Whilst on site at the M42, two operatives were identified as having high blood pressure, one at abnormally high levels, resulting in immediate transportation to the hospital, where he was successfully treated, highlighting the importance of this monitoring programme.

Mobile health screening trailer

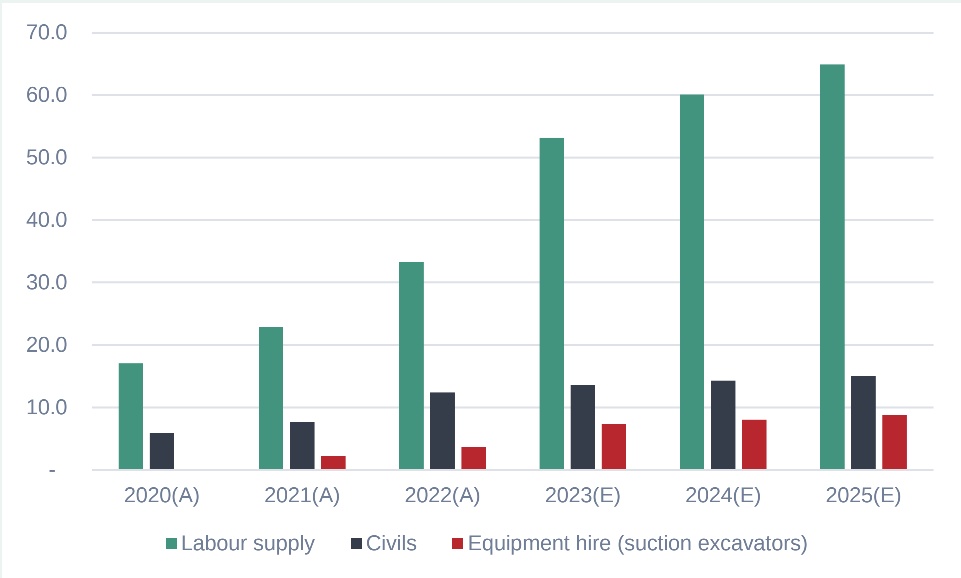
Source: Company

A dedicated Safety, Health, Environment & Quality Team carries out regular audits of the company's procedures and Hercules' systems are under constant review by external bodies. Hercules has several working groups to support its ESG commitments including a CSR Working Group, Mental Health Steering Group and Carbon Management Committee.

Financial KPIs – excellent growth; consistent margins

The Group comprises two divisions, Labour Supply and Construction Services, Labour Supply being by some distance the largest in terms of revenue and gross profit contribution. The two components of Construction Services (Civils and Equipment hire/ suction excavators) are also reported individually. Organic revenue growth has been running at 50% per annum over recent years, reflecting excellent contract win momentum, market share gains with larger customers and the introduction of new services, most notably the addition of the suction excavator fleet.

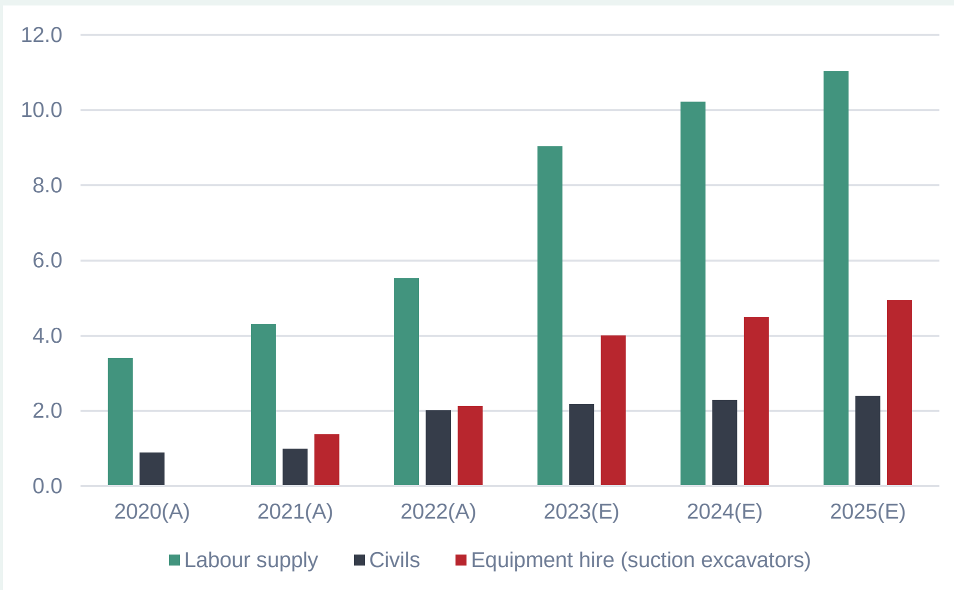
Revenue by division (Labour supply the key driver)



Source: Company, ED forecasts

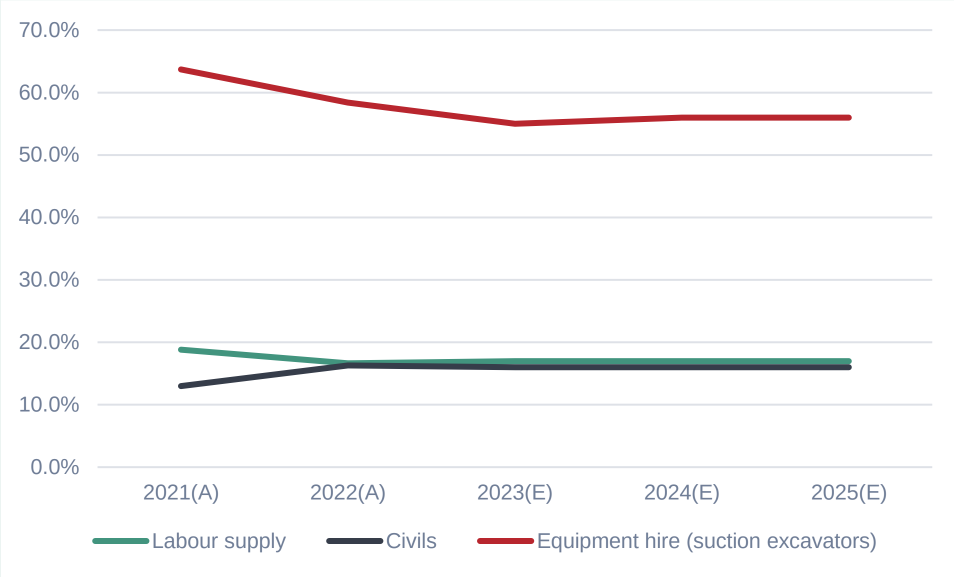
Gross profit has largely tracked the revenue trend, with a fairly stable margin profile, as shown on the following page.

Gross profit by division



Source: Company, ED forecasts

Gross profit margin by division



Source: Company historic data, ED forecasts

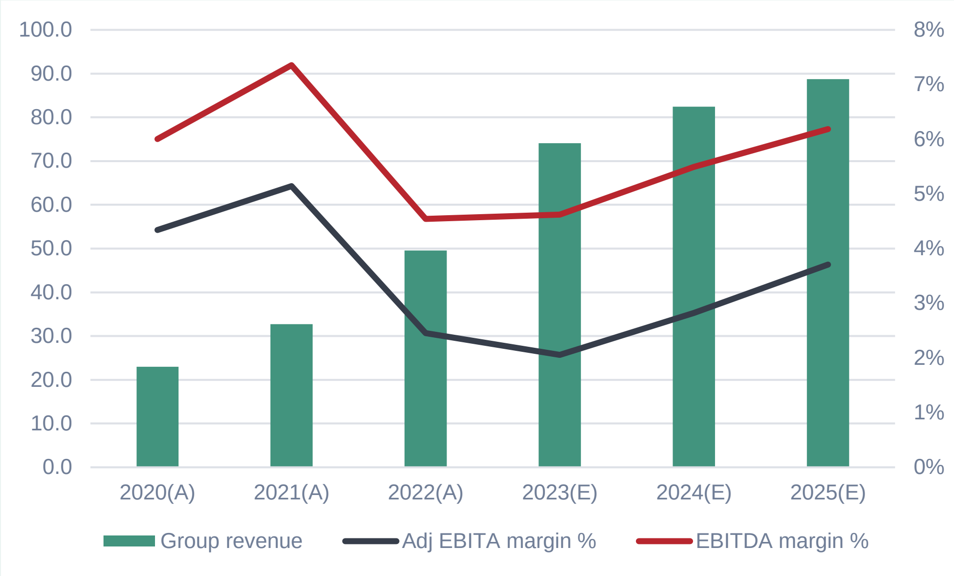
Gross margins are stable and have been predictable across the three divisions, generally in the high teens for Labour Supply and Civils, and between 50% and 60% for equipment hire. These are representative of their respective industries, and we expect similar margins over the forecast period.

For Labour Supply, revenue represents the total wages and other costs to the customer of the employee/ contractor whilst gross profit represents the net fee income received by Hercules (net of the payment to the employee/ contractor). Gross profit therefore represents the difference between the rate paid by the client and the sums it pays to its employees and contractors. This is standard reporting for the labour supply industry and gross profit, or net fee income is a key measure of the value accruing to Hercules.

In order to staff the projects, Hercules uses a mix of Construction Industry Scheme (CIS) contractors as well as its own employees in order to flex cost of sales. CIS contractors are temporary workers in the construction industry that move from project to project. As of March '23, there were 405 employees under PAYE in the Labour Supply division and 470 CIS contractors. Within Civils, there were 13 PAYE employees and 105 CIS contractors.

In FY22, with the Group carrying a greater level of investment, the EBITA margin (operating margin) was 2%, lower than the 5% achieved in recent years. We expect EBITA margins to recover towards historic levels as the business adds scale and achieves a return on recent investments.

Group revenue and EBITA/ EBITDA margin profile

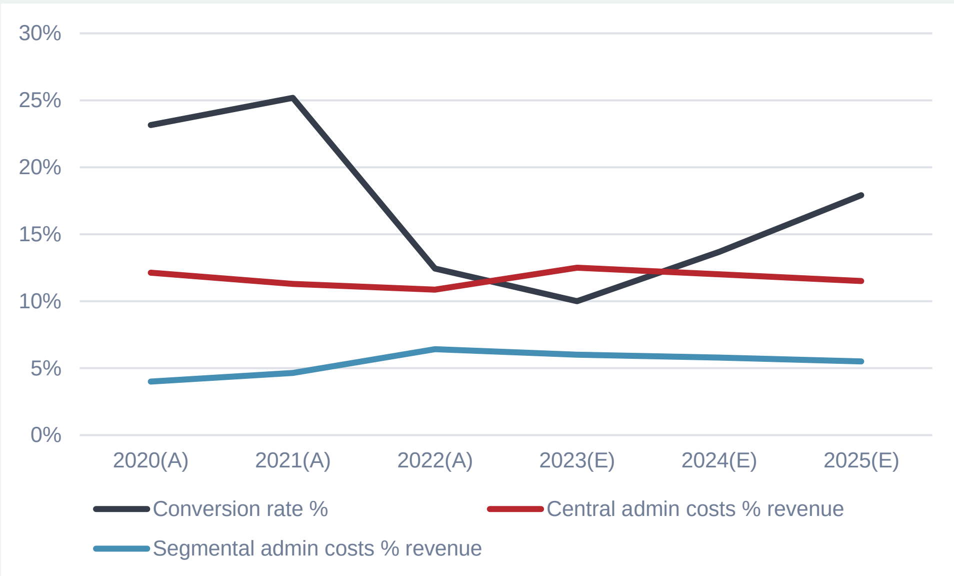


Source: Company historic data, ED forecasts

In terms of group level KPIs, we track central costs as a percentage of revenue as a measure of overhead efficiency, as well as the "conversion rate", which is calculated as operating profit divided by gross profit. Conversion rate is a common measure of performance in the recruitment sector. Hercules is a business that has invested in personnel, capital equipment and technology to support future growth plans. We therefore expect the benefits of this to be seen over coming years as the overhead percentage decreases and conversion rate increases.

We note that conversion rate is an imperfect measure given the blend of businesses within the Group (not a pure labour supply Group) but we still consider the trend to be informative and of interest to investors.

Efficiency and profitability metrics improving

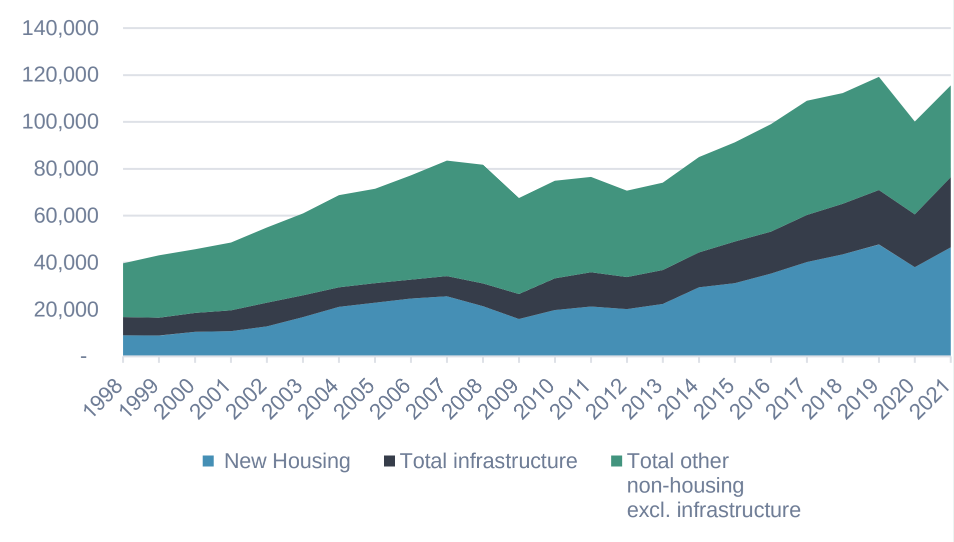


Source: Company historic data, ED forecasts

Construction industry – delivering long-term growth

The construction industry is one of the largest drivers of the UK economy. Although demand tends to be cyclical, particularly for residential and commercial construction, the long-term picture is positive, supporting economic growth and job creation. The industry employs between 2 and 2.5 million workers in the UK.

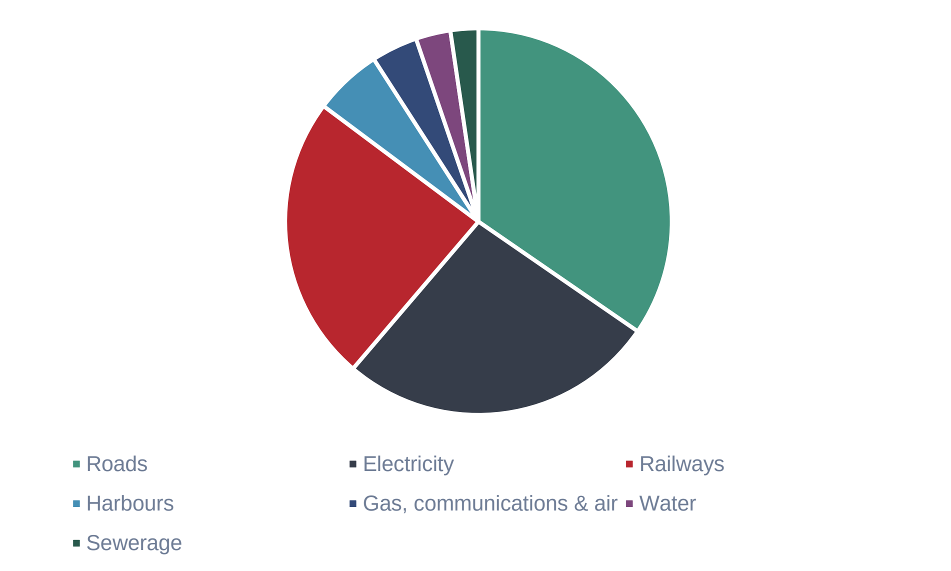
Value of construction output by type of work (£m)



Source: ONS

Infrastructure investment is an important component of overall construction output and tends to be less vulnerable to short term cyclical swings. Investment is generally committed several years ahead, particularly on large projects, providing good visibility for contractors. The pie chart below highlights the importance of the individual components of infrastructure spending with roads, electricity and railways accounting for c.85% of overall spending. Hercules has exposure to most of these areas with a particular focus on Railways, Roads and Water/ Sewerage.

Major components of UK infrastructure spending (2021)



Source: ONS

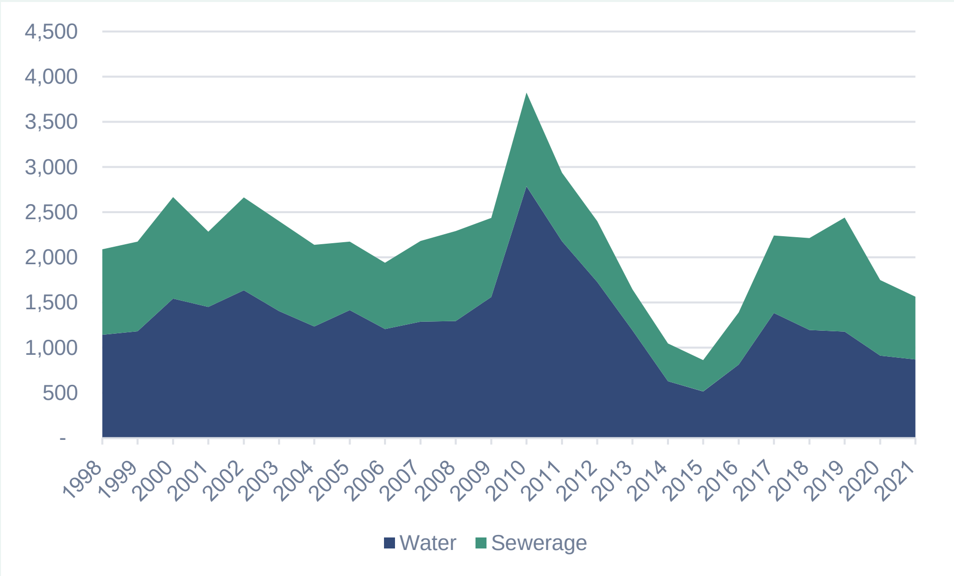
Rail has been a major contributor to growth in construction output over recent years with Crossrail and HS2 making their mark. Away from these significant and high profile projects, the government has committed to spending £44bn between April 2024 and March 2029 under the Contral Period 7 (CP7), regulated spending programme to fund the operation, maintenance and renewal of exisitng rail infrastructure.

Value of construction output (£m) – Rail

Source: ONS

The Water industry is also funded by regulated spending under the government's Asset Management Plan or "AMP" periods. The current five year AMP period, AMP7, runs from 2020 to 2025 and requires all UK water companies to align their own business plan objectives and budgets with government and regulatory objectives. AMP7 has an estimated value of £51bn, with an approximate 50:50 split between capital and operational investment. The water industry has been in focus recently with criticism of water companies for releasing sewage into coastal waters. Water UK, the industry body, has recently announced a further £10bn over five years to address the issue of sewage spills in addition to £3bn already committed under AMP7.

Value of construction output (£m) – Water and sewerage



Source: ONS

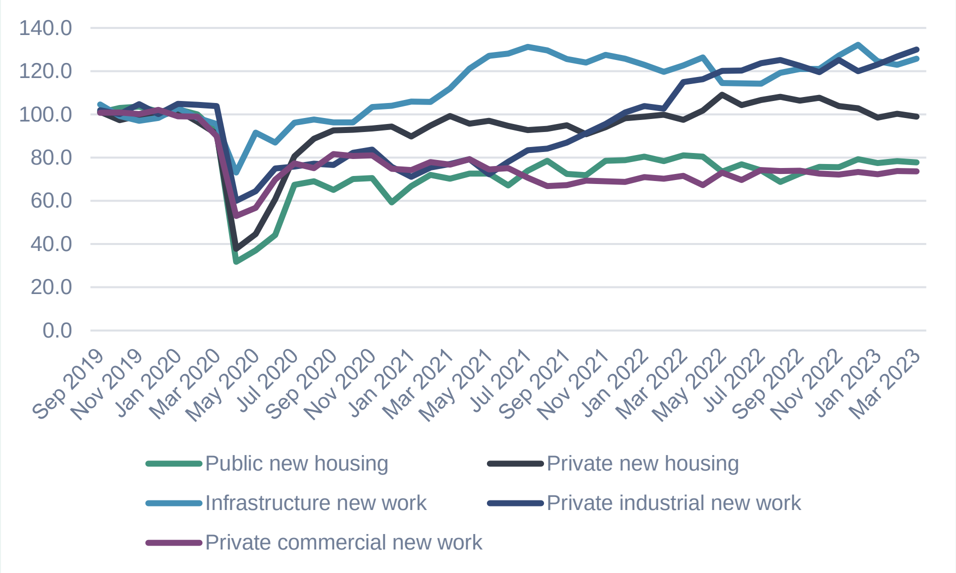
Post COVID bounce-back in activity – now fully recovered

Construction output has now fully recovered from the slump in activity triggered by the COVID crisis. There is, though, significant variation between the performance of the individual components of the sector. Specifically, the charts below highlight that infrastructure spending (light blue line, bottom chart) has been a key driver of the recovery, alongside private industrial new work. The real laggards have been public new housing and private commercial (with the office market responding to the impact of the pandemic on working practices etc).

Growth in construction output (indexed from 2019)

Source: ONS

Significant variation in output by market segment (indexed from 2019)

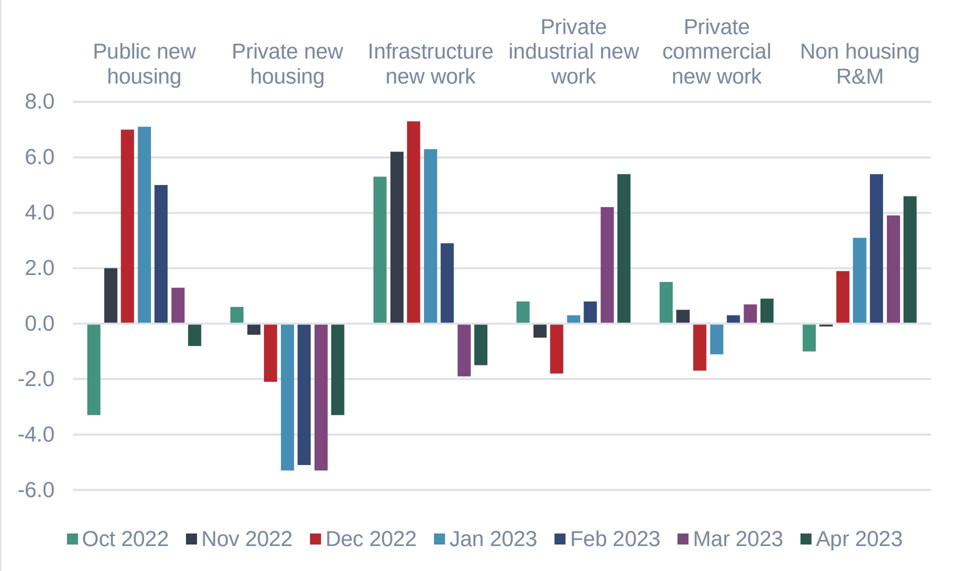


Source: ONS

Near-term market outlook: inflationary pressures

The construction industry is undoubtedly cyclical and economically sensitive. This is particularly true of the private housebuilding sector, which has seen a notable decline in activity over recent quarters as housebuilders have adjusted to changing market conditions. The chart below highlights the decline in private new housing output since October '22. The other areas of construction activity have been more resilient over this period, albeit infrastructure output has declined in the past two months.

Latest construction output data (volume % change quarter on quarter)



Source: ONS

The rapid increase in interest rates in response to stubbornly high inflation has pushed mortgage rates to their highest level since 2007. It is too early to assess the full impact on pricing and transaction volumes. Encouragingly housebuilders have pointed to a relatively resilient performance so far following an initial period of disruption in Q4'22 post the disastrous "mini-budget".

It is worth commenting that Hercules has limited exposure to the residential construction industry, with a much greater emphasis on the more resilient infrastructure sector, which benefits from long-term government commitments to modernise and improve transport links, energy and water infrastructure.

Infrastructure spending has not been immune to the impact of rising inflation and interest rates with a two-year delay to Phase 2a of HS2 (linking Birmingham to Crewe and Manchester) as well as a delay to the construction of the HS2 Euston terminus, which has been pushed back to be delivered alongside Phase 2b in response to inflationary pressures.

Nevertheless, HS2 remains one of the most significant infrastructure projects in Europe and Phase One (between London and the West Midlands) is well underway and is due to hit peak construction over the next three years with a total workforce exceeding 34,000.

FY23 recession, but growth in Infrastructure

Construction output has recently been running at record levels but a contraction is now considered to be unavoidable in 2023 from last year's record-high level of activity. The Construction Products Association (CPA) expects a 6.4% contraction, driven particularly by the decline in private housebuidling. Infrastrucutre spending is expected to continue to grow but recent government announcements delaying HS2 work at Euston station and on major roads schemes including the Lower Thames Crossing have reduced the pace of growth for the third-largest sector within this industry.

New build private housing and private housing RMI (Repair, Maintenace and Improvement) account for around 40% of total construction output and are considered to be the most sensitive to falling household incomes and higher interest rates. Private housing is forecast to experience a 17% declne in output in 2023.

Private housing RMI output is forecast to fall by 9% in 2023, as the pandemic-related stimulus for home improvments has now come to an end.

A wider recovery in economic growth in 2024 is expected to boost demand for both new build housing and RMI activity and total construction output is forecast to return to growth, rising by 1.1%.

In Infrastructure, the CPA's growth forecasts were downgraded in May's Spring Forecasts to 0.7% for 2023 and 1.2% for 2024, from 2.4% and 2.5% respectively in Winter. Activity on regulated frameworks in water & sewerage, road and rail provides sizeable opportunity, whilst growth in the sector tends to be driven by large projects; most recently by HS2, the Thames Tideway Tunnel and Hinkley Point C.

Water: an attractive market with regulatory driven demand

Water UK, the body which represents England's nine water and sewage companies, has apologised on behalf of the industry for not acting quickly enough on sewage, although the industry has been criticised for plans to pass the cost on to consumers. The recent £10bn pledge to improve the sewage system is certainly positive for the industry.

This has been front page news in recent months, pushing sewage and water infrastructure up the political agenda. This adds further support to the demand outlook for Hercules' Construction Services business, which has a particular focus on water infrastructure projects.

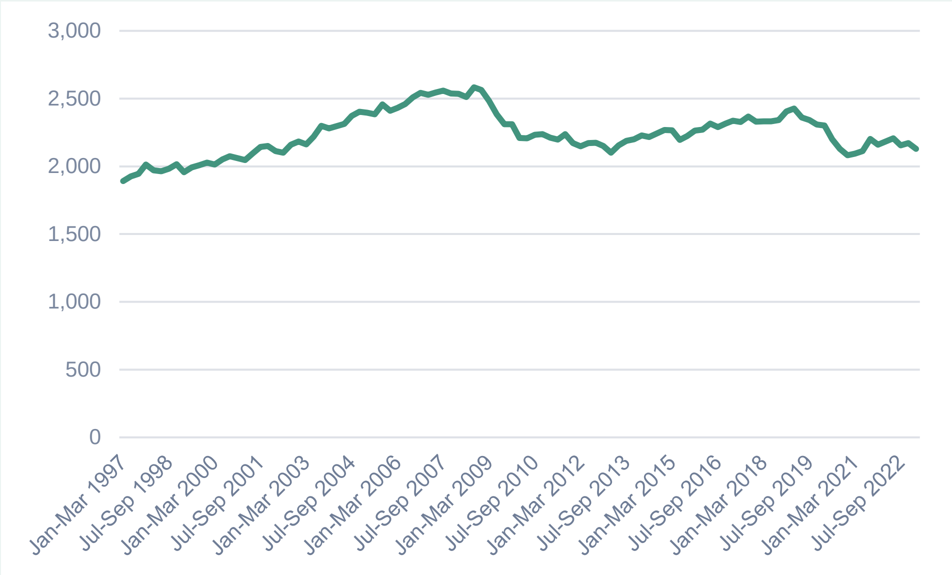
Addressing a structural shortage of skilled workers

Set against a positive medium-term outlook for construction activity, the industry continues to face a structural shortage in demand for skilled workers.

Whilst construction output is now above pre-COVID levels, construction employment has only partially recovered. There are several factors at play including the departure of EU workers post Brexit, repercussions of the pandemic (Great Resignation) and ongoing skills shortages, particularly among younger workers. On the other side of the same coin, construction industry vacancies are close to record highs.

Whilst overall employment in the construction industry has remained fairly stable for several years (and still remains below its pre financial crisis peak), vacancies have risen sharply in the past two years (as highlighted in the following two charts).

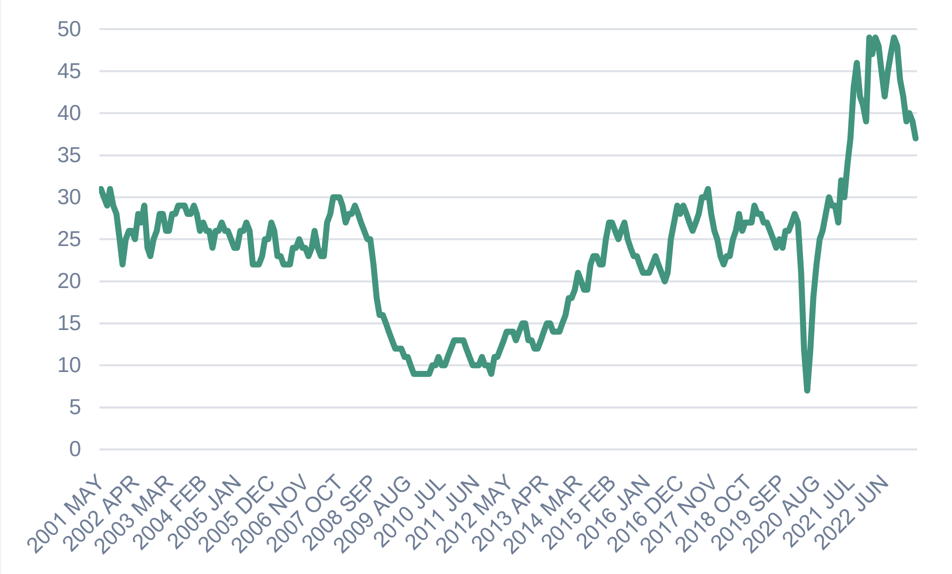
All employment in construction industry ('000s)



Source: ONS

This should underpin a robust demand environment for Hercules over the near to medium term whilst also creating a positive environment for wage growth. As well as sourcing labour for its clients, Hercules is actively taking steps to address the issue of skills shortages through its dedicated training centre and investing in softer benefits, which are becoming increasingly important to the workforce post pandemic, particularly around health and wellbeing and work/ life balance.

All vacancies in construction industry ('000s)



Source: ONS

Vacancies remain high by historic standards, but we do note that they have fallen from a peak of 49,000 in September 2022 to 37,000 in April 2023 (most recent reading), perhaps suggesting some impact from the uncertainty over the economic outlook.

KPMG and REC Report on Jobs

Softer trends in recent months

The widely followed KPMG/ REC Report on Jobs has noted a softening in the overall UK recruitment market in the past few months. The Report on Jobs is compiled by S&P Global from responses to questionnaires sent to a panel of around 400 UK recruitment and employment consultancies.

The latest report (released 8th June) highlighted more subdued hiring activity in May, indicating that caution around the outlook and delayed decision making has led to a fall in permanent staff appointments, while temporary billings rose slightly. At the same time, vacancies expanded at the second-softest rate since early 2021. Perhaps unsurprisingly, the retail sector is seeing the most notable decline in vacancies. Construction hiring saw a slight fall in permanent vacancies.

The recruitment sector reflects the uncertainty over the economic outlook, which is weighing on confidence and decision making, with permanent hires falling for eight months in a row. Temporary billings expanded slightly in May and remain positive.

Further evidence of the slowdown in permanent hiring came from Robert Walters, who recently issued a profit warning (14th June '23).

Total candidate supply is improving, reflecting the slowdown in permanent hiring activity. Rates of pay have been increasing at record levels over the past year and remain strong, but are now showing some signs of easing.

Financials and Forecasts

Income statement					
Year End Sep, £m	2021A	2022A	2023E	2024E	2025E
Group revenue	**32.8**	**49.5**	**74.1**	**82.4**	**88.8**
% growth rate	*43%*	*51%*	*50%*	*11%*	*8%*
% 2 Year CAGR	-	*47%*	*50%*	*29%*	*9%*
COGS	-26.1	-39.8	-58.9	-65.4	-70.4
% growth rate	*40%*	*53%*	*48%*	*11%*	*8%*
% of revenue	*80%*	*80%*	*79%*	*79%*	*79%*
Gross profit	**6.7**	**9.8**	**15.2**	**17.0**	**18.4**
% growth rate	*55%*	*46%*	*56%*	*12%*	*8%*
% margin	*20%*	*20%*	*21%*	*21%*	*21%*
Other operating income	0.2	0.0	0.0	0.0	0.0
% of revenue	*1%*	*0%*	*0%*	*0%*	*0%*
Segmental admin expenses	-1.5	-3.2	-4.4	-4.8	-4.9
% of revenue	*5%*	*6%*	*6%*	*6%*	*6%*
Central admin expenses	-3.7	-5.4	-9.3	-9.9	-10.2
% of revenue	*11%*	*11%*	*13%*	*12%*	*12%*
Add back D&A	0.7	1.0	1.9	2.2	2.2
% of revenue	*2%*	*2%*	*3%*	*3%*	*2%*
Adj. EBITDA	**2.4**	**2.3**	**3.4**	**4.5**	**5.5**
% growth rate	*75%*	*-7%*	*52%*	*32%*	*21%*
% margin	*7%*	*5%*	*5%*	*5%*	*6%*
% drop-through	*11%*	*-1%*	*5%*	*13%*	*15%*
Depreciation owned assets	-0.1	-0.1	-0.2	-0.2	-0.2
Depreciation right of use assets	-0.6	-0.9	-1.7	-2.0	-2.0
Amortisation	0.0	0.0	0.0	0.0	0.0
Adj. EBITA	**1.7**	**1.2**	**1.5**	**2.3**	**3.3**
% growth rate	*69%*	*-28%*	*25%*	*53%*	*41%*
% conversion rate (EBITA/GM%)	*25%*	*12%*	*10%*	*14%*	*18%*
% margin	*5%*	*2%*	*2%*	*3%*	*4%*
Fair value gains	0.0	0.0	0.0	0.0	0.0
Net interest	-0.2	-0.5	-1.3	-1.3	-1.3
Adj. PBT	**1.4**	**0.7**	**0.2**	**1.0**	**2.0**
% growth rate	*40%*	*-52%*	*-67%*	*359%*	*94%*
% margin	*4%*	*1%*	*0%*	*1%*	*2%*
Other Items/Exceptionals	-0.9	-0.5	0.0	0.0	0.0
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0
Reported PBT	**0.5**	**0.2**	**0.2**	**1.0**	**2.0**
Underlying tax	-0.6	0.2	0.6	0.0	-0.5
Exceptional tax			0.0	0.0	0.0
Underlying tax rate (%)	*40%*	*-24%*	*-269%*	*0%*	*25%*
Adj. PAT	0.8	0.8	0.8	1.0	1.5
PAT	-0.1	0.3	0.8	1.0	1.5

Source: Company historic data, ED forecasts and analysis

Hercules has delivered excellent revenue growth over recent years, in the region of 50% per annum in FY21 and FY22. Despite the increase in the revenue base, a similar level of growth is expected in FY23 and this is reflected in our forecasts.

The Group's maiden full year results as a listed company (for the year to September '22) showed revenue growth of 51% to £49.5m with Adjusted EBITDA in line with market expectations at £2.3m (FY'21 £2.4m), steady year on year following a period of investment in overheads to support future growth plans.

Growth in FY'22 was driven by the commencement of the key HS2 project (Labour Supply revenue +45%) as well as a very positive year for Civils in terms of new client acquisition (Civils revenue +61%).

Suction Excavators also delivered strong revenue growth (+68%) albeit from a lower base. Future growth from this smaller division looks well underpinned by recent fleet investment (fleet size now stands at 30, up from 9 at the time of IPO).

Segmental Revenue

Year-end Sep, £m	2021A	2022A	2023E	2024E	2025E
Labour supply	**22.9**	**33.3**	**53.2**	**60.1**	**64.9**
Growth rate	*34%*	*45%*	*60%*	*13%*	*8%*
Civils	7.7	12.4	13.6	14.3	15.0
Growth rate	*30%*	*61%*	*10%*	*5%*	*5%*
Suction excavators	2.2	3.6	7.3	8.0	8.8
Growth rate	*16045%*	*68%*	*100%*	*10%*	*10%*
Construction Services Total	**9.9**	**16.0**	**20.9**	**22.3**	**23.8**
Growth rate	*67%*	*62%*	*30%*	*7%*	*7%*
Other	-	0.3	0.0	0.0	0.0
Group	**32.8**	**49.5**	**74.1**	**82.4**	**88.8**
Growth rate	*43%*	*51%*	*50%*	*11%*	*8%*
Share of Group					
Labour supply	*70%*	*67%*	*72%*	*73%*	*73%*
Civils	*23%*	*25%*	*18%*	*17%*	*17%*
Suction excavators	*7%*	*7%*	*10%*	*10%*	*10%*

Source: Company historic data, ED forecasts and analysis

We assume the Group performance is driven in particular by continued growth in the Labour Supply division, with increasing demand for skilled workers on major infrastructure projects allied with Hercules' growing reputation as a trusted supplier to its blue-chip client base, supporting further market share growth.

We assume steady growth in Civils, noting management's measured approach to developing this business. In the Suction Excavators division, we assume a step-change in FY23/FY24 as utilisation of the fleet increases after the recent period of investment.

Excellent sales (£m) and gross margin (%) progression

Source: Company historic data, ED forecasts and analysis

Alongside the excellent revenue growth, gross margins have been maintained at the c.20% level and we assume this continues with a slight increase as mix changes to reflect the increasing utilisation of the suction excavator fleet (highest gross margin activity).

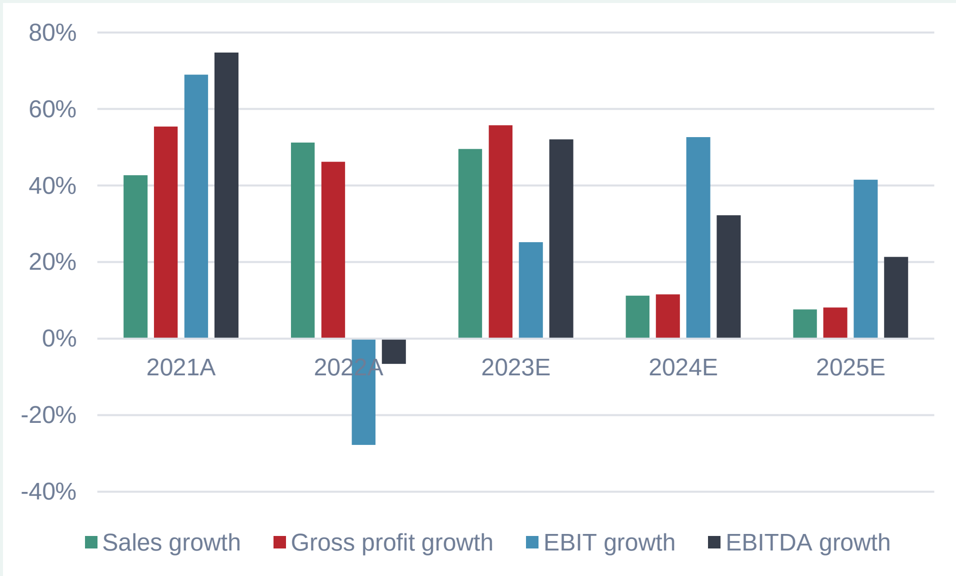
Segmental Gross profit

Year-end Sep, £m	2021A	2022A	2023E	2024E	2025E
Labour supply	4.3	5.5	9.0	10.2	11.0
Civils	1.0	2.0	2.2	2.3	2.4
Suction excavators	1.4	2.1	4.0	4.5	4.9
Other	0.0	0.1	0.0	0.0	0.0
Group	**6.7**	**9.8**	**15.2**	**17.0**	**18.4**
Gross margin					
Labour supply	*18.8%*	*16.6%*	*17.0%*	*17.0%*	*17.0%*
Civils	*13.0%*	*16.3%*	*16.0%*	*16.0%*	*16.0%*
Suction excavators	*63.7%*	*58.4%*	*55.0%*	*56.0%*	*56.0%*
Group	***20.4%***	***19.7%***	***20.6%***	***20.6%***	***20.7%***
Growth rate					
Labour supply	*26%*	*28%*	*64%*	*13%*	*8%*
Civils	*11%*	*102%*	*8%*	*5%*	*5%*
Suction excavators	-	*54%*	*88%*	*12%*	*10%*
Group	***55%***	***46%***	***56%***	***12%***	***8%***
Share of Group					
Labour supply	*64%*	*57%*	*59%*	*60%*	*60%*
Civils	*15%*	*21%*	*14%*	*13%*	*13%*
Suction excavators	*21%*	*22%*	*26%*	*26%*	*27%*

Source: Company, ED analysis

As we discuss earlier in the note, gross profit within the Labour Supply business reflects the net fee income received by Hercules. This is essentially the difference between the billing to clients for hours worked and the wages paid to the on-site workforce. Gross profit margin should therefore be fairly consistent and operating profit (EBIT) and operating profit margin are important measures of the underlying profitability and efficiency of the business.

Profit growth building over forecast period



Source: Company, ED estimates

With this in mind, the chart on the previous page highlights the growth trend for revenue and all profit measures over the past two years and the three-year forecast period. This shows sales and gross profit growing at similar rates, whilst EBITA and EBITDA growth should accelerate over the forecast period as the business adds further scale and reaps the benefits of recent investments in equipment, technology and experienced hires.

Hercules has an entrepreneurial culture and there are several future revenue opportunities building, which are yet to feature in our forecasts.

Segmental EBITA (operating profit)

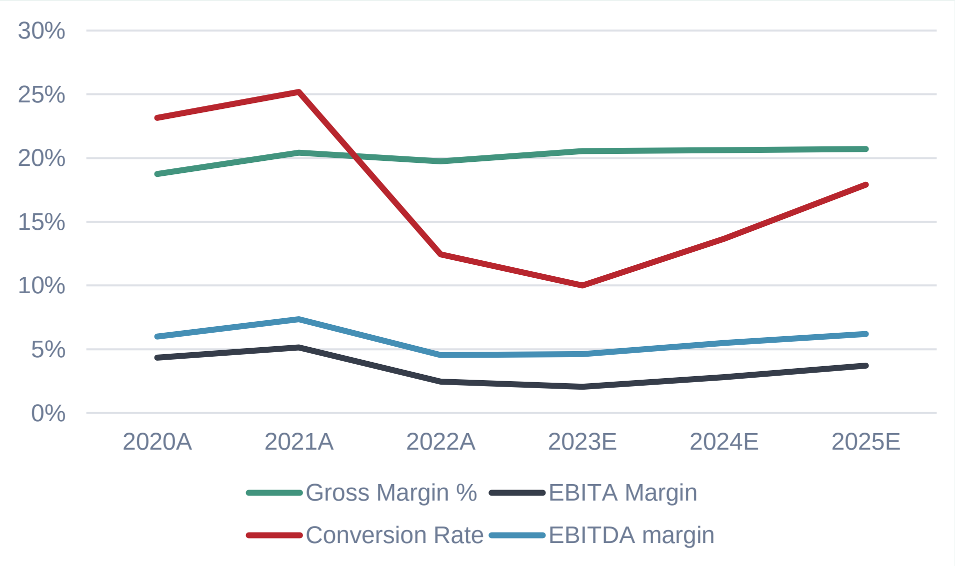
Year-end Sep, £m	2021A	2022A	2023E	2024E	2025E
Labour supply	3.7	4.2	6.9	7.8	8.4
Civils	0.5	1.2	1.4	1.4	1.5
Suction excavators	1.0	1.0	2.0	2.2	2.5
Other	0.0	0.1	0.0	0.0	0.0
Group	**5.2**	**6.6**	**10.3**	**11.5**	**12.4**
% EBIT margin					
Labour supply	*16.1%*	*12.8%*	*13.0%*	*13.0%*	*13.0%*
Civils	*6.7%*	*9.7%*	*10.0%*	*10.0%*	*10.0%*
Suction excavators	*44.2%*	*28.6%*	*28.0%*	*28.0%*	*28.0%*
Group	***15.8%***	***13.3%***	***13.9%***	***13.9%***	***14.0%***
% growth					
Labour supply	*6%*	*133%*	*13%*	*5%*	*5%*
Civils	-	*9%*	*96%*	*10%*	*10%*
Suction excavators	-	-	*-100%*	-	-
Group	***53%***	***28%***	***56%***	***11%***	***8%***
% of Group					
Labour supply	*56%*	*64%*	*67%*	*68%*	*68%*
Civils	*8%*	*18%*	*13%*	*12%*	*12%*
Suction excavators	*15%*	*16%*	*20%*	*20%*	*20%*

Source: Company, ED analysis

We believe that the last two years have seen a step change in investment for the Group, which has suppressed operating margins (EBITA margins) in the short term in the interests of building a Group with capacity to continue its high growth trajectory.

This has been seen across technology (supporting the development of the apps), experienced hires to dive new revenue streams (e.g. security and white-collar recruitment) and equipment (the expansion of the suction excavator fleet).

Margin inflection point post investment peak



Source: Company, ED estimates

Our forecasts assume a modest improvement in EBITA margins (operating margins) over the forecast period, which is intended to be a conservative position. Ultimately, we see potential for this to trend back into the mid-single digits over the medium term, which would have a meaningful impact on the Group's earnings profile.

Future catalysts

Organic earnings catalysts

Hercules has an entrepreneurial culture and there are several future revenue opportunities building, which are yet to feature in our forecasts.

These include a new training academy in Nuneaton, which will provide the Group with a regional base in the Midlands and the opportunity to reduce external training costs, to ensure high skill levels and quality across the workforce, and to provide specific training for clients.

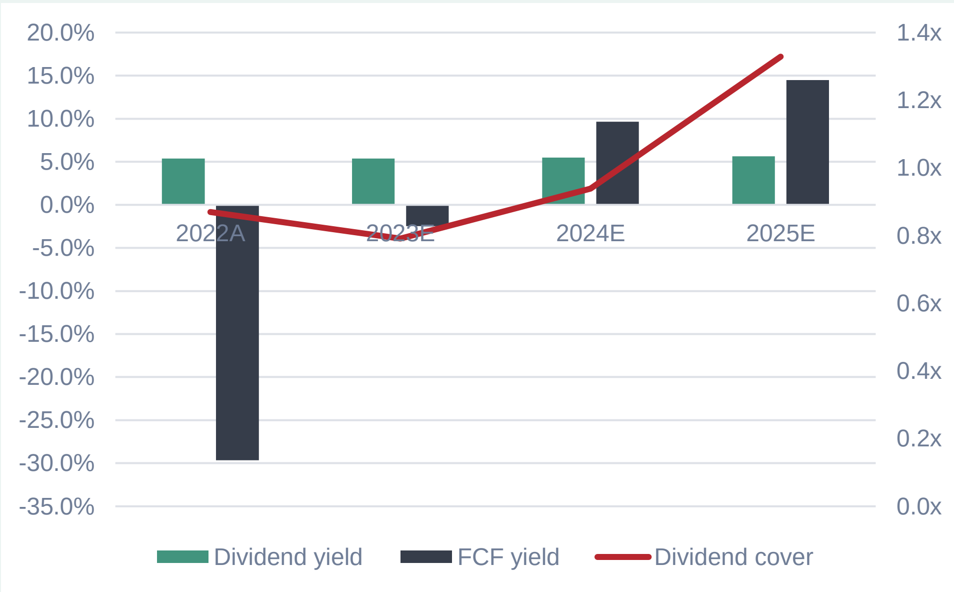
Similarly, we note the potential of the recently launched security and white-collar teams within Labour Supply but, for now, assume a limited contribution from these areas.

We have also highlighted the opportunity to drive licensing revenue from the Group's proprietary technology developments, but again assume no meaningful contribution in our forecasts.

Future M&A ambitions

We do not factor future M&A into our forecasts but note that management is ambitious to expand the Group's offering and has indicated that the Board will consider accretive M&A as a means to accelerating future growth.

Attractive dividend yield, and cover rising



Source: Company, ED estimates

Hercules has a progressive dividend policy and has paid/ declared dividends for FY22 and H1'23. Whilst these have also been periods of investment, this highlights the Board's confidence in the growth outlook and underlying cash generative potential of the Group, as well as the importance of dividends to the shareholder base.

The chart above highlights our expectation for the progression of free cash flow and dividend cover over the forecast period and we discuss cashflow further on the next page.

Cash flow/ movements in net debt

Year End Sep, £m	2021A	2022A	2023E	2024E	2025E
Adj. EBITA	**1.7**	**1.2**	**1.5**	**2.3**	**3.3**
Depreciation owned assets	0.1	0.1	0.2	0.2	0.2
Depreciation right of use assets	0.6	0.9	1.7	2.0	2.0
Gain on disposal of PPE	0.0	0.0	0.0	0.0	0.0
Exceptionals (inc IPO costs)	-0.9	-0.5	0.0	0.0	0.0
Other non-cash	0.0	0.1	0.0	0.0	0.0
(Increase)/decrease trade receivables	*-3.0*	*-9.6*	*-2.5*	*-2.0*	*-2.0*
(Increase)/decrease in inventories	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
(Increase)/decrease in trade payables	*-0.1*	*2.5*	*-0.4*	*1.0*	*1.5*
Working Capital Movement	-3.1	-7.1	-2.9	-1.0	-0.5
Operating Cash Flow	**-1.6**	**-5.3**	**0.5**	**3.5**	**5.0**
Net Interest	-0.1	-0.2	-1.3	-1.3	-1.3
Tax	0.0	0.0	0.6	0.0	-0.5
Net Operating Cash Flow	**-1.7**	**-5.6**	**-0.2**	**2.2**	**3.2**
Purchase of PPE	*-0.4*	*-0.2*	*-0.3*	*-0.3*	*-0.3*
Proceeds from sale of PPE	*0.0*	*0.5*	*0.0*	*0.0*	*0.0*
Total Net Capex	**-0.3**	**0.3**	**-0.3**	**-0.3**	**-0.3**
Equity Free Cash Flow	**-2.1**	**-5.3**	**-0.5**	**1.9**	**2.9**
M&A	0.0	0.0	0.0	0.0	0.0
Dividend	0.0	-0.4	-0.5	-1.1	-1.1
Share Issue	0.0	3.4	1.6	0.0	0.0
Leases*	-3.0	-6.5	-8.0	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**	**-7.4**	**0.8**	**1.8**
Net Debt - BOP	-4.0	-9.2	-18.2	-25.6	-24.8
Net Debt - EOP	**-9.2**	**-18.2**	**-25.6**	**-24.8**	**-23.0**

*Source: Company, ED analysis *lease additions*

The cash flow statement shows a period of relatively high working capital consumption in FY22 as a result of the significant revenue growth. This reflects the difference in the payment cycle for the workforce (typically paid weekly) and the receipts from clients (billed monthly typically on 35 to 60 day terms).

The other notable items in the cashflow statement are the shares issues in FY22 (IPO) and FY23 (Feb '23 placing to support working capital) and the investment in the suction excavator fleet, which can be seen in the leases line (representing lease additions).

We expect **a marked improvement in free cash generation from FY24** as utilisation of the fully invested suction excavator fleet increases and EBITDA increases to >£4m per annum on our forecasts.

Our dividend cash flow forecasts assume that the major shareholder received the dividend in full from FY'24 onwards, having waived the dividend in FY22 and FY23. We assume only a modest increase in the declared dividend per share but a larger increase in the related cash outflow in FY24 and FY25.

Note that the net debt position quoted includes the asset finance (finance leases) that have been used to fund the purchase of the suction excavator fleet. The balance sheet section on the following page shows cash, borrowings and leases in more detail.

Balance sheet

Year End Sep, £m	2021A	2022A	2023E	2024E	2025E
Non-Current assets					
PPE	9.2	14.6	21.0	19.1	17.2
Other	0.0	0.0	0.0	0.0	0.0
Sub-total NCAs	**9.2**	**14.6**	**21.0**	**19.1**	**17.2**
Current Assets					
Inventories	0.0	0.1	0.1	0.1	0.1
Trade and other receivables	8.3	17.9	20.4	22.4	24.4
Current tax receivable	0.1	0.1	0.1	0.1	0.1
Assets at fair value through profit or loss	0.3	0.0	0.0	0.0	0.0
Cash and cash equivalents	1.5	1.2	2.4	2.4	3.0
Sub-total CAs	**10.1**	**19.3**	**22.9**	**25.0**	**27.6**
Net working capital	**3.8**	**11.0**	**13.9**	**14.9**	**15.4**
Total Assets	**19.4**	**33.9**	**44.0**	**44.1**	**44.8**
Current Liabilities					
Trade and other payables	-4.5	-7.0	-6.6	-7.6	-9.1
Provisions	-0.3	-0.3	-0.3	-0.3	-0.3
Loans and borrowings	-3.1	-6.5	-9.0	-9.0	-9.0
Lease liabilities	-0.8	-2.1	-4.0	-4.0	-4.0
Other	0.0	0.0	0.0	0.0	0.0
Sub-total CLs	**-8.7**	**-15.9**	**-19.9**	**-20.9**	**-22.4**
Non-current liabilities					
Deferred tax liabilities	-0.4	-0.3	-0.3	-0.3	-0.3
Lease liabilities	-6.7	-10.9	-15.0	-14.2	-13.0
Other	0.0	0.0	0.0	0.0	0.0
Sub-total NCLs	**-7.2**	**-11.2**	**-15.3**	**-14.5**	**-13.3**
Total Liabilities	**-15.9**	**-27.1**	**-35.2**	**-35.4**	**-35.7**
NET ASSETS	**3.4**	**6.8**	**8.8**	**8.7**	**9.1**
Minorities	0.0	0.0	0.0	0.0	0.0
SHAREHOLDERS FUNDS	**3.4**	**6.8**	**8.8**	**8.7**	**9.1**

Source: Company, ED analysis

The balance sheet items of note reflect the working capital investment in Labour Supply (Trade and other receivable/ Trade and other payables) as well as fleet investment in the suction excavators (reflected in the PPE and lease liabilities lines).

The Loans and borrowings line comprises the Group’s invoice discounting facility, which is used to manage the timing difference between payment to the workforce and collection of billings from clients.

Whilst we are forecasting net debt of £25.6m at the end of the current year (Sep ’23), this includes £19m of lease liabilities, which is principally asset financing for the suction excavator fleet. Excluding leases, net debt is expected to be £6.6m. We forecast a gross cash position of £2.4m at the current year end.

Recent Interims (5th June '23): sustained momentum

Income statement						
Year End Sep, £m	**H1'22A**	**H2'22A**	**2022A**	**H1'23A**	**H2'23E**	**2023E**
Group revenue	20.0	29.6	49.5	37.0	37.1	74.1
% growth	42%	58%	51%	85%	25%	50%
% 2 Year CAGR	-	-	47%	-	-	50%
COGS	-15.9	-23.9	-39.8	-30.1	-28.8	-58.9
% growth	38%	64%	53%	89%	21%	48%
% of revenue	80%	81%	80%	81%	78%	79%
Gross profit	4.0	5.7	9.8	6.9	8.3	15.2
% growth	62%	37%	46%	71%	45%	56%
% margin	20%	19%	20%	19%	22%	21%
Other operating income	0.0	0.0	0.0	0.0	0.0	0.0
Segmental admin expenses	-1.5	-1.7	-3.2	-2.1	-2.3	-4.4
% of revenue	8%	6%	6%	6%	6%	6%
Central admin expenses	-2.3	-3.0	-5.4	-4.5	-4.8	-9.3
Add back D&A	0.5	0.6	1.0	0.8	1.1	1.9
Adj. EBITDA	0.6	1.6	2.3	1.1	2.3	3.4
% growth	-50%	44%	-7%	70%	45%	52%
% margin	3%	5%	5%	3%	6%	5%
Depreciation owned assets	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2
Depreciation right of use assets	-0.4	-0.5	-0.9	-0.7	-1.0	-1.7
Adj. EBITA	0.2	1.0	1.2	0.3	1.2	1.5
% growth	-80%	56%	-28%	75%	16%	25%
% margin	1%	3%	2%	1%	3%	2%
Fair value gains	0.0	0.0	0.0	0.0	0.0	0.0
Net interest	-0.2	-0.4	-0.5	-0.6	-0.7	-1.3
Adj. PBT	0.0	0.6	0.7	-0.2	0.5	0.2
% growth	-97%	19%	-52%	-925%	-29%	-67%
% margin	0%	2%	1%	-1%	1%	0%
Other Items/Exceptionals	-0.4	-0.1	-0.5	0.0	0.0	0.0
Reported PBT	-0.4	0.5	0.2	-0.2	0.5	0.2
Underlying tax	0.3	-0.1	0.2	0.6	0.0	0.6
Underlying tax rate (%)	-929%	16%	-24%	258%	-1%	-269%
Adj. PAT	0.3	0.5	0.8	0.4	0.5	0.8
PAT	-0.1	0.4	0.3	0.3	0.5	0.8

Source: Company, ED analysis

Hercules reported strong interims on 5th June, continuing the momentum of recent periods. Revenue increased by 85% to £37.0m, driven by the ongoing mobilisation of HS2 Phase One (northern section), with the number of operatives increasing to 400 (from 180 on 31st March '22). Gross profit increased by 71% to £6.9m, with gross margins being similar to the prior year at 19%. Adjusted EBITDA increased by 73% to £1.1m. An interim dividend of 0.6p was declared (H1'22: 0.6p).

Other highlights of the period included:

- First revenue generated from the SEE Everything Portal;
- New client wins in Amey and SGN (for the Civils business);

- Delivery of 10 suction excavators at the end of the period, taking fleet to 30;
- £1.7m fundraise completed for working capital purposes.

We note that the Group looks very well placed to meet (or exceed) our full year forecasts, with 50% of our full year revenue forecast delivered in H1. The Group is typically H2 weighted (for reasons of industry seasonality/ weather etc) and H2'23 will also benefit from, e.g. a first contribution from the suction excavators acquired in H1.

Valuation

In our view, Hercules has a unique growth profile amongst its listed peers with FY'23 set to be another year of 50% revenue growth despite the challenging macro-economic backdrop. Whilst growth rates will inevitably settle over time, we still see scope for strong double digit revenue growth over the medium term.

The next consideration is the timing of the transition to more significant profitability as the business matures and adds scale. We see operating margins as an important measure of the maturity of the business (and conversion rate as a useful supporting metric). Over time, we see conversion rate moving into the mid-teens and the EBITA margin trending into mid-single digits.

Whilst conventional earnings metrics (P/E, EV/EBITDA) are less useful while the Group remains on the path to meaningful profitability, we do believe these are important to consider in understanding the value of the Group. We therefore show the relevant peers and current valuation metrics in the table below.

Recruitment sector ratings									
Specialist recruitment firms	**P/E**		**EV/EBITDA**		**EV/Sales**		**EV/EBITA**		**Div Yield**
	FY1	**FY2**	**FY1**	**FY2**	**FY1**	**FY2**	**FY1**	**FY2**	**NTM**
Staffline Group plc	9.0x	7.4x	2.9x	2.6x	0.1x	0.1x	4.4x	3.7x	0.0%
Empresaria Group plc	7.2x		2.6x		0.2x		5.1x		2.8%
PageGroup plc	13.1x	10.5x	6.2x	5.1x	0.6x	0.6x	8.9x	7.2x	3.8%
Hays plc	12.2x	12.1x	6.4x	6.3x	0.2x	0.2x	8.6x	8.6x	5.9%
SThree plc	8.9x	8.2x	4.6x	4.2x	0.3x	0.2x	5.8x	5.2x	4.6%
Robert Walters plc	11.4x	8.7x	4.2x	3.5x	0.2x	0.2x	4.9x	4.2x	5.6%
Gattaca plc	24.3x	10.9x	2.8x	1.8x	0.1x	0.1x	5.7x	2.7x	1.7%
Average recruitment specialists	**12.3x**	**9.6x**	**4.2x**	**3.9x**	**0.2x**	**0.2x**	**6.2x**	**5.3x**	**3.5%**
Support services ratings									
Companies with infrastructure focus	**P/E**		**EV/EBITDA**		**EV/Sales**		**EV/EBITA**		**Div Yield**
	FY1	**FY2**	**FY1**	**FY2**	**FY1**	**FY2**	**FY1**	**FY2**	**NTM**
Renew Holdings plc	11.8x	11.9x	7.8x	7.6x	0.6x	0.6x	9.1x	8.8x	2.5%
Vp plc	7.6x	7.3x	3.9x	3.8x	1.1x	1.1x	8.4x	8.1x	6.5%
Van Elle Holdings plc	10.0x	11.6x	4.0x	4.0x	0.3x	0.3x	7.7x	8.3x	3.3%
HSS Hire Group plc	6.2x	5.7x	2.6x	2.5x	0.5x	0.5x	5.8x	5.5x	3.9%
Speedy Hire Plc	6.1x	5.8x	3.0x	2.9x	0.7x	0.7x	8.2x	8.0x	8.3%
Average infrastructure peers	**8.3x**	**8.5x**	**4.3x**	**4.2x**	**0.6x**	**0.6x**	**7.8x**	**7.7x**	**4.9%**
Selected construction ratings									
Selection of Hercules customers	**P/E**		**EV/EBITDA**		**EV/Sales**		**EV/EBITA**		**Div Yield**
	FY1	**FY2**	**FY1**	**FY2**	**FY1**	**FY2**	**FY1**	**FY2**	**NTM**
Balfour Beatty plc	10.3x	9.9x	4.6x	4.4x	0.2x	0.2x	6.5x	6.2x	3.3%
Costain Group PLC	4.2x	3.9x	0.4x	0.4x	0.0x	0.0x	0.6x	0.5x	3.7%
Galliford Try Holdings plc	11.3x	10.0x	0.9x	0.8x	0.0x	0.0x	1.5x	1.3x	4.6%
Average – selected customers	**8.6x**	**7.9x**	**2.0x**	**1.9x**	**0.1x**	**0.1x**	**2.9x**	**2.7x**	**3.9%**
Average all peers	**10.2x**	**8.9x**	**3.8x**	**3.6x**	**0.3x**	**0.3x**	**6.1x**	**5.6x**	**4.0%**

Source: ED analysis

We note that the relevant peer group is currently trading on a P/E ratio in a range of 9x to 13x and an EV/EBITDA ratio in the range of 4x to 5x. It would not be appropriate to apply these multiples to Hercules' relatively early-stage profitability.

Instead, we would look to the Group in its more mature state and suggest (without putting a timescale to it) that **Hercules has the growth profile and margin characteristics to become a £100m+ revenue business achieving a 5% EBITA margin**. This would imply potential PBT of c.£4m and EPS of c.4.5p, around 2x our current FY25 forecasts. Applying a very reasonable 13x multiple would imply a share price of c.60p.

Following the investment of the past two years, the FCF yield is set to increase significantly to >10%.

This is very attractive.

Our preferred valuation approach for companies transitioning to profitability is to look to the Group's cash generation and Free Cash Flow yield. Following the investment of the past two years, the FCF yield is, on our forecasts, set to increase significantly next year to 10% at the current share price and rising further in FY25. This is very attractive, and we consider this a good measure of the value in the shares today. Applying a 7.5% FCF yield (based on FY25 forecasts) establishes our Fair Value per share of 60p.

As we have noted elsewhere, we see numerous potential earnings catalysts, both organic and acquisitive, which would positively impact our valuation.

The 5% dividend yield, in the meantime, provides good underpinning and an unusual combination of growth and income.

Board of Directors

Henry Pitman, Non-Exec Chairman

Henry Pitman has 30 years' experience of building businesses in the UK and Africa. He is the current Executive Chairman of OPTIMISM Health Group and co-founder of African Century Group, an African investment group. Previously, he was founder and CEO at Tribal Group plc and a Non-Executive Director at Grainger plc. Mr Pitman took Tribal Group plc from a start-up to a business with over £200 million of revenues and 2,000 staff. During this time, Tribal Group plc made over 40 acquisitions.

Brusk Korkmaz, CEO

Brusk Korkmaz has worked in the construction industry for 20 years. Prior to founding Hercules in 2008, he held positions with MJ Gleeson, Black and Veatch and Hochtief UK, gaining experience across a range of civil engineering projects and labour supply for various sectors, including highways, rail, water industry and utilities. He is a member of the Institute of Civil Engineers and holds a BEng Honours Degree from University College London.

Paul Wheatcroft, CFO

Paul Wheatcroft has spent 25 years as a Finance Director working in a number of sectors including construction, building materials, energy, wholesale, manufacturing. He joined the Company in 2020 and has significant business experience in M&A, raising finance and financial management. Previously, Paul was Finance Director in three subsidiaries of Hanson PLC for over 13 years, and Group Finance Director of Ecotricity Group, a green energy company for eight years, responsible in all these roles for financial, legal, HR and IT matters. Paul is a Fellow of the Chartered Institute of Management Accountants.

Ahmet Iplikci, NED

Ahmet Iplikci is currently a strategic board member at Banco Finantia, a Portuguese bank, and a partner at Noctua Partners Europe Limited, a multi-family office with offices in Miami, New York and London. He also sits on the advisory boards of British Chamber of Commerce in Turkey, Fuel Ventures, an early-stage venture capital firm in the UK, and Privcorp Private Equity that invests in Emerging and Frontier markets. Ahmet was a Senior Adviser to the Turkish Prime Minister's Office Investment Agency from 2010 to 2014 and Senior Adviser to the Kazakh Invest National Company JSC from 2018 to 2020.

Richard Kilner, Independent NED

Richard Kilner is a chartered civil engineer and a member of the Institution of Civil Engineers. Educated in South Africa, he has a B.Sc. degree in civil engineering. He has held a number of senior positions in construction and private equity and also has specific experience of property development, business process outsourcing and healthcare. He was a partner at 3i Group plc where he was involved in significant investments in Asia, the USA and Europe. Richard also spent five years (including a year as acting Chairman) as a Non-Executive Director of University Hospitals of Leicester NHS Trust. Richard is currently Non- Executive Chairman of AIM-listed Nexus Infrastructure plc.

Robin Stevens, Independent NED

Robin Stevens is a Chartered Accountant and is Head of Capital Markets at MHA MacIntyre Hudson LLP, the UK member firm of Baker Tilly International. He was formerly an audit and corporate finance partner, and Head of Capital Markets, of Crowe UK LLP, having held senior corporate finance and audit partner positions with Mazars LLP and MRI Moores Rowland LLP. Robin has had an extensive career in corporate finance and is currently Non-Executive Chairman at AIM-listed Vector Capital plc, Non-Executive Director of Standard Segment- listed Aura Renewable Acquisitions Plc and Non-Executive Director of Annica Holdings Limited, listed on the Catalist Market of the Singapore Stock Exchange.

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