EDISON

Scale research report - Update

Daldrup & Söhne

Alternative energy

11 June 2020

New business focus should benefit FY20

FY19 was a year of significant change for Daldrup & Söhne (D&S), marked by the disposal of Geysir Europe. With a strengthened balance sheet, a renewed focus on its drilling activities, a healthy order book and further improvements to internal control mechanisms targeted, the management board (and consensus forecasts) expect an improvement in profitability in FY20.

FY19 results hit by restructuring

Daldrup & Söhne recorded a total output figure for FY19 of €41.8m, +9.8% (sales of €24.8m), and a loss of €10.8m at EBIT level. The key feature of the year was the two-stage sale of Geysir Europe. The total output figure of €41.8m exceeded the original FY19 guidance for the year of €40m. The EBIT loss of €10.8m failed to meet the FY19 target of a balanced EBIT, although this forecast was originally made in May 2019, before the divestment of Geysir Europe's business. D&S estimates an underlying EBIT loss for FY19 of c €1.3m, after accounting for one-off items of €9m in income and €18.5m in expenses. Thanks in large part to the disposal of Geysir, net debt reduced from €62.3m to €11.6m.

Improved performance anticipated in FY20

Daldrup & Söhne reports that the drilling and service business has hardly been directly affected by COVID-19, and that its supply and service chains continue to work on time. With a strengthened balance sheet following the disposal of its shares in Geysir, D&S will now focus on the drilling business, which has been profitable in recent years. Expanded funding and incentives for renewable heating provide a helpful backdrop and, with a strong market position, the company remains confident in its ability to generate profits. In view of the outlook, the management board is targeting a total output figure of around €40m for FY20 and a positive EBIT margin of between 2% and 4%.

Valuation: Margin a key to improving valuation

We base our valuation analysis on consensus forecasts for FY20 sales of €30.2m and EBIT of €1.1m. According to Refinitiv, at a share price of c €2, Daldrup & Söhne is trading on an EV/Sales ratio of 0.6x in FY20e (peer group median 1.6x), but due to low assumed margins, an EV/EBIT multiple of 18.0x in FY20e (peer group median 13.7x). A margin of c 5% (compared with management's FY20 target of 2–4%) on predicted sales of €30.2m would produce an EBIT of c €1.5m and an EV/EBIT ratio of 13.2x, broadly in line with the peer group median.

Consensus estimates

Year end	Sales (€m)	EBIT (€m)	Net income (€m)	EPS (€)	P/E (x)	Yield (%)
12/18	38.9	(16.3)	(18.5)	(2.9)	N/A	N/A
12/19	24.8	(10.8)	(12.3)	(2.1)	N/A	N/A
12/20e	30.2	1.1	2.0	0.2	10.4	N/A

Source: Refinitiv as at 4 June 2020, Daldrup & Söhne

Price	€2.08
Market cap	€12m

Share price graph

Share details

Code	4DS
Listing	Deutsche Börse Scale
Shares in issue	6.0m
Last reported net debt at December 2019	€11.6m

Business description

Daldrup & Söhne is a provider of drilling and environmental services.

Bull

- Emission reduction and renewable targets provide a positive macro environment.
- Strengthened balance sheet.
- Healthy order book.

Bear

- Volatility in project sales.
- Projects can be subject to delays.
- Low margins currently.

Analyst

Graeme Moyse +44 20 3077 5700

industrials@edisongroup.com

Edison profile page

FY19 results: A year of significant change

Daldrup & Söhne recorded a total output figure for 2019 of €41.8m and a loss of €10.8m at EBIT level. The key feature of the year was the two-stage sale of Geysir Europe, including Geysir's holdings in the geothermal power plants in Taufkirchen and Landau. The financial outcome for FY19 compared to original guidance for the year of an output figure in excess of €40m and a balanced result at the EBIT line.

The output figure (an aggregation of actual sales and work in progress) rose by 19.8% to €41.8m, helped by a significant rise in work in progress. The EBIT loss of €10.8m failed to meet the target of a balanced EBIT, although this forecast was originally made in May 2019, before the divestment of Geysir Europe's business, and it is therefore not directly comparable. D&S estimates the underlying EBIT figure for FY19 to be a loss of c €1.3m after accounting for one-off items of €9m of income (including €7.2m from deconsolidated businesses) set against €18.5m of expenses (the majority, €18m, is accounted for by the revaluation/losses of receivables due to D&S from the companies of Geysir Europe).

Thanks in large part to the disposals, liabilities to banks reduced from €11m to €8.7m, while other liabilities, which should also be treated as debt, declined from €53.7m to €5.6m. Cash increased from €2.4m to €2.7m, with the overall effect of reducing net debt from €62.3m to €11.6m.

Exhibit 1: FY19 results vs FY18 – key highlights

€m	FY18	FY19	Change (%)
Sales	38.9	24.8	-36.2%
Increase in work in progress	-4.0	17.0	N/A
Output	34.9	41.8	+19.8%
EBITDA	(12.4)	(7.9)	+68.5%
Depreciation, amortisation and impairment	(3.9)	(2.9)	-25.6%
EBIT	(16.3)	(10.8)	-33.7%
EBIT margin (%)	N/A	N/A	N/A
Debt	(64.7)	(14.3)	
Cash	2.4	2.7	+12.5%
Net debt	62.3	11.6	-81.4%
Cash flow			
From operating activities	34.4	4.1	-88.9%
From investing activities	(31.1)	(0.5)	+98.4%
From financing activities	8.2	(3.1)	-137.8%

Source: Daldrup & Söhne

Post year-end developments

Most significantly, in January, D&S announced that it had completed the sale of Geysir Group (it now holds no shares in Geysir) with its geothermal power plants to IKAV. The total consideration for the two-stage sale (48.9% in July 2019 and 48.9% January 2020) was a relatively modest €6.2m, but the key to the transaction is that the disposal allows €42m of debt associated with the power plants to be deconsolidated from the balance sheet, and Geysir Group's ongoing losses (€28.6m in 2010–18) will be eliminated as from 2020. As a result of the disposal, D&S expects to be less capital intensive going forward. However, D&S also took a hit to the value of capitalised services and receivables from the Geysir companies of €18m (out of a total of c €32m) in its FY19 results (see above). In the FY19 results, Geysir was treated as an equity investment.

In February, D&S completed its first exploratory well for Swiss Nagra, which it began drilling in April 2019. At the same time, D&S announced that it had already commenced the drilling of a second well for Nagra in Marthalen, with a project value of €5.3m. D&S's work for Nagra is designed to help it find a suitable site for a deep geological repository for radioactive waste in Switzerland.

In March, D&S also received a €20m order from the Dutch company, Aardwarmte Combinatie Luttelgeest (ACL), for a geothermal heating plant in the Netherlands, involving the drilling of three geothermal boreholes (D&S subsequently announced in June that it had successfully completed drilling the first well). The project is expected to complete in spring 2021. In March, at the time of the original announcement, D&S revealed that its order backlog totalled €51m, c 1.7x estimated annual sales for FY20. The ACL order can therefore be seen as substantial, both in the context of predicted annual sales (66%) and the total order backlog (39%).

Also in March, in a sequence of management changes, Josef Daldrup resigned from his position as chairman of the management board and was appointed to the supervisory board in April (to be confirmed at the AGM scheduled for 27 August 2020). Andreas Tönies, who has been with D&S since 2005, was appointed spokesman of the management board in succession to Mr Daldrup.

In May, D&S received an order from Zweckverband Therme Obernsees to drill a thermal water well for supply to the thermal baths. The work is expected to take six months and is due to start in late summer 2020.

Exhibit 2: Post year-end developments

Date	Event
15/01/20	Sells Geysir Group with geothermal power plants to IKAV Group
03/03/20	Completes first exploratory well for Swiss Nagra
12/03/20	Receives €20m order from ACL based in the Netherlands for geothermal heating plant
19/03/20	Josef Daldrup resigns from the board
25/05/20	Receives order for thermal water drilling well
05/06/20	Successfully drills production well for ACL geothermal heating plant

Source: Daldrup & Söhne

Strategy

During 2019, D&S's executive board adopted a strategy of 'realignment', with a desire to focus on the drilling service business and medium-sized power projects (a greater number of projects with smaller minority positions). D&S continues to adhere to this strategy as the disposal of Geysir Group illustrates. We expect D&S will also continue with its efforts to expand and tighten management control mechanisms. Ultimately, the goal is to create a business that generates predicable cash flows.

COVID-19 and FY20 outlook

D&S reports that the drilling and service business has hardly been directly affected by the COVID-19 pandemic, and that its supply and service chains continue to work on time. The company points to the improved liquidity position following the disposal of Geysir Group, and is also of the opinion that its order backlog is sufficient and well diversified into 2020, offering the prospect of regular group sales. Following the disposal of its shares in Geysir, D&S will focus on the drilling business, which has been profitable in recent years. Expanded funding and incentives for renewable heating provide a helpful backdrop to the business and, with a strong market position, the company remains confident in its ability to generate profits. In view of the outlook, the D&S's management board is targeting a total output figure of around €40m for FY20 and a positive EBIT margin of between 2% and 4%.

Valuation

Despite its assessment of improved prospects for 2020, following further declines, D&S's share price now stands at c €2. For the purposes of assessing the valuation of the company, we use consensus estimates for FY20, ie sales of €30.2m and EBIT of €1.1m (EBIT margin of 3.7%). According to Refinitiv, at a share price of c €2, D&S is trading on an EV/Sales ratio of 0.6x in FY20e (peer group median 1.6x) but, due to low assumed margins (within management guided range), an EV/EBIT multiple of 18.0x in FY20e (peer group median 13.7x). By way of illustration, a margin of c 5% on the predicted sales of €30.2m would produce EBIT of c €1.5m and an EV/EBIT ratio of 13.2x, broadly in line with the peer group median.

Exhibit 3: Comparable valuation analysis

		EV/Sales 2020e(x)	EV/Sales 2021e (x)	EV/EBIT 2020e (x)	EV/EBIT 2021e (x)
Daldrup &Söhne	4DS.DE	0.6	0.6	18.0	16.4
Awilco Drilling	AWDR.OL	-0.2	-0.1	0.2	0.1
SD Standard Drilling	SDSD.OL	1.4	1.3	4.8	3.8
Northern Drilling	NODL.OL	0.6	0.4	82.6	-3.7
Nabors Industries	NBR.BE	1.7	1.9	-12.3	-9.9
Transocean	RIG.BE	2.8	2.9	962.0	705.3
Odfjell Drilling	ODL.NO	1.5	1.5	14.9	10.8
7C Solarparken	HRPK.DE	9.6	8.6	32.5	26.7
Energiekontor	EKTG.DE	2.6	1.6	12.4	9.8
Good Energy	GOOD.LN	0.6	0.6	10.8	10.5
Ormat Technology	ORA.US	6.8	6.2	21.6	18.9
Median (excluding D&S)		**1.6**	**1.5**	**13.7**	**6.8**

Source: Refinitiv. Note: Prices as at 4 June 2020.

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Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1,185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia