October 6th, 2023
Research update

SMC Research
Small and Mid Cap Research

Platz 1 Europe Industrials (2018)
Platz 2 German Software & IT (2018)
Platz 1 German Software & IT (2017)
Mehrfacher Gewinner der renommierten Refinitiv Analyst Awards

Daldrup & Söhne AG

High momentum in the first half-year

Rating: Buy (unchanged) | **Price:** 8.04 € | **Price target:** 11.40 € (prev.: 11.80 €)

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Current development

Basic data

Based in:	Gruenwald
Sector:	Drilling services
Headcount:	137
Accounting:	HGB
ISIN:	DE0007830572
Ticker:	4DS:GR
Price:	8.04 Euro
Market segment:	Scale
Number of shares:	5.99 m
Market Cap:	48.2 m Euro
Enterprise Value:	51.0 m Euro
Free Float:	41.6 %
Price high/low (12 M):	15.00 / 7.06 Euro
Øturnover (12 M Xetra):	37,200 Euro

Sales and total output increase

The business activities of Daldrup & Söhne (D&S) were at a high level in the first half of 2023. The company was able to successfully complete several drilling projects, which was reflected in a significantly higher volume of final billings and led to a 146 percent increase in revenue to EUR 15.4 m. The revenue at D&S fluctuates strongly depending on the billing volume of large projects. Less volatile than that is the total output, which is therefore a better indicator of business development. It has also increased very significantly in the first half of the year, by 36 percent to EUR 24.1 m. Despite the high final billing volume, there was a further increase in inventories of EUR 8.7 m (previous year: EUR +11.5 m), which is mainly due to ongoing projects in Germany.

Operating margin slightly lower

Due to specific project requirements, D&S made disproportionately great use of third-party services, which caused the cost of materials to rise by 62 percent to EUR 10.9 m. The increase in other operating expenses (+42 percent to EUR 5.4 m) – due, among other things, to higher rental expenses for drilling equipment and higher costs for overburden and waste

FY ends: 31.12.	2020	2021	2022	2023e	2024e	2025e
Total output (m Euro)	47.5	44.9	36.9	42.5	44.0	45.5
EBIT (m Euro)	1.9	1.6	1.8	2.1	3.6	4.8
Net profit	-5.2	0.8	0.9	1.1	2.6	3.5
EpS	-0.87	0.13	0.14	0.18	0.43	0.58
Dividend per share	0.00	0.00	0.00	0.00	0.00	0.00
Total output growth	13.7%	-5.5%	-17.8%	15.3%	3.5%	3.4%
Profit growth	-	-	9.3%	23.5%	142.7%	36.2%
PSR	1.84	0.62	1.26	1.24	1.16	1.09
PER	-	61.8	56.5	45.8	18.9	13.8
PCR	29.8	-	29.1	12.0	12.3	9.8
EV / EBIT	27.0	32.2	27.6	24.4	14.1	10.5
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

removal – also reduced margins, while the increase in personnel costs (+9 percent to EUR 5.3 m), although also significant, was considerably lower than that of total output. In total, EBITDA improved by 9 percent to EUR 2.7 m, which means that the margin (in relation to total output) fell from 13.8 to 11.0 percent within a year. The margin effect on EBIT was less pronounced, as depreciation and amortisation (+1.6 percent) remained almost at the previous year's level. Therefore, the EBITDA growth led to a 15 percent increase in EBIT to EUR 1.4 m, equivalent to a reduction in the margin from 7.0 to 5.9 percent. With an improved financial result (from EUR -0.8 m to EUR -0.6 m), which again included write-offs on the remaining receivables from the sale of the power plant division amounting to EUR 0.4 m (previous year: EUR 0.5 m), and low tax expenses (EUR -0.1 m), this resulted in a strong improvement of the net result by 74 percent to EUR 0.7 m.

Group figures	**2021**	**2022**	***Change***
Sales	6.3	15.4	*+145.8%*
Total output	17.7	24.1	*+36.0%*
EBITDA	2.4	2.7	*+8.6%*
EBITDA margin	*13.8%*	*11.0%*	*-2.8Pp.*
EBIT	1.2	1.4	*+15.3%*
EBIT margin	*7.0%*	*5.9%*	*-1.1Pp.*
Period net result	0.4	0.7	*+74.1%*

In m Euro and percent, source: Company

Free cash flow significantly higher

Cash flow from operating activities also increased strongly, by 28 percent to EUR 2.6 m. In addition to the improvement in earnings, this was particularly helped by the reduction of receivables. The strong increase in inventories, on the other hand, did not have a negative impact, as it was offset by a significantly higher volume of advance payments received. However, the reduction of liabilities had a negative effect, whereas provisions increased significantly (which is reflected positively in the CF statement). In combination with the net outflows from investments, which halved to EUR -0.4 m compared to the previous year, a free cash flow of EUR +2.2 m results for the first half of the year, almost 150 percent more than a year earlier. The cash surplus generated and a part of the liquidity were used to significantly reduce liabilities to banks, which have fallen from EUR 7.8 m to EUR 4.6 m since the beginning of the year. As a result, the cash balance at the end of June was EUR 1.8 m, below the level from the beginning of the year (EUR 3.1 m).

Equity ratio rises to 57 percent

The reduction of receivables and liabilities and a further reduction of property, plant and equipment (since depreciation was higher than investments) led to a reduction of the balance sheet total from EUR 40.2 m to EUR 36.4 m. At the same time, thanks to the net profit for the period, equity increased from EUR 20.0 m to EUR 20.7 m, meaning that the equity ratio rose sharply from 49.7 to 57.0 percent and is at a very comfortable level.

Forecast confirmed

The order situation at D&S is currently comfortable, too: the order backlog has increased by 40 percent to EUR 38.0 m within a year, which in purely arithmetical terms ensures capacity utilisation well into 2024. New large-scale projects are already underway (drilling to expand the output of the Neustadt-Glewe geothermal power plant) or are about to begin (drilling for MTU), which ensures that business activities will continue at a high level. In addition, the company notes a clear normalisation of material supply and raw material prices. The forecast envisaging a total output of around EUR 41 m and an EBIT margin of between 3 and 5 percent for 2023 was therefore confirmed. A negative factor for the second half of the year is the maintenance of the largest drilling rig (Bentec), because on the one hand, the maintenance itself will lead to above-average maintenance costs, and on the other hand, the rig cannot be used in projects during this time.

Estimates for 2023 raised

The management forecast for the full year shows a total output of EUR 41 m. We had so far expected a total output of EUR 40.5 m. After the strong performance in the first half of the year, we now think this too low, which is why we are now raising the estimate to EUR 42.5 m, in particular due to the higher assumed build-up of inventories. Since we have also increased the assumptions for the most important cost items (materials, personnel, other operating expenses), in some cases substantially, we still expect EBITDA of EUR 4.3 m and EBIT of EUR 2.1 m.

Strong pipeline

We also consider the further growth prospects to be very positive. Both at the EU level, where the Parliament decided in September to increase the target share of renewable energies in the EU's final energy consumption from 32 to 42.5 percent by 2030, and in Germany, the general conditions for the expansion of geothermal energy are currently being significantly improved. In Germany, especially the Building Energy Act and the Municipal Heat Planning Act represent an important step forward, which could lead to a significant increase in the share of geothermal energy in heat generation in the medium to long term. In order to provide additional support, however, Daldrup believes that further improvements are necessary – in particular, an acceleration of the approval process and funding or financial security for the drilling. At present, the company is therefore still experiencing sluggish order placement in the deep geothermal sector, and banks give loans to customers more restrictively. Nevertheless, there is a noticeable increase in interest in new projects. This is particularly evident in the “relevant market volume” published by D&S, which reflects the volume of orders in the negotiation stage weighted with the probability of occurrence, which has increased very strongly within a year, from EUR 135.7 m to EUR 245.2 m.

Total output now higher

Against this backdrop and due to the strong development of total output in the first half of the year, we have slightly raised our projection for the development of total output in the further detailed forecast period. We now expect EUR 44 m for 2024 (previously: EUR 41.5 m) and a further increase to EUR 57 m in 2030 (previously: EUR 56.0 m). We still regard the average estimated growth rate (CAGR 24/30) of 5.0 percent (previously 5.5 percent, the reduction is due to the higher starting point) as conservative. In return, however, we have also increased investments.

m Euro	**12 2023**	**12 2024**	**12 2025**	**12 2026**	**12 2027**	**12 2028**	**12 2029**	**12 2030**
Total output	42.5	44.0	45.5	47.0	49.5	52.0	54.5	57.0
Total output growth	15.3%	3.5%	3.4%	3.3%	5.3%	5.1%	4.8%	4.6%
EBIT margin	4.9%	8.2%	10.6%	10.8%	11.3%	12.2%	13.3%	14.5%
EBIT	**2.1**	**3.6**	**4.8**	**5.1**	**5.6**	**6.4**	**7.2**	**8.2**
Tax rate	8.0%	8.0%	8.0%	8.0%	20.0%	30.0%	30.0%	30.0%
Adjusted tax payments	0.2	0.3	0.4	0.4	1.1	1.9	2.2	2.5
NOPAT	**1.9**	**3.3**	**4.5**	**4.7**	**4.5**	**4.5**	**5.1**	**5.8**
+ Depreciation & Amortisation	2.2	1.3	0.7	1.1	1.1	1.2	1.3	1.4
+ Increase long-term accruals	1.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3
+ Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross operating cash flow	5.3	5.0	5.5	6.0	5.9	6.0	6.7	7.5
- Increase Net Working Capital	-1.1	-1.2	-0.7	-0.5	-0.3	-0.3	-0.3	-0.3
- Investments in fixed assets	-0.9	-4.2	-4.0	-1.8	-2.0	-2.2	-2.4	-2.5
Free cash flow	**3.3**	**-0.4**	**0.9**	**3.7**	**3.6**	**3.5**	**4.0**	**4.7**

SMC estimation model

D&S will purchase a new drilling rig for medium depths (approx. 1 to 2.5 km), which will require an investment volume of EUR 3 to 4 m next year. As a precaution, we have scheduled another similarly large investment for the following period. This also increased depreciation and amortisation, which affected the EBIT margin. Due to the positive effect of the higher total output, we see this at 8.2 percent in 2024, slightly higher than previously (7.5 percent); at the end of the detailed forecast period, it is now 14.5 percent (previously 15 percent, reduction due to higher depreciation). It should be noted that the significant improvements in 2024 and 2025 are owed to a substantial extent to expiring depreciation for large drilling rigs, but we also expect positive effects in the medium term from the intensified efforts to improve efficiency. The table on the previous page shows the development of the key cash flow figures in the detailed forecast period to 2030, following our model update. Further details on the estimated development of the balance sheet, income statement and cash flow can also be found in the Annex.

Frame parameters unchanged

Subsequently, we continue to calculate the terminal value with a fifteen percent discount to the target margin of 2030 and a "perpetual" cash flow growth of 1 percent p.a. The discount rate (WACC) also remains unchanged at 6.6 percent. For this, we have assumed a cost of equity according to CAPM of 10.0 percent (with: safe interest rate of 2.5 percent, market risk premium of 5.8 percent and beta factor of 1.3), as well as a target capital structure of 55 percent debt, an interest rate on borrowed capital of 5,5 percent and a tax rate for the tax shield of 30 percent.

New price target: EUR 11.40

With the model adjustments, the fair value we have determined is now EUR 68.4 m or EUR 11.42 per share, from which we derive 11.40 as the new price target (a sensitivity analysis for the price target determination can be found in the Annex). The positive effect from the increase in estimates for total output was slightly overcompensated by the dampening effect of the higher estimated investments in 2024 and 2025. In this regard, our expectations hitherto had been a little too optimistic, but we have now, to be on the safe side, planned for another major investment in 2025 and thus a certain buffer. We rate the forecast risk on a scale of 1 (very low) to 6 (very high) as slightly above average at four points due to the project nature of the business.

Conclusion

The business development of Daldrup & Söhne was very dynamic in the first half of the year, the company was able to increase its total output by 36 percent to EUR 24.1 m. Although the cost development was disproportionately high in relation to this, EBITDA improved by 9 percent to EUR 2.7 m and EBIT by 15 percent to EUR 1.4 m. The EBIT margin has thus decreased from 7.0 to 5.9 percent.

For the full year, management has reaffirmed its forecast, which envisages a total output of around EUR 41 m and an EBIT margin of between 3 and 5 percent. In the second half of the year, cost-intensive maintenance of the largest drilling rig will burden profitability.

We consider the further outlook for D&S to be very promising: The order backlog of EUR 38 m (+40 percent) already extends well into the next year and the strong increase in the probability-weighted volume of orders in the negotiation stage, by 81 percent to EUR 245 m, signals a high future growth potential. Measures to improve efficiency also offer the opportunity for disproportionately high margin increases.

Following the positive development of the first six months, we have raised our estimates for the total output. At the same time, however, investments (from 2024) will be higher than we have assumed so far. Here we have now calculated with a safety buffer, which is the reason why our price target has been reduced slightly from EUR 11.80 to EUR 11.40. The share price has recently developed contrary to the operational progress, which is why there is now a high upside potential of more than 40 percent. Against this background, we reiterate our “Buy” rating.

Annex I: SWOT analysis

Strengths

- Very experienced management team and staff with great expertise.
- The company has a strong market position in the drilling business in its core markets. A large equipment park enables a wide range of services.
- Longstanding track-record in the successful implementation of drilling projects, especially at depths of up to 6 thousand metres.
- D&S is strongly positioned in the field of geothermal energy, which is one of the most promising renewable energies, especially for the heating market.
- The need for investment is manageable for the foreseeable future because of the existing rig portfolio.
- With an equity ratio of 57 percent, the company has a very solid balance sheet structure.

Weaknesses

- The margins in the drilling business are currently still relatively low. Last year, the EBIT margin was 5.1 percent.
- The project business is volatile; individual drilling projects can have a strong impact on the figures for a financial year.
- D&S still needs to become more efficient, especially in the management of large drilling projects.
- Replacement or supplementary investments in large drilling rigs (for very deep wells) are associated with a high investment volume.

Opportunities

- The good order situation ensures capacity utilisation well into 2024. A recent sharp increase in potential orders in the negotiation status also indicates further growth for the period thereafter.
- D&S is working on improving efficiency, which should improve margins in the medium term.
- The envisaged accelerated expansion of renewable energies could further stimulate investments in geothermal energy.
- The search for a final repository for radioactive waste offers great order potential for D&S, especially in Germany.
- In the future, D&S could participate in promising medium-sized geothermal heating plants.

Threats

- Fixed-price contracts in the drilling business carry the risk of losses if there are delays for which the company is responsible.
- Higher material, labour and energy costs have reduced the margin somewhat. The cost development could further prevent major margin improvements.
- The acquisition of qualified personnel is becoming increasingly difficult.
- Possible depreciation of residual items from the sold power plant business (at the end of June: approx. EUR 9.6 m).
- Government attempts to improve geothermal development could fail due, for example, to bureaucratic hurdles (approval processes).

Annex II: Balance sheet and P&L estimation

Balance sheet estimation

m Euro	2022 act.	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
ASSETS									
I. Total non-current	10.6	9.3	12.1	15.4	16.1	17.0	18.0	19.0	20.0
1. Intangible assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Tangible assets	5.7	4.4	7.3	10.5	11.3	12.1	13.1	14.1	15.2
II. Total current assets	29.3	28.8	31.4	33.5	38.8	43.8	46.7	50.3	54.6
LIABILITIES									
I. Equity	20.0	21.0	23.6	27.1	30.7	34.2	35.6	37.5	39.8
II. Accruals	1.1	2.2	2.6	2.9	3.2	3.6	3.9	4.3	4.6
III. Liabilities									
1. Long-term liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Short-term liabilities	19.1	15.1	17.5	19.1	21.2	23.3	25.4	27.7	30.4
TOTAL	**40.2**	**38.3**	**43.7**	**49.0**	**55.1**	**61.0**	**64.9**	**69.5**	**74.8**

P&L estimation

m Euro	2022 act.	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
Sales	38.2	38.9	41.6	44.1	46.1	48.5	51.0	53.4	55.9
Total output	36.9	42.5	44.0	45.5	47.0	49.5	52.0	54.5	57.0
Gross profit	23.5	25.4	26.6	28.0	29.1	30.7	32.3	34.1	35.8
EBITDA	4.2	4.3	5.0	5.6	6.1	6.7	7.6	8.5	9.7
EBIT	1.8	2.1	3.6	4.8	5.1	5.6	6.4	7.2	8.2
EBT	0.9	1.2	2.8	3.8	4.0	4.4	5.1	5.8	6.7
EAT (before minorities)	0.9	1.1	2.6	3.5	3.6	3.5	3.5	4.1	4.7
EAT	0.9	1.1	2.6	3.5	3.6	3.5	3.5	4.1	4.7
EPS	0.14	0.18	0.43	0.58	0.60	0.58	0.59	0.68	0.78

Annex III: Cash flows estimation and key figures

Cash flows estimation

m Euro	2022 act.	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
CF operating	1.7	4.0	3.9	4.9	5.6	5.9	6.2	6.9	7.8
CF from investments	-0.8	-0.9	-4.2	-4.0	-1.8	-2.0	-2.2	-2.4	-2.5
CF financing	-1.8	-4.1	1.0	-0.1	0.4	0.3	-1.9	-1.8	-2.0
Liquidity beginning of year	3.0	3.1	2.1	2.9	3.8	8.0	12.2	14.3	17.0
Liquidity end of year	3.1	2.1	2.9	3.8	8.0	12.2	14.3	17.0	20.4

Key figures

percent	2022 act.	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
Total output growth	-17.8%	15.3%	3.5%	3.4%	3.3%	5.3%	5.1%	4.8%	4.6%
Sales growth	-51.1%	1.8%	6.9%	6.1%	4.4%	5.3%	5.1%	4.8%	4.6%
Gross margin	63.7%	59.7%	60.5%	61.6%	62.0%	62.0%	62.2%	62.5%	62.8%
EBITDA margin	11.5%	10.1%	11.3%	12.2%	13.0%	13.6%	14.6%	15.7%	16.9%
EBIT margin	5.0%	4.9%	8.2%	10.6%	10.8%	11.3%	12.2%	13.3%	14.5%
EBT margin	2.4%	2.8%	6.4%	8.4%	8.4%	8.9%	9.8%	10.7%	11.8%
Net margin (after minorities)	2.3%	2.5%	5.8%	7.6%	7.7%	7.1%	6.8%	7.5%	8.2%

Annex IV: Sensitivity analysis

	Perpetual cash flow growth				
WACC	**2.0%**	**1.5%**	**1.0%**	**0.5%**	**0.0%**
5.6%	17.44	15.64	14.24	13.11	12.17
6.1%	15.14	13.79	12.69	11.79	11.04
6.6%	13.35	12.29	**11.42**	10.69	10.08
7.1%	11.91	11.07	10.36	9.76	9.25
7.6%	10.72	10.04	9.46	8.97	8.54

Disclaimer

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Charts
The charts were made with Tai-Pan (www.lp-software.de).

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II) Preparation and updating

The present financial analysis was prepared by: Dipl.-Kfm. Holger Steffen

Participants in the preparation of the present financial analysis: -

The present analysis was finished on 06.10.2023 at 14:40 Uhr and published on 06.10.2023 at 14:50.

For the preparation of its financial analyses, the sc-consult GmbH uses a five-tier rating scheme with regard to price expectation in the next twelve months. Additionally, estimation risk is quantified on a scale from 1 (low) to 6 (high). The ratings are as follows:

Strong Buy	We expect an increase in price for the analysed financial instrument by at least 10 percent. We assess the estimation risk as below average (1 to 2 points).
Buy	We expect an increase in price for the analysed financial instrument by at least 10 percent. We assess the estimation risk as average (3 to 4 points).
Speculative Buy	We expect an increase in price for the analysed financial instrument by at least 10 percent. We assess the estimation risk as above average (5 to 6 points).
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	than 10 percent, but explicitly mentioned temporary factors prevent a short-term realization of the price potential.
Sell	We expect that the price of the analysed financial instrument will drop by at least 10 percent. The forecast risk (1 to 6 points) has no further impact on the rating.

The expected change in price refers to the current share price of the analysed company. This price and any other share prices used in this analysis are XETRA closing prices as of the last trading day before publication. If the share is not traded on XETRA, the closing price of another public stock exchange is used with a separate note to that effect.

The price targets published within the assessment are calculated with common methods of financial mathematics, especially with the DCF (discounted cash flow) method, the sum of the parts valuation and a peer group analysis. The valuation methods are affected by economic framework conditions, especially by the development of the interest rates.

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Date	Investment recomm.	Target price	Conflict of interests
07.06.2023	Buy	11.80 Euro	1), 3), 4)
14.05.2023	Hold	11.00 Euro	1), 3), 4)
07.10.2022	Buy	8.00 Euro	1), 3), 4)
29.08.2022	Buy	8.00 Euro	1), 3), 4)
09.06.2022	Buy	6.70 Euro	1), 3), 4)
08.10.2022	Hold	5.60 Euro	1), 3), 4)

In the course of the next twelve months, sc-consult GmbH will presumably prepare the following financial analyses for the company: one update and one comment.

The publishing dates for the financial analyses are not yet fixed at the present moment.

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