June 9th, 2022
Research update

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Daldrup & Söhne AG

Positive trend in earnings development

Rating: Buy (prev.: Hold) | **Price:** 5.76 € | **Price target:** 6.70 € (prev.: 5.60 €)

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Recent business development

Basic data

Based in:	Gruenwald
Sector:	Drilling services
Headcount:	130
Accounting:	HGB
Ticker:	4DS:GR
ISIN:	DE0007830572
Price:	5.76 Euro
Market segment:	Scale
Number of shares:	5.99 m
Market Cap:	34.5 m Euro
Enterprise Value:	39.2 m Euro
Free Float:	41.6 %
Price high/low (12 M):	7.20 / 3.74 Euro
Øturnover (12 M Xetra):	18,900 Euro

The total output of Daldrup & Söhne (D&S) declined slightly in the last financial year, by 5.5 percent to EUR 44.9 m, but was still moderately above the management's target figure of roughly EUR 43 m. By contrast, the development of revenues was much more spectacular, almost tripling to EUR 78.1 m. However, this is an outlier resulting from the final settlement of a multi-year project for Stadtwerke München, which at the same time was associated with a large reduction of partially completed work.

Since the project margin had already been continuously collected during the implementation, the final invoice in 2021 no longer had a major effect on the group EBIT, which at EUR 1.5 m was 18.4 percent below the previous year's figure. However, while the figure from 2020 included significant one-off special effects, last year's result was generated operationally. Insofar, the EBIT margin of 3.4 percent, which was in the upper half of the management's target range (2 to 4 percent), is pleasing. For the current financial year, the company is aiming for an improved EBIT margin of 4 to 6 percent with a total output of EUR 42 m.

FY ends: 31.12.	2019	2020	2021	2022e	2023e	2024e
Total output (m Euro)	41.8	47.5	44.9	43.0	44.0	45.0
EBIT (m Euro)	-9.7*	1.9*	1.6	2.2	2.4	3.5
Net profit	-11.9*	-5.2*	0.8	1.1	1.2	2.0
EpS	-1.99*	-0.87*	0.13	0.18	0.21	0.33
Dividend per share	0.00	0.00	0.00	0.00	0.00	0.00
Total output growth	19.7%	13.7%	-5.5%	-4.1%	2.3%	2.3%
Profit growth	-	-	-	39.4%	13.6%	61.0%
PSR	1.39	1.32	0.44	0.94	0.92	0.90
PER	-	-	44.3	31.8	28.0	17.4
PCR	8.5	21.4	-	12.1	10.5	9.8
EV / EBIT	-	20.7	24.8	18.2	16.2	11.2
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

**including one-off effects associated with the disposal of the power plant division*

Total output decreases slightly

In the last financial year, Daldrup & Söhne recorded strong demand for its drilling services and, with a total output of EUR 44.9 m, slightly exceeded its own forecast (around EUR 43 m). Compared to the very strong previous year's figure of EUR 47.5 m, this meant a moderate decline of 5.5 percent. On the other hand, booked sales rose very strongly, by 198 percent to EUR 78.1 m. However, this figure represents an upward outlier resulting from the final settlement of a major multi-year project for Stadtwerke München. The execution of drilling for this project had caused a significant increase in partially completed work on the balance sheet in previous years, up to EUR 78.1 m as of 30 June 2021. In the second half of the year, there was a large net reduction in inventories (by EUR 48.2 m) due to the large final settlement, so that the partially completed work at the end of the year was reduced to only EUR 30.1 m.

Group figures	2020	2021	*Change*
Revenues	26.2	78.1	*+198.1%*
Total output	47.5	44.9	*-5.5%*
EBITDA	4.2	4.0	*-5.9%*
EBITDA margin	*8.8%*	*8.8%*	*unchgd.*
EBIT	1.9	1.5	*-18.4%*
EBIT margin	4.0%	3.4%	*-0.6pp.*
Result for the period	-5.2	0.8	-

In m Euro and percent; source: Company

Quality of earnings improved

Since the margin of the project had been collected continuously (which is always the case when day rate accounting is used), the final settlement − in contrast to other contracts where the project result is only visible with the final billing − did not have a major effect on the result. EBITDA was therefore 6 percent below the previous year's figure at EUR 4.0 m and developed almost in sync with total output. Nevertheless, the quality of earnings improved significantly last year, as in 2020 a positive balance of one-off income (approx. EUR 3.5 m) and charges (approx. EUR 1.5 m) from the disposal of the power plant division was still included in the EBITDA. This effect was now nearly compensated from the operating business, even though personnel expenses increased by 0.5 percent to EUR 8.9 m, which means that the personnel expense ratio (in relation to total output) rose from 18.6 to 19.8 percent. At the same time, however, the cost of materials was reduced by 15.3 percent to EUR 21.5 m, which was mainly due to the decline in the services purchased. The cost of materials ratio fell thus from 53.4 percent to 47.9 percent. Other operating expenses also decreased significantly, from EUR 13.5 m to EUR 11.0 m, and their decline clearly exceeded the non-recurring effect (the EUR 1.5 m mentioned). The figures thus show the first efficiency improvements that the company has achieved.

Return to profit zone

With a slight increase in depreciation and amortisation (+2.4 percent to EUR 2.4 m), the decline in EBITDA resulted in a drop in EBIT of 18.4 percent to EUR 1.5 m. Adjusted for the special effects outlined above, however, the operating profit improved significantly and, with a margin of 3.4 percent, also reached a figure in the upper half of the management forecast (2 to 4 percent). On balance, with minor tax payments and a negative financial result of EUR -0.7 m, this resulted in net income (after minority interests) of EUR 0.8 m. In the previous year, a loss of EUR 5.2 m had been reported, since write-offs on receivables from the former power plant division had burdened the financial result of 2020 with EUR 6.4 m.

Positive free cash flow

Nevertheless, the cash flow from operating activities was slightly negative at EUR -0.4 m, which is mainly due to the high volume of non-cash income. In contrast, in the previous year special effects resulting from the separation of the power plant division resulted in a net cash surplus of EUR 1.6 m. This time, there were positive one-off effects in the investment cash flow, where cash inflows of EUR 2.1 m, most of which resulted from a severance payment from the buyer of the power plant division, IKAV, led to an increase in cash surplus from EUR 0.6 m to EUR 1.3 m, although at the same time the acquisition of new drilling rigs increased expenditure on property, plant and equipment and intangible assets from EUR 0.8 m to EUR 1.2 m. Overall, free cash flow of EUR 0.9 m (previous year: EUR 2.3 m) was generated. With an almost balanced financing cash flow, in which redemption payments, interest payments and new borrowing were more or less in balance, the funds were used for a scheduled repayment of credit facilities (from EUR 5.8 to 4.9 m as part of the repayment of project financing). The balance sheet liquidity remained almost unchanged at around EUR 3 m.

Residual risks decrease

The receivables still due from companies of the former power plant division were further reduced in 2021 as part of the settlement agreement with the buyer IKAV and amount to EUR 4.7 m. In addition, a receivable amounting to EUR 4.4 m from the company J.D. Apparate- und Maschinenbau GmbH, which is independent but managed by Karl and Thomas Daldrup and therefore considered to be "related", was booked last year as part of a change of debtor. As a result, the company took over the utilisation of the power plant components that had passed into the possession of the Daldrup Group and whose estimated market value corresponds to the receivable. In March 2022, a smaller portion of these components was sold at a price above the proportionate carrying amount.

Equity ratio at almost 50 percent

Nevertheless, the other loans, in which the receivables are shown, remain the largest single item on the assets side of the balance sheet at EUR 9.7 m, ahead of the other assets, which include an additional loan receivable from J.D. Apparate- und Maschinenbau GmbH in the amount of EUR 6.0 m, and which amounted to EUR 8.5 m as of the reporting date. Other notable assets are property, plant and equipment (EUR 7.2 m), inventories (EUR 6.2 m) and trade receivables (EUR 4.1 m). On the liabilities side, equity increased slightly from EUR 18.2 m to EUR 19.0 m. In relation to the balance sheet total of EUR 38.6 m (previous year: EUR 38.5 m), the equity ratio improved from 47.3 to 49.3 percent.

High order potential

Daldrup reported an order backlog of EUR 20.2 m at the end of March. Although this figure has fallen significantly compared to last August (EUR 28.0 m), it already ensures capacity utilisation by the end of the third quarter. The management is also confident that it will soon be able to report further orders. The company puts the probability-weighted volume of potential projects that are in the negotiation stage at around EUR 104 m – this is significantly more than the EUR 83 m that had been communicated as status for last August. Overall, Daldrup reports a further increase – from a high level – in interest in geothermal projects. The sharp rise in energy prices, also as a result of the war in Ukraine, and the need to develop new energy sources are placing greater emphasis on geothermal energy, especially for the heating market. In the area of near-surface geothermal energy for private households, the company is already working to capacity until November. In total, the management expects a total output of EUR 42 m for the current year, which would thus be slightly below the previous year's figure. At the same time, however, the EBIT margin is to be significantly improved to a figure between 4 and 6 percent.

Update of estimates

The total output forecast is slightly below our expectations, which projected EUR 44 m. However, the company had also calculated the total output conservatively for 2021 and exceeded it in the end. Nevertheless, we are lowering our estimate to EUR 43 m as a precaution. On the other hand, we are very positive about the targeted margin improvement to 4 to 6 percent, which reflects an increased margin level of orders. We had previously expected 4.4 percent and are now raising this figure to 5 percent.

Good prospects

Beyond that, we expect positive general conditions for the business development of Daldrup & Söhne. On the one hand, the search for a repository for radioactive waste will also be accelerated in Germany in the coming years, which promises a high potential for lucrative drilling contracts (after D&S has already successfully completed a major multi-year project in this field in Switzerland). On the other hand, geothermal energy could play an important role in the German and European energy transition, as intensified development could make a major contribution to meeting heating needs. However, it is still up to policy makers to improve the framework conditions in such a way that the great potential can be tapped more quickly. The limiting factor for D&S is likely to be staff availability: skilled workers are already hard to come by. For this reason, as before, we only expect a moderately growing total output from 2023 onwards to a target value of EUR 50 m in 2029 (CAGR 2022 to 2029: 2.5 percent p.a.). At the same time, the focus on further profitability improvements and decreasing scheduled depreciation should enable a significant margin increase. We have revised depreciation and now expect a significant decrease for 2024 and 2025, as the large drilling rigs will then be fully depreciated and, according to management, no replacement investments of this magnitude will be necessary for quite some time. We now see the target EBIT margin in 2029 at 9.0 percent (previously: 7.0 percent in 2028).

An overview of the development of the key cash flow indicators resulting from these assumptions until 2029 can be found in the table below; further details on the projected balance sheet, income statement and cash flow statement can also be found in the Annex.

Framework data remain the same

Subsequently, we continue to calculate the terminal value with a fifteen percent discount to the target margin of 2029 and a "perpetual" cash flow growth of 1 percent p.a. The discount rate (WACC) also remains unchanged at 5.8 percent. For this, we have assumed a cost of equity according to CAPM of 8.5 percent (with: safe interest rate of 1.0 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 5.0 percent and a tax rate for the tax shield of 30 percent.

Price target: EUR 6.70

These assumptions result in a fair market value of equity of EUR 40.2 m or EUR 6.71 per share. On this basis, we set a new price target of EUR 6.70 (a sensitivity analysis for determining the price target can be found in the Annex). The increase compared to our

m Euro	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027	12 2028	12 2029
Sales	36.6	37.4	38.3	39.1	40.0	40.8	41.7	42.5
Sales growth		2.3%	2.3%	2.2%	2.2%	2.1%	2.1%	2.0%
EBIT margin*	5.0%	5.5%	7.8%	8.9%	9.0%	9.0%	8.8%	9.0%
EBIT	**2.2**	**2.4**	**3.5**	**4.1**	**4.2**	**4.3**	**4.3**	**4.5**
Tax rate	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
Adjusted tax payments	0.6	0.7	1.0	1.2	1.3	1.3	1.3	1.3
NOPAT	**1.5**	**1.7**	**2.4**	**2.9**	**3.0**	**3.0**	**3.0**	**3.1**
+ Depreciation & Amortisation	2.4	2.3	1.5	0.5	0.6	0.7	0.8	0.9
+ Increase long-term accruals	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
+ Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross operating cash flows	4.4	4.5	4.4	3.8	4.0	4.1	4.2	4.5
- Increase Net Working Capital	-1.6	-1.3	-1.0	-0.5	-0.2	-0.2	-0.2	-0.3
- Investments in fixed assets	-1.3	-1.3	-1.4	-1.5	-1.6	-1.7	-1.8	-1.9
Free cash flow	**1.4**	**1.8**	**1.9**	**1.8**	**2.2**	**2.2**	**2.1**	**2.3**

**to total output; SMC estimation model* last valuation (EUR 5.60) is due to the effect of the roll-over of the model to the new base year 2022 and, above all, to a more positive assessment of the operating margins in view of the issues outlined. 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

With a total output of EUR 44.9 m, Daldrup und Söhne slightly exceeded the management forecast (around EUR 43 m) last year and achieved an EBIT margin of 3.4 percent in the upper half of the target range (2 to 4 percent). We see this as a satisfactory development, because these figures conceal a clear improvement in the quality of results: While the EBIT margin of 4.0 percent achieved in the previous year was largely due to special effects, the result in 2021 was generated operationally.

This trend is expected to continue in the current year, for which the Executive Board is forecasting an EBIT margin of 4 to 6 percent with a total output of EUR 42 m. We consider this a positive surprise. We had so far expected 4.4 percent and have now raised our estimate to 5 percent.

For the subsequent period, we anticipate a further increase in margins with a moderate increase in total output as well. In addition to falling depreciation (following the end of depreciation for the largest drilling rigs), further efficiency improvements and favourable market conditions should contribute to this. We believe it is likely that the targeted accelerated expansion of renewable energies in Europe will have a positive impact on the drilling business in the geothermal sector − D&S is already sensing increasing interest. Another revenue driver is the search for repository sites for radioactive waste, which will be accelerated in the coming years, especially in Germany.

After updating the estimates, with which we have in particular raised our margin forecasts, we now see the price target at EUR 6.70. As we see a good chance that the margin situation will improve sustainably, we upgrade the rating from "Hold" to "Buy".

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 almost 50 percent, the company has a very solid balance sheet structure.

Weaknesses

- Due to a failed expansion in the field of geothermal power plant operation (with electricity production), D&S has recorded high losses in recent years. The business unit was sold in 2019/20.
- The margins in the drilling business are currently still relatively low. Group-wide, an EBIT margin of 4 to 6 percent is targeted for 2022.
- D&S still needs to become more efficient, especially in the management of large drilling projects.
- Due to the strong influence of the power plant business on the figures of the last few years, it is still difficult to calculate the potential for generating free cash flows in the core business.
- Replacement or supplementary investments in large drilling rigs (for very deep wells) are associated with a high investment volume.

Opportunities

- D&S is actively working to improve efficiency. The margin increase forecast for 2022 indicates the first successes of these efforts.
- At EUR 103 m, the volume of possible orders in the negotiation stage is currently very high.
- The envisaged accelerated expansion of renewable energies, also because of the Russian issue, 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.
- Perspectively, 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.
- Rising material prices as well as energy and labour costs can put pressure on margins.
- The acquisition of qualified personnel is becoming increasingly difficult.
- Possible depreciation of residual items from the sold power plant business (at the end of 2021: approx. EUR 9 m).
- Electricity production with deep geothermal energy is still dependent on state subsidies; a reduction in subsidies would greatly reduce the project potential here.

Annex II: Balance sheet and P&L estimation

Balance sheet estimation

m Euro	2021 act.	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e
ASSETS									
I. Total non-current	16.8	15.7	14.6	14.6	15.6	16.6	17.6	18.7	19.7
1. Intangible assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Tangible assets	7.2	6.0	5.0	4.9	5.9	6.9	8.0	9.0	10.0
II. Total current assets	21.8	25.6	29.6	33.5	36.5	39.8	41.6	43.3	45.2
LIABILITIES									
I. Equity	19.0	20.1	21.4	23.3	25.7	28.1	29.1	30.1	31.2
II. Accruals	1.2	1.6	2.1	2.5	2.9	3.3	3.7	4.2	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	18.4	19.6	20.9	22.3	23.6	25.0	26.4	27.8	29.2
TOTAL	**38.6**	**41.3**	**44.3**	**48.1**	**52.2**	**56.4**	**59.3**	**62.0**	**64.9**

P&L estimation

m Euro	2021 act.	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e
Sales	78.1	36.6	37.4	38.3	39.1	40.0	40.8	41.7	42.5
Total output	44.9	43.0	44.0	45.0	46.0	47.0	48.0	49.0	50.0
Gross profit	23.4	23.1	23.7	24.3	24.7	25.3	25.9	26.4	27.0
EBITDA	3.9	4.6	4.8	5.0	4.6	4.8	5.0	5.1	5.4
EBIT	1.6	2.2	2.4	3.5	4.1	4.2	4.3	4.3	4.5
EBT	0.8	1.7	1.9	3.0	3.5	3.6	3.7	3.7	3.8
EAT (before minorities)	0.8	1.1	1.2	2.0	2.3	2.4	2.5	2.4	2.5
EAT	0.8	1.1	1.2	2.0	2.3	2.4	2.5	2.4	2.5
EPS	0.13	0.18	0.21	0.33	0.39	0.40	0.41	0.41	0.42

Annex III: Cash flows estimation and key figures

Cash flows estimation

m Euro	2021 act.	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e
CF operating	-0.4	2.8	3.3	3.5	3.5	4.0	4.1	4.2	4.4
CF from investments	1.3	-1.3	-1.3	-1.4	-1.5	-1.6	-1.7	-1.8	-1.9
CF financing	0.0	0.1	0.2	0.2	0.1	0.2	-1.2	-1.3	-1.3
Liquidity beginning of year	3.0	3.0	4.7	6.8	9.2	11.2	13.8	15.0	16.0
Liquidity end of year	3.0	4.7	6.8	9.2	11.2	13.8	15.0	16.0	17.3

Key figures

percent	2021 act.	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e
Total output growth	-5.5%	-4.1%	2.3%	2.3%	2.2%	2.2%	2.1%	2.1%	2.0%
Sales growth	198.1%	-53.2%	2.3%	2.3%	2.2%	2.2%	2.1%	2.1%	2.0%
Gross margin*	52.1%	53.8%	53.9%	54.1%	53.8%	53.8%	53.9%	53.9%	53.9%
EBITDA margin*	8.8%	10.7%	10.8%	11.1%	10.0%	10.2%	10.4%	10.4%	10.8%
EBIT margin*	3.5%	5.0%	5.5%	7.8%	8.9%	9.0%	9.0%	8.8%	9.0%
EBT margin*	1.8%	4.0%	4.4%	6.7%	7.7%	7.7%	7.7%	7.5%	7.6%
Net margin (after minorities)*	1.7%	2.5%	2.8%	4.4%	5.1%	5.1%	5.1%	5.0%	5.1%

**to total output*

Annex IV: Sensitivity analysis

	Perpetual cash flow growth				
WACC	**2.0%**	**1.5%**	**1.0%**	**0.5%**	**0.0%**
4.8%	11.20	9.73	8.66	7.83	7.18
5.3%	9.40	8.36	7.57	6.94	6.43
5.8%	8.08	7.32	**6.71**	6.22	5.81
6.3%	7.07	6.49	6.01	5.62	5.29
6.8%	6.27	5.82	5.44	5.12	4.85

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 09.06.2022 at 7:10 and published on 09.06.2022 at 8:15.

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Hold	We expect that the price of the analysed financial instrument will remain stable (between -10 and +10 percent). The forecast risk (1 to 6 points) has no further impact on the rating. The rating "hold" is also used in cases where we perceive a price potential of more

	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.

The rating resulting from these methods reflects current expectations and can change anytime subject to company-specific or economic changes.

More detailed explanations of the models used by SMC Research can be found at:
http://www.smc-research.com/impressum/modellerlaeuterungen

An overview of the recommendations prepared and distributed by SMC Research in the last 12 months can be found at: http://www.smc-research.com/publikationsuebersicht

In the past 24 months, sc-consult GmbH has published the following financial analyses for the company:

Date	Investment recomm.	Target price	Conflict of interests
08.10.2022	Hold	5.60 Euro	1), 3), 4)
24.06.2021	Hold	5.60 Euro	1), 3), 4)
25.02.2021	Hold	5.60 Euro	1), 3), 4)
12.10.2020	Hold	4.90 Euro	1), 3), 4)
22.06.2020	Hold	4.70 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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