

## Daldrup & Söhne

Alternative energy

26 June 2018

### Increased profits and business activity

Daldrup & Söhne made progress in building its presence in geothermal generation during FY17 and this is expected to yield additional benefits in FY18. A stable regulatory framework, an order book at record levels and additional geothermal projects under development (Neuried and Puchheim) are also expected to contribute to growing profitability in the forecast period (see consensus forecasts).

### FY17 results: Targets met, growth achieved

FY17 results from Daldrup & Söhne revealed total output of €43m (target €40m) and an EBIT margin of 2.6% (target 2.0-5.0%). In addition to meeting its overall financial targets, the results demonstrated year-on-year growth. Total output rose by 9.1% to €43m, although sales revenue fell due to the delayed completion of a significant drilling project in the Netherlands – the project has since been invoiced. EBIT increased by c 20% to €1.1m, although it did not cover interest costs of €1.8m. Net debt rose to €13.1m (from €7.9m), however a capital increase (€6.3m gross) post the year-end has strengthened the balance sheet.

### Operational progress and favourable outlook

FY17 was also a year of operational progress, with Daldrup & Söhne increasing its holding in two geothermal projects, namely Landau and Taufkirchen. These two plants are expected to significantly increase their contribution in FY18 (first full year of consolidation), with EBIT in the region of €1m (according to management). In addition, with a stable regulatory framework and buoyant order volumes (the FY17 order book stood at c €49m), the prospects for FY18 appear promising. The company's financial target for FY18 is for total output of at least €40m and an EBIT margin of between 2% and 5%.

### Valuation: Premium rating

Our valuation analysis is based on management's FY18 projections for revenue (€40m) and EBIT margin (2-5%). Daldrup & Söhne is trading on a FY18 EV/sales ratio of c 2x, assuming revenue of €40m. The figure of 2x represents a premium to the wider market but a discount to the selected group of renewable and drilling companies.

#### Historic figures

Year end	Revenue (€m)	EBIT (€m)	PBT (€m)	EPS (€)	P/E (x)	Yield (%)
12/16	31.1	1.0	(0.2)	0.03	355	N/A
12/17	24.8	1.1	0.0	0.00	N/A	N/A

Source: Daldrup & Söhne

Price €10.65

Market cap €64m

#### Share price graph



#### Share details

Code	4DS
Listing	Deutsche Börse Scale
Shares in issue	6.0m
Last reported net debt at 31 December 2017	€13.1m

#### Business description

Daldrup & Söhne AG is an onshore drilling and environmental services company with vertically integrated competencies in geothermal projects (from feasibility study, permitting and constructing to power supply contracting). It is seeking to create predictable revenue streams as an independent power producer.

#### Bull

- Emission reduction and renewable energy targets provide a helpful macro environment.
- Favourable feed-in tariffs in Germany for geothermal energy.
- Increased focus on operational plant should reduce financial volatility.

#### Bear

- Investment in geothermal projects likely to increase the capital intensity of the business.
- The time frame for the development of geothermal energy projects is longer than for some other renewable technologies.
- FY17 EBIT did not cover interest charge for year.

#### Analyst

Graeme Moyle +44 20 3077 5700

[industrials@edisongroup.com](mailto:industrials@edisongroup.com)  
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## FY17 results: Meet targets and demonstrate growth

Daldrup & Söhne's FY17 results exceeded its self-imposed targets, with total output of €43m (target €40m) and an EBIT margin of 2.6% (target 2.0-5.0%). At this point it is worth reiterating that the company reports according to German GAAP and as such all costs and expenses are recognised immediately when they are incurred, but profitability is based on output (invoiced revenue plus change in work in progress). The inclusion of the change in work in progress helps to smooth out the timing difference between revenue recognition and cash flows. The delay in invoicing a significant drilling project led to a decline in sales volume in FY17, but did not adversely affect total output.

In addition to meeting its financial targets, Daldrup & Söhne demonstrated strong year-on-year growth. Output rose by 9.1%, to €43m, and EBIT achieved an increase of c 20%, to €1.1m, although it remained below the level required to cover total interest costs (€1.8m). Of the total sales revenue of c €24.8m, €12.4m, or c 50%, was accounted for by the geothermics business. Drilling and exploration contributed €5.3m, water €4.1m and the environmental business, EDS, €2.9m. Of the total revenue, 85% related to operations located in Germany. The main driver of the increase in profitability, aside from the increase in gross revenue, was the reduction in the cost of raw materials (in part offset by a slight rise in employee costs).

At the year-end the balance sheet showed a significant increase (+€11.3m) due to the first time consolidation of geox GmbH, the operating and holding company for the Landau geothermal plant. The consolidation of Landau also accounted for a significant rise in the balance sheet total for technical equipment and machinery (+67.1% to €22.7m). The year-end FY17 balance sheet also showed cash at bank of €1.5m (FY16: €0.8m) and an equity ratio of 45.3% (FY16: 50.4%).

### Exhibit 1: FY16 vs FY17 results – key highlights

€m	FY16	FY17	% change	Comment
Sales	31.137	24.758	-20.5%	
Increase in work in progress	8.321	18.286	+119.7%	Delay in invoicing Dutch drilling project
Output	39.458	43.044	+9.1%	Increase in output reflecting increase in activity and order book
EBITDA	4.557	4.743	+4.1%	Despite higher employee costs higher revenue-feeds through to higher EBITDA
Depreciation, amortisation and impairment	(3.605)	(3.604)	NM	
EBIT	0.951	1.139	+19.8%	
EBIT Margin (%)	2.4%	2.6%	N/A	EBIT margin increase and within target range helped by flat D&A
Interest expenses	(1.354)	(1.797)	+32.7%	Rise in indebtedness
Net profits	(0.228)	(0.025)	-89.0%	
<b>Cash flow</b>				
From operating activities	3.654	9.897	+170.8%	Significant improvement in w/k cap. movements
From investing activities	(1.130)	(13.151)	NM	Large increase in investment in PPE
From financing activities	(2.304)	(1.298)	+43.7%	Increased issue of bonds and loans
Net Debt	(7,863)	(13,059)		

Source: Daldrup & Söhne

## Post year-end developments

Since the year-end Daldrup & Söhne has successfully issued fresh equity, raising €6.4m (gross) in February. As a result of the issue, the number of shares has increased to 6m and the share of the equity held by the Daldrup family has fallen from 65% at the year-end to 59% post the issue. Since the year end the company has continued to receive drilling orders and has raised its holding in the

Taufkirchen geothermal plant to 55.2% at the group level (from 29%) via the acquisition of Axpo Power's 35% holding. In FY17 Daldrup & Söhne raised its holding (at the group level) in the Landau geothermal plant to 67% (from 30%), although this deal was concluded in February 2018.

#### Exhibit 2: Post year-end developments

Date	Event
4 May 2018	Order for geothermal drilling from Stadtwerke Schwerin
9 April 2018	Stadtwerke München commissions six deep geothermal drillings
27 February 2018	Issue of 544,500 shares raising €6.4m
5 February 2018	Concludes Increase in stake in Landau geothermal plant to 67%
25 January 2018	Increase in stake in Taufkirchen geothermal plant 55.21%

Source: Daldrup & Söhne

## Outlook

The outlook for Daldrup & Söhne appears favourable. The regulatory framework remains relatively benign, with geothermal energy plants receiving a feed-in tariff (FiT) of 25.2 cents/kWh. The company now enjoys a strengthened balance sheet, post the rights issue, with an ability to develop the projects at Puchheim and Neuried. There is also the prospect of a significantly increased contribution from Landau and Taufkirchen geothermal plants in FY18. The potential revenue contribution from the two geothermal plants is expected to be in the region of €5m, with EBIT of c €1m. Order volume at the end of FY17 stood at c €49m (a record) and the total order pipeline at €98m. The company's financial target for FY18 is for total output of at least €40m and an EBIT margin of between 2% and 5%. Both of these targets are below consensus forecasts.

## Valuation

We base our valuation commentary on management's FY18 projections for revenue (€40m) and EBIT margin (2-5%). Our analysis compares Daldrup & Söhne to the wider market and a list of comparable companies.

Daldrup & Söhne is trading on a FY18 EV/revenue ratio of c 2x assuming a revenue figure of €40m. The figure of 2.0x represents a premium to the wider market but a discount to the selected group of renewable and drilling companies (see Exhibit 3). By way of illustration, assuming a revenue figure of €45m, D&S's forecast EV/revenue multiple declines to 1.8x.

#### Exhibit 3: Daldrup & Söhne – comparable valuation analysis

		P/E 18 (x)	P/E 19 (x)	EV/Sales 18 (x)	EV/Sales 19 (x)	EV/EBIT 18 (x)	EV/EBIT 19 (x)
DJ STOXX 600	SXXP	14.5	13.3	1.6	1.5	N/A	N/A
<b>Drilling companies</b>							
BAUER	BSA GY	11.2	7.99	0.6	0.6	10.1	9.1
Odfjell Drilling	ODL NO	114.3	21.7	3.0	2.6	27.1	17.3
Average		62.8	14.8	1.8	1.6	18.6	13.2
<b>Renewable companies</b>							
7C Solarparken	HRPK GY	25.7	25.7	7.8	7.5	24.4	22.4
Energy Development Corporation	EDC PM	9.7	8.8	4.2	4.0	10.0	9.6
Engiekontor	EKT GY	34.3	10.7	3.2	1.6	14.4	7.5
Good Energy	GOOD LN	10.7	8.2	0.7	0.7		
Ormat Technology	ORA US	22.6	21.5	5.1	4.8	16.2	14.2
Polish Energy Partners	PEP PW	43.6	15.8	0.5	0.5	20.7	14.2
Average		24.4	15.1	3.6	3.2	17.1	13.6
<b>Combined average</b>		<b>34.0</b>	<b>15.0</b>	<b>3.1</b>	<b>2.8</b>	<b>15.4</b>	<b>11.8</b>

Source: Bloomberg. Note: Priced at 25 June 2018.

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