June 6th, 2024
Research update

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Daldrup & Söhne AG

Annual results above forecast – optimistic outlook

Rating: Buy (unchanged) | **Price:** 9.12 € | **Price target:** 10.50 € (prev.: 11.40 €)

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Current development

Basic data

Based in: Gruenwald
Sector: Drilling services
Headcount: 139
Accounting: HGB

ISIN: DE0007830572
Ticker: 4DS:GR
Price: 9.12 Euro
Market segment: Scale
Number of shares: 5.99 m
Market Cap: 54.6 m Euro
Enterprise Value: 58.8 m Euro
Free Float: 41.6 %
Price high/low (12 M): 13.70 / 6.60 Euro
Ø turnover (12 M Xetra): 24,500 Euro

Total output well above forecast

Thanks to a good order situation, Daldrup & Söhne significantly increased its total output last year by 31.3 percent to EUR 48.4 m, while sales were even slightly higher at EUR 49.1 m (+28.6 percent) (the difference is due to a negative change in inventories). Growth was driven in particular by numerous major projects in the areas of geothermal energy (sales of EUR 26.1 m, +80 percent) and raw materials/exploration (EUR 20.4 m, +14 percent), while sales in the two smaller areas of water management (EUR 0.9 m, -75 percent) and environmental services/EDS (EUR 1.7 m, -21 percent) declined. This reflects the company's flexibility to use its drilling capacities in the areas where there is the greatest need. The focus of activities in 2023 was mainly in Germany, with a revenue share of 81 percent (previous year: 42 percent) and also in Switzerland, where the majority of foreign revenue is likely to have been generated. Total output significantly exceeded the management's target figure of EUR 41 m, which according to the company was mainly due to supplements to major projects. This means that D&S has also performed significantly better than we expected (EUR 42.5 m).

FY ends: 31.12.	2021	2022	2023	2024e	2025e	2026e
Total output (m Euro)	44.9	36.9	48.4	47.0	49.5	53.0
EBIT (m Euro)	1.6	1.8	2.6	3.2	3.7	4.1
Net profit	0.8	0.9	0.9	2.0	2.4	2.7
EpS	0.13	0.14	0.15	0.34	0.40	0.45
Dividend per share	0.00	0.00	0.00	0.00	0.00	0.00
Total output growth	-5.5%	-17.8%	31.3%	-2.9%	5.3%	7.1%
Profit growth	-	12.2%	4.5%	127.0%	18.6%	11.4%
PSR	0.70	1.43	1.11	1.22	1.15	1.06
PER	71.9	64.1	61.4	27.0	22.8	20.5
PCR	-	33.1	12.5	12.2	11.3	9.8
EV / EBIT	37.1	31.8	22.6	18.6	15.8	14.3
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Group figures	2022	2023	*Change*
Sales	38.2	49.1	*+28.6%*
Total output	36.9	48.4	*+31.3%*
EBITDA	4.2	4.9	*+16.9%*
EBITDA margin	*11.5%*	*10.2%*	*-1.3Pp.*
EBIT	1.8	2.6	*+42.6%*
EBIT margin	*4.9%*	*5.3%*	*+0.4Pp.*
Period net result	0.9	0.9	*+4.5%*

In m Euro and percent, source: Company

EBITDA increases by 17 percent

The cost of materials has also increased in line with the higher total output. Due to the increased use of third-party services, it rose disproportionately by 58.9 percent to EUR 21.2 m, meaning that the cost of materials ratio (in relation to total output) increased from 36.3 to 44.0 percent. In contrast, the increase in personnel expenses was only moderate at 3.7 percent to EUR 10.3 m, meaning that the personnel expense ratio fell from 27.0 to 21.3 percent. The increase in other operating expenses (+26.9 percent to EUR 13.2 m) was below average as well. On balance, EBITDA grew by 17 percent to EUR 4.9 m, which corresponds to a margin of 10.2 percent (previous year: 11.5 percent). The decline in margins is partly a mathematical effect of the higher volume of third-party services, which are invoiced (with small mark-ups) to the company's own customers.

EBIT margin also above target

As depreciation and amortisation fell slightly by 2.4 percent to EUR 2.4 m, the absolute increase in EBITDA had a clearly positive effect on EBIT, leading to an increase of 42.6 percent to EUR 2.6 m. As a result, the EBIT margin rose from 4.9 to 5.3 percent, which means that the management's targets (3.0 to 5.0 percent) and our estimate (4.9 percent) were also exceeded. However, the financial result was significantly more negative this time (EUR -1.7 m, previous year: EUR -1.0 m), which, with slightly higher interest expenses (EUR 0.9 m, previous year: EUR 0.8 m), was mainly due to write-downs (EUR 0.8 m, previous year: EUR 0.3 m) on outstanding receivables from the sold power plant business. With a slightly higher, but in absolute terms minor tax burden (EUR -55,000), this resulted in a consolidated profit of EUR 0.9 m, which was 4.5 percent higher than the previous year's figure.

Operating cash flow more than doubled

The positive development was reflected much more strongly in the cash flow from operating activities, which improved by 165 percent to EUR 4.4 m. This is due to several different factors. Notably, a substantial portion of the expenses that pushed the net result downwards close to the previous year's level was not cash-effective – in addition to the write-downs on some of the receivables from the sale of the power plant business, EUR 0.4 m was also written off on power plant components that D&S holds in its portfolio and still intends to sell (these were part of the purchase price). In addition, provisions increased considerably and the balance from the cumulative change in receivables and inventories was significantly less of a burden. Investments also rose sharply in the last financial year (investment cash flow: EUR -3.0 m, after EUR -0.8 min the previous year), as D&S acquired a new drilling rig. Nevertheless, the free cash flow improved by 60 percent on balance to EUR 1.4 m. After deducting interest payments and a moderate net loan repayment (financing cash flow: EUR -0.9 m), this resulted in an increase in liquidity from EUR 3.1 m to EUR 3.6 m.

Equity ratio back above 50 percent

With the net profit for the year, equity also increased further, by 5 percent to EUR 21.0 m. In contrast, the increase in total assets was dampened by the decline in liabilities to banks and other liabilities and was just 3.5 percent to 41.5 m. The equity ratio thus increased from 49.7 to 50.6 percent within the space of a year and remains very sound.

Good order situation

In recent months, D&S has reported further major orders. This involves two geothermal wells for Stadtwerke Neuruppin with a contract volume of around EUR 5 m and the revision of the existing boreholes of the Kirchweihdach deep geothermal power plant for around EUR 3 m. The drilling in Neuruppin will start soon. The company is also working on other major projects, including the construction of a geothermal doublet (production and injection well) for MTU in Munich. D&S's order situation for the current financial year is therefore comfortable. At the end of March, the order backlog stood at EUR 38.5 m (compared to EUR 33.2 m in May last year), which means that – purely in terms of figures – capacity is already fully utilised into next year. On this basis, the management expects a total output of EUR 47 m for the current financial period and an improvement in the operating EBIT margin to between 5 and 7 percent. This is helped by declining depreciation, as two large drilling rigs have reached (11/23) or will reach (06/24) the end of their depreciation period, which will improve the annualised result by EUR 1 m.

Geothermal energy in focus

The prospects beyond this are also very promising. Geothermal energy is increasingly coming into focus as a renewable energy source for the heating market, which in Germany is still supplied with almost 82 percent fossil fuels (as of 2023, source: Daldrup/Federal Environment Agency). Last year, heat generation from geothermal energy and environmental heat in Germany increased by 18 percent to 25.7 TWh, but the potential is far greater – a study by Fraunhofer/Helmholtz puts it at a quarter of the German heat demand (around 300 TWh). Politicians are attempting to advance the development with various initiatives, and the government is currently even considering providing cover for the exploration risks of drilling via KfW. At the moment, the most important instruments for accelerating development are the Building Energy Act, the federal funding of efficient heating networks and the municipal heat planning act. The regulations stipulate, among other things, that new heating networks must use at least 65 percent renewable energy from this year, while the quota for existing networks is 30 percent from 2030. D&S assumes that the first cities and municipalities will complete their heating planning in the first half of 2025 and then put new geothermal projects out to tender.

High potential order volume

The newly prescribed comprehensive planning process for the municipal heating supply – as well as the cuts to the Climate and Transformation Fund (KTF) following the judgement of the Federal Constitutional Court on the federal budget – has led to delays in numerous projects, but at the same time interest has continued to grow. This can also be seen in the “relevant market volume” of D&S, which reflects the volume of orders in the negotiation stage weighted by the probability of occurrence: At the end of March, it totalled around EUR 260 m, compared to EUR 203 m in May 2023. Geothermal energy is a key driver here, but not the only one. The drilling required for the search for nuclear repositories is also an important factor in increasing demand. The company is responding to this by expanding its drilling capacities and has announced further extensive investments for this year, which are to be financed by debt.

Adjustments to estimates

The positive outlook supports the expansion scenario that we have modelled for the company. At EUR 47 m, the total output forecast for 2024 is higher than our previous estimate (EUR 44.0 m). Given the positive trend, we are now following the guidance and adjusting our estimate to the management's forecast. However, we had hoped for somewhat greater progress in the EBIT margin, which we had previously estimated at 8.2 percent due to the positive depreciation effect and operating progress. We are now expecting it at 6.7 percent, taking into account the company's targets and the significant increase in material costs. These adjustments consequently affect the following years, yielding an overall increased path for total output – although the assumed average growth rate (CAGR 24/31) is still a conservative 4.6 percent – and an assumed significant improvement in margins, which will, however, be lower than previously expected. We now see the target EBIT margin at 12.1 percent, compared to 14.5 percent previously. The table on the next page shows the development of the key cash flow figures in the detailed forecast period up to 2031 based on our model update. Further details on the estimated development of the balance sheet, in-

m Euro	12 2024	12 2025	12 2026	12 2027	12 2028	12 2029	12 2030	12 2031
Total output	47.0	49.5	53.0	55.5	58.0	60.5	62.5	64.5
Total output growth	-2.9%	5.3%	7.1%	4.7%	4.5%	4.3%	3.3%	3.2%
EBIT margin	6.7%	7.5%	7.7%	8.9%	9.9%	10.8%	11.2%	12.1%
EBIT	**3.2**	**3.7**	**4.1**	**4.9**	**5.8**	**6.5**	**7.0**	**7.8**
Tax rate	8.0%	8.0%	8.0%	20.0%	30.0%	30.0%	30.0%	30.0%
Adjusted tax payments	0.3	0.3	0.3	1.0	1.7	2.0	2.1	2.3
NOPAT	**2.9**	**3.4**	**3.8**	**3.9**	**4.0**	**4.6**	**4.9**	**5.4**
+ Depreciation & Amortisation	1.7	1.5	1.8	1.8	1.9	1.9	2.2	2.1
+ Increase long-term accruals	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
+ Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross operating cash flow	5.1	5.5	6.0	6.2	6.4	7.0	7.6	8.1
- Increase Net Working Capital	-0.8	-0.7	-0.6	-0.4	-0.3	-0.4	-0.4	-0.4
- Investments in fixed assets	-4.4	-4.3	-2.0	-2.2	-2.4	-2.6	-2.7	-2.8
Free cash flow	**-0.1**	**0.5**	**3.5**	**3.7**	**3.6**	**4.1**	**4.5**	**4.9**

SMC estimation model

come statement and cash flow can be found in the Annex.

Possible further payments

Our model also takes into account – as non-operating assets – future returns from the sale of power plant components (book value: EUR 3.7 m) as well as a potential settlement of receivables from the sale of the division and possible earn-out payments (book value: EUR 3.5 m). The latter depend on the development of units sold. Last year, around EUR 740,000 could theoretically have been received (according to D&S's calculation), but this did not happen due to the necessary renovation of the Taufkirchen power plant, which led to the write-downs. However, since operations are now starting, payments could soon be made. Nevertheless, further write-downs on the items are conceivable, which is why we have still only recognised 50 percent of the book value (and therefore now EUR 3.6 m) in our model.

Frame parameters unchanged

We continue to calculate the terminal value with a fifteen percent discount to the target margin of 2031 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 10.50

With the model adjustments, the fair value we determined is now EUR 62.7 m or EUR 10.48 per share, from which we derive EUR 10.50 as the new price target (a sensitivity analysis for the price target determination can be found in the Annex). The slight reduction compared to our last estimate (EUR 11.40) is due to the more cautious margin estimate, which has more than offset the positive effect of the higher estimated total output. We continue to 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

Daldrup & Söhne increased its total output very strongly last year, by 31.3 percent to EUR 48.4 m, significantly exceeding both its own targets and our expectations. On this basis, EBIT improved by 42.6 percent to EUR 2.6 m despite significant increases in the cost of materials. The margin of 5.3 percent was also above the guidance and our estimates.

However, the net result increased only slightly, by 4.5 percent to EUR 0.9 m. This was mainly due to the negative impact of the write-downs on outstanding receivables from the sale of the power plant division. In contrast, the cash flow from operating activities shows the positive development much more clearly, increasing by 165 percent to EUR 4.4 m.

The outlook for the current period is also promising. An order backlog of EUR 38.5 m already ensures capacity utilisation, so that the management is forecasting total output of EUR 47 m and an improvement in the EBIT margin to between 5 and 7 percent.

We see it as very positive that geothermal energy is increasingly becoming the focus of attention as an alternative energy source for heat supply, especially in Germany. Although the temporary uncertainty regarding funding due to cuts in the Climate and Transformation Fund (KTF) and the obligation of cities and municipalities to carry out extensive heat planning have led to a significant delay in many projects, the volume of orders weighted by the probability of occurrence at the negotiation stage of the company has risen further, from EUR 203 m in May 2023 to now around EUR 260 m. A major surge in demand seems thus possible in the future, to which the company is already responding with higher investments.

Overall, we expect a positive development of Daldrup & Söhne, which is reflected in an updated price target of EUR 10.50. The reduction is due to the somewhat lower margin expectations, but we still see attractive upside potential of 15 percent and 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.
- With an equity ratio of 50 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 5.3 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 until the first quarter of 2025. 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 in the heating market 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.
- There have recently been significant increases especially in material costs. If this continues, it could slow down the targeted 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 December: around EUR 7,2 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	2023 act.	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e
ASSETS									
I. Total non-current	10.4	13.1	15.9	16.1	16.5	17.1	17.7	18.2	18.8
1. Intangible assets	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
2. Tangible assets	6.2	9.0	11.8	12.0	12.4	13.0	13.6	14.1	14.8
II. Total current assets	30.9	31.6	33.0	37.9	43.1	46.6	50.6	54.9	59.6
LIABILITIES									
I. Equity	21.0	23.0	25.4	28.1	31.0	32.3	34.0	35.7	37.6
II. Accruals	2.8	3.3	3.8	4.3	4.8	5.3	5.8	6.3	6.8
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	17.8	18.7	19.9	21.9	24.1	26.3	28.7	31.4	34.2
TOTAL	**41.5**	**45.0**	**49.1**	**54.3**	**59.9**	**63.9**	**68.5**	**73.4**	**78.7**

P&L estimation

m Euro	2023 act.	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e
Sales	49.1	44.6	47.5	51.5	53.9	56.4	58.8	60.8	62.7
Total output	48.4	47.0	49.5	53.0	55.5	58.0	60.5	62.5	64.5
Gross profit	27.1	27.1	28.8	31.1	33.0	34.9	36.8	38.3	39.9
EBITDA	4.9	4.8	5.2	5.8	6.7	7.6	8.5	9.2	9.9
EBIT	2.6	3.2	3.7	4.1	4.9	5.8	6.5	7.0	7.8
EBT	0.9	2.2	2.6	2.9	3.7	4.4	5.1	5.4	6.1
EAT (before minorities)	0.9	2.0	2.4	2.7	2.9	3.1	3.5	3.8	4.2
EAT	0.9	2.0	2.4	2.7	2.9	3.1	3.5	3.8	4.2
EPS	0.15	0.34	0.40	0.45	0.48	0.51	0.59	0.63	0.71

Annex III: Cash flows estimation and key figures

Cash flows estimation

m Euro	2023 act.	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e
CF operating	4.4	4.5	4.8	5.6	6.1	6.5	7.2	7.8	8.4
CF from investments	-3.0	-4.4	-4.3	-2.0	-2.2	-2.4	-2.6	-2.7	-2.8
CF financing	-0.9	-0.8	-0.6	0.2	0.3	-1.5	-1.6	-1.8	-1.9
Liquidity beginning of year	3.1	3.6	2.9	2.9	6.7	10.9	13.5	16.5	19.9
Liquidity end of year	3.6	2.9	2.9	6.7	10.9	13.5	16.5	19.9	23.6

Key figures

percent	2023 act.	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e
Total output growth	31.3%	-2.9%	5.3%	7.1%	4.7%	4.5%	4.3%	3.3%	3.2%
Sales growth	28.6%	-9.1%	6.5%	8.2%	4.8%	4.5%	4.3%	3.3%	3.2%
Gross margin	56.0%	57.7%	58.2%	58.7%	59.4%	60.1%	60.8%	61.3%	61.8%
EBITDA margin	10.2%	10.3%	10.6%	11.0%	12.1%	13.1%	14.0%	14.6%	15.3%
EBIT margin	5.4%	6.7%	7.5%	7.7%	8.9%	9.9%	10.8%	11.2%	12.1%
EBT margin	1.9%	4.7%	5.3%	5.5%	6.6%	7.6%	8.4%	8.7%	9.4%
Net margin (after minorities)	1.8%	4.3%	4.8%	5.0%	5.2%	5.3%	5.8%	6.0%	6.6%

Annex IV: Sensitivity analysis

	Perpetual cash flow growth				
WACC	**2.0%**	**1.5%**	**1.0%**	**0.5%**	**0.0%**
5.6%	16.07	14.42	13.13	12.08	11.23
6.1%	13.92	12.68	11.67	10.84	10.15
6.6%	12.24	11.27	**10.48**	9.81	9.24
7.1%	10.89	10.12	9.48	8.93	8.46
7.6%	9.78	9.16	8.63	8.18	7.78

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 06.06.2024 at 7:30 a.m. and published on 06.06.2024 at 9:15 a.m.

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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).
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

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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
06.10.2023	Buy	11.40 Euro	1), 3), 4)
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)

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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