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Research comment

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Daldrup & Söhne AG

"Veritable rush for the projects"

Rating: Buy (unchanged) | **Price:** 7.62 € | **Price target:** 11.20 € (prev.: 10.50 €)

Analyst: Dipl.-Kfm. Holger Steffen
sc-consult GmbH, Alter Steinweg 46, 48143 Münster

Phone: +49 (0) 251-13476-93
Telefax: +49 (0) 251-13476-92
E-Mail: kontakt@sc-consult.com
Internet: www.sc-consult.com

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Current development

Basic data

Based in:	Gruenwald
Sector:	Drilling services
Headcount:	139
Accounting:	HGB
ISIN:	DE0007830572
Ticker:	4DS:GR
Price:	7.62 Euro
Market segment:	Scale
Number of shares:	5.99 m
Market Cap:	45.6 m Euro
Enterprise Value:	49.8 m Euro
Free Float:	41.6 %
Price high/low (12 M):	10.50 / 6.60 Euro
Øturnover (12 M Xetra):	19,500 Euro

FY ends: 31.12.	2023	2024e	2025e
Total output (m Euro)	48.4	50.0	52.0
EBIT (m Euro)	2.6	4.0	4.4
Net profit	0.9	2.8	3.0
EpS	0.15	0.47	0.50
Dividend per share	0.00	0.00	0.00
Total output growth	31.3%	3.3%	4.0%
Profit growth	4.5%	217.3%	6.2%
PSR	0.93	0.96	0.91
PER	51.3	16.2	15.2
PCR	10.4	8.8	8.3
EV / EBIT	19.1	12.4	11.2
Dividend yield	0.0%	0.0%	0.0%

Profitability greatly improved

According to preliminary calculations, Daldrup & Söhne more than doubled its consolidated EBIT in the first half of the year from EUR 1.4 m in the reference period of 2023 to around EUR 3 m. The jump in earnings is the result of a combination of several factors, including especially the positive development of total output (benefiting from a very good order situation (see below)), declining depreciation following the end of amortisation for the largest drilling rigs and the improvement measures implemented to increase profitability. In recent years, D&S has initiated a whole raft of measures to increase the operating margin, which are now taking full effect. On the one hand, better contractual conditions were achieved – many major contracts are now realised using the day-rate procedure, in which the client bears a larger share of the project risk – and on the other hand, project management and supplementary management were better structured, which has improved the overall return on large drilling projects. In addition, the company has addressed staff shortages with targeted recruitment and, in return, reduced the use of temporary workers, as well as invested in new drilling rigs that can be operated with fewer staff. As a result, the forecast for the EBIT margin for the full year has now been raised from between 5 and 7 percent to between 7 and 9 percent.

Fully booked until mid-2025

At the same time, the company has also raised its outlook for total output for the current year from EUR 47 m to around EUR 50 m on the basis of the good order situation. Since December 2023 alone, D&S has been able to report the acquisition of three major orders, all of which are in the geothermal energy sector. These are two geothermal wells for Stadtwerke Neuruppin with a contract volume of around EUR 5 m, the revision of the existing boreholes of the Kirchweihdach deep geothermal power plant for around EUR 3 m and an exploratory and doublet drilling for the Oldenburg Baederbetrieb for around EUR 5 m.

CEO Andreas Toenies also points to a good order situation in other areas, particularly in the follow-up handling for the mining industry. D&S currently has an order backlog totalling EUR 34 m, which, according to the management, means that capacity is already fully booked until the middle of next year.

New forecast still conservative

In view of the figures for the first six months, the forecast for the full year still seems rather cautious, as it would be achievable, a total output of EUR 50 m supposed, with an EBIT of just EUR 0.5 to 1.5 m (lower and upper end of the range) in the second half of the year. In this regard, the management refers to the uncertainties that still exist as to the start date of projects, which result, among other things, from pending approvals. If the projects progress favourably over the next few months, it is entirely possible that the new target figures will be exceeded.

Favourable market conditions

The outlook beyond the current year is also very positive, as the general conditions for business development have continued to improve. Following the uncertainty about the further funding conditions in the wake of the Federal Constitutional Court's judgement on the federal budget, project postponements had occurred in the market towards the end of 2023, but this backlog is gradually dissolving in the current year. An important driver is the federal subsidy for efficient heating networks, which enables funding of up to 40 percent of the investment costs (up to EUR 100 m) for geothermal projects. In addition, progress has been made in insuring the exploration risks with offers from Munich Re and KfW. According to the management, the improvements in the basic conditions and the requirements for further decarbonisation of the heat supply have created a veritable rush for the projects, as interested parties want to secure the foreseeably scarce drilling capacities for the period from 2025 onwards. D&S is currently holding contract award talks at close intervals and expects to be awarded further major contracts. The “relevant market volume”, which reflects the volume of orders in the negotiation stage weighted by the probability of occurrence, has now grown to EUR 297 m, compared to around EUR 260 m at the end of March.

Capacity expansion targeted

A trend towards significantly larger projects can be observed. Whereas in the past, doublets (injection and production wells) were often drilled, currently planned projects often comprise four or six wells. This means that the projects extend over several years, offering D&S the advantage that a large drilling rig can work at the same location for a longer period of time, which improves profitability. In view of this foreseeable high demand, the company is working on strategic partnerships, in order to increase capacity in a targeted manner.

Estimates raised

We consider it very positive that D&S can expect to achieve a further improvement in its total output and margin this year – despite some temporary uncertainty in the market regarding the further funding of geothermal projects – and take this as evidence of the potential that we see in the business model and market development. Hitherto, we had anticipated a decline in total output to EUR 46.5 m in 2024, but we now expect an increase to EUR 50 m in line with the updated corporate planning – and further growth in the coming years in view of the foreseeable sustained increase in demand. At the end of the detailed forecast period, we are therefore now expecting a total output of EUR 67 m, compared to the previous estimate of EUR 64.5 m. The new estimate also corresponds to a conservative CAGR 24/31 of total output of 4.3 percent p.a. We have not yet assumed any major investments, but only supplementary investments for the medium-sized drilling rigs. We are also significantly raising our EBIT margin estimates at the beginning of the detailed forecast period – from 6.7 to 8.0 percent for the current year and from 7.5 to 8.5 percent for 2025. However, as we had already assumed significant margin progress over the course of the detailed forecast period, we are allowing the positive delta to the previous figures to slowly decrease in the years thereafter, so that the target margin remains unchanged at 12.0 percent. The table on the next page shows the development of the key cash flow indicators resulting

m Euro	12 2024	12 2025	12 2026	12 2027	12 2028	12 2029	12 2030	12 2031
Total output	50.0	52.0	54.5	57.5	60.5	63.0	65.0	67.0
Total output growth	3.3%	4.0%	4.8%	5.5%	5.2%	4.1%	3.2%	3.1%
EBIT margin	8.0%	8.5%	8.7%	9.3%	10.1%	10.8%	11.2%	12.0%
EBIT	**4.0**	**4.4**	**4.7**	**5.4**	**6.1**	**6.8**	**7.3**	**8.1**
Tax rate	8.0%	8.0%	8.0%	20.0%	30.0%	30.0%	30.0%	30.0%
Adjusted tax payments	0.3	0.4	0.4	1.1	1.8	2.0	2.2	2.4
NOPAT	**3.7**	**4.1**	**4.3**	**4.3**	**4.3**	**4.7**	**5.1**	**5.6**
+ Depreciation & Amortisation	1.7	1.6	1.8	1.9	1.9	2.0	2.3	2.2
+ 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	5.9	6.2	6.7	6.7	6.7	7.3	7.8	8.3
- Increase Net Working Capital	-0.9	-0.7	-0.6	-0.4	-0.4	-0.4	-0.4	-0.4
- Investments in fixed assets	-4.7	-4.5	-2.1	-2.3	-2.5	-2.7	-2.8	-2.9
Free cash flow	**0.4**	**0.9**	**4.0**	**4.0**	**3.8**	**4.2**	**4.7**	**5.1**

SMC estimation model

from our model up to the year 2031; further details are provided in the Annex.

New price target: EUR 11.20

With unchanged basic parameters (WACC 6.6 percent, terminal value with a 15 percent margin discount and perpetual growth of 1.0 percent), the update of the model results in a new fair value of EUR 67.3 m or EUR 11.24 per share, from which we derive EUR 11.20 as the new target price (a sensitivity analysis for determining the target price can be found in the Annex). The increase compared to our last update (EUR 10.50) is due to the increase in the expected total output over the entire detailed forecast period and the margin in this year and in subsequent periods. 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

Daldrup & Söhne's business developed very well in the first half of the year, with EBIT more than doubling from EUR 1.4 m to around EUR 3 m in comparison to last year. As a result, the company has raised its forecast for the year and now expects a total output of EUR 50 m (previously: EUR 47 m) and an EBIT margin of between 7 and 9 percent (previously: 5 to 7 percent). With a total output at the level now envisaged, the forecast would already be achievable with an EBIT of EUR 0.5 to 1.5 m in the second half of the year, which according to the company is due to some uncertainties regarding the granting of approvals and the start date of projects. If the projects progress favourably over the next few months, it is entirely possible that the new targets will be exceeded.

The outlook for the time after 2024 is also promising. The federal subsidy for efficient heating networks is now having an ever greater impact and, according to the management, is causing a veritable “rush for projects”. The weighted volume of orders in the negotiation stage has now grown to almost EUR 300 m and the company expects to be awarded further major projects in the coming months. As a result, we have raised our estimates for business development, Increasing thus our price target from EUR 10.50 to EUR 11.20. The improvement in business performance and prospects has so far been insufficiently recognised on the stock market. We now see an upside potential of more than 40 percent for the share 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

- Margins in the drilling business have been relatively low in the past. As recently as last year, the EBIT margin was only 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 has yet to prove that the efficiency gains currently achieved in the management of large drilling projects are sustainable.
- The growth in total output is limited by the existing drilling capacities, which are already heavily utilised. 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 mid-2025. A recent sharp increase in potential orders in the negotiation status also indicates further growth for the time thereafter.
- D&S has already significantly improved the margin in the current year, but still has potential for further increases.
- The envisaged accelerated expansion of renewable energies in the heating market is likely to 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

- The current market upturn in geothermal energy is closely linked to the funding conditions. The general conditions could deteriorate again, for example in the event of a change of government in Germany.
- Government attempts to improve geothermal development could fail due, for example, to bureaucratic hurdles (approval processes).
- Fixed-price contracts in the drilling business carry the risk of losses if there are delays for which the company is responsible.
- 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).

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	13.4	16.3	16.5	17.0	17.6	18.2	18.8	19.4
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	9.3	12.2	12.5	12.9	13.5	14.1	14.7	15.3
II. Total current assets	30.9	33.3	35.5	41.3	46.9	50.5	54.5	59.0	63.9
LIABILITIES									
I. Equity	21.0	23.8	26.8	30.0	33.2	34.5	36.2	37.9	40.0
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	19.8	21.5	23.8	26.1	28.5	31.0	33.8	36.7
TOTAL	**41.5**	**46.9**	**52.1**	**58.1**	**64.1**	**68.3**	**73.0**	**78.0**	**83.5**

P&L estimation

m Euro	2023 act.	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e
Sales	49.1	47.5	50.0	52.9	55.9	58.8	61.3	63.2	65.2
Total output	48.4	50.0	52.0	54.5	57.5	60.5	63.0	65.0	67.0
Gross profit	27.1	29.4	30.8	32.5	34.4	36.5	38.3	39.8	41.4
EBITDA	4.9	5.7	6.0	6.5	7.2	8.0	8.8	9.5	10.2
EBIT	2.6	4.0	4.4	4.7	5.4	6.1	6.8	7.3	8.1
EBT	0.9	3.1	3.3	3.5	4.0	4.7	5.2	5.6	6.3
EAT (before minorities)	0.9	2.8	3.0	3.2	3.2	3.3	3.6	3.9	4.4
EAT	0.9	2.8	3.0	3.2	3.2	3.3	3.6	3.9	4.4
EPS	0.15	0.47	0.50	0.53	0.53	0.54	0.61	0.65	0.73

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	5.2	5.5	6.2	6.6	6.9	7.5	8.1	8.7
CF from investments	-3.0	-4.7	-4.5	-2.1	-2.3	-2.5	-2.7	-2.8	-2.9
CF financing	-0.9	0.3	-0.2	0.4	0.3	-1.7	-1.7	-1.9	-2.0
Liquidity beginning of year	3.1	3.6	4.4	5.3	9.8	14.4	17.1	20.2	23.6
Liquidity end of year	3.6	4.4	5.3	9.8	14.4	17.1	20.2	23.6	27.4

Key figures

percent	2023 act.	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e
Total output growth	31.3%	3.3%	4.0%	4.8%	5.5%	5.2%	4.1%	3.2%	3.1%
Sales growth	28.6%	-3.3%	5.1%	5.9%	5.6%	5.3%	4.2%	3.2%	3.1%
Gross margin	56.0%	58.8%	59.2%	59.7%	59.9%	60.3%	60.8%	61.3%	61.8%
EBITDA margin	10.2%	11.4%	11.5%	12.0%	12.5%	13.3%	14.0%	14.6%	15.3%
EBIT margin	5.4%	8.0%	8.5%	8.7%	9.3%	10.1%	10.8%	11.2%	12.0%
EBT margin	1.9%	6.2%	6.3%	6.4%	7.0%	7.8%	8.3%	8.6%	9.4%
Net margin (after minorities)	1.8%	5.6%	5.8%	5.8%	5.6%	5.4%	5.8%	6.0%	6.5%

Annex IV: Sensitivity analysis

	Perpetual cash flow growth				
WACC	**2.0%**	**1.5%**	**1.0%**	**0.5%**	**0.0%**
5.6%	17.07	15.35	13.99	12.90	12.01
6.1%	14.84	13.53	12.48	11.62	10.89
6.6%	13.09	12.07	**11.24**	10.54	9.94
7.1%	11.68	10.87	10.20	9.62	9.13
7.6%	10.52	9.87	9.32	8.84	8.42

Disclaimer

Editor
sc-consult GmbH
Alter Steinweg 46
48143 Münster
Internet: www.sc-consult.com

Phone: +49 (0) 251-13476-94
Telefax: +49 (0) 251-13476-92
E-Mail: kontakt@sc-consult.com

Responsible analyst
Dipl.-Kfm. Holger Steffen

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 29.08.2024 at 7:10 and published on 29.08.2024 at 8:15.

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Date	Investment recomm.	Target price	Conflict of interests
06.06.2024	Buy	10.50 Euro	1), 3), 10)
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)

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