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# DDH1 (DDH)

## Perenti to acquire DDH; FY23 earnings update

Recommendation
Hold (Buy)
Price
$0.915
Target (12 months)
$0.94 (previously $1.20)

**GICS Sector**

**Commercial Services and Suppliers**

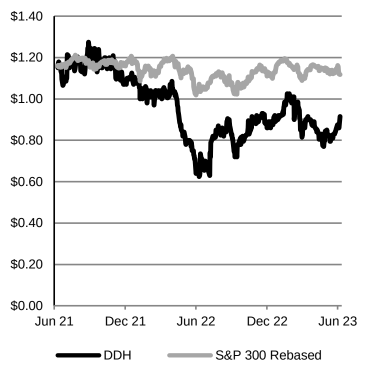
| Expected Return | |
|---|---|
| Capital growth | **2.7%** |
| Dividend yield | **2.2%** |
| Total expected return | **4.9%** |

| Company Data & Ratios | |
|---|---|
| Enterprise value | **$393m** |
| Market cap | **$367m** |
| Issued capital | **401m** |
| Free float | **53.9%** |
| Avg. daily val. (52wk) | **$1.1m** |
| 12 month price range | **$0.6125-1.035** |

**Price Performance**

| | (1m) | (3m) | (12m) |
|---|---|---|---|
| **Price (A$)** | 0.85 | 0.83 | 0.68 |
| **Absolute (%)** | 7.6 | 10.9 | 35.6 |
| **Rel market (%)** | 10.2 | 9.2 | 27.4 |

**Absolute Price**




SOURCE: IRESS

## Perenti to acquire DDH

Perenti (PRN; not rated) and DDH have announced that they have entered into a binding Scheme Implementation Agreement (SIA) pursuant to which PRN will acquire 100% of the fully paid ordinary shares in DDH. Under the SIA, DDH shareholders can elect maximum scrip or cash alternatives (subject to scale back based on a total cash offering of $50m), with the formal consideration being $0.1238 cash and 0.7111 PRN shares per DDH share held. The consideration implies an initial acquisition price per DDH share of $1.01 (based on PRN's 5-day VWAP leading up to the SIA announcement). Post deal completion, PRN and DDH shareholders will own 71% and 29% of the diluted share capital of the combined entity, respectively. The DDH Board has unanimously recommended the Scheme, so have Oaktree, Matt Iznet, Richard Bennett and Kent Swick, indicating Scheme support across ~38.0% of DDH's equity share base. The deal is subject to ASIC registration and Court approval, and other standard conditions precedent. DDH shareholders are scheduled to vote at a Scheme meeting in September 2023, with Scheme implementation targeted by October 2023.

DDH also provided a FY23 earnings update: underlying EBITDA is expected to be within $117-121m (BPe old $128m). The earnings update reflects a continuation of weak operating conditions since early January 2023 due to delayed customer drilling program commencements and regulatory approvals, and wet weather. On a positive note, utilisation and revenues are improving in Q4 FY23 as customer drilling programs recommence. In this report, EPS downgrades reflect this weaker than expected operational update: -12% FY23; -3% FY24; and nc FY25.

## Investment view: Hold (prev. Buy), TP$0.94ps (prev $1.20ps)

In light of the binding SIA to acquire 100% of DDH's fully paid ordinary shares, we downgrade to Hold (previously Buy), with our Target Price set at the current implied acquisition price of $0.94 per DDH share. The implied price values DDH at 3.4x FY23 EBITDA (BPe). This valuation multiple is larger than those of comparable, capital-intensive mining services companies on the ASX.

**Earnings Forecast**

| Year ending 30 June | 2022a | 2023e | 2024e | 2025e |
|---|---|---|---|---|
| Sales (A$m) | 415 | 521 | 557 | 565 |
| EBITDA (A$m) | 97 | 119 | 133 | 135 |
| NPAT (reported) (A$m) | 36 | 46 | 56 | 57 |
| NPAT (adjusted) (A$m) | 42 | 44 | 56 | 57 |
| EPS (adjusted) (¢ps) | 11.2 | 10.6 | 14.0 | 14.2 |
| EPS growth (%) | -45.6% | -5.3% | 31.4% | 1.8% |
| PER (x) | 8.2x | 8.6x | 6.5x | 6.4x |
| FCF Yield (%) | 5.9% | 16.2% | 12.4% | 12.3% |
| EV/EBITDA (x) | 4.3x | 3.3x | 2.9x | 2.9x |
| Dividend (¢ps) | 5.2 | 5.3 | 5.5 | 5.5 |
| Yield (%) | 5.6% | 5.8% | 6.0% | 6.0% |
| Franking (%) | 100% | 100% | 100% | 100% |
| ROE (%) | 15% | 13% | 15% | 14% |

SOURCE: BELL POTTER SECURITIES ESTIMATES

# Summary: DDH1 Limited (DDH)

## Company description

DDH1 (DDH) is a leading provider of specialised drilling services to the Australian mining industry and operates Australia's largest surface fleet of operational mineral drill rigs. The company is headquartered in Perth, Western Australia, and also maintains a Brisbane office to service the east coast market.

DDH offers its drilling services via four specialised brands: (1) DDH1 Drilling; (2) Strike Drilling; (3) Ranger Drilling; and (4) Swick Mining Services, each with differing specialities and target market. DDH1 Drilling, which represents ~70% of revenue, typically focuses on technically challenging directional drilling at depth, Strike Drilling specialises in early-stage exploration, Ranger Drilling specialises in iron ore, and Swick Mining Services is entirely underground drilling.

Revenue is a function of the number of rigs, utilisation and charge-out rates, although specialisation (expertise, equipment and complexity), productivity (metres per shift) and operating efficiency (variable costs) also drive profitability per rig.

## Investment view: Hold (prev. Buy), TP$0.94ps (prev $1.20ps)

In light of the binding SIA to acquire 100% of DDH's fully paid ordinary shares, we downgrade to Hold (previously Buy), with our Target Price set at the current implied acquisition price of $0.94 per DDH share. The implied price values DDH at 3.4x FY23 EBITDA (BPe). This valuation multiple is larger than those of comparable, capital-intensive mining services companies on the ASX.

## Valuation methodology

Our valuation reflects the current implied acquisition price of DDH shares by PRN under the binding Scheme Implementation Agreement announced 26 June 2023.

# Key risk to investment thesis

## Risks to investment thesis

Key risks to DDH include, although are not limited to:

**Risk of failure to complete takeover by Perenti:** Failure to complete the takeover by Perenti could result in a negative reaction to DDH's share price. Our Target Price reflects the current implied acquisition value of DDH and assumes the takeover will complete.

**Commodity price risk:** Exploration expenditure decisions are typically made in part based upon commodity prices that are inherently cyclical. Lower than expected prices, or adverse changes in demand for any of the key commodities (e.g. gold, iron ore, copper) may have an adverse effect on demand for DDH's services, particularly Greenfield exploration.

**Supply of equipment:** DDH's revenue is leveraged to drill rigs. Any impediments accessing drill rigs to renew and grow its fleet in a timely affordable fashion, or required ancillary equipment and supplies, may adversely affect DDH's financial performance.

**Contract risk:** DDH's contracts are generally awarded via competitive tendering processes and are between three months to three years in length. Contracts can typically be terminated at convenience with minimal compensation (usually limited to demobilisation costs). Any significant mispricing of tenders, terminations by customers, or variance in scope may adversely affect DDH's financial performance.

**Competition risk:** DDH operates in a competitive fragmented market, with many competitors of differing sizes. An escalation in competition or competitors consolidating the market may result in lower rates, margins or market share.

**Concentration risk:** While DDH has a relatively diversified customer base, its top 10 clients contributed ~62% of FY20 revenue. Any termination or material reduction in service levels to a key customer may adversely affect earnings, particularly if DDH is unable to redeploy its resources in a timely manner.

**Risks of labour shortages and costs:** Increases to activity in the resources industry, particularly drilling, is increasing the competition for skilled personnel. The loss of, or failure to attract and retain skilled labour, or any increases to costs that cannot be recouped, would likely have an adverse effect on DDH's operations and financial performance.

**Key staff risk:** The loss of key management personnel, delays in their replacement, and/or failure to attract new talent may adversely affect DDH's operations.

**Occupational health & safety risk:** Any adverse workplace incident or the failure to comply with regulations may result in significant liabilities against DDH. Any claim or resultant interruptions could adversely affect DDH's operations and reputation.

**Acquisition risks:** DDH has undertaken several acquisitions in the last four years, and has stated that it continues to evaluate acquisition opportunities. There is a risk that DDH will not be able to execute acquisitions as planned, with risks to integration, retention of key people, realisation of synergies and execution of financial forecasts.

**Reputational risk:** Poor delivery of services, operational failures, adverse media coverage or other disputes may impact DDH's brand and reputation, adversely impacting relationships with potential and existing customers and/or employees.

**Regulatory risk:** Any adverse change in regulations that affect DDH's, or its underlying customer's business models, such as additional environmental regulations, could adversely affect costs and demand for DDH's services.

# DDH1
as at 26 June 2023

| | |
|---|---|
| Recommendation | Hold |
| Price | $0.915 |
| Target (12 months) | $0.94 |

## Table 1 - Financial summary

| | | |
|---|---|---|
| Date | | 26/06/23 |
| Price | A$/sh | 0.92 |
| Target price | A$/sh | 0.94 |

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**PROFIT AND LOSS**

| Year ending 30 June | Unit | 2021a | 2022a | 2023e | 2024e | 2025e |
|---|---|---|---|---|---|---|
| Revenue | $m | 295 | 415 | 521 | 557 | 565 |
| Expenses | $m | (220) | (318) | (402) | (424) | (430) |
| **Underlying EBITDA** | **$m** | **75** | **97** | **119** | **133** | **135** |
| Depreciation | $m | (22) | (30) | (46) | (42) | (44) |
| Amortisation | $m | (2) | (6) | (10) | (8) | (6) |
| **EBIT** | **$m** | **51** | **61** | **64** | **84** | **85** |
| Net interest expense | $m | (3) | (2) | (3) | (4) | (3) |
| **Profit before tax** | **$m** | **48** | **60** | **60** | **80** | **81** |
| Tax expense | $m | 15 | (18) | (17) | (24) | (25) |
| **NPAT (underlying)** | **$m** | **64** | **42** | **44** | **56** | **57** |
| Adjustments (post-tax) | $m | (6) | (6) | 2 | - | - |
| **NPAT (reported)** | **$m** | **57** | **36** | **46** | **56** | **57** |
| Acquired amortisation (post-tax) | $m | (2) | (4) | (11) | (5) | (4) |
| **NPAT(A) (underlying)** | **$m** | **65** | **46** | **55** | **61** | **61** |

**CASH FLOW STATEMENT**

| Year ending 30 June | Unit | 2021a | 2022a | 2023e | 2024e | 2025e |
|---|---|---|---|---|---|---|
| **OPERATING CASH FLOW** | | | | | | |
| Receipts from customers | $m | 314 | 448 | 577 | 544 | 567 |
| Payments to suppliers and employee | $m | (245) | (363) | (453) | (414) | (431) |
| Tax paid | $m | (18) | 1 | (3) | (24) | (25) |
| Net interest | $m | (3) | (2) | (3) | (4) | (3) |
| Other | $m | - | - | - | - | - |
| **Operating cash flow** | **$m** | **49** | **84** | **118** | **102** | **108** |
| **INVESTING CASH FLOW** | | | | | | |
| Capex | $m | (39) | (65) | (61) | (57) | (63) |
| Disposal of assets | $m | 0 | 0 | 2 | - | - |
| Other | $m | 0 | 1 | 2 | - | - |
| **Investing cash flow** | **$m** | **(39)** | **(64)** | **(57)** | **(57)** | **(63)** |
| ***Free cash flow*** | ***$m*** | ***10*** | ***20*** | ***61*** | ***45*** | ***45*** |
| **FINANCING CASH FLOW** | | | | | | |
| Debt proceeds/(repayments) | $m | (61) | - | 10 | - | - |
| Dividends paid | $m | - | (18) | (19) | (22) | (22) |
| Proceeds from share issues (net) | $m | 32 | - | - | - | - |
| Buy-back payments | $m | - | - | (25) | - | - |
| Other | $m | (3) | (3) | (3) | - | - |
| **Financing cash flow** | **$m** | **(33)** | **(20)** | **(37)** | **(22)** | **(22)** |
| **Change in cash** | **$m** | **(23)** | **(0)** | **24** | **23** | **23** |

**BALANCE SHEET**

| Year ending 30 June | Unit | 2021a | 2022a | 2023e | 2024e | 2025e |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Cash | $m | 15 | 18 | 42 | 65 | 88 |
| Receivables | $m | 56 | 94 | 75 | 90 | 91 |
| Property, plant & equipment | $m | 129 | 223 | 241 | 257 | 275 |
| Other assets | $m | 82 | 139 | 134 | 126 | 120 |
| **Total assets** | **$m** | **281** | **474** | **493** | **539** | **575** |
| **LIABILITIES** | | | | | | |
| Payables | $m | 29 | 51 | 40 | 52 | 52 |
| Borrowings | $m | - | 30 | 40 | 40 | 40 |
| Provisions | $m | 9 | 21 | 23 | 23 | 23 |
| Leases | $m | 10 | 19 | 18 | 18 | 18 |
| Other liabilities | $m | - | 11 | 21 | 21 | 21 |
| **Total liabilities** | **$m** | **48** | **132** | **142** | **154** | **154** |
| **NET ASSETS** | **$m** | **234** | **342** | **350** | **385** | **421** |
| Share capital | $m | 375 | 465 | 441 | 442 | 443 |
| Reserves | $m | (263) | (262) | (257) | (257) | (257) |
| Retained earnings | $m | 121 | 140 | 166 | 200 | 235 |
| Non-controlling interest | $m | - | - | - | - | - |
| **SHAREHOLDER EQUITY** | **$m** | **234** | **342** | **350** | **385** | **421** |
| Weighted average shares | m | 308 | 376 | 411 | 398 | 398 |

**FINANCIAL RATIOS**

| Year ending 30 June | Unit | 2021a | 2022a | 2023e | 2024e | 2025e |
|---|---|---|---|---|---|---|
| **VALUATION** | | | | | | |
| EPS (adjusted) | c/sh | 20.6 | 11.2 | 10.6 | 14.0 | 14.2 |
| EPS growth (Acps) | % | 135.6% | -45.6% | -5.3% | 31.4% | 1.8% |
| PER | x | 4.4x | 8.2x | 8.6x | 6.5x | 6.4x |
| DPS | c/sh | 2.2 | 5.2 | 5.3 | 5.5 | 5.5 |
| Franking | % | 100% | 100% | 100% | 100% | 100% |
| Yield | % | 2.4% | 5.6% | 5.8% | 6.0% | 6.0% |
| FCF/share | c/sh | 3.1 | 5.4 | 14.8 | 11.3 | 11.2 |
| FCF yield | % | 3.4% | 5.9% | 16.2% | 12.4% | 12.3% |
| EV/EBITDA | x | 6.0x | 4.3x | 3.3x | 2.9x | 2.9x |
| **LIQUIDITY & LEVERAGE** | | | | | | |
| Net debt / (cash) | $m | (5) | 31 | 15 | (8) | (31) |
| Net debt / Equity | % | -2.1% | 9.2% | 4.4% | -2.0% | -7.3% |
| Net debt / Net debt + Equity | % | -2.2% | 8.4% | 4.2% | -2.1% | -7.8% |
| Net debt / EBITDA | x | -0.1x | 0.3x | 0.1x | -0.1x | -0.2x |
| EBITDA /net interest expense | x | 26.0x | 55.1x | 36.7x | 35.4x | 39.1x |
| **PROFITABILITY RATIOS** | | | | | | |
| EBITDA margin | % | 25.3% | 23.4% | 22.9% | 23.9% | 23.9% |
| EBIT margin | % | 17.3% | 14.8% | 12.2% | 15.1% | 15.0% |
| Return on assets | % | 23.9% | 11.2% | 9.0% | 10.8% | 10.2% |
| Return on equity | % | 34.4% | 14.6% | 12.6% | 15.1% | 14.1% |
| Return on invested capital | % | 31.5% | 21.9% | 17.2% | 23.4% | 22.9% |

**Half yearly assumptions**

| Year ending 30 June | Unit | 1H Dec-21a | 1H Dec-22a | 1H Dec-23e | 1H Dec-24e | 1H Dec-25e |
|---|---|---|---|---|---|---|
| **Revenue** | **$m** | **169** | **286** | **274** | **280** | **275** |
| Expenses | $m | (126) | (220) | (209) | (213) | (211) |
| **Underlying EBITDA** | **$m** | **43** | **66** | **66** | **67** | **64** |
| Depreciation | $m | (12) | (23) | (20) | (22) | (23) |
| Amortisation | $m | (1) | (6) | (4) | (3) | (3) |
| **EBIT** | **$m** | **30** | **37** | **41** | **42** | **37** |
| Net interest | $m | (0) | (1) | (2) | (2) | (2) |
| **Pre-tax profit** | **$m** | **30** | **35** | **39** | **40** | **36** |
| Tax expense | $m | (9) | (9) | (12) | (12) | (11) |
| **NPAT (underlying)** | **$m** | **21** | **26** | **27** | **28** | **25** |
| Adjustments (post-tax) | $m | (1) | 2 | - | - | - |
| **NPAT (reported)** | **$m** | **20** | **28** | **27** | **28** | **25** |
| Acquired amortisation (post-tax) | $m | (1) | (8) | (3) | (2) | (2) |
| **NPAT(A) (underlying)** | **$m** | **22** | **34** | **30** | **30** | **27** |

**Sum-of-the-parts valuation**

| Component | | T+1 |
|---|---|---|
| DDH Drilling, Ranger Drilling & Strike | $m | 312 |
| Swick Mining Services | $m | 166 |
| **Enterprise value** | **$m** | **478** |
| Net debt / (cash) | $m | 4 |
| **Equity value (risked, diluted)** | **$m** | **474** |
| **Equity value (risked, diluted)** | **$/sh** | **1.19** |
| Current share price | $/sh | 0.92 |
| Equity value upside to current share pr | % | 30% |

SOURCE: BELL POTTER SECURITIES ESTIMATES

**Recommendation structure**

**Buy:** Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

**Hold:** Expect total return between -5% and 15% on a 12 month view

**Sell:** Expect <-5% total return on a 12 month view

*Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.*

*Such investments may carry an exceptionally high level of capital risk and volatility of returns.*

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