



BUY
OTC: DPDW

Oilfield Services

June 16, 2008
Note # 6084

Neal Dingmann
SVP – Equity Research
(713) 658-9800
ndingmann@dahlmanrose.com

Deep Down Inc.

Update – Recent Acquisitions Have the Potential to Reshape the Company

- ▶ **Positive acquisition of Flotation Technologies.** Deep Down recently announced its decision to purchase Flotation Technologies for \$23.3 million. This acquisition complements the company's strategy in the offshore market in deepwater operations. We expect strong sales for this segment throughout the year and next as sales last year reached \$17 million and orders have already piled up. Deep Down booked a \$5.5 million contract a month ago to be completed in 2H08. The company also recently announced \$18 million in its deepwater marine drilling riser floatation systems for the new-build Delba III and IV semisubmersible drilling rigs. We believe there could be multiple other South American orders following the Delba order given the record demand in the region.
- ▶ **Mako could see record expansion.** Deep Down currently has two remote offshore vessels (ROVs) working and demand remains at a record level. As such, the crux of the segment will be how many units the company can add to its fleet as any additional unit is likely to be soaked up quickly.
- ▶ **Fundamentals remain solid.** We believe fundamentals continue to be quite positive for Deep Down. Increased offshore projects as well as larger jobs result in higher demand for all company products such as flying leads, umbilical hardware, bend limiters, Seastax, and others.
 - o Umbilicals – given the huge offshore demand for umbilicals and Deep Down's industry leading technology, we forecast that the company could see more than \$100 million in orders the next couple years.
 - o BS Latcher Receiver – Deep Down announced a couple months back a \$1.5 million in ROV – installable subsea hardware consisting of four BS Latchers along with other equipment.
- ▶ **Further sales of deepest class rated LARS.** DPDW recently shipped its second 4,000 meter launch and retrieval system for use on vessels for handling of subsea equipment, such as ROVs, in ultra deep water environments. We anticipate increased sales of this equipment as more deepwater projects in harsh environments come online.
- ▶ **Reiterate Buy rating and \$2.50 price target.** Our \$2.50 price target is derived using a 15x peer group EV/EBITDA multiple applied to our \$32 million 2009 EBITDA estimate. While our target multiple is higher than the peer group average, we believe it is warranted given the high growth potential we anticipate at Deep Down this year and next.

EBITDA (mils)	2007E	2008E	2009E
1Q	\$0.2	\$0.6	\$5.9
2Q	\$0.8	\$3.0	\$6.0
3Q	\$0.4	\$4.5	\$5.9
4Q	\$0.8	\$6.0	\$7.5
FY	<u>\$2.1</u>	<u>\$14.1</u>	<u>\$31.9</u>
EV/EBITDA	<u>76.7x</u>	<u>11.3x</u>	<u>6.4x</u>

Recommendation	
Rating	Buy
Price Target	\$2.50
Exp. Return	107%
Div. ('08E)	\$0.00
Yield	n/a
Exp. Total Return	107%

Stock Statistics	
Priced as of 6/13/2008	
Symbol	DPDW
Price	\$1.21
52W Range	\$0.35-\$2.35
Shares Out. (MM)	180.0
Mkt. Cap. (MM)	\$217.8
Net Debt (MM)	\$9.1

Fundamentals	
NAV / Share	n/a
P / NAV	n/a
EPS ('08E)	\$0.05
PE ('08E)	25.5x
CFPS ('08E)	\$0.06
P/CF ('08E)	21.9x

Please read Required Disclosures and Analyst Certification on last pages of this report.

Target Price Analysis

(In 000's except per share)

2009 Estimates

Total Revenue	\$127,591.99
Gross Margins	44.0%
Gross Profits	\$56,140.48
SG&A	\$24,242.48
Depreciation	\$2,551.84
Interest Expense	\$0.00
Net Income (loss) before taxes	\$29,346.16
Income tax provision (benefit)	\$7,336.54
Reported Net Income (loss)	\$22,009.62
EBITDA	\$31,898.00
EV/EBITDA Multiple	15.0x
Price Target	\$2.50

Source: Dahlman Rose and Bloomberg

We believe total sales of approximately \$128 million and an overall operating margin of approximately 44% are likely next year.

		2009 Forecasted Total Gross Margin				
		42%	43%	44%	45%	46%
2009 Forecasted Total Sales	\$120,000	\$2.07	\$2.16	\$2.25	\$2.34	\$2.43
	\$125,000	\$2.23	\$2.32	\$2.42	\$2.51	\$2.61
	\$127,592	\$2.31	\$2.41	\$2.50	\$2.60	\$2.70
	\$130,000	\$2.39	\$2.49	\$2.58	\$2.68	\$2.78
	\$135,000	\$2.55	\$2.65	\$2.75	\$2.85	\$2.95

Source: Dahlman Rose and Bloomberg

EPS	(\$0.00)	\$0.01	\$0.02	\$0.02	\$0.01	\$0.05	\$0.11
CFPS	\$0.00	\$0.01	\$0.02	\$0.02	\$0.01	\$0.06	\$0.12
EBITDA	\$640.8	\$3,027.7	\$4,502.3	\$5,977.5	\$2,084.8	\$14,148.4	\$31,898.0

Deep Down Inc.

Historical and Forecasted Income Statement

(amounts in 000's \$, except as noted)

	2008 Quarterly Results/Est.						
	1Q08	2Q08E	3Q08E	4Q08E	2007	2008-E	2009-E
	90	91	92	92	365	365	365
Income Statement							
Last fiscal year ended 12/31/2007							
Deep Down		9,664.0	9,509.3	12,410.1	15,652.8	31,583.4	61,108.8
ElectroWave		1,500.0	1,500.0	1,500.0	3,736.9	4,500.0	12,000.0
Flotation Technologies			5,000.0	8,000.0	0.0	13,000.0	32,483.2
Mako		2,000.0	2,000.0	2,000.0	0.0	6,000.0	22,000.0
Total Revenue	6,279.5	13,164.0	18,009.3	23,910.1	19,389.7	61,362.8	127,592.0
COGS	3,876.4	7,635.1	10,085.2	13,389.6	13,020.4	34,986.3	71,451.5
Gross Profit	2,403.1	5,528.9	7,924.1	10,520.4	6,369.4	26,376.5	56,140.5
SG&A	1,762.2	2,501.2	3,421.8	4,542.9	4,284.6	12,228.1	24,242.5
Depreciation	298.1	263.3	360.2	478.2	427.0	1,399.8	2,551.8
Loss on Sale of Assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operating Income	342.7	2,764.4	4,142.1	5,499.3	1,657.8	12,748.6	29,346.2
Interest Expense	769.0	(92.1)	0.0	0.0	2,335.7	677.0	0.0
Interest (Income)	(39.2)	0.0	0.0	0.0	0.0	(39.2)	0.0
Other Income /Expenses	(28.4)	0.0	0.0	0.0	(2,015.1)	(28.4)	0.0
Pretax Income	(358.8)	2,856.5	4,142.1	5,499.3	1,337.2	12,139.1	29,346.2
Exceptional Items	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Income (loss) before taxes	(358.8)	2,856.5	4,142.1	5,499.3	1,337.2	12,139.1	29,346.2
Income Tax Current	(269.4)	714.1	1,035.5	1,374.8	369.7	2,855.1	7,336.5
Income Tax Deferred	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operating Net Income (loss)	(89.4)	2,142.4	3,106.6	4,124.5	967.6	9,284.0	22,009.6
Non-recurring items	0.0	0.0	0.0	0.0	(15.1)	0.0	0.0
Reported Net Income (loss)	(89.4)	2,142.4	3,106.6	4,124.5	952.5	9,284.0	22,009.6
Basic Reported EPS	(0.00)	0.02	0.02	0.03	0.01	0.07	0.16
Basic Operating EPS	(0.00)	0.02	0.02	0.03	0.01	0.07	0.16
Diluted Reported EPS	(0.00)	0.01	0.02	0.02	0.01	0.05	0.11
Diluted Operating EPS	(0.00)	0.01	0.02	0.02	0.01	0.05	0.11
Basic Shares Outstanding	78,476	116,190	135,619	135,619	73,917	116,476	135,619
Diluted Shares Outstanding	142,253	179,968	199,396	199,396	104,349	180,253	199,396
EBITDA	640.8	3,027.7	4,502.3	5,977.5	2,084.8	14,148.4	31,898.0

Margin Analysis

COGS							
Gross Margin	38.27%	42.00%	44.00%	44.00%	33.95%	42.07%	44.00%
% of Sales							
SG&A	28.06%	19.00%	19.00%	19.00%	23.47%	21.27%	19.00%
Depreciation	4.75%	2.00%	2.00%	2.00%	2.30%	2.69%	2.00%
Other	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Operating Income	5.46%	21.00%	23.00%	23.00%	8.19%	18.11%	23.00%
Interest Expense	6.96%	5.00%	5.00%	5.00%	39.54%	5.49%	5.00%
Interest (Income)	-0.62%	0.00%	0.00%	0.00%	0.00%	-0.16%	0.00%
Other Income /Expenses	-0.45%	0.00%	0.00%	0.00%	-9.80%	-0.11%	0.00%
EBITDA Margin	10.21%	23.00%	25.00%	25.00%	10.48%	20.80%	25.00%

Cash Flow Statement

Net Income	(89.4)	2,142.4	3,106.6	4,124.5	967.6	9,284.0	22,009.6
DD&A	298.1	263.3	360.2	478.2	427.0	1,399.8	2,551.8
Deferred Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discretionary Cash Flow	208.7	2,405.7	3,466.8	4,602.7	1,394.5	10,683.8	24,561.5
Cash Flow/Share	0.00	0.01	0.02	0.02	0.01	0.06	0.12

Source: Dahlman Rose and company documents

Disclosures

Disclaimer:

The information presented in this report is for informational purposes only. It was prepared based on information and sources that we believe to be reliable, but we make no representations or guarantees as to the accuracy or completeness of the information contained herein. This report is not to be construed as an offer to sell or a solicitation of an offer to buy any security.

Dahlman Rose & Company, LLC, its affiliates, or any of its officers and employees may have positions or options in and may, as a principal or an agent, purchase or sell securities in the subject company. The opinions expressed in this report may change without notice.

Certification:

Each analyst identified in this report certifies, with respect to companies and securities discussed in this report, that the recommendations and opinions expressed accurately reflect the analyst's personal views and no part of the analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed herein.

Required Disclosures:

- Dahlman Rose & Company, LLC, and/or its analysts, officers or employees may have positions in any of the securities discussed in this report. However, none of those positions equal or exceed 1% of the equity securities outstanding for the subject company.
- Dahlman Rose & Company, LLC, and/or any of its analysts, officers or employees, or any household members do not serve as an officer, director or advisory board member of any of the subject company discussed in this report.
- Dahlman Rose & Company, LLC may seek to be a financial advisor or engage in investment banking services with one or any of the subject companies discussed in its research reports and as such, may receive compensation for such services over the next three to twelve months. As a result, investors should be aware that the firm might have a conflict of interest that could affect the objectivity of this report. During the past 12 months, Dahlman Rose & Company has not provided investment banking services to the subject company of this report.
- Dahlman Rose & Company, LLC is not a tax or legal advisor and provides no legal or tax advice or opinions with respect to the securities recommended in this report.
- Dahlman Rose & Company, LLC makes a market in the subject company of this report.

Stock Ratings:

Dahlman Rose & Company, LLC assigns the following ratings to the securities of the subject companies:

Buy – The fundamentals/valuations of the subject company are **improving** and the investment return is expected to be 5 to 15 percentage points **higher** than the general market return.

Sell – The fundamentals/valuations of the subject company are **deteriorating** and the investment return is expected to be 5 to 15 percentage points **lower** than the general market return.

Hold – The fundamentals/valuations of the subject company are **neither improving nor deteriorating** and the investment return is expected to be **in line** with the general market return.

Ratings Distribution:

As of March 31, 2008, Dahlman Rose & Company, LLC has 84 companies under its research coverage.

83.3% have been assigned a **Buy** rating and 15.6% of the companies in this rating category are investment banking clients.

0.0% have been assigned a **Sell** rating and are not investment banking clients.

16.7% have been assigned a **Hold** rating and 0.0% of the companies in this rating category are investment banking clients.