

## Deutsche Rohstoff

Oil & gas

5 September 2019

### Cub Creek wells on budget and on target

Deutsche Rohstoff's (DR0) main focus is the development of oil and gas production in the US. At end FY18, DR0 held interests in 44 operated horizontal wells and 40 non-operated wells in Colorado, with minor interests in numerous wells in North Dakota and Utah. DR0 almost doubled production from 5.1kboed in FY17 to 9.6kboed in FY18. A c \$60m drilling campaign was initiated in Q219 at Cub Creek, Colorado. FY18 was marked by the \$59.6m sale of Salt Creek, delivering c 40% ROIC. DR0's management sees a point of inflexion in the metals unit, with Almonty Industries (12.8% stake) generating a profit in for the nine months ended 30 June 2019 and nearing Sangdong mine financing. Management guides to FY19 sales of €40–50m and EBITDA of €25–35m, lower than FY18, mainly due to natural well depletion and new investments expected to come online in early 2020. For FY20, it guides sales of €75–85m and EBITDA of €55–65m.

### Drilling programme at Cub Creek

A drilling programme is currently underway at Cub Creek. The \$60m plan is to drill 11 horizontal wells and production is scheduled to commence in early 2020. Cub Creek has another well pad in the area, and according to current plans, a similar number of wells could be drilled in 2020. Elster is also expected to take part in drilling activities in the coming months, with a c \$5–10m investment.

### US oil and gas production is core

Colorado subsidiaries Cub Creek Energy and Elster Oil & Gas are the largest contributors to group oil and gas production. While DR0 continues to invest in the region, its strategy also includes expanding in Utah and North Dakota, seeking business opportunities to develop and monetise. The Salt Creek disposal in FY18 with an ROIC of 40% is a success story that DR0 intends to replicate.

### Valuation: Undervalued versus 1P and 2P reserves

DR0's end-FY18 independent 1P and 2P valuation of its oil and gas assets totalled \$186.3m. We apply H119 book values to the company's mining and oil investments, minus H119 net debt of €52.2m. This amounts to a SOTP valuation of c €137.3m or €27.0/share, rising to €28.6/share including 2P reserves. DR0 currently trades at a 52% discount to its 1P reserve value and a 54% discount to its 2P reserve value on this basis. Further detail on the valuation was presented in our [last note](#).

#### Consensus estimates

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	Capex (€m)	Yield (%)
12/17	53.75	36.13	1.10	0.65	(51.8)	5.0
12/18	109.05	97.93	2.74	0.70	(66.2)	5.3
12/19e	N/A	N/A	N/A	N/A	N/A	N/A
12/20e	N/A	N/A	N/A	N/A	N/A	N/A

Source: Deutsche Rohstoff

**Price** €13.10  
**Market cap** €67m

#### Share price graph



#### Share details

Code	DR0
Listing	Deutsche Börse Scale
Shares in issue	5.08m
Net debt as at 30 June 2019	€52.2m

#### Business description

Deutsche Rohstoff identifies, develops and monetises resource projects in North America, Australia and Europe. The company's focus is on the development of oil and gas opportunities in the US.

#### Bull

- Track record of value creation.
- Acquisition opportunities in US onshore.
- Technology driving increased US returns.

#### Bear

- Diverse commodity focus for a small company.
- Disparate US peer group.
- High operational leverage if oil prices fall.

#### Analyst

Carlos Gomes +44 (0)20 3077 5722

[oilandgas@edisongroup.com](mailto:oilandgas@edisongroup.com)

[Edison profile page](#)

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## Setting the ground for a production increase

DR0's core subsidiaries onshore US, Cub Creek Energy and Elster Oil & Gas, like all companies in the DJ Basin, struggled with operational and infrastructural issues during the first half of 2019, but production was in line with management expectations. Further optimisation of existing production facilities is underway in these assets, and gas lift, which is already equipped in two pads, is to be implemented in the remaining two pads, in H219 at Cub Creek to maintain production. Meanwhile, a \$60m drilling programme at Cub Creek is underway. The plan is to drill 11 horizontal wells from the Olander pad and production is scheduled to commence in early 2020. This should lead to a material uplift in the group's US production.

In H119, Salt Creek Energy and Bright Rock Energy completed acquisitions in Utah and North Dakota, set to be strategic growth drivers for the group in the near term. In Germany, Rhein Petroleum (DR0 10% stake) had an exploration success with the Steig-1 well discovery. The well has been tested and the size and development potential are currently being evaluated.

## Financials: 2019 down but 2020 production boost

Recent H119 results showed revenues of €24.2m, down from €54.1m, based on group (net) oil and gas sales of 5.3kboed. These are predominately in the US, with Cub Creek and Elster Oil & Gas accounting for €10.5m and €12.1m respectively. EBITDA of €15.2m (vs H118 €52m) was in line with management expectations.

<b>Exhibit 1: Financial summary</b>			
<b>German GAAP (€000s)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
<b>Income statement</b>			
Sales revenue	9,170	53,746	109,052
Growth %	383%	486%	103%
EBITDA	6,374	36,126	97,933
EBITDA Margin %	70%	67%	90%
EBIT	(541)	5,300	32,700
Net profit (after minority interests)	102	5,549	13,872
Number of shares ('000s)*	5,063	5,063	5,063
EPS adj. (€/share)	0.02	1.10	2.74
DPS (€)	0.60	0.65	0.70
<b>Balance sheet</b>			
Cash and cash equivalents	28,090	29,699	59,989
Total assets	193,472	213,574	224,845
Total debt	75,243	106,576	93,385
Total liability	109,146	121,901	151,007
Shareholders' equity	66,121	56,675	
<b>Cash flow statement</b>			
Net cash from operating activities	2,914	37,848	68,674
Net cash from investing activities	(38,791)	(51,625)	(28,268)
Net cash from financing activities	11,516	24,735	(28,626)
Net cash flow	(24,360)	10,958	11,780
Bank balances (including investments)	24,634	28,368	45,646
Net debt/(cash)	47,153	76,877	33,395
Source: Deutsche Rohstoff. Note: *H119 number of shares: 5,082m.			

Management guides to FY19 sales of €40–50m and EBITDA of €25–35m, c 30% and 47% lower than FY18, primarily driven by natural well depletion. Production at Elster Oil & Gas is expected to normalise from September 2019.

In FY20, the company guides to sales of €75–85m and EBITDA of €55–65m, which incorporates the added production and revenues from the \$60m investment in Cub Creek's Olander site and the c \$5–10m investment by Elster to boost production. Current consensus expectations do not appear to reflect recent asset divestments or management guidance on future profitability and dividend payments.

DR0's end-June 2019 balance sheet showed net debt of €52.2m (a 60% increase since end 2018), reflecting the high levels of investment at Salt Creek Oil & Gas and Bright Rock Energy at c €10.2m. These outlays will reduce considerably in 2020 and simultaneously lead to expanded production, revenues and earnings. DR0 also transferred securities from current assets to fixed assets so they are not accounted in cash and cash equivalents anymore.

## Valuation

Since there is no reserve update since our last note, the only driver behind the change in our valuation is the foreign exchange update from \$1.29/€ to \$1.13/€. The US dollar has appreciated when compared to the euro, and since DR0's oil and gas revenues are in US dollars, this reflects positively in the company valuation. The NPV<sub>10</sub> of the 1P and 2P reserves for its net oil and gas assets, plus the H119 book value of mining and oil investments minus net debt, is now €137.3m (€27.0/share) and €145.2m respectively (€28.6/share).

At the time of the independent report valuation, the WTI price was \$51.44 per barrel before transport and marketing costs. On average, for the first half the year, DR0 achieved a selling price after transport costs of approximately \$52.45 per barrel, relatively in line with the competent person's report (CPR).

**Exhibit 2: DR0 assets and per-share value**

Asset	Value basis	CPR net NPV <sub>10</sub> 1P		CPR net NPV <sub>10</sub> 2P	
		Value (€m)	Value per share (€/share)	Value (€m)	Value per share (€/share)
Oil & gas assets	CPR*	157.1	30.9	164.9	32.5
Mining and oil investments	H119 book value	32.4	6.4	32.4	6.4
Cash at bank	H119 book value	35.4	7.0	35.4	7.0
Debt	H119 book value	(87.5)	(17.2)	(87.5)	(17.2)
<b>Total equity valuation</b>		<b>137.3</b>	<b>27.0</b>	<b>145.2</b>	<b>28.6</b>
Market value**		66.6	13.1	66.6	13.1
Difference		106%	106%	118%	118%

Source: Deutsche Rohstoff, Edison Investment Research. Note: Number of shares: 5.082m; \$1.13/€. \*Ryder Scott CPR (Cub Creek and Elster) dated December 2018. \*\*Share price as at 27 August 2019.

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Frankfurt +49 (0)69 78 8076 960  
Schumannstrasse 34b  
60325 Frankfurt  
Germany

London +44 (0)20 3077 5700  
280 High Holborn  
London, WC1V 7EE  
United Kingdom

New York +1 646 653 7026  
1,185 Avenue of the Americas  
3rd Floor, New York, NY 10036  
United States of America

Sydney +61 (0)2 8249 8342  
Level 4, Office 1205  
95 Pitt Street, Sydney  
NSW 2000, Australia