EDISON Scale research report - Update

Deutsche Rohstoff

Oil & gas

17 August 2021

Solid H1 results, strong cash flow generation

Strong production and oil prices led to Deutsche Rohstoff's (DRAG's) solid results in H121 with EBITDA up 150% to c €40m (c €16m in H120) and net cash flow generation of c €17m. Management, which is typically conservative, has increased earnings guidance for 2021 and 2022. An extensive $60m drilling programme, comprising 12 wells at Cub Creek's Knight pad and one well at Bright Rock's new acreage in Wyoming, is due for completion by end-Q3 with production commencing in Q4.

Strong cash flow generation in H1

Production has been running at full capacity since early January, with oil production at c 3,700bopd and oil and gas production at 7,801boepd (higher-than-expected due to increased gas at the Olander pad). Combined with strong oil prices, this led to a solid performance in H121. EBITDA increased by c 150% to c €40m in H121 versus €15.8m in H120. Strong net cash flow generation of c €17m compares to a c negative €47m in H120, assisted by sales of shares in oil and gas and mining companies of c €12m. Due to the strong results, management has upgraded revenue and EBITDA guidance for 2021 and 2022. The mid-point of EBITDA guidance was increased by 34% for 2021 and 16% for 2022.

Investment in drilling to provide upside by end-2021

An extensive $60m investment programme in 12 wells at Cub Creek's Knight pad and one well at Bright Rock's new acreage (acquired in June 2020) in Wyoming is due for completion by the end of Q3 with production commencing in Q4. This would provide further upside to management's oil and gas production guidance of 5,700–6,300boepd, which has been surpassed already in H1.

Valuation: Below audited reserve values

DRAG's 8 March 2021 independent 1P and 2P valuation of its oil and gas assets was $211.6m (€176.3m), including Elster Oil & Gas, Cub Creek Energy, Salt Creek Oil & Gas and Bright Rock Energy. It assumes a long-term oil price of c $55/bbl. We assume DRAG's mining assets are valued at book value and adjusted for end-H121 net debt. This amounts to a sum-of-the-parts (SOTP) valuation for 1P reserves of c €114m or €22.3/share (39% above the current share price), rising to €26.2/share including 2P reserves.

Consensus estimates

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	Capex (€m)	Dividend yield (%)
12/19	41.2	22.7	0.1	0.1	28.7	0.6
12/20	38.7	23.9	(3.1)	0.0	36.8	N/A
12/21e*	69.5	44.5	>0**	N/A***	N/A	***
12/22e*	67.5	42.5	>0**	N/A***	N/A	***

Source: Edison Investment Research, DRAG. Note: *FY21 and FY22 figures are mid points of company guidance. **DRAG expects to achieve clearly positive group results in both FY21 and FY22. ***Payment of a reliable and, if possible, increasing dividend remains a key objective.

Price	**€16.1**
Market cap	**€82m**

Share price graph

Share details

Code	DR0
Listing	Deutsche Börse Scale
Shares in issue	5.082m
Net debt at end Q221	€79.2m

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 United States.

Bull

- High operational leverage provides benefit in a strong oil price environment.
- Cheaply acquired undeveloped acreage offering potential for up to 100 new wells.
- Stable liquid position.

Bear

- A permanently low oil price (WTI<$40/bbl) would threaten DRAG's existence.
- May be unable to raise sufficiently low-cost debt.
- Faster than expected declines in existing wells, or more than expected uneconomic wells in yet-to-be-developed acreage.

Analysts

James Magness	+44(0)20 3077 5700
Elaine Reynolds	+44(0)20 3077 5713

oilandgas@edisongroup.com

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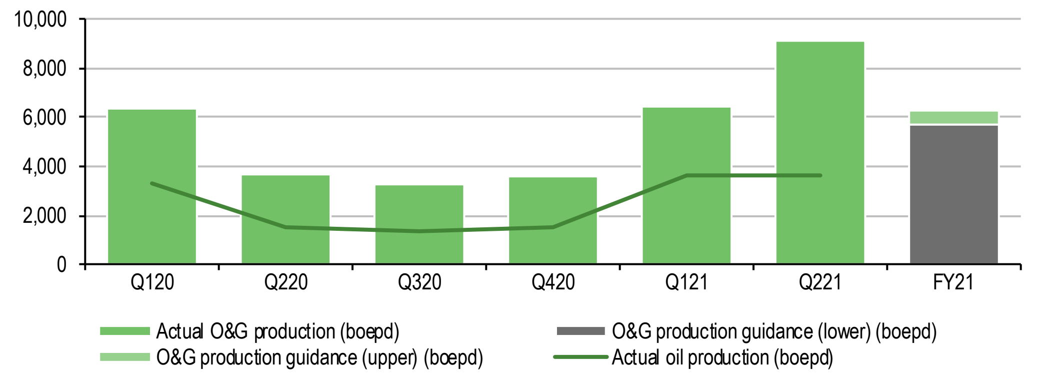
Strong increase in production

Higher than expected oil and gas production in H121, combined with increased oil prices, has delivered a strong set of half year results for DRAG. Net average oil and gas production for H121 was 7,801boepd across all four of the company's subsidiaries: Cub Creek Energy and Elster Oil & Gas in Colorado, Bright Rock Energy in Wyoming and Utah and Salt Creek Oil & Gas in North Dakota. This is ahead of full year guidance of 5,700–6,300boepd. The production was skewed towards Q2 at 9,155boepd, with Q1 at 6,432boepd and resulted from higher-than-expected gas content from Cub Creek's Olander pad (c 80% of production comes from Cub Creek). Overall, oil production remained more or less flat in Q2 (3,641bopd) versus Q1 (3,659bopd), which, again, is above full year guidance (2,300–2,600bopd).

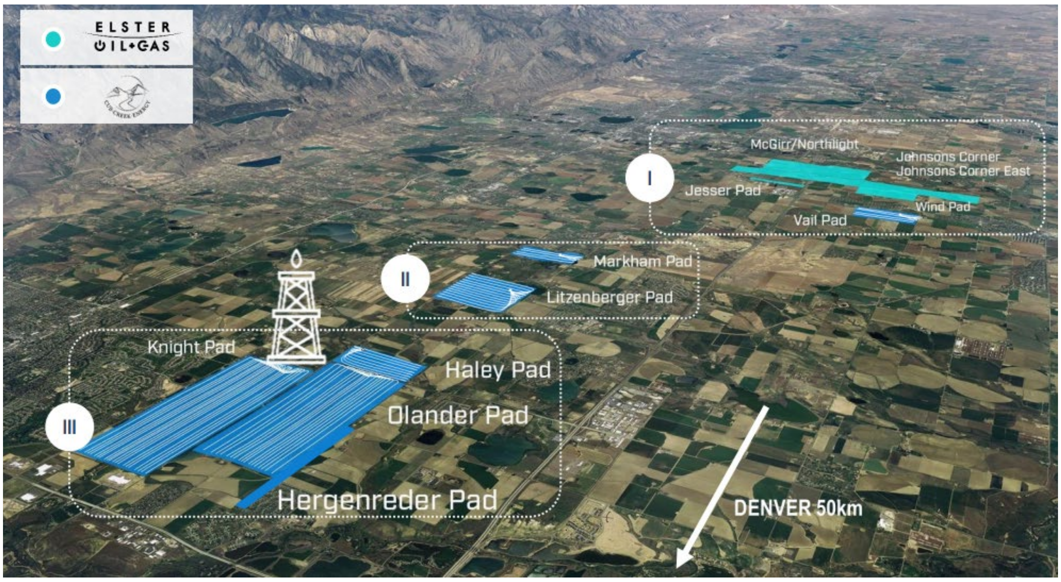
Exhibit 1: Oil and gas production reported in Q120 to Q221 versus guidance for FY21 (boepd) and oil production (bopd)



Source: Edison Investment Research, DRAG

In its most extensive drilling programme to date, Cub Creek drilled 12 wells from the Knight pad, which sits immediately to the west of Olander, between February and May 2021. Each well has a horizontal section of 2.25 miles and the campaign cost c $60m of which Cub Creek pays c 90%. The wells are currently being completed and are expected to come onstream in Q421.

Exhibit 2: Location of Knight and Olander pads, Colorado



Source: Deutsche Rohstoff

Bright Rock is looking to advance the development of c 28,000 acres which it acquired in Wyoming in 2020 through the drilling of a well in 2021. The objective of the well is to prove the economics of the acreage and will be used to define and hold an area of approximately 10,000 acres, known as a federal unit. A drilling permit was issued in March 2021 and the well is expected to be drilled in August 2021.

Financials

Revenue for the first six months of the year was €38.8m, nearly 50% above H120 (€26.1m), while EBITDA more than doubled to €39.9m (from €15.8m in H120). EBITDA includes other operating income of €13.9m, of which €11.7m relates to income from sale of shares in oil and gas and mining companies (oil equities and bonds have now largely been sold). This performance has resulted in management increasing its guidance for revenue and EBITDA for 2021 and 2022; this upgrade was made on the release of the preliminary H121 results on 6 July. In 2021, it has a revised full year revenue forecast of €68–73m (previously €57–62m) together with projected EBITDA of €57–62m (previously €42–47m), and in 2022, revenue is upgraded to €70–75m (previously €60–65m) and EBITDA to €47–52m (previously €40–45m). Management's forecast is based on an expected average oil price (WTI) of $70/bbl in Q321, $65/bbl in Q421 and $60/bbl in FY22 (previously $60/bbl in both years), and a gas price (Henry Hub) of $3.0/mmbtu in 2021 and $2.75/mmbtu in 2022. It assumes a €/$ exchange rate of 1.22. The EBITDA guidance for 2021 is higher than 2022 due to the income from sales of shares in 2021.

Strong net cash generation in H121 of €16.8m (€36.8m at the operating level) resulted in cash increasing from €22.8m at end-2020 to €41.3m at end-H121 and net debt decreasing from €105.6m at end-2020 to €79.3m at end-H121. We note that net cash generation becomes c €5m when adjusted for sales of shares in oil and gas and mining companies; solid cash generation should continue in the coming quarters assuming the oil price remains strong.

Exhibit 3: Financial summary

€'000	2016	2017	2018	2019	2020	H121*
Income statement						
Sales revenue	9,170	53,746	109,052	41,204	38,683	38,814
% growth	383%	486%	103%	-62%	-6%	49%
Other operating income	10,497	1,124	19,060	4,312	7,692	13,886
EBITDA (reported)	6,374	36,138	97,933	22,725	23,935	39,915
% margin	70%	67%	90%	55%	62%	103%
EBITDA (adjusted)**	-1,923	35,014	79,251	20,283	18,243	26,029
% margin	n/m	65%	73%	49%	47%	67%
EBIT (reported)	-541	5,306	32,691	5,630	-16,135	22,546
Net profit (after minority interests) (reported)	102	5,549	13,872	308	-15,509	16,523
Number of shares ('000)	5,063	5,063	5,063	5,082	5,082	5,082
EPS (reported) (€)	0.02	1.10	2.74	0.06	-3.05	3.25
DPS (€)	0.60	0.65	0.70	0.10	0.00	0.00
Balance sheet						
Fixed assets	120,556	148,361	126,985	161,690	134,671	131,063
Financial assets (non-current)	21,043	22,710	22,001	36,780	35,697	35,970
Cash and cash equivalents, including marketable securities	28,091	29,699	59,989	66,637	22,816	41,263
Total assets	193,472	213,574	224,845	278,925	206,722	226,619
Total debt	75,243	106,576	93,385	139,111	128,381	120,562
Total liabilities	127,351	156,899	151,007	207,424	161,133	160,406
Shareholders' equity	66,121	56,675	73,837	71,501	45,589	66,213
Net debt	47,152	76,877	33,395	72,474	105,566	79,299
Cash flow statement						
Net cash from operating activities	13,991	37,848	68,674	13,938	13,991	36,796
Net cash from investing activities	-48,730	-51,625	-28,268	-34,238	-48,730	-8,381
Net cash from financing activities	-17,692	24,735	-28,626	35,292	-17,692	-11,321
Forex movement	639	-7,225	5,136	1,004	639	254
Net cash flow	-53,071	18,183	6,644	13,989	-53,071	16,841
Cash and cash equivalents	24,634	28,368	45,646	61,281	8,210	25,558
Capex (included in net cash from investing activities)	-36,841	-51,775	-66,208	-28,728	-36,841	-10,229

Source: Edison Investment Research, DRAG. Note: *Unaudited; ** Adjusted for one-offs and other operating income.

Valuation

We have calculated a SOTP valuation (Exhibit 4) for DRAG, based on the following:

- An independent oil and gas reserves valuation (competent person's report, or CPR), dated 8 March 2021, published by the company, which valued 1P+2P reserves at $211.6m (€176.3m). We show separate valuations for 1P and 2P reserves.
- Book value of financial assets at end-H121 (€36.0m). This includes listed shareholdings in Almonty Industries, Hammer Metals and Northern Oil & Gas, as well as an unlisted shareholding in Rhein Petroleum.
- Book value of net debt at end-H121 (€79.3m).

The per share valuation based on 1P reserves is €22.3, which is 39% above the current share price of €16.1. Including the 2P reserves adds €3.8 per share, giving a share valuation of €26.2, which is 63% above the current share price. The CPR is based on a long-term oil price assumption of c $55/bbl (Nymex forward price), which is the same price assumption that DRAG adopts in project appraisals.

Exhibit 4: DRAG assets and per share value

Asset	Valuation basis	Reserves (mboe)	Valuation (€m)	Value per share (€)
Oil & gas assets:	CPR*			
2P reserves		14.6	19.5	3.8
1P reserves		128.8	156.8	30.9
Sub-total		**143.4**	**176.3**	**34.7**
Financial assets (non-current)	H121 book value		36.0	7.1
Cash and cash equivalents	H121 book value		25.6	5.0
Marketable securities	H121 book value		15.7	3.1
Total debt	H121 book value		(120.6)	(23.7)
Total equity valuation: 1P+2P reserves			**133.0**	**26.2**
Excluding 2P reserves			(19.5)	(3.8)
Total equity valuation: 1P reserves			**113.5**	**22.3**
Market value			**81.8**	**16.1**
% difference			**39%**	**39%**

Source: Edison Investment Research, DRAG. Note: Number of shares: 5.082m; $1.2/€. *CPR dated 8 March 2021. **Share price at 16 August 2021.

As a downside sensitivity, we note that DRAG also published a CPR, dated 31 December 2020, based on a long-term oil price assumption of c $45/bbl (Nymex forward price at that date). This report valued 1P+2P reserves at €119.5m (using $1.2/€). All else equal, this gives a share valuation based on 1P+2P reserves of €15.0, or €12.6 based on 1P reserves. We note that the oil prices have enjoyed a sustained rally since the year end, with the WTI spot price averaging c $64/bbl ytd.

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