Deutsche Rohstoff

Material ramp-up in production in H2

Deutsche Rohstoff (DRAG) generated group sales of €32.1m and EBITDA of €23.5m in H117, significantly de-risking consensus full year forecasts, which imply 600% revenue growth in 2017. Sales are to be further enhanced in the coming months with a planned 50-well drilling programme across Cub Creek, Elster and Salt Creek. DRAG's metals and mining investments saw a strong recovery during the first half of 2017, underpinned by a strong rise in the price of zinc, copper and a number of rare earth commodities.

Significant drilling activity ahead in the US

Management expects a strong increase in net production in H217 as drilling activity ramps up across Salt Creek, Elster Oil & Gas and Cub Creek. Production in the first half was dominated by Cub Creek at 79% of net group total, and is to benefit from the addition of seven wells from the Haley drilling site from mid-September in addition to 16 wells from the Litzenberger drilling site, which are expected to add to production in Q118. A US$25m gross investment in Elster is driving a 20-horizontal well programme which is expected to augment production in Q118. Lastly, Salt Creek has 33 drilling proposals outstanding, which are currently being executed – six of these were start to add to production in September 2017. As highlighted in our initiation report, well pad returns are highly leveraged to the oil price with break-evens at c US$35/bbl.

Balance sheet remains robust

Group liquidity remains solid, with a cash and equivalents position of €47.1m, an increase of €11.4m since year-end December 2016, reflecting tax receipts. Net debt including liquid long-term assets stood at €43.3m at the half year, giving a 12-month trailing leverage ratio (net debt/EBITDA) of 1.3x.

Valuation: Compares favourably to peers

The last published CPR NPV_{10} for the company's 1P oil and gas asset base stands at €137.2m (using an FX rate of US$1.17/€). Assuming mining assets are valued at book value and adding in net debt and tax receivables at December 2016, this equates to a SOTP valuation of c €123.1m or €24.3/share, or €39.2/share including 2P reserves. In this report, we update our US valuation comparables. DRAG continues to compare favourably.

Historical financials and consensus estimates

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	Capex (€m)	Yield (%)
12/15	1.9	4.9	(0.11)	0.55	(15.1)	2.8
12/16	9.2	6.4	0.02	0.58	(38.8)	2.9
12/17e	55.3	42.2	1.75	0.65	N/A	3.3
12/18e	109.0	96.1	7.72	0.65	N/A	3.3

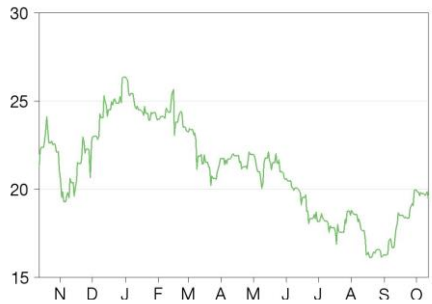
Source: DRAG, Bloomberg consensus (06/10/17). Note: Consensus does not reflect company guidance and was last updated prior to reporting of interims. 2018 numbers reflect the view of only one analyst.

Oil & gas

13 October 2017

Price	€19.41
Market cap	€98m

Share price graph



Share details

Code	DR0
Listing	Deutsche Börse Scale
Shares in issue	5.06m
Net debt as at 30 June 2017	€43m

Business description

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

Bull

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

Bear

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

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Edison profile page

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Valuation

The market value of DRAG remains at a discount to the NPV_{10} (Ryder Scott CPR) of its net oil and gas investments, plus the book value of mining assets minus net debt. We believe asset value is an appropriate basis for valuing DRAG over traditional P&L metrics such as P/E or EV/EBITDA due to the nature of its investments. We would expect DRAG's P&L to remain volatile due to asset acquisitions, divestments and asset impairments. Over a longer time horizon, investors may wish to consider return metrics such as ROACE, ROIC and ROE to formulate a view on management's ability to create value through its 'acquire, develop and divest' strategy.

Exhibit 1: DRAG assets and per share value

		CPR net NPV_{10} - 1P		CPR net NPV_{10} - 2P	
Asset	**Value basis**	**Value €m**	**Value €/share**	**Value €m**	**Value €/share**
Oil and gas assets	See column heading	137.2	27.1	212.6	42.0
Mining assets	Book value FY16	20.0	4.0	20.0	4.0
Tax refund due	Book value FY16	13.0	2.6	13.0	2.6
Cash at bank	Book value FY16	28.1	5.5	28.1	5.5
Debt	Book value FY16	-75.2	-14.9	-75.2	-14.9
Total equity valuation		**123.1**	**24.3**	**198.5**	**39.2**
Market value		98.7	19.5	98.7	19.5
Delta		25%	25%	101%	101%

Source: Deutsche Rohstoff, Edison Investment Research. Note: €/US$1.17

Peer valuation

We have updated our peer analysis, comparing DRAG to its geographic peers using metrics typically used to value US onshore E&Ps. We expect the valuation gap to the US onshore sector to close as net US shale production and net cash flow ramps up. Typical comparable valuation metrics include EV/acre, EV/flowing barrel and EV/reserves. We note that DRAG's peer group contains a varied mix of companies in terms of market cap, play diversity, resource phase mix and financial leverage, therefore 'comparable' companies shown in the table below should not be considered in isolation.

In Exhibit 2 below we adjust DRAG's EV for the book value of mining assets, tax receivable and net debt to compare the company's US onshore business with a number of pure plays. As mentioned above, the peer group is diverse; nevertheless, based on headline metrics, DRAG trades at discount to the group below on an EV/1P, EV/flowing barrel and EV/NPV_{10} (1P) basis. We also note that DRAG has significantly less financial leverage than a number of peers.

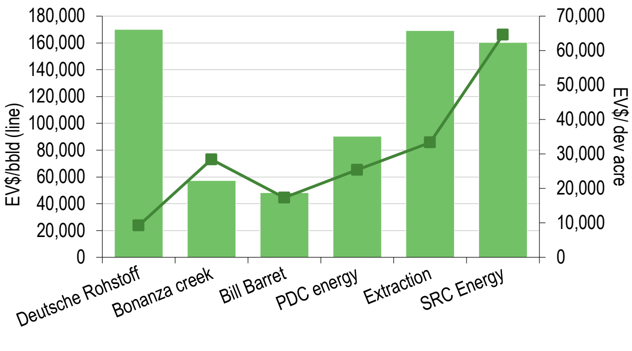
Exhibit 2: Peer group comparison

Company	Ticker	EV ($m)	Production (mboed)	1P mmboe	% liquids	SEC NPV_{10}	Dev net acres	EV/1P	EV/b/d	EV/ dev acre	EV/ NPV_{10}	2017e EV/ EBITDA (x)	Prod'n CAGR (2016-2018)	2017e Net debt/ EBITDA
Bonanza creek	BCEI	1,612	21.7	101.3	75%	328	71,236	15.9	74,270	22,624	4.9	7.8	3%	2,065.8
Bill Barret	BBG	769	17.0	83.7	77%	328	40,359	9.2	45,235	19,054	2.3	5.6	13%	2.6
PDC energy	PDCE	4,029	60.5	273	60%	1097	112,155	14.8	66,592	35,922	3.7	6.3	24%	1.9
SRC Energy	SRCI	1,977	11.7	66.2	57%	391	31,100	29.9	169,438	63,580	5.1	8.4	44%	neg.
Extraction	XOG	2,602	29.9	158.7	64%	836	38,900	16.4	87,039	66,882	3.1	9.6	42%	0.3
Peer Average								17	88,515	41,612	3.8	7.5	25%	414
Deutsche Rohstoff	DRAG	110*	4.6	15.1		160.6	1,650	7.3	23,933	66,723	0.7			0.7
Discount/(premium) sector %								(58)	(73)	(60)	(82)			

Source: Edison Investment Research, Bloomberg consensus. Note: *Includes book value of mining and tax refund due.

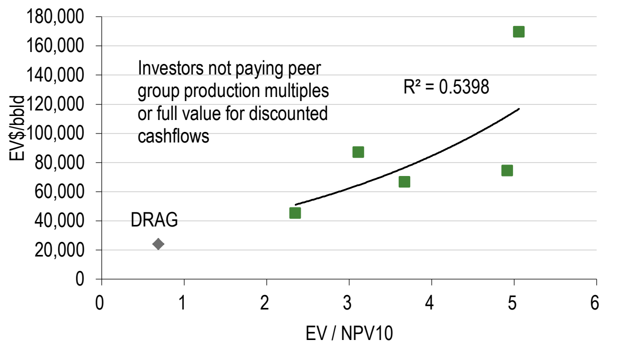
DRAG trades at a discount to the peer group on a number of metrics including enterprise value per flowing barrel (EV/b/d). We have included EV/NPV_{10} as a valuation metric to compare the company's enterprise value to the SEC standardised measure of discounted cash flows. It is worth noting that DRAG's audited assessment NPV_{10} for Salt Creek, Elster and Cub Creek uses marginally different price decks to those prescribed by the SEC, so some caution is required when using this metric as a comparative.

Exhibit 3: Valuation on basis of production and developed acres



Source: Bloomberg, Edison Investment Research

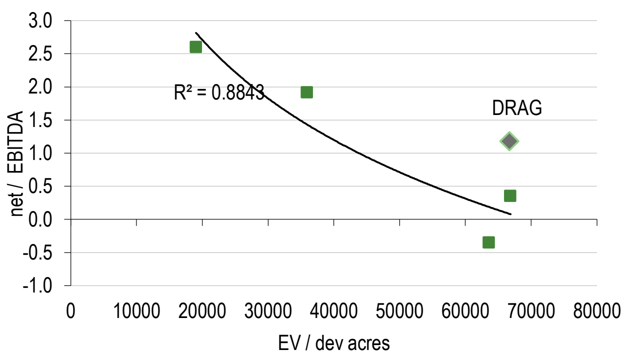
Exhibit 4: EV/flowing barrel vs EV/NPV10*



Source: Bloomberg, Edison Investment Research. Note: *SEC standardised measure for US comps and last audited figures (NPV_{10}) for DRAG

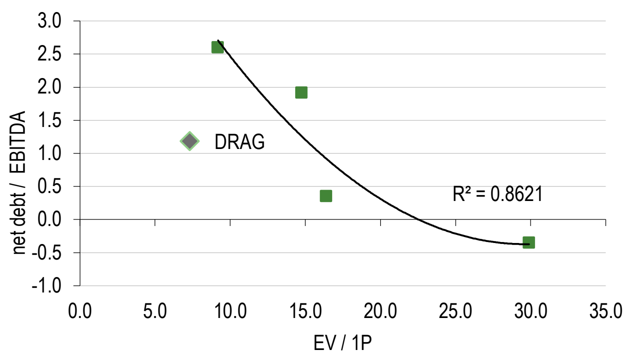
On consensus estimates, DRAG appears to trade at a discount to the peer group when considering the relationship between financial leverage and EV/1P reserves and a slight premium on an EV/developed acre basis. In our view, the company appears to be relatively undervalued and modestly leveraged compared to peers.

Exhibit 5: Net debt/EBITDA vs EV/developed acre



Source: Bloomberg, Edison Investment Research

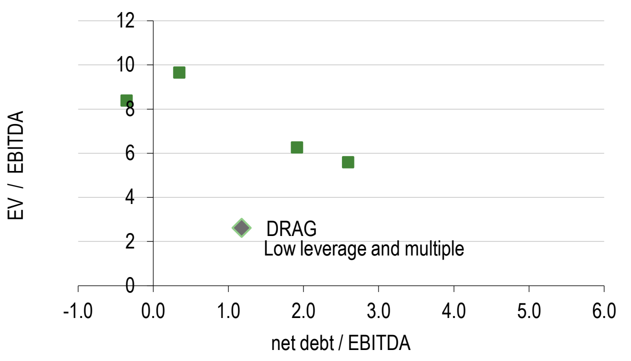
Exhibit 6: Net debt/EBITDA vs EV/1P



Source: Bloomberg, Edison Investment Research

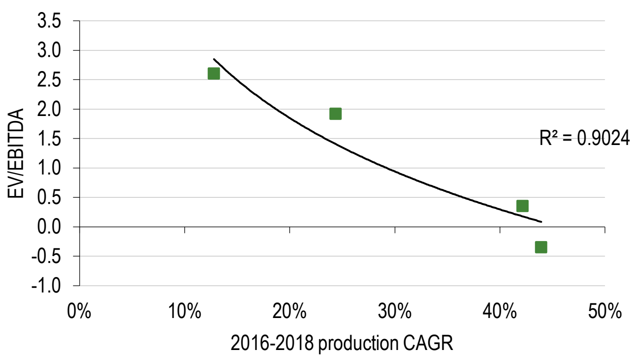
DRAG also appears to trade at a discount when considering 2017 EBITDA consensus forecasts and production growth. It trades on a relatively low EV/EBITDA multiple given its financial leverage.

Exhibit 7: 2017 EV/EBITDA vs net debt/EBITDA



Source: Bloomberg, Edison Investment Research. Note: EBITDA based on DRAG management forecasts for 2017.

Exhibit 8: EV/EBITDA vs production growth



Source: Bloomberg, Edison Investment Research

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