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RESEARCH 6 November 2019

Rose Petroleum plc

Stock Data

Share Price:	1.30p
Market Cap.:	£3.7m*
Shares in issue:	285.9m*

*Pro forma until 21 November 2019

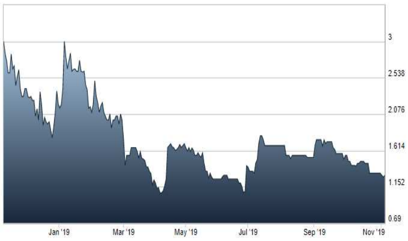
Company Profile

Sector:	Oil &Gas
Ticker:	ROSE.L
Exchange:	AIM

Activities

Rose is a junior oil and gas E&P company with a core focus on oil and gas interests in the Rocky Mountain region of the US.

Share price performance



Source: LSE

Past performance is not an indication of future performance.

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Rose has signed a binding Letter of Intent with Captiva Energy Holdings II LLC to acquire an initial 10% of Captiva's 89.5% net working interest in the 317 acre McCoy lease located in the Denver-Julesburg (DJ) Basin in Colorado. This acquisition represents the initial stage of ownership in what may ultimately become a considerably larger Drilling Space Unit (DSU) to accommodate a multi-well drilling programme of two-mile horizontal wells targeting up to four reservoir formations. This deal is being expedited with a view to establishing early production and cash flow within the next 12 months.

Over the last six months, Rose has restructured the company's board and management team and initiated a revised strategic focus on oil and gas opportunities in the Rocky Mountain region of the US. While maintaining the restructured Paradox project as an important part of the longer term strategic vision of the company, Rose also intends to take advantage of the highly fragmented smaller end of the US E&P sector and grow a more balanced portfolio through the acquisition of more 'bite sized' interests which represent lower risk, near term cash flow generative projects with longer term development upside.

For a modest consideration of only US$0.27m payable to Captiva in Rose shares at a premium to the current share price, the company has agreed to acquire an initial 10% of Captiva's 89.5% working interest in the McCoy lease with an option to acquire up to a further 80% of Captiva's interest at a later stage.

Among several factors, the acquisition is conditional on regulatory approval for a wider DSU to accommodate the drilling of two-mile horizontal wells. When the deal completes, Rose will gain the right to participate in the proposed drilling of an initial tranche of 12 wells which will target the productive Niobrara and Codell reservoirs. Rose estimates that there is the capacity to drill a maximum of 23 wells including boundary zone wells which will require further agreement with offset pad owners. As the eventual DSU will be considerably larger than the initial McCoy lease, Rose expects that its initial net interest across the eventual DSU will be approximately 2.217%, with the potential to increase to 19.954% in the event that Rose exercises its option to acquire the additional 80% interest in Captiva.

Gross capex for an initial 12-well programme is estimated to be US$72m (average well cost of US$6m) with Estimated Ultimate Recovery (EUR) from each well of c.0.85 mmboe. We anticipate that Rose's share of initial capex will US$1.59m with an additional US$175,000 payable as a function of Rose's paying 11.1% for a 10% net working interest under the terms of the agreement with Captiva. Should the option to increase Rose's interest in Captiva be exercised fully, the company could incur a further US$12.6m of capex as its share of the initial 12-well programme.

In order to fund part of the work programme as outlined in the deal with Captiva, Rose has conditionally raised £1.25m through the issue of 113.6 million new shares at 1.1p per share. This will be conducted in two tranches, the second of which is subject to shareholder approval at a General Meeting to be held on 21 November 2019.

With the restructured Paradox project representing an attractive medium term appraisal play for the company, Rose is now expediting its new strategic focus on near term, lower risk plays in the Rocky Mountain region of the US with the potential to generate production within a 12-month timeframe. We anticipate that a successful conclusion of the acquisition of an interest in the McCoy project could represent the first of several such deals as Rose develops a pipeline of potentially attractive projects to grow the company's asset portfolio.

Rose’s strategy

A restructured business

In recent months, Rose has undergone a major restructuring which includes:

- Bolstered operational and governance framework through restructuring of Board and management team (See Appendix 2 for full management biographies)
- Revised focus on upstream oil and natural gas opportunities in the U.S. Rocky Mountain region
- New strategy to grow asset portfolio through value-accretive production and development acquisitions
- McCoy deal meets all internal acquisition criteria and will give the company low-risk near term production alongside a strong industry partner
- Paradox project restructured into a more focused and fundable project
- Pipeline of further projects to grow portfolio
- Significant news flow over coming months

Rose’s strategy is to build a balanced portfolio of assets, exhibiting both free cash flow and long-term development opportunities. The restructured Paradox project and the McCoy acquisition sit firmly within this strategic vision and the Board looks forward to adding additional projects to the portfolio in the short-term.

Building a portfolio

In Rose’s 2018 annual report, released in June 2019, the management outlined its belief that strong financial returns could be generated from the highly fragmented smaller end of the US oil exploration and production sector and the board is now in the process of restructuring Rose so that it can be a stable public growth vehicle targeting this part of the market. Rose believes that the construction of a balanced portfolio, exhibiting both free cash flow and long-term development opportunities, is core to successful growth. The company’s vision for a balanced portfolio includes:

1) Production assets acquired at compelling valuations
2) Near-term, lower-risk yet highly economic development opportunities located in core acreage positions in established basins. In particular, the company will target infill horizontal development drilling opportunities in basins long established through vertical production
3) Longer-term, high-potential appraisal and exploration projects designed to add significant scale, such as the current opportunity in the Paradox.

Investment criteria

Rose already has significant long-term appraisal and exploration exposure through its restructured Paradox asset and as such, is focusing acquisition efforts on near-term development and production opportunities. As part of this process, the company has adopted the following high-level methodology for screening potential acquisitions based on the following factors, and all acquisitions will need to be consistent with the criteria listed below:

- **Geographic criteria**: Utah, Colorado or Wyoming (the Rocky Mountain Region)
- **Portfolio criteria:** Near term development (PUD) or accretive producing (PDP) opportunities
- **Expertise criteria:** Prior management experience operating asset or similar assets

- **Cash flow criteria:** Cash flow generative within 12 months of acquisition
- **Entry criteria:** Proprietary acquisition angle (such as via land strategy, relationship, or unique view on upside opportunity) or uncommonly good value
- **Partner validation**: Strategic financial or industry partner validation

Rose believes that these specific criteria give the company a clear focus and the McCoy opportunity fits very neatly within this strategic profile and complements the Paradox asset.

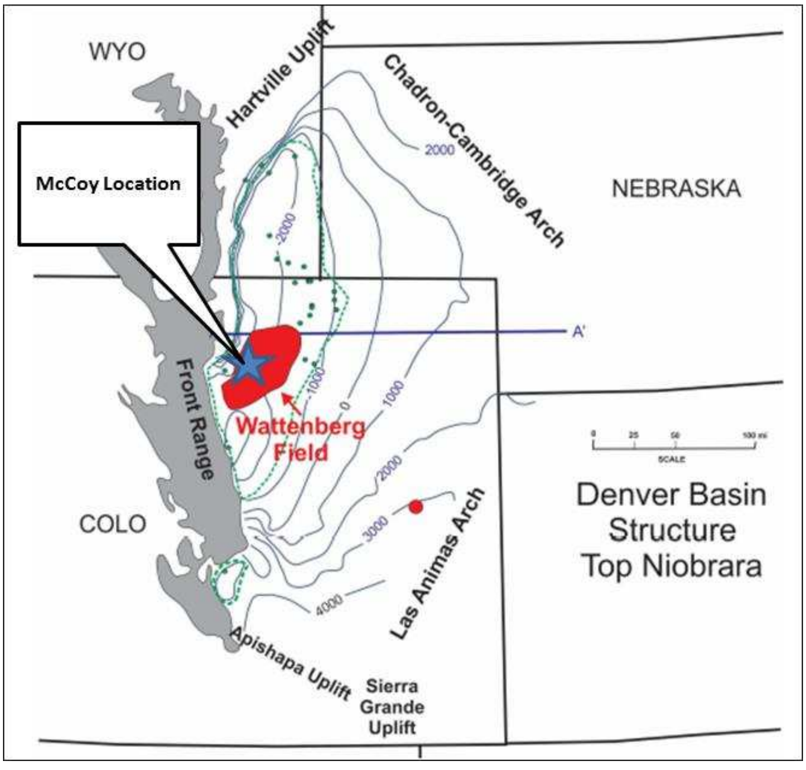
Acquisition of interest in the McCoy lease

In October 2019, Rose signed a binding Letter of Intent with Captiva Energy Holdings II to acquire an initial 10% of Captiva's 89.5% net working interest in the 317 acre McCoy lease located in the Denver-Julesburg (DJ) Basin in Colorado, USA. Rose also has the option to acquire up to a further 80% of Captiva's net working interest in the McCoy lease at the company's sole discretion. For further details on Captiva and its management team, please refer to Appendix 2 at the end of this report.

This deal is expected to provide Rose with near-term, low risk development drilling exposure to the prolific Niobrara Formation resource play and on other acreage contiguous to other major DJ Basin operators including Occidental Petroleum Corp, Great Western Operating Company LLC and Crestone Peak Resources.

The DJ Basin is a mature liquids rich basin which is currently experiencing resurgence as one and two-mile horizontal well developments replace older vertical well production. Over 4,000 horizontal wells have been drilled in the DJ Basin to date and there is significant infrastructure in place with available capacity and good access to service providers and contractors.

Location of the McCoy lease in Weld County, Colorado



Source: Rose Petroleum

Terms of the planned acquisition

Captiva acquired its interest in McCoy from Vanguard Natural Resources and Captiva's total cash expenditure on the project is US$2.7m to date. Rose has agreed to purchase the company's initial 10% interest in the McCoy project at Captiva's pro-rata cost equivalent to US$0.27m. Rose believes that this is an attractive valuation compared to other acreage transactions in the immediate area.

The company intends to make the payment in new Rose shares priced at 1.32p per share, representing a 20% premium to the proposed equity fund raising announced simultaneously with this deal. As part of the deal, Rose will receive an option to acquire a further 80% of the McCoy leasehold from Captiva which is valid until 28 February 2020 and extendable at the sole discretion of Rose if the company can demonstrate sufficient means to fund the McCoy development capital expenditure budget.

Rose may acquire the additional 80% in several tranches of any percentage it chooses at its sole discretion and at the same pro rata rate as the company's initial 10% interest. This payment or payments will be payable in new Rose shares and will be determined by the 60-day volume weighted average price of ordinary shares on the date the option is exercised. Pro-rated costs will include any additional development costs accrued prior to the exercise of the option.

Under the terms of the agreement, Rose will carry Captiva for an equivalent 11.1% of Rose's share of capex on the first 20 wells drilled on the lease.

Related party transaction

Captiva is indirectly controlled by Origin Creek Energy LLC (OCE) whose shareholders include Rick Grant, Chairman of Rose and Colin Harrington, CEO of Rose. Mr Grant and Mr Harrington are also directors of OCE and Captiva. On completion of the deal, an ongoing management fee will be payable by Rose to the Captiva management team to manage and oversee the project on behalf of Rose.

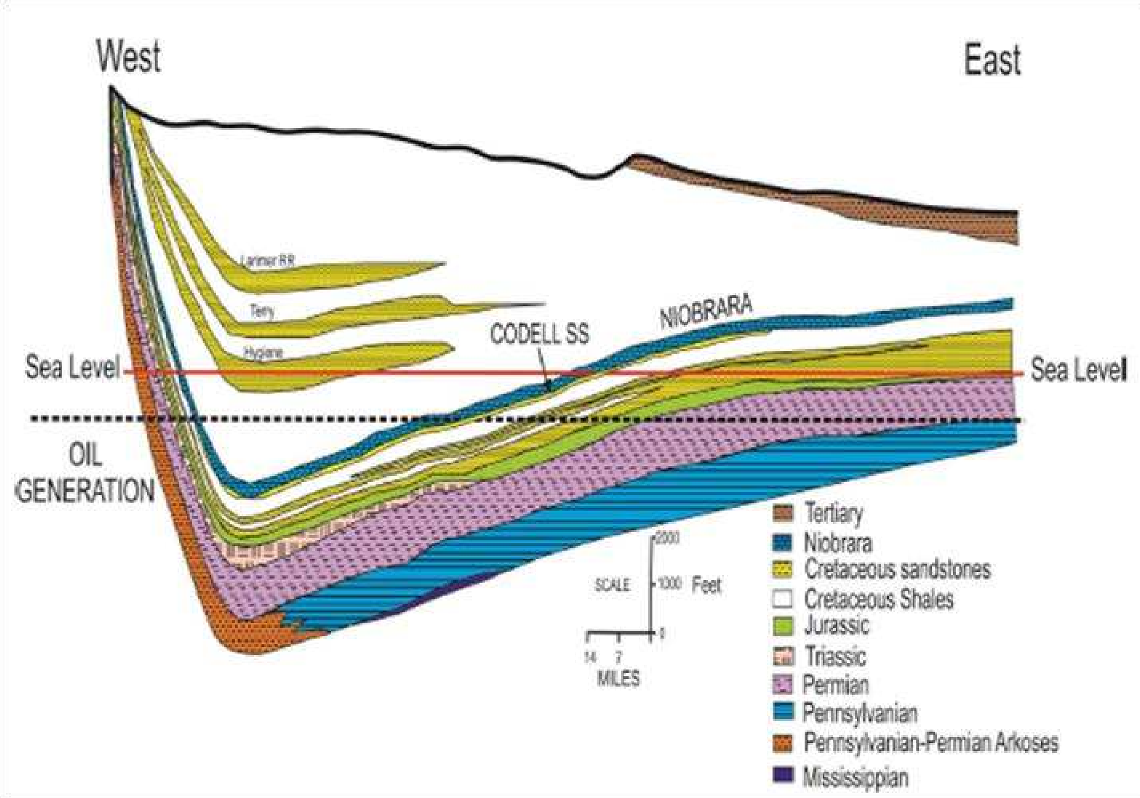
Proposed work programme

The acquisition and subsequent work programme is contingent on the execution of a formal sale and purchase agreement, the conclusion of partnership discussions and the approval for the application of a wider Drilling Space Unit (DSU) to accommodate the drilling of two-mile horizontal wells given that the initial McCoy acreage amounts to approximately half a square mile at this stage.

Rose will gain the right to participate in the proposed drilling of an initial tranche of 12 wells which will target three Niobrara chalk reservoirs and the Codell sandstone reservoir, potentially from a single well site in mid-2020. Rose estimates that there is the capacity to drill a maximum of 23 wells across the proposed DSU, including boundary zone wells which will require further agreement with offset pad owners. As the eventual DSU will be larger than the initial McCoy lease, Rose expects that its ultimate interest will be approximately 2.217% across the eventual DSU. This could increase to a maximum of 19.954% in the event that Rose exercises its option to acquire the additional 80% interest in Captiva.

Total capex for an initial 12 well programme is estimated by the company to be c.US$72m amounting to approximately US$6m per horizontal well including completion and tie-in to gathering infrastructure. Estimated Ultimate Recovery (EUR) from each well is expected to be around 850,000 barrels of oil equivalent with the larger proportion of total production in the early months and years of production as is characteristic of output from tight reservoir formations.

Reservoir targets within the McCoy lease



Source: Rose Petroleum

We anticipate that Rose's share of initial capex will be modest at US$1.6m assuming a US$72m work programme. This would be increased by approximately US$175,000 as a function of Rose's paying 11.1% for a 10% net working interest. Should the option to increase Rose's interest in Captiva be exercised fully, the company could incur a further US$12.6m of capex as its share of the initial 12-well programme.

Funding the transaction

Rose has conditionally raised £1.25m before expenses through the issue of 113.6 million new shares at 1.1p per share to new and existing shareholders. Of the funds raised, £0.907m is conditional on the approval of shareholders at a General Meeting to be held on 21 November 2019.

A total of £0.343m representing 31.2 million placing shares at the placing price of 1.1p has been raised within Rose's existing share allotment authorities (the First Placing). These shares are expected to be admitted to trading to AIM on 8 November 2019.

The balance of the placing shares, amounting to 82.5 million new shares at the placing price, is conditional upon shareholder approval at Rose's upcoming General Meeting which is expected to provide the company's directors with the authority to issue further shares to enable completion of the second tranche of the placing (the Second Placing).

Warrants and fees

In addition to the placing shares, Rose is issuing 56.8 million warrants to subscribe for the same number of new shares, representing one warrant for every two placing shares. The warrants will be exercisable at a price of 2.0p per share, representing a premium of 82% to the placing price, for a period of two years from issue.

In conjunction with the placing, Rose is issuing its joint broker, TPI, with approximately 1.3 million new shares in respect of fees due as a professional adviser. The company is also issuing TPI with 3.272 million warrants to subscribe for the same number of shares as part of TPI's fees for undertaking the placing. These warrants will be exercisable to a price of 1.32p per share for a period of three years after the date of issue.

We note that Origin Creek Energy LLC, whose directors and shareholders include Rick Grant and Colin Harrington, has subscribed for 43.6 million new shares as part of the placing. Upon completion of the Second Placing and admission of the shares, OCE will hold a 24.0% interest in Rose Petroleum.

Paradox Basin update

In mid-October 2019, Rose negotiated a new agreement with its joint-venture partner, Rockies Standard Oil Corporation (RSOC) in regard to the company's Paradox project in Utah. The agreement enables Rose to focus on a core acreage position of approximately 12,920 acres which contains up to 21 high-priority drilling targets and estimated 2C contingent recoverable resources of 8.3 mmboe net to Rose. Rose has valued this acreage position at a post-tax NPV (10%) of US$59m net to the company.

We note that the original agreement with RSOC was based on a considerably larger area of at least 80,000 acres over which the partners focused a 3D seismic survey on an area measuring 17,250 acres. In April 2018, a CPR by Gaffney Cline attributed some 12.3 mmboe net to Rose from the area covered by 3D seismic. Consequently, we note that this realignment of Rose's net acreage focus is slightly improved compared to the 2018 CPR in terms of barrels equivalent per acre.

Rose has terminated its remaining farm-in rights over less prospective acreage in the original agreement and has reassigned those rights back to RSOC. This re-assignment is consistent with the Company's intent to focus its efforts on the area covered by the existing 3D seismic.

The new agreement with RSOC enables Rose to reduce the overall cost of maintaining the project. However, the core change is that Rose now has immediate ownership of the 12,920 acre package rather than an obligation to drill and appraisal well to earn its 75% net interest. Of the entire acreage position, there is a remaining nine year lease term on 5,240 acres and a two year lease extension on the balance, subject to regulatory approval.

The new agreement

As outlined, the new agreement enables Rose to gain an immediate 75% working interest ownership and operatorship of the key acreage within the Paradox project and replaces the earn-in structure in the original agreement with RSOC. The agreement will also reduce Rose's annual lease costs and allow further time to develop and market the project for a potential farm-in partner on drill-ready acreage.

Of the 12,920 acre position, 5,240 acres carries a 12.75% royalty and a nine year lease term remaining and the balancing 7,680 acres carries a 20% royalty and has a two year lease extension subject to regulatory approval. The new lease is almost entirely covered by 3D seismic data includes the fully permitted GV22-1 drill location. As stated earlier, the wider acreage contains a portfolio of 21 drilling targets with a gross EUR from each of the wells, targeting solely the Cane Creek reservoir zone, estimated to be 0.85 mmboe.

The estimated resources of 8.3 mmboe do not include the additional exploration potential contained within a further five stacked, high-graded prospective zones on the acreage which have the potential to create a multi-zone play and add substantial further upside to a potential development project.

As part of the deal, Rose will maintain the obligation from the original earn-in agreement to carry RSOC for a 25% working interest on the first well drilled on the project. The gross cost of such a well is estimated to be US$7m - US$8m, implying that the value of the carry to RSOC is c.US$1.9m. If Rose does not drill its first project well within a five year period, all leases, with the exception of the 5,240 leases with nine year lease terms, will be assigned back to RSOC.

Appendix 2 – Rose Board of Directors

Rick Grant – Non-Executive Chairman

Rick has over 40 years' experience in the oil and gas industry. He is co-founder and Chairman of Origin Creek Energy LLC (OCE). OCE makes US$2m - US$20m foundational investments in the domestic US energy sector. The firm's capital is provided by its partners and two affiliated family offices.

Prior to OCE, Rick was CEO of Suez North America LNG and then served as CEO of Suez Global LNG ("Suez LNG"). During his tenure, Suez LNG grew from an initial US$680m acquisition of Cabot LNG (where Rick previously served as President), into the world's third largest liquefied natural gas business, one active across the entire global natural gas chain from upstream production through to distribution to end-users. Before his time at Cabot, Rick was President of Mountaineer Gas, the largest natural gas distribution company in West Virginia (which also held a sizable upstream portfolio). During his career, Rick has had significant success managing multi-billion dollar organisations and developments, and has been involved in a number of profitable corporate exits.

Colin Harrington – Chief Executive Officer

Colin is CEO of OCE whose capital is provided by its partners and two affiliated family offices. As CEO of OCE, Colin spearheaded the firm's efforts to originate and build value from existing upstream investments in the Rockies and Marcellus regions. Colin began his career in energy finance in 1998, and previously worked in New York, London, Washington DC and San Francisco. In addition to his banking and investment management experience, he founded several companies focused on both the traditional and alternative energy sectors.

Prior to founding OCE, Colin was Managing Partner of the Wellford Energy Group and former CEO of Wellford Capital Markets, a FINRA-registered broker dealer. Prior to Wellford, Mr. Harrington was Senior Vice President of Energy Investment Banking at FBR Group in San Francisco. Colin holds an MBA from the Wharton School and was a Hansard Scholar at the London School of Economics.

Chris Eadie – CFO and Director

Chris is a Chartered Accountant with over 25 years' post qualification experience. In particular, he has held a number of senior finance positions with Cable and Wireless plc and has extensive experience of fundraising and cash management with AIM listed natural resources companies. Over the last two decades Chris has gained significant experience as an AIM Finance Director.

Gordon Stein – Non-Executive Director

Gordon is a member of the Chartered Institute of Public Finance & Accountancy and is currently the CFO and an Executive Director of Columbus Energy Resources plc, an AIM-traded oil & gas company with operations in Trinidad. He was previously CFO of AIM quoted Madagascar Oil Limited from June 2013 to October 2016 and has also been CFO of Cadogan Petroleum plc, an independent oil and gas exploration, development and production company with onshore gas and condensate assets in Ukraine.

Preceding this, Gordon was CFO at Vanguard Energy Limited and Regal Petroleum plc. He has also held senior financial and operational management positions in Fairfield Energy Limited, Acorn Oil and Gas Limited, LASMO PLC, Monument Oil & Gas plc, Centrica plc and BG pc. Mr Stein has over 26 years' experience in the upstream oil and gas sector in the UK and internationally, including Ukraine, Trinidad, Tunisia, Venezuela, Madagascar, Algeria and Turkmenistan.

Tom Reynolds – Non-Executive Director

Tom is a chartered Chemical Engineer with 25 years' experience in the energy sector spanning executive management of private and public E&P companies, private equity investment and advising early stage companies. He led two public E&P companies between 2008-2016: Bridge Energy ASA and Iona Energy Inc., providing him with a broad range of North Sea experience including cross border mergers, IPOs, acquisitions & disposals, the Nordic bond market, debt restructuring and investor relations in London, Oslo and Toronto. Previously, Tom joined the oil and gas investment team of 3i in 2003 where he led the origination and assessment of E&P opportunities in the North Sea and internationally.

Appendix 2 - Background on Captiva

The acquisition of McCoy marks the beginning of a partnership with Captiva that is expected to provide further deal flow, access to proven competence and a wealth of experience in the Rocky Mountain region. The company believes that this initial deal fits well with Rose's strategy of targeting low-risk, low-entry cost acquisitions which can deliver near-term production to balance the longer-term Paradox Basin appraisal asset.

Executive Management biographies

Captiva is managed by executive team Paul Onsager and Bill Hayworth, professional engineers, each with more than 30 years' experience in the industry, including decades in the DJ Basin. Since founding Captiva in 2016, the team executed a successful horizontal development on farm-out acreage from Anadarko, sold a horizontal development to Great Western Oil & Gas and purchased the McCoy asset from Vanguard Natural Resources.

Prior to Captiva, Paul and Bill led a DJ Basin horizontal development programme for a Colorado-based private equity backed oil and gas firm. Prior to that, Paul was VP Operations for the Rockies Asset team at Pioneer, former VP for Reservoir Engineering at Norwest Corp and former Reservoir Engineering team leader at the U.S. Bureau of Land Management. Bill is the former President of PRB/Black Raven Energy and the former VP of Operations at Intoil (both Rocky Mountain focused oil companies) and has held senior engineering and operations roles at Unit Corporation, Patrick Petroleum and Phillips Petroleum. Both Bill and Paul are registered Professional Engineers in the State of Colorado.

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