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Marketing Communication
Your Capital is at Risk

TP RESEARCH 1 July 2020

Rose Petroleum plc

Stock Data

Share Price: 0.55p
Market Cap.: £1.58m
Shares in issue: 287.1m

Company Profile

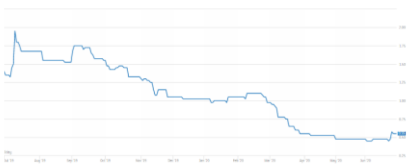
Sector: Oil & Gas
Ticker: ROSE
Exchange: AIM

Activities

Rose Petroleum plc ('Rose', 'ROSE', 'the Group' 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. Its current strategy includes responsible resource development growth via the acquisition of near-term development and production opportunities located in prolific basins of the Western United States.

Website: www.rosepetroleum.com

1-Year Share Price Performance



Source: LSE

Note: Past performance is not an indication of future performance.

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Rose yesterday published its full year 2019 results and provided notice of its 29th July 2020 AGM, at which it proposes to change the Group's name to Zephyr Energy plc ('Zephyr'). This completes a rebranding exercise following a transformative 2019, as a result of which the Group now presents itself as a low-overhead, unlevered and value-focused vehicle with a management team equipped to deliver on its ambitious objectives. Post year-end, Rose successfully extended its option to acquire a working interest in the 317-acre Denver-Julesburg Basin ('DJ Basin') McCoy lease(the 'Acquisition'), while also recognising the recent energy market turmoil is presenting it with 'multiple attractive' investment opportunities in search of which it is now engaged with both industry and financial partners to identify value targets which might be added to its portfolio.

Restructuring and a revised strategy

The past 6 months has been a highly challenging period for the US onshore oil exploration and production ('E&P') industry, during which time it has suffered shockwaves from the dual impact of the coronavirus pandemic and exceptional oil price volatility. Effectively this has culminated a problematical decade of disappointing financial returns, during which time it became the worst performing sector across the public markets and also widely criticised due to its highly publicised poor environmental, social and corporate governance ('ESG'). Against this background, Rose's Board is now pronouncing a strong narrative both to counter such claims and also to recognise the potential value/opportunity that presently exists for it to focus on corporate cash flows based on prudent pricing assumptions within a seemingly oversold domestic market place, rather than adopt the US industry's historical approach which was based on well level IRRs and increased production volumes.

Rose is now completing the development of an operational framework which will be used to achieve this and expects to detail this to shareholders shortly.

Acquisition rationale and criteria

Rose's Board considers strong financial returns can be generated from the highly fragmented smaller end of the US E&P sector. It also believes that the construction of a balanced portfolio, exhibiting both free cash flow and long-term development opportunities, is core to successful growth. The Board's vision for a balanced portfolio includes: (i) production assets acquired at compelling valuations; (ii) near-term, lower-risk yet highly economic development opportunities located in core acreage positions in established basins; and (iii) longer-term, high-potential appraisal and exploration projects designed to add significant scale, such as its current opportunity with its Paradox Project in Utah.

As part of this process, the Board has implemented a high-level methodology for screening potential acquisitions based on a defined list of factors against which all target acquisitions must remain consistent. In addition to this screening criteria, and in an effort to build increased predictability, accuracy and efficiency into its valuation process, management has developed a series of proprietary tools for use in evaluating assets in the region of focus.

The detailed review contained in Rose's 2019 AR&A demonstrates solid progress in respect of implementing the Group's new strategic focus on nearer-term, lower risk plays in the Rocky Mountain region of the US, including the proposed Acquisition of the McCoy lease. With a pipeline of further targets in focus and pending substantive news events, potentially including completion of the acquisition, a farm-out of the Paradox Project and/or its securing of grant funding along with the cash resources necessary to implement its strategy going forward, investors should anticipate continuing fulfilment in coming months.

Financial results for the year to end-December 2019

The Group reported a net loss after tax from continuing operations of US$3.0 million or a loss of 1.74 cents per share for the year ended 31 December 2019 (2018: net loss after tax from continuing operations of US$1.0 million or 0.74 cents per share). Administrative costs for the year of US$1.8 million were slightly higher than those in the prior year (2018: US$1.6 million) primarily due to the costs of the Group restructuring. The impact of the current cost reduction programme will be reflected in the annual results for the year ended 31 December 2020.

Total investment in the Group's intangible exploration and evaluation assets at 31 December 2019 was US$13.5 million (2018: US$13.1 million), reflecting continuing investment in the Paradox project. Cash and cash equivalents at 31 December 2019 were US$1.1 million (2018: US$0.6 million). During the period, Rose raised gross proceeds of US$2.0 million (2018: US$1.3 million) through the placing of new ordinary shares. While the Board recognises the Group does not currently have sufficient funding in place to enable it to meet is financial liabilities for the next twelve months as part of its Going Concern issues, it remains confident that it will be able to secure the required funding through equity issue or other financial instruments in support of its ongoing activities.

Extended option terms for proposed acquisition of the McCoy Project ('the Project')

Due to the economic crises related to coronavirus and the associated downturn in the oil price since the Group signed the McCoy lease working interest acquisition letter of intent on 4 November 2019, the Project was not drilled in the first half of 2020 as originally planned. However, the Board has since been able to extend the Group's Option with Captiva Energy Holdings II to proceed with the acquisition until the end of December 2020. This is expected to give time for further recovery in the oil price and in market sentiment. In addition, capital costs to drill two-mile wells in the DJ Basin have been reduced by over 30% over the last three months, significantly lowering breakeven prices on horizontal developments. The Group believes that in the current market with lowered capital costs, the breakeven oil price at McCoy will be below US$30 per barrel of oil equivalent ('BOE'). Drilling is now expected to commence in H1 2021.

In accordance with its defined strategy, the McCoy acquisition is expected to bring multiple commercial benefits for the Group, including: (i) A low risk development opportunity alongside Great Western Petroleum, one of the most active developers in the DJ Basin, and one with a long track record of successful horizontal development in the immediate area; (ii) Near-term production programme proposed, with drilling anticipated in the first half of 2021; and (iii) Optionality to acquire up to a further 80% of CEH's working interest in the McCoy lease at the Group's sole discretion.

Revised Project Paradox joint venture agreement (the 'Agreement')

Rose entered into discussions with its joint venture partner, Rockies Standard Oil Corporation ('RSOC'), to restructure the joint venture in order that the project might be positioned and developed in line with its new strategy. Superseding all previous arrangements with RSOC, as announced on 10 February 2020, this enabled the Group to gain an immediate 75% working interest ownership and operatorship of key acreage, replacing the earn-in structure in the original agreement. The Agreement has resulted in a significant reduction in the Group's annual lease costs and allows further time to develop and market Project Paradox, while maintaining a highly valuable acreage position that is 'drill ready'.

Based on the 2018 Competent Person's Report ("CPR") methodology, as applied by Gaffney Cline and Associates ('GCA'), the 12,920 acres that formed the initial focus contain estimated 2C contingent recoverable resources of 8.3 mmBOE net to the Group. Subsequent to a subset of leases located within the project core being extended for a further two years and added back into the Group's portfolio, together with the new RSOC Agreement, the Group has now been able to refocus on a core acreage position of c.19,900 acres. This contains an enlarged estimated net 2C Contingent Recoverable Resources of c.9 mmBOE associated with 22 drilling targets in the Cane Creek reservoir. The Group also recognises further exploration potential in 5 shallower reservoir targets which could add further value to the project over time.

In return for this restructuring, the Group maintains the obligation from the original earn-in agreement to carry RSOC for a 25% working interest on the first well drilled on the project (expected to cost c.US$1.9 million). The Group has also agreed to carry RSOC for a 25% working interest for the acquisition of specific targeted leases in and around the core acreage area, in aggregate, up to a total of US$0.5 million, but it is the current view of both the Group and RSOC that the final figure will be considerably lower and any payments would be incurred over an extended period of time. If the Group does not drill its first project well within a five-year period, however, all leases, with the exception of the 5,240 leases with nine-year lease terms, will be assigned back to RSOC. Further, the Group has terminated its remaining farm-in rights over less prospective acreage. With the project restructuring completed and the land position now clarified, the Group plans to recommence its farm-out process for the Paradox Project in the near-term.

US Department of Energy ('DOE') partnership and grant funding

Subject to contract, grant funding from the U.S. Department of Energy (the "DOE") and the University of Utah is potentially available to the Group. The final amount of any grant funding is still to be agreed although, as part of this effort, the DOE project team is also planning to drill a vertical stratigraphic well during 2020 as part of an overall study related to improving production in Utah's emerging northern Paradox unconventional oil play and raising the overall profile of the northern Paradox Basin in order to gather data to improve the understanding of the play. The well will target the Cane Creek and potentially the C18/19 reservoirs, acquiring both core data and a comprehensive well log suite.

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