

PRIVATE EQUITY

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Innoven Partners

DEAL STORY: ROCKWELL PETROLEUM RESURFACES THANKS TO INNOVEN

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OIL EXPLOITATION

Rockwell Petroleum resurfaces thanks to Innoven

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When Innoven Partners decided to invest in the young Canadian oil company RockWell Petroleum in 2005, all the signs looked good. The RockWell technology (RWT) offers an unprecedented opportunity to exploit US oil fields that have not been exploited for several decades. Traditionally, oil companies drilled wells from the surface to bring up the oil. Around ten years ago, mining engineers Mark See and John Hoak developed a technique adapting mineral extraction methods. Using this technique, the hydrocarbon is pumped from tunnels built underneath the oil deposits and brought to the surface solely by the effect of gravity. In short, the technique would allow the extraction of most of the oil reserves from wells that have already been exploited, whereas only 20% of the reserves are able to be extracted through the conventional method. The business plan presented by the group of engineers consisted of three stages: developing the technology, exploiting the oil fields acquired and ultimately listing the company.

key dates

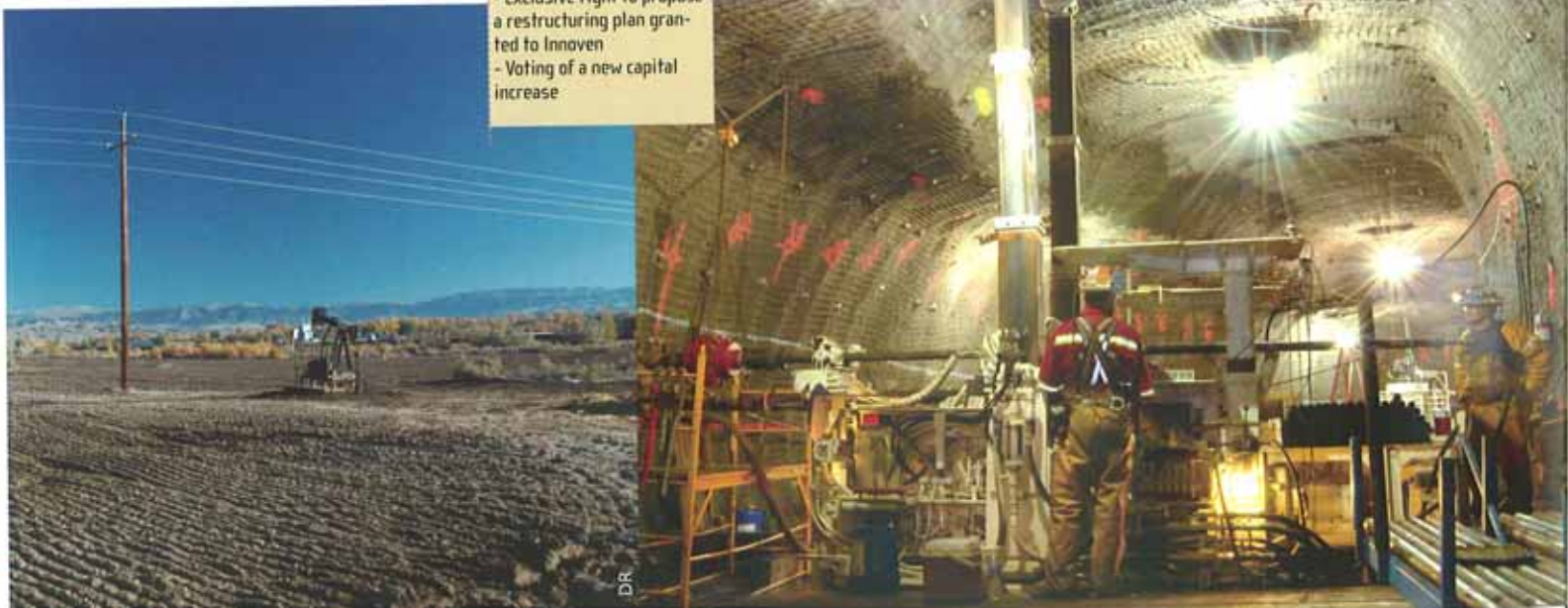
- > 2005 :**
 - Creation of RockWell Petroleum
 - First round of fund-raising from Innoven Partners and other investors
 - Acquisition of oil fields (pilot project in Wyoming)
- > 2006 :**
 - Acquisition of oil fields in Wyoming (\$20m), Louisiana and Texas
 - Second capital increase subscribed for by Innoven
- > 2007 :**
 - Capital increase of \$130 million through a private placement
 - Announcement of planned IPO on LSE
- > 2008 :**
 - Acquisition of oil fields in Pennsylvania and Texas
 - Failure of IPO
 - Filing for Chapter 15 protection
- > 2009 :**
 - New board of directors - replacing of management
 - Exclusive right to propose a restructuring plan granted to Innoven
 - Voting of a new capital increase

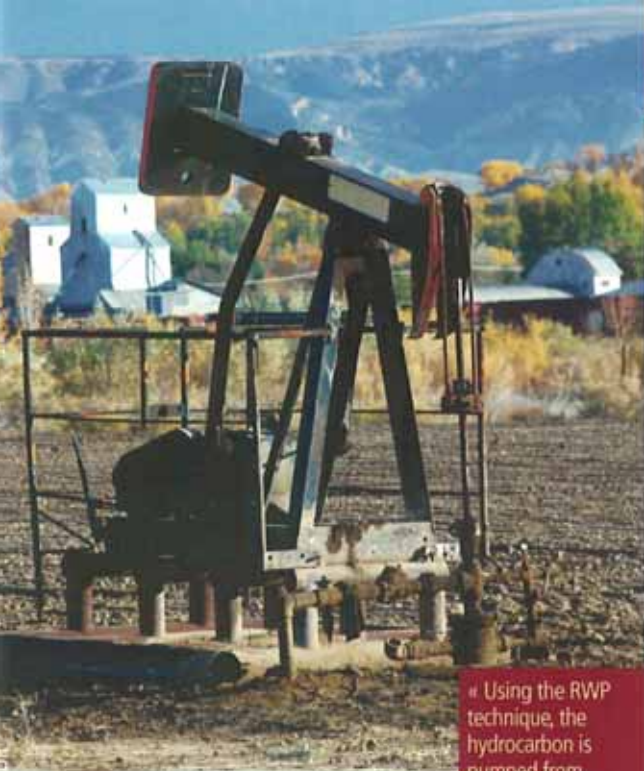
From its creation, the company's founders attracted positive attention from many European investors, such as the Swiss investor Semper Gestion, Go Capital, Bernard Arnault's investment holding company Fidelity, Banque Martin Maurel, the English fund CQS, hedge funds and the French venture capital fund Innoven. In line with its co-leader strategy, the VC fund took part in the first two financing rounds in 2005 and 2006 and invested around €11 million to become the third largest shareholder with 7% of the capital. The number of shareholders quickly grew, reaching 800. In under than three years, the company collected \$280 million, with a value-creation potential of around one billion dollars. The Canadian company consequently managed 300km² of oil and gas fields in Pennsylvania, Wyoming, Louisiana and Texas.

The business model goes off track

In 2007, the sharp rise on the world market in the oil price per barrel, which rose up to \$140, whetted the appetite of oil companies for the financing of less costly extraction tech-

niques. This was an ideal situation for Rockwell's founding directors, who saw the value of their technology soar. Without consulting the shareholders, the management and its board decided to raise \$135 million through a private placement in the third quarter of 2007. Fidelity acquired shares in the amount of \$45 million, at a price of \$4.5 per share, whereas the share price was only \$0.45 in 2005. The directors of Innoven reacted to this sudden enthusiasm. "It was then that we suspected that the business model was going off track", admits its CEO Thomas Dicker. The highly capital-intensive company was continuing to behave like a technology company in terms of investment to the detriment of exploitation operations". A request for clarification of the company's objectives was officially sent. There was no reply. In the meantime, the company announced that it had hired Merrill Lynch and the broker Numis to prepare for its floating on the London Stock Exchange's FTSE250. The directors hoped to raise some \$500 million at prices ranging from \$7 to \$12 per share for a capitalisation of more than one billion. Innoven began to lock horns with the board of directors, believing that the operation was too risky. "Given the lack of visibility we suggested a complete U-turn with a plan to refinance the technology that





« Using the RWP technique, the hydrocarbon is pumped from tunnels built underneath the oil deposits and brought to the surface solely by the effect of gravity. »

involved refocusing on traditional extraction activity”, recalls Innoven’s CEO. The board rejected this proposal several times.

Failure of the IPO

The financial crisis finally put paid to the planned IPO, which was already compromised at the start of summer 2008. The value of RWP completely collapsed, creating a real shock wave. “The previous financing rounds were so easy that the management and the board couldn’t imagine being unable to continue”, explains Thomas Dicker. The latter took matters into his own hands by creating a team of specialists from the oil/gas sector and undertaking lengthy background work to gain shareholder support for his plans. For its part, the company’s management, which was short of cash, declared the termination of payments and filed for Chapter 15 protection, which is the Canadian equivalent of Chapter 11 in the US. Its headcount was divided by 10, bringing it down to 30 employees. In the belief that the potential of existing assets was underexploited, a group of shareholders in league with Innoven decided to launch an audit, “€2 million of which was financed by the personal funds of Innoven’s partners”.

Derisking the company

This started a real race against time, as the North American bankruptcy regulations give priority to the repayment of accounts receivable. After being reassured by the audit report, the French shareholder continued with its strategy. “As an example, the McCamey field in Texas alone has 600 wells, only 20 of which have been exploited. The three main fields owned by RWP cover a surface area of

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160km² and offer potential reserves of more than 400 billion barrels”, explains the investor. The shareholders and the judge still had to be convinced. An initial victory was won in the courts in early 2009. The US judge granted Innoven the exclusive right to present a rescue plan. This plan is also based on a capital increase of between \$30 and \$50 million, which should be finalised in two stages between July and September 2009, “at a price equivalent to the assets audited, whose valuation is low to encourage existing or new shareholders to subscribe on a large scale”, summarised Innoven. The turning point came on 6 March. The Annual General Meeting gave its support to Innoven’s plan and elected

a new board of directors, which revoked the mandates of the existing management. The founders were permanently relieved of the company’s management. At the moment, the plan still depends on leaving Chapter 15 protection, which should happen in September, and giving the company a new injection of capital. Innoven should ultimately increase its holding to 30% of the capital, as the original major shareholders have decided not to participate in the capital increase. In any case, Innoven’s proactive management will have proved to sceptics that a French VC fund, and what is more a minority investor, is able to take the measure of the “risk” associated with its profession. ■

Thomas Dicker, CEO of Innoven Partners, talks about his involvement with Rockwell Petroleum

INTERVIEW

What were the main difficulties that led to the mistakes made by Rockwell Petroleum?



DR

interests of our unitholders and the company.

Venture capital companies are there to fund projects led by inventors who don’t necessarily have managerial skills. The economic validation of their technology may depend on their abilities as entrepreneurs and then managers if they want to keep hold of the reins. Spending all your resources on technology to the detriment of operations can be a mistake, as was the case for Rockwell. Even though it is not the role of shareholders to run companies, it is up to them to get founders back on track with a more appropriate business model. If shareholders voice their concerns but still no action is taken, they must take action themselves and take less diplomatic measures as a last resort. The venture’s future depends on it. That’s what we had to do, short of staging an actual “coup d’état” in the

How do you see the future for Rockwell and its shareholders?

The first important deadline is September when Rockwell should no longer be under Chapter 15 protection. We are also counting on a return to positive cash flow in 2010. Our plan includes development through mergers and acquisitions, either of companies within the oil sector that are struggling, or assets with record low valuations because of the crisis environment. We have not forgotten our objective, which is to use RWP’s technology to exploit additional reserves, but we must first generate profits to make development possible. If everything goes ahead as planned, capital-raising operations will start in 2012. With regard to shareholders, the capital increase that we are proposing is very profitable. The return on investment is estimated at 7.4 times for both existing shareholders and new arrivals.

Did your unitholders understand this operation?

Our crisis management of this affair, overseen full-time by four people, has been guided by concern for our unitholders’ interests. Our goal has been to ensure complete transparency since our visibility increased after the election of the new board of directors. Of course there was the issue of the liquidation of the 1998-2000 FCPIs (innovation-focused mutual funds) with which we invested. The regulations allow us to stay for up to 10 years in the interests of our unitholders. We are also in constant contact with the AMF (French financial markets authority) on this subject to try to find a solution, based on the idea that we need to take as long as necessary to return to value creation. Overall our unitholders have understood very well.



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S.A à Directoire et Conseil de Surveillance au Capital de 300 000€ - RCS Paris B 418 248 019
Agrément de l'Autorité des Marchés Financiers N°GC04-019 en date du 15 Avril 2004