AIM Advisers, Inc.
Maximizing Present & Future Value

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Diversified Gas & Oil Raises $50 Million in AIM IPO

Overview

Birmingham, Alabama-based Diversified Gas & Oil raised $50 million in its recent IPO on the London Stock Exchange's AIM and commanded an opening market capitalization of $87 million. The Company was founded in 2001 and generated $18 million of revenue during 2016. The trailing pre-money revenue and EBITDA multiples were 1.99 and 16.59. Proceeds from the AIM IPO will be used to recapitalize the balance sheet and provide working capital for existing operations and to execute its acquisition strategy. The Company intends to pay not less than 40% of its operating free cash flow as dividends.

Diversified Gas & Oil (DGO) owns and operates 7,500 gas and oil producing wells in the Appalachian Basin in the northeastern U.S. The Company has grown rapidly by capitalizing upon opportunities to acquire conventional, low risk oil and gas producing assets from large U.S. E&P companies, which are today focused increasingly upon the opportunities from unconventional shale production, as well as from small, family-run gas and oil companies. The Company's operations are based entirely in the neighboring states of Ohio, Pennsylvania and West Virginia and run by 81 employees.

DGO has over 1 million acres under lease which are all held by production, meaning the leases do not expire as long as the land is still producing. DGO has total proved reserves of oil of 2,271 thousand barrels (1,470 producing) and gas of 153,695 million cubic feet (135,402 producing). Current gas production is running at 26,000 thousand cubic feet per day and oil production is running at 475 barrels per day. The Company continues to invest in its infrastructure at the well head, through an extensive network of Company-owned pipeline and at the pumping and compression sites. DGO's operational structure enables it to generate significant operating cash flow, even in the current low energy price environment, with an average operating cost of $9.53 per barrel of oil equivalent.

The Company has a track record of sourcing, financing and closing acquisitions. Since September 2014, the Company has completed five acquisitions for an aggregate consideration of $16 million, adding significant production volume and cash flow. The Company intends to continue capitalizing on current market conditions with further acquisitions of conventional oil and gas producing assets from larger public and private E&P companies focused on unconventional shale production in the Appalachian Basin. A key selling point for DGO, which causes prospective sellers to be less price sensitive, is being a proven and competent operator who is capable of continuing production. The competency of the buyer is an important factor for the seller because the continuation of production from the conventional assets protects the future drilling opportunity for the deeper shale formations retained by the seller.

With respect to pricing, DGO has the experience to deal with the issues caused by the movement in oil and gas prices. To protect its revenue, the Company utilizes hedging strategies as well as forward fixed pricing purchase contracts with natural gas purchasers. Although disadvantageous in periods of price inflation, the Company believes that active and effective hedging strategies create the advantage of a more predictable income flow. Through financial hedges, DGO has hedged 43% of its commodity price exposure for gas production and 62% of its price exposure for oil production for 2017. Through fixed price contracts, the Company has protected 55% of its net market price received for 2017 gas production.

With respect to distribution, the Company sells natural gas directly into the local market. DGO's customers are large regional utilities and pipeline marketing companies with long operating track records in the Company's local markets. DGO's producing wells have direct connections into the gathering pipeline systems of these large regional utilities and pipeline companies. Oil is sold to local distributors who collect the oil from production sites with collection vehicles and then sell on to the local oil refineries.

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Key Financial Metrics

(in USD millions)	Y/E 12/31/14	Y/E 12/31/15	Y/E 12/31/16	Δ '14 - '15	Δ '15 - '16
Revenue	$7.4	$6.3	$18.3	-15%	+190%
Cost of Sales	3.6	4.3	12.8	+19%	+198%
Depr/Depl/Amort	2.2	3.4	4.0	+55%	+18%
Gain/(Loss) on Hedging	1.1	0.4	(0.8)	-64%	-300%
Administrative Expenses	1.0	1.0	2.5	+0%	+150%
Interest Expense	2.7	4.1	3.3	+52%	-20%
Other Expenses	0.2	0.9	0.8	+350%	-11%
Net Loss	1.2	7.0	5.9	+483%	-16%
EBITDA	3.9	1.4	2.2	-64%	+57%
Cash	0.0	0.1	0.2	N/A	+100%
Oil & Gas Properties	31.1	42.4	76.8	+36%	+81%
Debt	34.4	42.9	37.3	+25%	-13%

Since the IPO completed within nine months of the latest audited financial statements, unaudited, comparative stub period financials were not required. An unaudited pro forma statement of net assets is never required in connection with an AIM IPO but was provided to illustrate the recapitalization of the balance sheet by way of paying off the debt and the remainder of the net proceeds of the IPO added to the Company's cash resources.

Key Listing Metrics

- $50.0 million gross was raised, $46.2 million net of offering costs, to be used as follows:
  - $40.1 million to recapitalize the balance sheet
  - $ 6.1 million for working capital

- The offering costs amounted to 7.6% of the gross capital raised
  - The offering was undertaken on a 'best efforts' basis, as opposed to being underwritten
    - Nominated Adviser earned a corporate finance fee of $275,000
    - Company engaged Joint Brokers who earned an aggregate commission of 5%
    - Nomad and Joint Brokers received 5-year warrants equating to 5% of the Placing

- Opening market capitalization of $86.5 million
- Dilution to existing shareholders of 57.8%
- Free float of 58.1%

- Trailing pre-money revenue multiple of 1.99
- Trailing pre-money EBITDA multiple of 16.59

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Shareholder Base

The Company had 44.6 million shares outstanding prior to the IPO and issued 61.0 million new shares for cash in the IPO, leaving the Company with 105.6 million shares outstanding. The table below details those who held 3% or more of the Company prior to and after the IPO, along with the aggregate holding of the other new UK investors who individually hold less than 3%.

Shareholder	Pre-IPO %	Post-IPO%
Founder and Chief Executive Officer	45.24	18.94[1]
Executive Chairman	45.24	18.94[1]
Chief Financial Officer and Chief Operating Officer	5.00	2.09[1]
Non-Executive Directors	4.52	1.94[1]
Global Institution	-	5.79
Global Institution	-	4.99
Other New UK Investors	-	47.31
Totals	100.00	100.00

Diversified Gas & Oil was founded in 2001. The Executive Chairman joined the Company in 2005 as a 50% owner alongside the Founder and Chief Executive Officer.

As a result of the AIM IPO, the Company paid off its debt, freeing up additional borrowing capacity, and now has an adequate amount of working capital for existing operations and to execute upon its acquisition strategy. The new, UK-based, blue-chip investors have broadened the shareholder base and can, if required, provide additional capital to fund acquisitions. The Company intends to pay not less than 40% of its operating free cash flow as dividends.

The Board believes that the Company’s success is highly dependent upon the quality and loyalty of the current and future Directors and employees. To assist in the recruitment, retention and motivation of high quality Directors and employee, the Company must have an effective compensation strategy. The Board considers that an important part of this compensation strategy is the ability to award equity incentives and, in particular, share options. As such, the Company now has a Share Option Plan wherein a maximum of 10% of the shares outstanding at any given time will be available for the option pool.

[1] Subject to an 18-month lock-in.

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Board of Directors and Corporate Governance

The Board consists of five Directors; three executives (the Executive Chairman, the Founder/CEO and the CFO/COO) and two Independent Non-Executive Directors (NEDs), all with solid resumes and a good blend of complementary experiences and skill sets.

Companies listed on AIM are not required to comply with the UK Corporate Governance Code published by the Financial Reporting Council, which is mandatory for companies listed on the Main Market of the London Stock Exchange. AIM-listed companies typically comply with the Quoted Companies Alliance's Corporate Governance Code for Small and Mid-Sized Quoted Companies, which the Company intends to comply with, where relevant. In particular, the Directors are responsible for overseeing the effectiveness of the internal controls of the Company designed to ensure that proper accounting records are maintained and that the financial information on which business decisions are made, and which are issued for publication, are reliable and that the assets of the Company are safeguarded. An overarching principle of corporate governance on AIM is to ensure that companies are managed in an efficient, effective and entrepreneurial manner for the benefit of all shareholders over the long term.

The Board will meet regularly to review and consider reports relating to the Company's operations and finances. The Board is responsible for formulating, approving and reviewing the Company's strategy, budgets, major line items of expenditure and senior personnel appointments.

In accordance with best practice, the Company has established Audit and Remuneration Committees. The Audit Committee is Chaired by the CFO/COO with both NEDs serving as members. The Audit Committee's main functions include reviewing and monitoring the Company's internal financial control systems and risk management systems, considering annual and interim accounts and audit reports, making recommendations to the Board in relation to the appointment and remuneration of the Company's auditors and monitoring and reviewing their independence, objectivity, effectiveness and qualifications.

The Remuneration Committee is Chaired by one of the NEDs with the Executive Chairman and the other NED serving as members. The Remuneration Committee is responsible for reviewing the performance of the three Executive Directors and for setting the scale and structure of their remuneration, paying due regard to the interests of the shareholders as a whole and the performance of the Company. The Remuneration Committee will also approve the design of and determine the targets for any performance-related pay plans operated by the Company, including the newly established Share Option Plan.

Since the Founder/CEO and the Executive Chairman remained substantial shareholders of the Company, they entered into a Relationship Agreement with the Company with two broad objectives; to ensure that the Company is capable of carrying on its business independently of them and to ensure that transactions and relationships between them and the Company are entered into at arm's-length and on normal commercial terms. Specifically, they are required to ensure that no additional Directors are appointed nor removed without consulting the Nominated Adviser, no general meeting is called to amend the Company's articles of association in such a way as might reasonably be expected to adversely affect the independence of the Company from them or undermine the effect of the Relationship Agreement to the detriment of the Company, there are and remain at all times not less than two Independent NEDs, they shall not procure or vote on any resolution to cancel the Company's admission to trading on AIM without consulting the Nominated Adviser and without the approval of the Independent NEDs and any resolutions at any annual general meeting of the Company relating to either the authority of the Board to issue shares, limited on an annual basis to 30% of the shares outstanding, or the disapplication of pre-emption rights, limited on an annual basis to 10% of the shares outstanding, are passed without amendment.

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<u>Accounting Considerations</u>
The Company is incorporated in the UK; therefore, it is required to report using IFRS. The Group is structured with a wholly-owned U.S. subsidiary below the Company which has several wholly-owned U.S. subsidiaries. Since the primary economic environment in which the Group operates is the U.S., the U.S. Dollar is the functional currency and was also chosen as the reporting currency.

The UK Member Firm of an international accountancy network acted as Auditor and Reporting Accountant. An unaudited pro forma statement of net assets is never required in connection with an AIM IPO but was provided to illustrate the recapitalization of the balance sheet by way of paying off the debt and the remainder of the net proceeds of the IPO added to the Company's cash resources.

<u>Legal Considerations</u>
Since the Company is incorporated in the UK, the three significant differences between U.S. and UK corporate law automatically apply as follows:

1. Pre-emption rights (i.e. anti-dilution) – Shareholders may participate in, or the Company must obtain approval from at least 75% of them for, the issuance of shares for cash of more than 10% of the then outstanding shares during any 12-month period.[2]

2. Notifiable interests – Shareholders are required to notify the Company of, and the Company is required to publicly announce, holdings at or above the 3% level and whenever a full percentage point is breached in either direction.

3. Takeovers (i.e. mandatory offer) – If any party, or parties deemed to be acting in concert, accumulates a holding of 30% or more, they must make a cash offer to the other shareholders at the highest price they paid for the Company's shares during the last 12 months.

The IPO was not subject to Regulation S of the U.S. Securities Act of 1933. Since the Company is incorporated in the UK, the shares are eligible for dematerialization and trading within CREST, the most common electronic system for the holding and transfer of shares in the UK. As such, it was not necessary to appoint a Depository and create Depository Interests, as would be the case for a company incorporated outside the UK or one of its Crown Dependencies, the Channel Islands and the Isle of Man.

[2] This is the typical level at which AIM-listed companies seek an annual standing authorization from their shareholders for the issuance of additional shares for cash. This flexibility increases the certainty and speed of small capital raises during the year and reduces transaction costs, since further communications with, and approvals from, shareholders are not required.