

ROYALE REPORT

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Fourth Quarter 2017

How Trump's Tax Proposal Could Affect Oil and Gas

Republicans in Congress introduced a plan for sweeping tax reform, proposing to cut the corporate income tax from 35 percent to 20 percent, among other significant changes. Reducing the corporate income tax, currently among the highest in developed nations, seems like a home run for oil and gas producers in Texas. But for a national industry that receives over \$4 billion of tax exemptions annually, simplifying the tax code to eliminate loopholes might not be uniformly positive. The fate of key exemptions during negotiations will determine how much oil and gas producers actually benefit.

Importantly for oil and gas investments, the proposed reform maintains deductions for “intangible drilling costs” (IDC), the largest exception enjoyed under the current tax code. IDCs, which include costs from drilling new wells like labor and supplies, can be immediately deducted from taxable income. That offers an advantage relative to other industries who have to deduct upfront expenses over time. Rather than repeal the exception, the proposed tax plan expands immediate expensing across all industries, allowing them to “write off the cost of new investments” for at least five years to incentivize domestic investment. **Under the new plan, oil and gas investors will continue deducting IDCs and will get to deduct other investment costs as well.**

The future of an allowance known as “percentage depletion,” which favors how smaller producers depreciate their assets, is uncertain. (Source: texasmonthly.com)

Intangible Drilling Costs (IDC)

Intangible drilling costs are one of the largest tax breaks available specifically to oil and natural gas, allowing companies and individuals to deduct the cost of drilling new wells in the United States.

In order to determine taxable income, U.S. businesses can normally deduct expenses from revenue so they are only taxed on profits. Under normal income tax rules, a company that pays expenses in order to make future profits would need to deduct the expenses over the same time period as profits. The break for IDCs is an exception to the general rule. Independent producers and individuals can choose to immediately deduct all of their intangible drilling costs.



Intangible drilling costs are defined as costs related to drilling and necessary for the preparation of wells for production. These include costs for drilling, wages, fuel, supplies, repairs, survey work and site preparation.

The deduction for intangible drilling costs has been permitted since the beginning of the income tax code in 1913. Only IDCs associated with domestic wells may be deducted.

Royale's IDCs costs are 80% of the total cost of the investment and 100% deductible in the year of investment.

Tangible Drilling Costs (TDC)

Tangible drilling costs include hard assets such as the wellhead and production equipment. TDCs are approximately 20% of the total cost of the investment and are typically depreciated over a seven year period. In some cases, TDCs may be accelerated under Section 179 of the Tax Code. If Section 179 is elected, 100% of the TDCs can be deducted in the year of investment.

Example of Tax Savings

1 Unit Drilling Investment:	\$100,000
Less: Federal Tax Deduction:	\$100,000
(at Maximum Tax Rate 35%) Refund	\$35,000
Less: State Tax Refund:	\$10,000
(where applicable) (State Tax 10%)	

Investment after Federal & State Tax Refund: \$55,000



CORPORATE REPORT

On October 16, 2017 the SEC declared Royale Energy’s S-4 registration statement effective, which allows us to move forward with the shareholder vote and merger with Matrix Oil Management Corp., (Matrix). Royale shareholders of record date of September 29, 2017 will receive notice of and the right to vote at the Royale’s shareholder meeting on November 16.

On the same day as Royale’s registration statement was declared effective, Royale also jointly announced with Matrix an initial rate of 350 barrels per day for the Sansinena 9A-4 oil well. This is the first well drilled in the Sansinena field since Matrix acquired the field in June 2016. Matrix is currently producing the well at a restricted rate of approximately 200 barrels of oil per day. “We are extremely pleased with the results of this well and what it may mean for the Royale and Matrix shareholders. The initial rate is more than twice our expectation”, said Johnny Jordan of Matrix. Subject to permitting and capital requirements, Royale and Matrix plan to drill a minimum of six additional wells in Sansinena in 2018. **Royale and Matrix’s management believe that the test results support drilling of more than 70 additional development well locations in the Sansinena field.** The field was acquired from California Resources Corp., (CRC), that was a spin-off from Occidental Petroleum in 2014.

Royale is also having some great success in the Rio Vista field joint venture with CRC. We have drilled 4 successful natural gas wells with CRC in the Rio Vista field. We have drilled a total of 6 successful wells with the CRC projects and are 6 for 6 with the Strain 11-2, CRC 8-1, CRC 8-2, CRC 8-3, CRC 8-4, and the Sansinena 9A-4 wells

Industry News

In a Wall Street Journal article headlined “Natural Gas Prices May Surprise This Winter,” Spencer Jakab says that after nine years of booming production of Natural Gas, this winter could be one of the rare instances when supply and demand combine to drive up prices.

“Those expecting prices to rise have had plenty to point to on the demand side of the equation; Scores of industrial plants have sprung up, the U.S. has become a major exporter of gas, and coal plants are closing in droves in favor of environmentally friendlier and more flexible gas-fired generators.”

EIA– U.S. Energy Administration

In a new trend, U.S. Natural Gas exports exceeded imports in 3 of the first 5 months of 2017. The United States has been a net Natural Gas importer for the last 60 years making this a major change for the industry.

World Oil

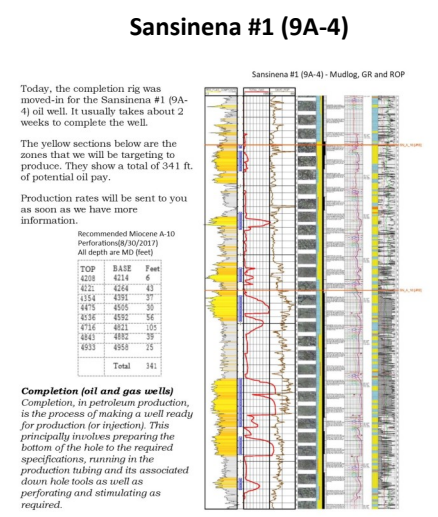
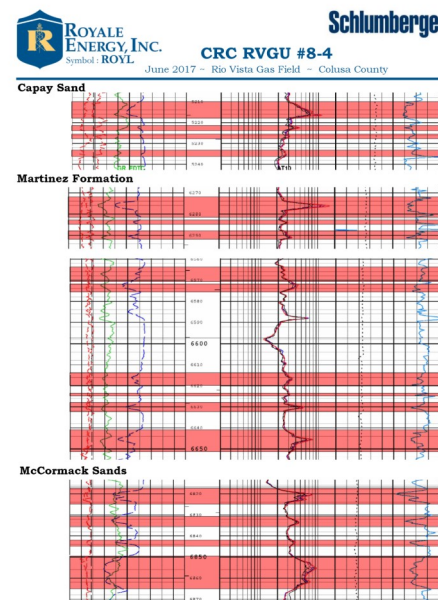
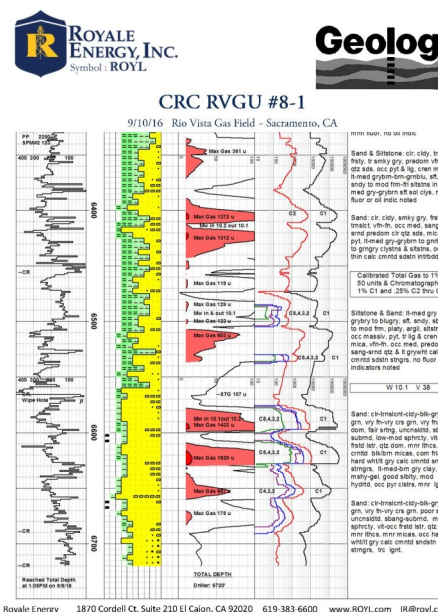
China is about to do for global Natural Gas demand what it did for oil.

China is in a “golden age” for Natural Gas that will make it the worlds biggest consumer of the fuel. The nation is poised to outpace the U.S., the current #1 consumer of Natural Gas. China led growth in global oil demand for much of the past 20 years.

OilPrice.com

Big Oil to Bet on Petrochemicals

Remember that “This Ain’t Your Daddy’s Oil” commercial that blew up on twitter at this years Super Bowl? It was about crude oil being used for things other than fuel– useful, sometimes indispensable things. Like it or not this is what the future holds for the industry, according to a new report from Wood Mackenzie. It’s demand for petrochemicals that will keep global demand growing until about 2035, Wood Mac says.



Recommended Micaceous A-10 Perforations(9/20/2017)
All depths are MDI (feet)

TOP	BASE	FEET
4208	4214	6
4312	4314	2
4354	4391	37
4415	4505	90
4535	4552	17
4716	4821	105
4847	4882	35
4933	4958	25
Total		341

Completion (oil and gas wells)
Completion, in petroleum production, is the process of making a well ready for production (or injection). This principally involves preparing the bottom of the hole to the required specifications, running in the production tubing and its associated down hole tools as well as performing and stimulating as required.



2018 ENERGY SUMMIT ~ FOUNDERS SERIES



Royale will be hosting its 9th exclusive gathering at Ronald Reagan's Rancho del Cielo. This annual retreat at Reagan Ranch is not open to the public, but we have made special accommodations for a private tour with special guest speakers. Every year we go up to the Ranch, Royale attendees have said this was one of the best trips they have ever made.

May 9-11, 2018, we'll hold the Royale Energy Summit in Beautiful Santa Barbara, CA.

This exclusive retreat will be held in Santa Barbara with visits to the Reagan Ranch Center in Downtown Santa Barbara and the private mountain top Reagan Ranch. You will walk through the former President's originally furnished house and barn, afterwards enjoying a hearty BBQ luncheon on the property where he loved to ride his horses.

Highlights Include:

- ◆ Two nights, five star accommodation at the exquisite Beach Resort in Santa Barbara.
- ◆ Dinner presentation with Keynote speaker, full breakfast and a gourmet western BBQ in the Reagan Ranch Barn with special guests that knew President Reagan while in office and beyond.
- ◆ VIP tour of the Ronald Reagan's "Western White House", Rancho del Cielo which still contains Reagan's original 1970s furniture. Plus a tour of the Secret Service Bunker, the Stables and Barn.

Call Royale Energy at (800) 447-8505 or email events@royl.com for more information.

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