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Sefton Resources, Inc* –Interim results - strengthened operational position and increased independent asset valuations - maintain buy at 2.45p with a 9p target price

Sefton Resources ("Sefton"), the US oil and gas exploration company, announced interim results for the year to 30th June 2011 on 2nd September. Highlights include a 4.9% increase in revenues, a 20% increase in net assets from 31st December 2010, and strengthening of operations through infrastructure investment.

Revenues to 30th June 2011 rose by 4.9% from the same period last year to \$2,028,000, despite a 29% decrease in production. The rise was assisted by higher global oil prices and an increase in local California oil prices, which were trading at a 5% premium to NYMEX in the first half of 2011 (compared to an 11% discount in the first half of 2010). The fall in production was caused by maintenance of various infrastructures, and due to the termination of cyclic steaming. As the majority of maintenance has been completed, and continuous steaming has been implemented, we expect production to increase in the second half of this year.

Costs of production rose 63% due to two main drivers; the construction costs of the continuous pilot steam-flood system, and costs attributable to maintenance work across the Tapia Canyon oil field. The continuous steaming process is now fully operational, and with the construction costs now sunk, we expect the company to see the full benefits of this. General and Administrative costs increased by 28% from the same period last year to \$872,000, due to strengthening of the team. The total cost increase led to a 78% decline in interim net income, but as the company's operational position has significantly improved, we expect this to recover in the second half of 2011.

Net assets increased to \$11,945,576, up \$1,993,066 from 31st December 2010, through continued investment in oil and gas properties, and a reduction in net debt. Even after an increase in capital expenditure and decrease in net income, total debt reduced by \$0.79 million from year end 2010 to \$6.5 million, and after accounting for cash of over \$900,000, net debt reduced to \$5.54 million (31st December 2010: \$6.30 million). In addition to reducing debt, the company reaffirmed the US\$10 million senior debt facility with Bank of the West, which has been extended to 1st June 2013 and can be used for acquisitions if necessary.

In August 2011, Karl F. Arleth was appointed President and Chief Executive Officer, having been a Non-Executive Director since August 2010. Mr. Arleth has over 30 years of domestic and international oil and gas experience, and was previously Chief Operating Officer of the group between 2001 and 2003. At the same time, Jim Ellerton moved from the role of Chief Executive Officer and Acting Chairman to become Executive Chairman. Through this position Mr. Ellerton will be able to fully utilise his skills and experience within identification of acquisition opportunities, development of group strategy, as well as allowing additional focus on investor relations. Finally, Bill Brand was appointed as a financial consultant to the company. It is intended that he will become Chief Financial Officer on or before 30th April 2012.

Key Data	
EPIC	SER
Share Price	2.45p
Spread	2.4p – 2.5p
NMS	15,000
Total no of Shares	280,031,959
Market Cap	£6.86 million
Net Debt	US\$5.54 million
12 Month Range	1.125p – 6.125p
Market	AIM
Website	www.seftonresources.com
Sector	Oil & Gas
Contact	Jim Ellerton Acting Chairman & CEO +1 (303) 759 2700

Oil in California

The company's oil production operations currently take place in Tapia Canyon, California. A further development site in Eureka Canyon, California covers 1,500 acres of land, and is due to undergo further analysis through surface mapping and sample collection. Approximately 99% of oil produced by the company is heavy oil, with an API gravity of 17°-19° (heavy oil has an API of between 22.3° and 10.0°, with 22.3° being the lightest gravity classed as heavy oil). This heavy oil now trades at a premium to NYMEX, as demand has risen from refineries requiring heavy oil for blending, thereby assisting the company's revenues. At 30th June 2011 the company had proved oil reserves independently estimated at 3.77 million barrels, implying a pre-tax net present value on a PV10 (10% discount rate) basis of \$136.76 million, a 24% improvement from 31st December 2010. Going forward, we expect this valuation to further increase as reserves are upgraded from proven undeveloped (PUD) reserves to proven developed (PD) reserves through continuous steaming.

A report undertaken by Dr. Farouq Ali in 2010 suggested that steam injection could increase both the rate of production and the total retrievable reserves. This prompted the company to begin a programme of continuous steam injection, the benefits of which are already being realised. Oil production rose from 118 barrels of oil per day ('BOPD') in June to 135 BOPD in August. A second report by Dr. Ali is expected in October 2011, and should provide further guidance on optimal retrieval methods the company can implement to fully develop the site.

In an additional development, a subsidiary of Occidental has begun drilling an adjacent oil field in Tapia Canyon, which is essentially a mirror image of Sefton's oil field separated by a series of small faults. Occidental is the fourth largest US oil exploration company, and the fact that it is targeting an almost identical resource less than one mile from Tapia Canyon is highly encouraging.

Gas/Pipelines in Kansas

Sefton Resources owns three pipelines in Kansas - Vanguard, LAGGS and Waverly - but in 2011 has been focusing on the repairing and reactivation of the Vanguard and LAGGS pipelines in Leavenworth County. The North and West sections of the LAGGS pipeline are in the final stages of repair and awaiting third party independent certification. The south section of the LAGGS line is being repaired in specific segments, which when completed could add value through the connection of additional gas sources, or through the connection of other pipelines. Inactive wells owned by Sefton are being developed adjacent to the LAGGS pipeline and will provide initial gas flow upon completion. Further leases are being acquired on a continual basis to increase total gas resources.

The company is actively trying to increase the reach of its pipelines, and has signed a letter of intent to acquire a gas production site, with accompanying infrastructure and a pipeline, subject to relevant due diligence. These assets are currently producing gas, and will immediately contribute to group cash flow, as well as adding wells, leases, reserves and additional pipeline capacity to the company's portfolio. It is expected this acquisition will be completed by the end of 2011. Furthermore, Sefton is expecting to sign an agreement with Southern Star, a regulated interstate pipeline, at the end of September in order to form a joint with the LAGGS pipeline. Construction is expected to take 4-6 months, finishing in the first half of 2012 barring any delays, and once completed will enable the transportation of the company's gas from Leavenworth Country to national markets.

None of the gas resources in Kansas are presently in operation, but on 12th May 2011 the total owned gas assets were independently valued at \$100.1 million in an independent competent persons report conducted by Dr. Nafi Onat. Significant progress has already been made on all existing sites, and the asset base has been increased through the continuous acquisition of additional assets. Once active, the Kansas pipelines will not only mobilise gas from the company's gas production sites, but will also carry a large amount of third party gas, which on the most conservative basis would provide a modest royalty.

Forecasts

We expect margins to recover in the second half of this year as the benefits of continuous steam injection are realised, compared with the first half of this year where no steaming was taking place and large costs were incurred for the implementation of the steaming programme. We are readily awaiting the report from Dr. Ali expected in October 2011, which should highlight methods for the optimisation of oil production processes in California. While net assets are not fully reflective of gas infrastructure, assuming pipelines become operational by the year end we expect further strengthening of balance sheet assets and cash flow contribution during 2012. As these cash flows develop, oil production margins should benefit as oil revenues are currently covering all costs across California and Kansas.

We feel our previous model, valuing the company's oil reserves at £12.7 million, is still valid and the recent increase in the independent oil reserve valuation on a PV10 basis to \$136.76 million underpins this. If we include 20% of Dr. Onat's total independent valuation of Kansas gas assets of \$100.1 million to our valuation model, this adds a further £12.5 million and brings our total valuation to £25.2 million, or a share price of 9p. Despite the fact that we have slightly downgraded our forecasts due to lower than expected net income in the first half, the strengthened operational position and increased independent valuations add value to the company. The management team is actively delivering against its business plan, and as oil and gas assets are developed and news flows increase, we would expect the market to become more cognisant of their value, which should start to be reflected in the share price. We maintain our stance of **buy** at 2.45p, with a target price of 9p.

Forecast Table

Year to 31st December	Turnover (US\$ million)	Pre-tax Profit (US\$ million)	Earnings Per Share (cents)	Price Earnings Ratio (x)	Dividend (cents)	Yield (%)
2008A	4.69	0.33	0.29	13.3	0.0	0.0
2009A	2.74	(0.29)	(0.25)	NA	0.0	0.0
2010A	3.85	0.40	0.31	12.5	0.0	0.0
2011E	4.50	0.70	0.27	14.3	0.0	0.0

Source: Company and Growth Equities & Company Research

Note: * P/E ratio calculated using an exchange rate of £1 = \$1.5793

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