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Sefton Resources* – Finals point the way to further news flow Buy at 4.15p with a 9p price target

Sefton Resources is producing oil in Tapia, California with gas interests in Kansas. Results for the year to December 31st were announced on May 25th and showed a net profit of \$403,217 with a positive cash flow of \$947,000.

More importantly, are the proven oil reserves of 3.8 million barrels which, according to independent research reported at end of year, is worth \$80.6 million. Going forward from this relatively strong position the news flow should be about how production will be increased. The results are awaited of the continuous steaming pilot study and the recommendations of Dr Farouq Ali's report on the company's prospects. The Tapia prospect offers the company a big opportunity to dramatically increase its production and steaming is seen to be the key to unlock the potential of this heavy oil reservoir. Work by Dr Farouq Ali will evaluate and indicate how best to develop the field in the most cost effective manner and is due to be announced in the coming weeks. As steaming improves the oil recovery rate production will increase.

The 12th May release stated that Dr Nafi Onat valued the Kansas gas assets at \$100.1 million (around £60 million). This Independent Competent Persons Report was commissioned last year and provides transparency and an evaluation of the potential of the existing and newly acquired assets. Dr Onat's geotechnical review and economic evaluation covered both conventional (sandstone, limestone and dolomite) and unconventional (coalbed methane gas) prospects in Anderson, Franklin and Leavenworth counties, Kansas. The oil price and operating costs assumptions were kept constant throughout, but the gas price began at \$4 per mcf and increased by 10% pa until reaching a ceiling of \$6.50 per mcf. This report by Dr Onat's validated the reasons why the management team diversified into the gas infrastructure in Kansas. At present the company is focusing on that part of the project which could yield near term cash flow which is the LAGGS pipeline. Before the end of the year the board is confident that first revenue from transporting third party gas along its reactivated pipelines will become established. This move looks as though it will probably be the precursor to Sefton operating its own gas wells. This region of Kansas has vast gas reserves and Sefton owns the pipelines which are the route to market and can therefore demand good terms for carrying third party gas. There is also oil in the area that currently cannot be produced as the associated gas cannot be flared. Combining the total oil resources stand at 1.75 million barrels, gas resources at 51.03 Bcf, cumulative cash flows at \$220.4 million and NPV on a 10% discount rate at \$100.1 million. As the resource classifications confirm, confidence in these quantities is low (contingent, prospective, possible), but given this is only the first assessment, we would expect Sefton to lift its classification over time.

Key Data	
EPIC	SER
Share Price	4.15p
Spread	4p - 4.3p
NMS	15,000
Total no of Shares	280,031,959
Market Cap	£11.62 million
Net Debt	US\$6 million
12 Month Range	0.5p – 6.125p
Market	AIM
Website	www.seftonresources.com
Sector	Oil & Gas
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Further news that builds the value is a receipt of an Outstanding Oil Field Lease and Facility Award for Sefton's 2010 operation of the Tapia oil field (California) and the partial completion of its acquisition of acreage (leases, wellbores, equipment and technical data) proximate to the LAGGS pipeline. Of the \$200,000 purchase price for the acreage, due diligence has been completed on \$108,681 worth, and this partial acquisition was completed on the 29th of April. In a separate acquisition, TEG Mid-Continent paid Cholla \$35,000 for a computerised database of proprietary well data and shallow gas prospects in the Leavenworth area, print maps, cross sections and a proprietary report detailing all prospects, geology, and engineering in the area.

News flow for the next four months could be strong; as there is a report to come from Dr Farouq Ali this is important as it should provide the basis of the oil development strategy and the potential is to double production to 300 barrels a day and further out there is a potential of more than 1,000 barrels a day, clearly investment would be needed. There is a General Meeting late in June where there could also be updates on the development of the company's gas infrastructure activities in Kansas. The interims are due in September where a number of updates can be expected. Firstly the ongoing results from the continuous steam pilot and the increase production at Tapia Canyon helped by steaming and maybe drilling of further wells. Secondly, the progress of cash flow from the gas pipeline infrastructure in Kansas. Thirdly and perhaps most significantly to increase reserves both at Tapia Canyon and in Kansas which will come when the engineering reports are updated and reserves are recalculated at the half year stage. In addition, there is likely to be news regarding the strengthening the board of directors and the management to create a management structure to run a larger organisation which Sefton is focused to become. This could make for some interesting reading as the bulk of this news flow looks as though it will add more value to Sefton which would easily prompt GE&CR to increase its target price, which in light of all the above is quite plainly a highly conservative.

The results of Dr Ali's original study were positive enough to stimulate this more extensive report being awaited where there could be a significant improvement in oil recoveries from steaming the thick tar like oil so it flows more freely thus the \$80.6 proven oil reserve could be upgraded. At the same time, once the pipelines in Kansas are operational current possible and probable reserves will shift to the proven category and the board expect that a certain portion of the contingent and prospective resources identified by Dr Onat in his report will shift into the 3P proven categories. All these moves will add value and allow an improved valuation to be placed on the company. So it does seem that the Present Value figures for California and Kansas of \$80.6 million and \$100.1 million respectively are likely to be successively improved as the company begins to achieve its goals for 2011.

We recently increased our target price to 9p based on valuing Sefton's Californian assets at £12.7 million, even if we attribute only 20% of Dr Onat's Kansas valuation (\$100.1 million) to our analysis, this adds another £12.5 million to our valuation. Further upside remains in the enhanced recovery techniques being evaluated in California and of course the monetisation of its Kansas pipeline infrastructure. The stance remains **Buy**.

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	14.8	0.0	0.0
2009A	2.74	(0.29)	(0.25)	NA	0.0	0.0
2010A	3.8	0.4	0.31	13.9	0.0	0.0
2011E	5.2	1.2	0.47	9.3	0.0	0.0

Source: Company and Growth Equities & Company Research

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