BEAUFORT SCALE Issue 3: July 2013
News blowing in from the City

Welcome

Welcome to the third edition of the new monthly newsletter from the Beaufort Securities Research team, *The Beaufort Scale*.

Inside this edition we look at the exciting rule changes planned for ISA investing which could be good news for AIM investors and present a round-up of the companies our research team has covered during the last month.

ISA investment changes to benefit AIM listed Companies

On 1st July the Treasury said it would permit individual savings accounts (ISAs) to hold AIM shares, including shares traded on other small company stock markets in Europe.

The rule change follows a two-month consultation and will allow investors to invest up to £11,520 in the current tax year to invest into the smaller company equity markets. Gains from the growth of the investment would be tax-free. Up till now AIM stocks have been regarded as too risky for mainstream retail investors.

Treasury Statement:

The government announced at Autumn Statement 2012 that it would consult on expanding the list of qualifying investments for stocks and shares ISAs to include shares traded on small and medium-sized enterprise (SME) equity markets.

This policy could lead to an important capital injection for SME equity markets and encourage more investment in growing businesses. It will also improve choice for ISA investors by widening the range of shares eligible to be held in an ISA. Investors will still be free to choose the investments they hold in their ISA.

The consultation, which closed on 8 May 2013, proposed a change to the ISA rules to allow company shares admitted to trading on recognised stock exchanges within the European Economic Area (EEA) to be eligible to be held in a Stocks & Shares ISA. It asked for views on this proposed method of implementation and on possible alternative approaches.

Instrument	Value	Change on Month (%)	Year-to-date
FTSE 100	6,215	-5.6	5.4
FTSE All Share	3,290	2.5	12.3
FTSE 250	13,798	-2	11.5
FTSE Aim All Share	692	-5.2	-2.1
Dow Jones Industrial Average	14,910	-1.4	5.2
Nasdaq	3,403	-1.5	12.7
CAC 40	3,739	-5.3	2.7
Xetra Dax	7,959	-4.7	4.6
Nikkei	13,677	-0.7	31.5
Hang Seng	20,803	-7.1	-8.1
GOLD ($)	1,201	-15.1	-27.4
Oil Brent Jul ($)	102.16	1.8	-8.1

The majority of respondents to the consultation broadly agreed with the government's proposal. However, some respondents expressed concern about the potential impact of this proposal, or suggested alternative approaches. The government has carefully considered all of the responses it received during the consultation. On balance, it believes that its proposed approach remains the most appropriate: its reasons are set out in the summary of responses.

Next steps

The government will amend the ISA regulations in line with the consultation proposal. They will be amended to expand the range of ISA qualifying investments to include company shares admitted to trading on a recognised stock exchange in the EEA. This will meet the main objective of allowing company shares on SME equity markets into the scope of ISA qualifying investments. The government plans to introduce the necessary legislation in July 2013 and it is expected that this will take effect shortly after.

In the Document we have extracted some highlights:

Policy objectives of the Autumn Statement 2012 announcement

1.6 Access to finance for smaller growing companies is key to promoting private investment and delivering a sustainable economic recovery. The Government wants to ensure that businesses, particularly small businesses, are able to access finance and support.

1.7 At Autumn Statement 2012, the Government announced that it would consult on expanding the range of ISA qualifying investments, to enable more shares traded on SME equity markets to be held in a Stocks & Shares ISA. This policy could lead to an important capital injection for SME equity markets and encourage more investment in growing businesses.

1.8 A further objective of this policy is to improve choice for ISA investors by widening the range of shares eligible to be held in an ISA. Investors will still be free to choose the investments they hold in their ISA, so do not have to invest in assets that they do not want to.

A copy of the Treasury Document is available via the link below:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/188404/consult_isa_qualifying_investments.pdf.pdf

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Small Cap Round-up

Our objective of the Round-up is to highlight a number of stocks we have seen and to be open about our thoughts and views. In addition we will highlight a few companies we are particularly keen on and why, but detailing only on the previous month's news. Further information is available from your Broker upon request.

TXO (TXO, 0.14p) - AIM, Speculative Buy

June News

In June, TXO announced its interim unaudited results for the year ended 31st March 2013. Total loss for the first half of 2013 was US$807,642 versus US$541,973 for the same period last year, reflecting TXO's investment in projects are yet to become profitable. The loss figures were in line with the management expectations. During the period, TXO raised US$2.4m via equity and convertible loan notes. As on 31st March 2013, consolidated gross assets and net assets stood at US$5.9m and US$3.7m, respectively. In TXO's investee company Grand Bahama Group (GBG), Barge Martha has been declared seaworthy and ready for operations. The revised hydrocarbon recovery plan has been finalised. GBG is planning to sell-off its Morgan Oil business since it is not in line with the company's core business strategy.

Left: GBG is planning to sell-off its Morgan Oil business

The company expects consistent cash flows from the second half. Joint venture Tasmanian Oil and Gas Ltd

(TOG) is facing a couple of court cases and its license appeal is under review. TOG has received a letter of intent for the drilling program in Tasmania conditionally dependent upon success in the license appeal. In a separate announcement, TXO said it has received a significant number of requests for equity conversion of its loan notes.

Our view: *TXO reported higher losses in the first half of 2013; however, we see drastic changes to the company's fortunes in the near future. Investee Company GBG is expected to make substantial profits in future years following revenues from Barge Martha, which has been declared seaworthy, and on subsequent commissioning of the Hydrocarbon Recovery Plant. Rapid progress at TOG is also likely to help the company to strengthen its foothold in Tasmania, Australia. Though the performance at TOG is dependent upon the results of the court cases, the company has expressed confidence of favourable outcomes from the ruling. The conversion of a significant number of loan notes into equity also acts in the company's favour as it enhances the equity base. Given the positive developments from GBG and the confidence shown by the Board that TXO can become profitable in the next financial year, we maintain a Speculative Buy for the stock.*

Herencia Resources (HER, 0.6p) - AIM, Speculative Buy

June News

In June Herencia Resources held its Annual General Meeting (AGM). The Chairman stated that the company has made good progress with its endeavour to transform into a full-scale multi project mining development group from being a pure exploration company. The company expects to translate the good network developed within mining sector in Chile into further growth opportunities, leading to an increase in revenues and shareholder returns.

Our view: *Herencia's successful transformation into a multi project mining development group is likely to open up a huge set of business opportunities for the company. Chairman's assertion regarding smooth progress of its flagship Pagunata project and the Australian joint venture operations creates confidence in the firm's ability to continue these projects effectively. The company's recent acquisition of 100% interest in the Guamanga Project from Inversions Santa Patricia Limitada and an equity issue of US$950,000 present a bright picture of the company's future prospects. We maintain a Speculative Buy for the stock.*

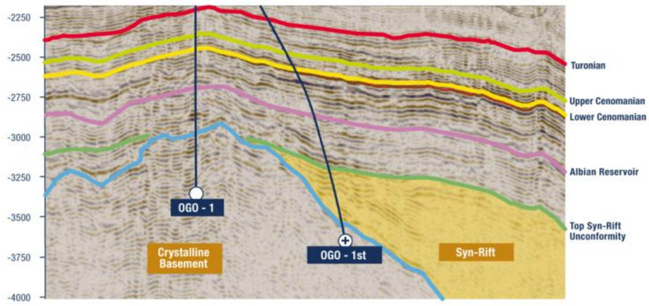
Left: Drilling at Paguanta

Afren (AFR, 132.6p) - AIM, Buy & Lekoil (LEK, 42.75p) - AIM, Speculative Buy

June News

During June Afren and Lekoil announced the results of drilling and wireline logs at the highly productive Ogo-1 well located in the OPL310 license offshore Nigeria. As per the results, a gross hydrocarbon section of 524 feet with 216 feet of net stacked pay has been identified upon 10,518 feet deep drilling (true vertical depth subsea - 10,402 feet) at Ogo-1. Following the successful testing, the prospective resources from the well are likely to increase significantly beyond the initial estimate of 78 million barrels of oil equivalent (mmboe) of gross P50 prospective resources. Further evaluation of its potential is being done through wireline logs study after which, further drilling upto 11,800 feet (true vertical depth subsea - 11,684 feet) would be undertaken. The Ogo-1 discovery, testing a four-way dip-closed structure in the Turonian, Cenomanian, and Albian sandstone reservoirs, the extension of the same Cretaceous sandstones that have yielded other significant discoveries along the West African

Transform Margin. The Ogo-1 well is jointly owned by Optimum (operator), Afren and Lekoil. The participating and economic interest for Optimum is 60% and 30%, for Afren (22.9% and 40%) and for Lekoil (17.1% and 30%). Once the drilling operations are completed, the partners intend to drill a planned side track to test a new set of sediments trapped in the area. Shares of both Afren and Lekoil jumped 7.3% and 9.6%, respectively, on the London Stock Exchange following this announcement.



Above: The Ogo well

Our view (Afren): *The discovery of significant light oil at the Ogo-1 well is a major operational success for Afren as the resource base for Ogo-1 is likely to be revised upwards due to the latest discovery. This discovery marks the probable extension of the oil rich West African Transform Margin. The company is optimistic about the presence of some highly productive untapped zones in the well, which could be extracted by drilling the well further. The above success is in line with Afren's strategy of expanding its existing reserve base through a multi-well exploration and appraisal drilling in both established and new basins, along with a focus on growing the production levels. Afren has licenses across multiple geographies of Kenya, Tanzania, Madagascar, Ethiopia and the Seychelles, which are believed to have significant upside potential. Considering its decent track record of project delivery, success in the exploration activities and strategic partnerships, we maintain a Buy for the stock.*

Our view (Lekoil): Lekan Akinyanmi, CEO, said: "The discovery of oil in the Ogo-1 well opens up a new oil basin in an under-explored region and represents a possible extension of the Cretaceous play along the West African Transform Margin. The discovery is a clear validation of Lekoil's technical analysis and of our extensive studies on the Dahomey Basin. "Results to date indicate that the discovered resources could be significantly in excess of P50 estimates prior to drilling. While Lekoil notes these results are preliminary, we believe there exists substantial scope for upward revisions to the data announced today as drilling and interpretation continues. We maintain a Speculative Buy for the stock.

Ariana Resources (AAU, 1.025p) - AIM, Speculative Buy

June News

In June Ariana Resources announced the completion of a Definitive Feasibility Study (DFS) for the Kiziltepe Sector of the Red Rabbit Gold Project in Western Turkey by independent consultants, Tetra Tech. Much of the DFS remains essentially unchanged from the interim feasibility study, which was announced on 29th October 2012. In the base case, an Internal Rate of Return (IRR) of 37.8% was arrived at, considering the Net Present Value (NPV) of US$34.4m and a discount rate of 8%. Gold and silver prices of US$1,304/ounce (oz) and US$22.6/oz, respectively, were assumed along with cash costs of US$600/ gold equivalent oz. Tetra Tech also provided sensitivity analysis results with scenarios of +/-30% change in the gold prices and cash costs ranging between US$588-611/gold equivalent oz. The model is based on assumption of 8 years of mine life (including low-grade stockpile) and 1.2 million tonnes of selected pit reserve. Having concluded the feasibility study, Dr. Kerim Sener, Managing Director, said the company intends to advance discussions with potential lenders for the project and remains on track for delivery of first production in the second half of 2014. The Red Rabbit Gold Project is a joint venture between Ariana (82% equity stake) and Proccea Construction Co. As per the terms agreed, Proccea would be funding US$8m to earn in to its 50% stake in the project. Directors bought stock in June: Dr Karim Sener (MD), 350,000 (total holding now 6,699,091) and Michael de Villiers 3,636,360 (total holding now 6,735,502).

Our view: *The favourable results of the DFS for the Kizitepe Sector is very positive news for the company. The sensitivity studies reveal that even in the worst case scenario of a 30% decline in the gold prices, the* *project can earn an IRR of 13.7% or a payback of 3.6 years. Moreover, the company seems to be in a good position to secure the requisite financing for the operations and to achieve the production targets for second half of the next year. The Red Rabbit Gold project is the flagship project of Ariana having JORC compliant resource of 448,000 oz of gold equivalent. Just last month, Ariana had announced an exploration target of up to 92,000 oz gold and 1,100,000 oz silver at Kiziltepe. The company had also announced the Salinbas-Ardala system to contain an indicated resource of 180,000 oz gold and 820,000 oz silver. Considering the huge production potential of these highly productive assets within the Red Rabbit project, we remain optimistic that the company would be able to showcase good productivity levels and expand its revenue base. Directors buying are an added positive. We maintain a Speculative Buy for the stock.*

Right: RC Drilling at the 'Red Rabbit' project where Ariana have JORC compliant resource of 448,000 oz of gold equivalent

Nostra Terra Oil & Gas (NTOG, 0.4p) - AIM, Speculative Buy

June News

On 21st June , Nostra Terra Oil & Gas announced that it has raised £750,000 through the issue of 187.5m new shares at a price of 0.4p per share. The net proceeds from the placement, which was at a discount of 10% from the underlying price at the time, would be used for drilling more wells in the Chisholm Trail Prospect in Oklahoma and for leasing in the High Plains Prospect in Texas. Following encouraging results at the High Plains prospect, which led Nostra Terra to increase its stake in the asset to 20%, the company has now commenced reprocessing the proprietary 3D seismic data. Leasing is expected to begin during H2 2013, which in turn will result in the formation of several prospects, each with multiple drilling locations. Further news on the Richfield Judgement on Monday last the company gave a further update on the Richfield Judgement (see June issue of the Beaufort Scale). 'On 27 June, 2013 certain of the assets securing the Note Richfield defaulted upon, resulting in a Judgment in favour of Nostra Terra, were sold at a Sheriff's foreclosure sale in Russell County, Kansas. Nostra Terra submitted the winning bids for the cumulative amount of US$165,000. 'The assets are known locally as the Furthmyer #1 well (West), the Neidenthal #1 well (South), two producing oil wells, their associated production equipment, facilities and leases, along with a common Salt Water Disposal well, the Furthmyer #11. Current production on these leases averages approximately 6 barrels of production per day (gross).

Our view: *Attaining the backing of Institutional investors following recent success at the Chisholm Trail and High Plains prospect is positive news for Nostra Terra. The company plans to utilise the funds raised to further develop its Chisholm Trail prospect, which is housed in the Hunton Limestone Play, considered to be a highly prospective region that continues to attract large investments. Nostra Terra's recent participation in the sixth well on the Chisholm Trail prospect would enable the company to further accelerate oil production. Over the past few months, all the previous four wells at Chisholm Trail play have produced oil ahead of expectations. The early encouraging results from the High Plains venture in Texas, where Nostra Terra has raised its interest to 20% from the original working interest of 5%, augurs well for the company. With the company approaching its initial target of 125 barrels of oil per day, it is now aiming towards its next target of 250 barrels. Given Nostra Terra's successful track record, we remain optimistic that the company is likely to generate rapid payouts with continued strong production. The latest settlement in the Richfield saga is most welcome not only providing immediate production but with valuable production equipment and facilities including a Common Salt Water Disposal Well. We maintain a Speculative Buy for the stock.*

Fusion IP (FIP, 60.5p) - AIM, Speculative Buy

June News

Fusion IP announced that one of its portfolio companies, Diurnal, was granted approval for a Paediatric Investigation Plan from the European Medicines Agency (EMA) for a new formulation of hydrocortisone- Infacort. Diurnal is developing a unique approach to drug delivery that will aid patients suffering from lower levels of the key hormone cortisol (hydrocortisone). Infacort will be developed for the treatment of cortisol deficiency in children below 6 years of age. This drug is being developed by Diurnal and its partners under the EU collaborative research programme, which will for the first time, create a regulatory-approved paediatric version of hydrocortisone. Diurnal's lead drug, Chronocort, is in the second phase of study at the National Institute of Health (US) and has already received two Orphan Drug designations from the European Medicines Agency. This will provide the company ten years of exclusive market rights once the marketing authorization for Europe is received. It also announced that its portfolio company, MedaPhor, continues to expand both its sales and global distribution with the announcement of an exclusive distribution agreement with Tellyes Scientific Inc ("Tellyes") to sell MedaPhor's range of ultrasound simulators into mainland China. Tellyes, a $40m medical simulation manufacturing and distribution business, based in Tianjin, China, has 100 dedicated sales staff. As part of the agreement Tellyes is purchasing 10 ScanTrainer systems that will be sited in its five regional offices, covering the north, south, east, northwest and southwest of China. With ScanTrainer, Tellyes will be targeting China's 3,000 nursing schools, medical colleges and universities. MedaPhor's lead product, ScanTrainer, is a virtual reality based 'real feel' ultrasound-training simulator that enables trainees of any level to literally 'feel' what they see on the computer screen in order to develop the complex mix of cognitive skills and eye-hand movement coordination required to learn all the key ultrasound scanning skills. The simulator uses real patient scans, within an educationally driven training programme, to teach all the core and advanced skills, but without the need for an ultrasound machine or a patient and with considerably reduced direct supervision by an expert.

Our view: *Fusion IP has achieved a significant breakthrough with its portfolio company Diurnal receiving the approval for a Paediatric Investigation Plan for a new formulation of hydrocortisone - Infacort. Chronocort, a similar formulation developed by the company in the past, has successfully reached advanced levels of testing. The distribution deal in China for MedaPhor's lead product ScanTrainer, is a significant development as it continues to expand its global distribution. ScanTrainer, is a virtual reality based 'real feel' ultrasound-training simulator that enables trainees of any level to literally 'feel' what they see on the computer screen in order to develop the complex mix of cognitive skills and eye-hand movement coordination required to learn all the key ultrasound scanning skills. Tellyes will be targeting China's 3,000 nursing schools, medical colleges and universities.*

Left: MedaPhor's *ScanTrainer* product in action

Fusion IP continues to build a strong portfolio of companies, with several of these companies now reaching material value inflection points. It enjoys long-term exclusive agreements with two of the UK's leading research-intensive universities, the University of Sheffield and Cardiff University, giving it exclusive access to all the IP generated by their research departments. The recent £20m placement will provide Fusion the funding to invest in new start-ups emerging from its two new university partners and will also fund a number of its existing key companies that are in their late stage funding rounds. Also, with a portfolio that now comprises 23 companies, Fusion could soon look to sell some off, with the potential for some very significant returns. Given the huge commercial opportunity presented by this latest *formulation, and the high quality of Fusion's businesses, many of which are already at the commercialisation/revenue stage, we retain a Speculative Buy rating on the stock.*

Magnolia Petroleum (MAGP, 2.525p) - AIM, Speculative Buy

June News

Magnolia Petroleum announced an update on its US onshore formations such as the Bakken/Three Forks Sanish in North Dakota, and the Mississippi Lime and Woodford/Hunton formations in Oklahoma. At the 100% owned and operated Roger Swartz #1 vertical well targeting the Mississippi Lime formation, initial production rate of 17 barrels of oil per day (bopd) was reported, in line with management expectations. So far, the company has sold 338 barrels of oil from the Roger Swartz well and a further 51,000 barrels of oil equivalent (boe) are seen recoverable. The Directors believe there is potential for an additional 10,000 barrels of recoverable reserves from the Vertz pay-zone. The total cost of the well including drilling, completing and stimulating costs was within budget at around US$730,000. Also, Magnolia said production has begun on the Flinders 1-25H well, also targeting the Mississippi Lime, at an initial rate of 143 barrels of oil equivalent per day (boepd) or 2.64 boepd net to the company. Magnolia also revealed that it is participating in three new wells in the Oklahoma play namely Omega 1-33H operated by Equal Energy, N. Cana Filler 1H-34X operated by Newfield and Smith Trust 1-2H operated by Marathon Oil. Total cost consideration for these three wells is under US$87,500. Company also reported its participation in three new wells in Oklahoma including a Mississippi Lime formation well in which Magnolia has a 10% working interest. Rita Whittington, COO of Magnolia, said, "Magnolia now has interests in 158 wells in proven US onshore formations, 113 of which are currently producing with the remainder either at various stages of development or waiting to spud. This represents a major increase on the 101 wells we had an interest in as at 31 December 2012. Combined with higher than average interests in several new wells announced this year such as the Blaser (12.5%) and Great White (10%), we believe we are on course to once again significantly grow full year net production and revenues which, in line with our strategy, will help fund our participation in new drilling. "We are delighted with the initial production rate for the Gustafson well which demonstrates the prolific nature of the Bakken formation in North Dakota. Combined with a 4% NRI in the well, net production attributable to Magnolia from Gustafson is currently 50 boepd. "Since 31st December 2012, in addition to Gustafson, a number of new wells have come on stream and we therefore expect our next CPR to report a significant increase in production as at 31 December 2013."

Left: Magnolia's first vertical well drilled as operator, at Roger Swartz

Our view: *Magnolia Petroleum commencing production at Roger Swartz, its first vertical well drilled as operator, is a significant milestone for the company. The initial production rates match expectations, and the identification of another potential payzone, the Vertz, adds to the attractive economics of the well. Only last month, the company has taken participating interests in eleven new wells, split between the Mississippi Lime and Woodford plays in Oklahoma, as well as the Bakken and Three Forks Sanish plays in North Dakota. It is looking to rapidly increase net production and prove up reserves on the 13,500 plus net mineral acres it holds with over 600 potential drilling sites. A recent Competent Person's Report (CPR) showed a 422% increase in the value of Magnolia's 3P reserves to US$94m and a sixteen-fold increase in net production to 122.5 boepd. The current net production upgraded to 122.5 boepd, generates significantly higher revenues that will be reinvested into new wells. The CPR also identified that there could be as many as 696 additional drilling locations within the 7,866 acres Magnolia acquired in Montana, in what is considered an extension of the prolific Bakken formation. Considering the increase in the number of wells that* *would come on stream in 2013, many of which are materially larger interests, Magnolia is well positioned to generate substantial shareholder value. We maintain a Speculative Buy rating.*

Other Companies

Greene King (GNK) reported another set of excellent figures, and Rooney Anand, Greene King chief executive officer, comments:

"This has been another successful year with record results and further, significant progress, led by our retail business, which has delivered 12% profit growth. Our strategy is on track and we have continued to provide exceptional value, service and quality to our customers. We achieved growth in both earnings and dividends, and further improvement in ROCE for our shareholders.

We have made a strong start to the year, but the overall outlook remains subdued and we are not assuming a pick-up in the economy. However, our strategy is designed, and proven to be appropriate, for these conditions as we shift our business towards higher growth areas of our markets and constantly improve our customer offer. We are confident of maintaining this momentum and delivering further value to our shareholders."

Greene King is one of our Shares of the Year and despite its performance we continue to rate it as a **BUY**.

The management of **EMED Mining (EMED)** came in to give an update on the permitting of the large Rio Tinto mine that EMED wish to reopen and develop. Having raised $15m from a new convertible note issued to XGC and Red Kite. The convertible note has a term of 18 months with a 9% coupon for the first 12 months and 11% thereafter. The conversion premium is 58% over the 5 day VWAP with a conversion price of 9 pence, with a right to repay the note early, one year after issue. Also, there is a further off-take to buy 1% of production for every US$1m subscribed for. Good news for EMED giving them the time they need in terms of funding before permitting is put into place to re-start the Rio Tinto copper mine. Whilst it is frustrating that the permitting has been has taken a lot longer than expected, they appear optimistic that a positive result to go ahead will be given this year. If true then without doubt they will have a good value project to develop.

Speedy Hire (SDY) is the largest plant and tool hire business in the UK and Ireland and is uniquely positioned to service the infrastructure, construction and industrial markets.

We met the CEO, Steve Corcoran and FD Lynn Krige in June, following the publication of year to March 331 2013results in May. Revenues grew 4.3% to £340.4m and pre-tax profit grew 35% to £16.8.* Recent history is one of recovery, less reliance on too many smaller customers and building long-term relations with the large infrastructure players, building on outsourcing potential and significantly increasing servicing. Regarding the latter, partnered services, training and test-repair-inspection-maintenance (TRIM) are assisting and promoting clients to outsource. It is the focus on the right clients, sectors and contracts that drive improving quality and long term revenues. With the right client and market focus has allowed revenues to grow, right position is seeing a balance from hire (72%) and non-hire (28%); an effective cost base (down2%) and quality service is client recommendations. ROCE is up t0 7.9% (6%) on 12 months rolling basis. Construction is a tough market but Speedy's revenue growth from its target markets shows Infrastucture up 4.7%, Industrial up 11.5% and construction -2.2%, against a market -8.8%**. More importantly Speedy's growth with Construction News' top ten is up 4.6% but with top 50 is down 0-0.6%, demonstrating its upscale trend. Whilst construction remains a key market at 49% the emphasis is on growth with the Top 10. Infrastructure, Industrial and other are each up 1% to 27%, 9%, and 8% respectively.

Whilst the outlook for construction is subdued for 2014, with over 50% revenue non-construction, and 7% revenues are now based on overseas markets (keep an eye out for any future announcements), and 28% revenues are now non-capital service income. Speedy has a strong balance sheet and strong management with a focused strategy that is delivering. The shares have had a strong run but deserve the re-rating.

*Pre amortisation and exceptional costs

Recommendations

During the three months to end-June 2013, the number of stocks on which Beaufort Securities has published recommendations was 158, and the recommendations were as follows: Buy - 60; Speculative Buy - 71; Hold - 26; Sell - 1.

Full definitions of the recommendations used by Beaufort Securities in its publications and their respective meanings can be found on our website here.

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