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Profiting from the downturn in natural resources

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Game-changers

How new technologies are revolutionising the oil and gas industry and how to exploit this when picking shares

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Background


10000
8000
6000
4000
3352.42
2000
2008
2009
2010
2011
2012
2013
AXBASR Index (FTSE AIM All-Share Supersector Index - Basic Resources) Daily 040
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Market performance



Aim basic resources index:

-49% from May 2012 to Oct 2013



Aim oil & gas index:

-29% from May 2012 to Oct 2013

Individual tip performance

Total money-weighted return: 18% Simple return: 7%

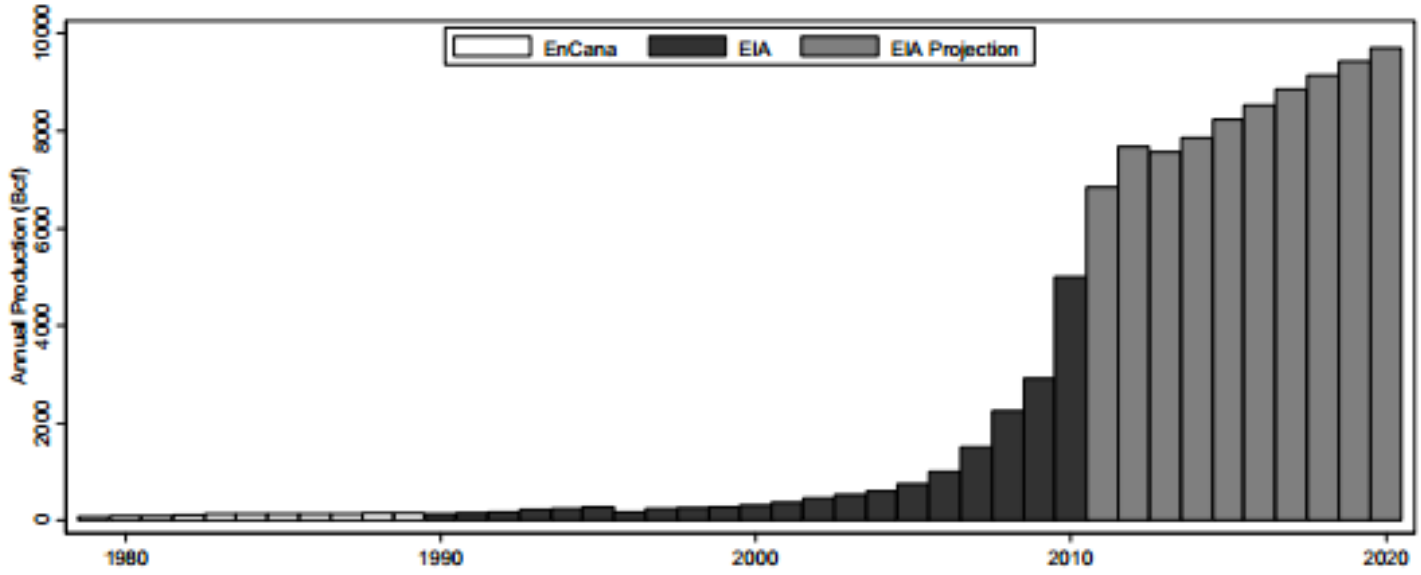
*Includes dividends but does not account for brokerage fees

Company Name	Tip type	Open or closed	Performance (%)
Central Asia Metals (CAML)	Buy	Open	91%
West African Minerals (WAFM)	Sell		82%
Lonmin (LMI)	Sell		57%
Sirius Minerals (SXX)	Sell	Open	54%
Metminco (MNC)	Sell		42%
Leyshon Resources (LRL)	Spec buy		40%
Ithaca Energy (IAE)	Buy	Open	38%
Sunrise Resources (SRES)	Sell		36%
Fortescue Metals (FMG-A)	Sell		34%
First Quantum Minerals (FQM)	Sell		21%
Pan African Resources (PAF)	Buy		19%
Kefi Minerals (KEFI)	Buy		16%
Valiant Petroleum (VPP)	Spec buy		16%
Afferro Mining (AFF)	Buy		4%
Cairn Energy (CNE)	Buy	Open	4%
Rambler Metals & Mining (RMM)	Buy	Open	4%
EnQuest (ENQ)	Buy	Open	2%
Alkane Energy (ALK)	Buy	Open	1%
Highland Gold (HGM)	Buy		-1%
Parkmead Group (PMG)	Buy	Open	-2%
Ophir Energy (OPHR)	Buy	Open	-5%
Tethys Petroleum (TPL)	Spec buy	Open	-6%
Petra Diamonds (PDL)	Buy	Open	-7%
Salamander Energy (SMDR)	Buy		-13%
Northcote Energy (NCT)	Spec buy	Open	-15%
Maple Energy (MPLE)	Buy		-15%
Providence Resources (PVR)	Buy		-21%
Aureus Mining (AUE)	Buy		-42%
Atico Mining (ATY-V)	Spec buy		-48%
Leyshon Resources (second time)	Spec buy	Open	-56%
Tangiers Petroleum (TPET)	Spec buy	Open	-60%
Strategic Minerals (SML)	Spec buy		-61%

*As of 3 Oct 2013

Technology and the Oil & Gas Sector

Figure 2. Annual Shale Gas Production and Projected Production, 1979–2020



Sources: Energy Information Administration 2013 and Curtis 2009.

Follow the trends

Four key ways technology is currently changing the industry

1) Accessing previously inaccessible types of hydrocarbons
2) Software & The Digital Oilfield
3) Working safely in remote or harsh environments
4) Cleantech and alternative fuels

How to exploit this when picking shares

Case studies

- Plexus +700% since April 2010
- Iofina +900% since Jan 2012
- Velocys +200% since May 2012
- Thalassa +800% since Jan 2012
- Getech +300% since Jan 2012

Case study 1: Plexus

- Plexus has a patented new type of well head equipment
- POS-GRIP equipment is reportedly safer, superior, and cost-effective
- Blue sky upside: new deep-sea well-head technology could potentially save tens of millions of pounds per well



1) Macondo disaster
2) Significant contract wins
3) Strong financial results
4) More contracts, JV with majors, positive trading update
5) Postive financial results followed by speculation
6) Positive trading update

Case study 2: Thalassa Holdings

- Thalassa provides marine seismic equipment and services
- Financial results have repeatedly exceeded market expectations



1) Financial results show major revenue growth (+500%)
2) Medium-sized contract win leads to positive trading update
3) Letter of intent signed with Statoil for major new contract
4) Very strong interim results
5) Positive trading update again

Lessons learned

- Time your entry
- It's all about commercialisation

  => Focus on how they are monetising their technology

- Profit from an earnings upgrade cycle

  => Watch out for significant contract wins, strong trading updates and financial results acting as catalysts

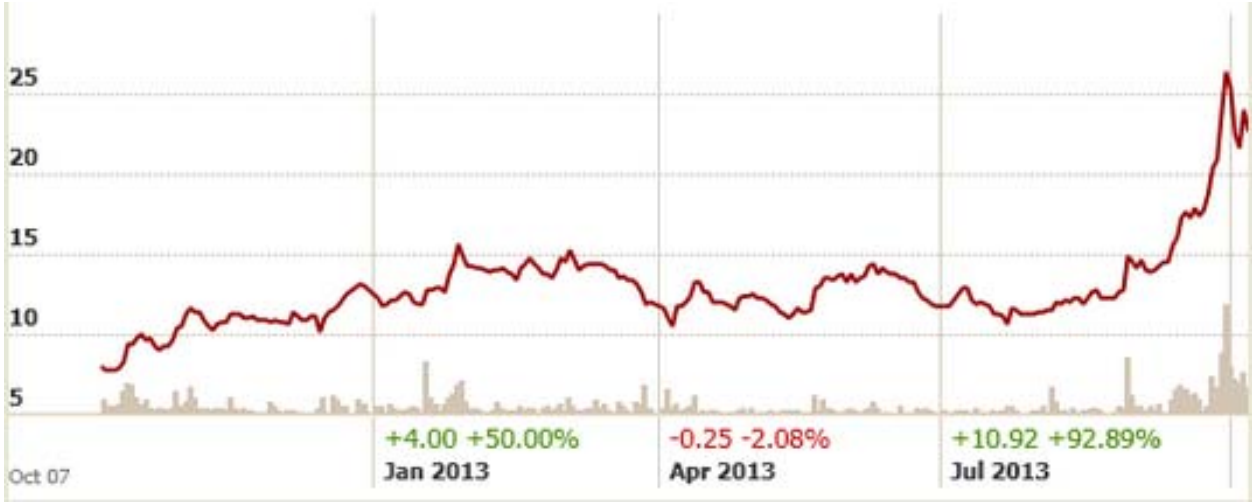
- Look for disruptive technologies that solve a problem

  => Does it save costs or boost efficiency?

Quadrise Fuels (QFI)

Market cap: £173m

Share price: 22.5p



- Quadrise produces a low-cost alternative to heavy fuel oil used in the shipping, refining and power generation markets
- Leading container shipping company, Maersk, is trialling the fuel across several vessels and expects to conclude a proof of concept study by the end of 2013, ahead of commercial roll-out in H2 2014

Quadrise Fuels

- Disruptive tech
- Good intellectual property (IP) protection
- On the cusp of commercialisation
- Huge market: marine fuel oil market alone estimated to be worth $120bn (£74bn)
- Early framework agreements with several major industry players (Maersk, Mexico's Pemex, Saudi Aramco, Colombia's Ecopetrol)

Bear points: 1) Timing concern

2) Valuation appears high on a forecast earnings basis

3) Execution risk

Velocys (VLS)

Market cap: £167m

Share price: 144p



- Velocys has a patented gas-to-liquids technology where it converts gas from unconventional, stranded or small fields into more valuable liquid fuels on-site
- Plants can be deployed cost effectively in remote locations and on smaller fields than competing systems (between 1,000-15,000 barrels per day)

Velocys

- Disruptive tech
- Huge market: estimated untapped resources totalling 25 million barrels per day
- On the cusp of commercialisation
- First $8m order received in H1
- Agreements with several industry players: Ventech, GreenSky London, Red Rock Biofuels, Pinto Energy, Calumet

Bear points: 1) Long lead times for contracts

2) Valuation concerns

MyCelx Technologies (MYX)

Market cap: £87m

Share price: 510p



- MyCelx has a patented, molecular solution for removing oil from water that is more effective than traditional filters or chemical treatments
- More effective than other technologies: down to 1 ppm

MyCelx

- Not hugely disruptive
- Medium-sized but competitive market
- Bringing in commercial revenues
- Strong revenue growth (+85% in H1), solid cost control, recently became profitable (PBT $0.33m)
- Strong prospect pipeline and order book

Bear points: 1) Not hugely disruptive

2) Shares are thinly traded

3) End user delays in H2 are expected to defer associated revenues into 2014

KBC Advanced Technologies (KBC)

Market cap: £52m

Share price: 86p



- KBC provides software and consultancy services to the global hydrocarbon processing industry
- Focus on strategic investment support, asset optimisation and developing technical capabilities of workforce

KBC

- Riding an earnings upgrade cycle

  => rising number of contract wins flowing straight into bottom-line earnings
- Recent director dealing
- Successful Simon Thompson buy tip, fair value target price of 100p represents ~15% upside
- Four-month timeline with a potentially very positive trading update in January acting as a catalyst
- Attractive valuation

Bear points: 1) Not very disruptive

2) Possibly in latter stages of earnings upgrade cycle

Summary

- What to look out for:
  -disruptive, proven technologies
  -prefer technologies that capture the imagination of speculators
  -time your entry, be alert for catalysts
  -near commercialisation or project commissioning

- Risk vs reward:
  -still risky but perhaps less than traditional E&Ps
  -value created more slowly but can result in equivalent share price gains

Game-changers

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