

# Orca Exploration Group Inc. (ORC.B-V, \$12.05)

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September 4, 2007

**Investment Brief** – Orca has already established a material natural gas resource in Tanzania, and is potentially less than 18 months away from contracting all its natural gas reserves for a period that would extend to 2026. A steady cash-flow stream and minimal capital commitments provide the opportunity for a steady return to shareholders. Upside potential from both exploration and development drilling could result in additional reserves for the Company. A recent exploration into Uganda provides a new dynamic to the Company.

**Rating** SECTOR OUTPERFORM  
**Target Price** \$17.00  
**Risk Profile** SPECULATIVE

**Forecast Risk** High  
**Financial Risk** Moderate  
**Valuation Risk** Moderate  
**Political Risk** Moderate

Current Price \$12.05  
 Return 41%  
 52-Week High / Low \$15.00 / \$8.45  
 Shares O/S 29.6M (basic) / 32.3 M (F/D)  
 Market Capitalization \$357 million  
 Enterprise Value \$327 million  
 Daily Volume 22,900

Note: All amounts in US\$ unless otherwise noted

	2006A	2007F	2008F	'07/06	08/07
Gas mmcf/day	13.3	23.8	62.7	80%	163%
% Gas	100%	100%	100%	0%	0%
Cash Flow	6,030	12,583	49,579	109%	294%
CFPS - Diluted	\$ 0.24	\$ 0.44	\$ 1.73	83%	294%
CFPS C\$ - Diluted	\$ 0.27	\$ 0.49	\$ 1.91	78%	293%
EPS - Diluted	\$ 0.10	\$ 0.24	\$ 1.25	142%	419%
Capital Expenditures	6,043	32,957	10,500	445%	-68%
Net Debt (Wkg Cap)	(20,430)	(1,456)	(40,074)	-93%	2652%
Company Avg \$/mcf	\$ 3.82	\$ 3.55	\$ 3.31	-7%	-7%
<b>Valuation Parameters</b>					
Price/CFPS Diluted	51.4	28.0	7.1	-45%	-75%
Price/EPS Diluted	123.3	51.1	9.8	-59%	-81%
Target Price/CFPS Dil'd	64.5	35.1	8.9	-45%	-75%
EV/boe/day	\$ 159,142	\$ 88,492	\$ 33,633	-44%	-62%
Target EV/boe/day	\$ 206,306	\$ 114,718	\$ 43,600	-44%	-62%

## Q2 Affected by Seasonal Rains

### Production up 5% year over year

Production averaged 12.5 mmcf/day, up 5% year over year but down from 18.4 mmcf/day in Q1/07 after seasonal rains allowed hydro generation to temporarily recover. Current production is 26.2 mmcf/day.

### SS-10 drilling to continue in September

Drilling of SS-10 will continue in September after rig repairs are completed. This well is expected to add 50 mmcf/day to the Company's production capability.

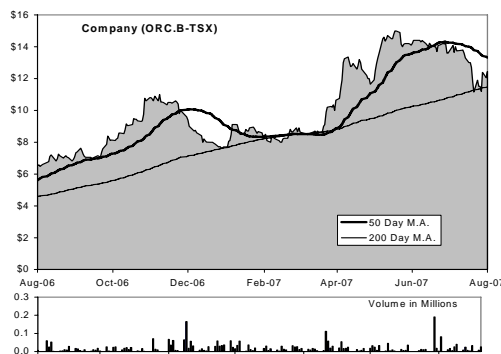
### Uganda activities to begin in Q4

Orca will begin seismic acquisition in Q4 with a view to spudding the first of two exploration wells in Q3/08. These prospects are exposing the Company to several 100 mmbbls of potential reserves based on recent successes in the immediate area.

**Valuation** – Our target price of \$17.00 reflects a price to 2008 CFPS ratio of 8.9 times. This is obviously a premium multiple supported by the extensive reserves that allow the Company to maintain production at peak levels until 2026. We view the move to expand the asset base to oil assets and to invest the growing cash flow in a potentially accretive asset as positive. We continue to rate Orca as SECTOR OUTPERFORM.

**Catalysts** – Adding to the thermal generating infrastructure as planned adds to our confidence level in the ability of the Company to contract its natural gas reserves. The announcement of an oil property acquisition would be positive. Development drilling has begun, and exploration drilling is expected to start in 2008, both having the potential to increase the Company's reserves.

## Price Performance



Source: Bloomberg

### Industry & Company Profile

Oil and Gas – Orca is a natural gas producer with operations focused in Uganda and Tanzania, East Africa. Orca has been particularly effective in establishing a market for its material natural gas reserves base.

### Revisions, Date of Record

Rating – Changed to SECTOR OUTPERFORM from Under Review, January 31, 2007  
 Target – Increased to \$17.00 from \$14.25 on June 4, 2007.

### Company Information

President – Peter Clutterbuck  
 Company Web Site  
[www.orcaexploration.com](http://www.orcaexploration.com)

Please see rating structure, important disclosures, risk profile parameters, disclaimers, and notes on pages 10 to 13 of this report.

ORCA EXPLORATION GROUP INC.							ORC.B-TSXV		
Rating: SECTOR OUTPERFORM			Implied Gain: 41%		One Year Target Price: \$17.00				
Current Price (C\$)		\$12.05			Market Capitalization	C\$M		356.7	
Shares O/S (millions)		29.6	Dilution		Current Net Debt (Cash)	C\$M		(28.5)	
Shares O/S - FD (millions)		32.3	9.1%		Enterprise Value	C\$M		328.2	
Book Value (US\$M)		38.3			EV / BV in C\$			8.6	
Orca - Operating and Financial Forecast (US\$ unless noted)									
		2005A	2006A	2007F	2008F	2009F	2010F	'07/06	'10/06
<b>Production</b>									
Natural Gas - mmcf/day									
Industrial		2.1	4.0	5.7	10.5	13.5	19.7	41%	391%
Power		4.6	9.2	18.2	52.2	56.7	55.0	97%	495%
		6.7	13.3	23.8	62.7	70.2	74.7	80%	463%
Total - boe/day		1,118	2,209	3,972	10,451	11,702	12,443	80%	463%
% Change			98%	80%	163%	12%	6%		
<b>Financial (US\$000's)</b>									
Revenue		5,759	13,828	23,711	61,459	67,552	58,884	71%	326%
Operating Expense		495	793	1,019	1,229	1,245	1,258	29%	59%
Net Operating Revenue		5,264	13,035	22,691	60,230	66,307	57,627	74%	342%
Earnings (Loss)		388	2,577	6,904	35,829	39,653	24,237	168%	841%
Cash Flow		2,081	6,030	12,583	49,579	54,252	39,504	109%	555%
EPS - Basic	\$	0.02	\$ 0.11	\$ 0.26	\$ 1.34	\$ 1.48	\$ 0.90	134%	722%
- Diluted	\$	0.02	\$ 0.10	\$ 0.24	\$ 1.25	\$ 1.39	\$ 0.85	142%	748%
CFPS - Basic	\$	0.09	\$ 0.26	\$ 0.47	\$ 1.85	\$ 2.02	\$ 1.47	81%	467%
- Diluted	\$	0.08	\$ 0.24	\$ 0.44	\$ 1.73	\$ 1.90	\$ 1.38	83%	476%
% Change			191%	83%	294%	9%	-27%		
CFPS - Basic C\$	\$	0.11	\$ 0.30	\$ 0.52	\$ 2.03	\$ 2.22	\$ 1.62	75%	448%
- Diluted C\$	\$	0.10	\$ 0.27	\$ 0.49	\$ 1.91	\$ 2.09	\$ 1.52	78%	456%
US/CD F/X		0.8255	0.8793	0.9075	0.9100	0.9100	0.9100		
<b>Sensitivity - CFPS US\$</b>									
Industrial Price	\$0.25/mcf		\$	0.010	\$ 0.027	\$ 0.022	\$ 0.024		
Power Price	\$0.25/mcf		\$	0.009	\$ 0.018	\$ 0.012	\$ 0.009		
Additional Gas - Industrial	1.0 mmcf/d		\$	0.045	\$ 0.083	\$ 0.048	\$ 0.035		
Additional Gas - Power	1.0 mmcf/d		\$	0.015	\$ 0.025	\$ 0.017	\$ 0.013		
Industrial Price	\$0.25/mcf			2.0%	1.5%	1.1%	1.6%		
Power Price	\$0.25/mcf			1.8%	1.0%	0.6%	0.6%		
Additional Gas - Industrial	1.0 mmcf/d			9.5%	4.5%	2.4%	2.4%		
Additional Gas - Power	1.0 mmcf/d			3.1%	1.4%	0.8%	0.9%		
Capex		5,648	6,043	32,957	10,500	26,500	2,500	445%	-59%
Net Debt (Cash)		(2,211)	(20,430)	(1,456)	(40,074)	(26,491)	(76,696)	-93%	275%
Common Shares O/S (000s)		23,264	26,804	26,804	26,804	26,804	26,804	0%	0%
Weighted Average		23,264	23,418	26,804	26,804	26,804	26,804	14%	14%
<b>Per Mcf (US\$)</b>									
<b>Gas Price</b>									
Industrial	\$	7.07	\$ 8.22	\$ 7.86	\$ 7.95	\$ 7.33	\$ 7.33	-4%	-11%
Power - Ubungo	\$	1.66	\$ 1.75	\$ 2.19	\$ 2.40	\$ 2.50	\$ 2.60	25%	49%
Power - Other	\$	2.66	\$ 2.10	\$ 2.21	\$ 2.38	\$ 2.60	\$ 2.70	5%	29%
Total	\$	3.37	\$ 3.82	\$ 3.55	\$ 3.31	\$ 3.50	\$ 3.91	-7%	2%
Revenue	\$	2.35	\$ 2.86	\$ 2.73	\$ 2.68	\$ 2.64	\$ 2.16	-5%	-24%
Operating Expenses	\$	0.20	\$ 0.16	\$ 0.12	\$ 0.05	\$ 0.05	\$ 0.05	-28%	-72%
Net Operating Revenue	\$	2.15	\$ 2.70	\$ 2.15	\$ 3.15	\$ 4.15	\$ 5.15	-20%	91%
Depletion and Depreciation	\$	0.37	\$ 0.44	\$ 0.56	\$ 0.56	\$ 0.56	\$ 0.56	28%	26%
Earnings (Loss)	\$	0.16	\$ 0.53	\$ 0.79	\$ 1.56	\$ 1.55	\$ 0.89	50%	68%
Cash Flow	\$	0.85	\$ 1.25	\$ 1.45	\$ 2.16	\$ 2.12	\$ 1.45	16%	16%
<b>Valuation Parameters</b>									
Current Price/CFPS Diluted Multiple C\$		149.6	51.4	28.0	7.1	6.5	8.9	-45%	-83%
EV / DACF Multiple (Debt-Adjusted CF)			66.6	28.9	6.6	6.3	7.6	-57%	-89%
Target Price/CFPS Diluted Multiple C\$		187.7	64.5	35.1	8.9	8.2	11.2	-45%	-83%
Price/EPS Diluted Multiple C\$		616.5	123.3	51.1	9.8	8.9	14.5	-59%	-88%
EV/boe/day C\$		\$314,319	\$159,142	\$88,492	\$33,633	\$30,038	\$28,247	-44%	-82%
Target EV/boe/day C\$		\$353,652	\$206,306	\$114,718	\$43,600	\$38,940	\$36,619	-44%	-82%

Source: Orca Exploration Group and Haywood Securities

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## Investment Thesis

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Orca is in a position to contract all its existing, material natural gas reserves over the next 18 months and generate a steady cash-flow stream that would continue through 2026. The expected annual cash flow would require minimal capital commitment, therefore putting the Company in the position of potentially paying an annual dividend of approximately \$1.00 per share. Alternatively, the Company's plans to execute the acquisition of at least two crude oil properties, likely in Africa, by the end of the year will likely result in a more accretive use of capital.

*NOTE: Orca reports in US\$. All amounts discussed below are in US\$ unless otherwise noted.*

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## Quarterly Results Down Owing to Impact of Seasonal Rains

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**Production** in Q2 averaged 12.5 mmcf/day, down 32% from 18.4 mmcf/day in Q1/07 and 5% greater than the same quarter last year. Power-related sales in particular have a seasonal component. During and immediately after the rainy season, the reservoirs in Tanzania are replenished (in many years, only partially), resulting in the gas-powered generation being replaced with hydro. Industrial-related demand generally peaks during Q3, although each year Orca has added to its customer base for industrial-related sales. **In July 2007, total sales were 26.2 mmcf/day (power of 21.6 mmcf/day and industrial of 4.6 mmcf/day)—more than double the Q2 average and 42% greater than the Q1 average (Orca's highest sales volume quarter).**

**CFPS** in the quarter was \$0.05 (diluted \$0.05), down from the previous quarter owing to the seasonally lower sales volumes as discussed above. Average gas prices were \$4.41 per mcf, 38% greater than the Q1 average of \$3.19 per mcf. Industrial sales prices were relatively static between the two quarters. However, the industrial sales price increased to \$8.61 from \$7.70 (12%) in Q2 versus Q1.

Orca posted a **loss of \$0.02**, down from EPS of \$0.00 in Q1/07 largely owing to the impact of a \$0.8 million charge for share-based compensation (\$0.2 million in Q1/07) following the award of 200,000 common shares to a newly appointed officer. These shares vest one-third per year, starting in 2007.

**Orca continues to negotiate a long-term price contract with the Tanzania Electric Supply Company Limited (TANESCO) for its power-related sales.** The sales tied to the sixth Ubungo turbine (42 MW) were included in the original concept, and as such, will likely receive a different price contract than that for the 245 MW (which could be subject to a minimum 70% take or pay provision or 184 mmcf/day) of other permanent generation being installed between now and mid-2008. Short-term contracts for the 168 MW of emergency power generation (expected to be decommissioned by mid-2009). are also under discussion. We are cautiously optimistic that an agreement can be reached by the end of 2007, but at this point, we are not expecting a significant ramp-up in prices from the current levels.

**Capital expenditures** in the quarter totalled \$15.0 million, taking the year-to-date total to \$26.1 million. The **SS-10** development well began drilling on April 28, 2007, and \$12.9 million or 86% of the quarter's expenditures were related to this well. The well is a deviated well, with the bottom hole located approximately

1 kilometre offshore. Total depth was originally planned to be 6,400 feet. The well was drilled to 5,540 feet by mid-June, but owing to problems with the rig, the well was secured to 3,523 feet, and drilling suspended during rig repairs by the owner. It is expected to be drilling again by early September. Orca had also intended to drill the **Songo Songo North** appraisal and the **Songo Songo West** exploration well, likely in 2008. Both of these wells have been deferred to at least 2009 given the plans to drill two wells in Uganda.

**Gas-fired power generation within Tanzania continues to expand as anticipated, with 310 MW of demand in the country expected by year-end.** Mid-year capacity of 170 MW was increased by 40 MW related to the installation of a Dowan's emergency plant in August, and in October, a 100 MW Wartsila plant is scheduled to be installed. In 2008, there will be 45 MW of gas-powered generation added at Tegeta, and the Independent Power Tanzania Limited (IPTL) conversion from heavy fuel oil to natural gas—100 MW—will start.

**Net debt at June 30, 2007, was \$3.1 million.** This is the first time the Company has not been in a working-capital position. However, in July the Company completed an equity financing, raising C\$34.5 million in gross proceeds on the sale of 2.5 million Class B shares at a price of C\$13.80 per share. After the share issue, the Company has 27.9 million common shares outstanding. In 2007, the Company expects to spend another \$10.0 million to complete drilling the SS-10 well and \$6.0 million for seismic and other costs related to the farm-in to Block 5 in Uganda. The Company will also spend between \$10 million and \$15 million in Uganda in 2008 to pay 82.33% of the costs to drill two exploration wells (the higher amount if the wells are tested).

Orca Exploration - Quarterly Summary (US\$000's, except per-share amounts that are US\$/share)										ORC.B - TSXV		
		Q2/06	Q3/06	Q4/06	Q1/07	Q2/06	% Chg vs. Q2/06	6 Mo '07	6 Mo '06	% Chg 6 mo		
<b>Oil and Gas Revenue</b>		3,198	3,835	4,722	3,831	3,021	-5.5%	6,852	5,271	30%		
<b>Cash Flow</b>		1,333	1,589	2,438	1,190	1,251	-6.2%	2,441	2,003	22%		
	% Chg - Prev Qtr	99%	19%	53%	-51%	5%						
	% Chg - Prev Yr	n/a	27%	78%	77%	n/a						
<b>CFPS</b>	Basic \$/sh	\$ 0.06	\$ 0.07	\$ 0.10	\$ 0.04	\$ 0.05	-16.7%	\$ 0.09	\$ 0.09	0%		
	Diluted \$/sh	\$ 0.05	\$ 0.06	\$ 0.10	\$ 0.04	\$ 0.05	0.0%	\$ 0.08	\$ 0.08	0%		
	% Chg - Prev Qtr	84%	20%	67%	-60%	25%						
	% Chg - Prev Yr	n/a	21%	85%	47%	0%						
Note: Until Q4/06 Orca's reported CFPS uses Cash Flow from Operations plus change in Working Capital Our calculation uses only Cash Flow from Operations; therefore, CFPS varies from the reported amounts												
<b>Net Earnings (Loss)</b>		660	809	1,025	128	-608	n/a	-480	743	n/a		
<b>EPS</b>	Basic \$/sh	\$ 0.03	\$ 0.03	\$ 0.04	\$ 0.00	\$ (0.02)	n/a	\$ (0.02)	0.03	n/a		
	Diluted \$/sh	\$ 0.03	\$ 0.03	\$ 0.04	\$ 0.00	\$ (0.02)	n/a	\$ (0.02)	0.03	n/a		
	% Chg - Prev Qtr	n/a	0%	33%	-100%	n/a						
	% Chg - Prev Yr	n/a	0%	100%	n/a	n/a						
<b>Capital Expenditures</b>		1,034	749	23,432	11,077	14,989	1349.6%	26,066	1,885	1283%		
<b>Net Debt (Working Capital)</b>		(2,448)	(3,298)	(20,430)	(10,570)	3,050	n/a	3,050	(2,448)	-225%		
	Net Debt/Cash Flow (Annualized)	n/a	n/a	n/a	n/a	0.6	n/a	0.6	n/a	n/a		
<b>Production</b>												
	Natural Gas - mmcfd/day											
	Industrial	3.8	5.3	4.3	3.3	4.4	14.4%	3.9	3.2	21%		
	Power	8.1	8.1	13.1	15.1	8.2	0.8%	11.6	7.9	48%		
		11.9	13.4	17.4	18.4	12.5	5.2%	15.5	11.0	40%		
	Total - boe/day	1,989	2,237	2,906	3,069	2,092	5.2%	2,577	1,840	40%		
	Q/Q % Change	18%	12%	30%	6%	-32%	-279.2%					
	% Gas	100%	100%	100%	100%	100%		100%	100%			
<b>Commodity Prices - net of hedges</b>												
	Gas (US\$/mcf)											
	Industrial	\$ 8.69	\$ 8.63	\$ 8.09	\$ 7.70	\$ 8.61	-0.9%	\$ 8.22	\$ 8.27	-1%		
	Power	\$ 2.13	\$ 1.69	\$ 1.95	\$ 2.19	\$ 2.17	1.9%	\$ 2.18	\$ 1.97	11%		
	Total	\$ 4.23	\$ 4.45	\$ 3.48	\$ 3.19	\$ 4.41	4.2%	\$ 3.69	\$ 3.79	-3%		
	% Chg - Prev Qtr	30%	5%	n/a	-8%	38%						
	% Chg - Prev Yr	-32%	72%	n/a	-2%	4%						

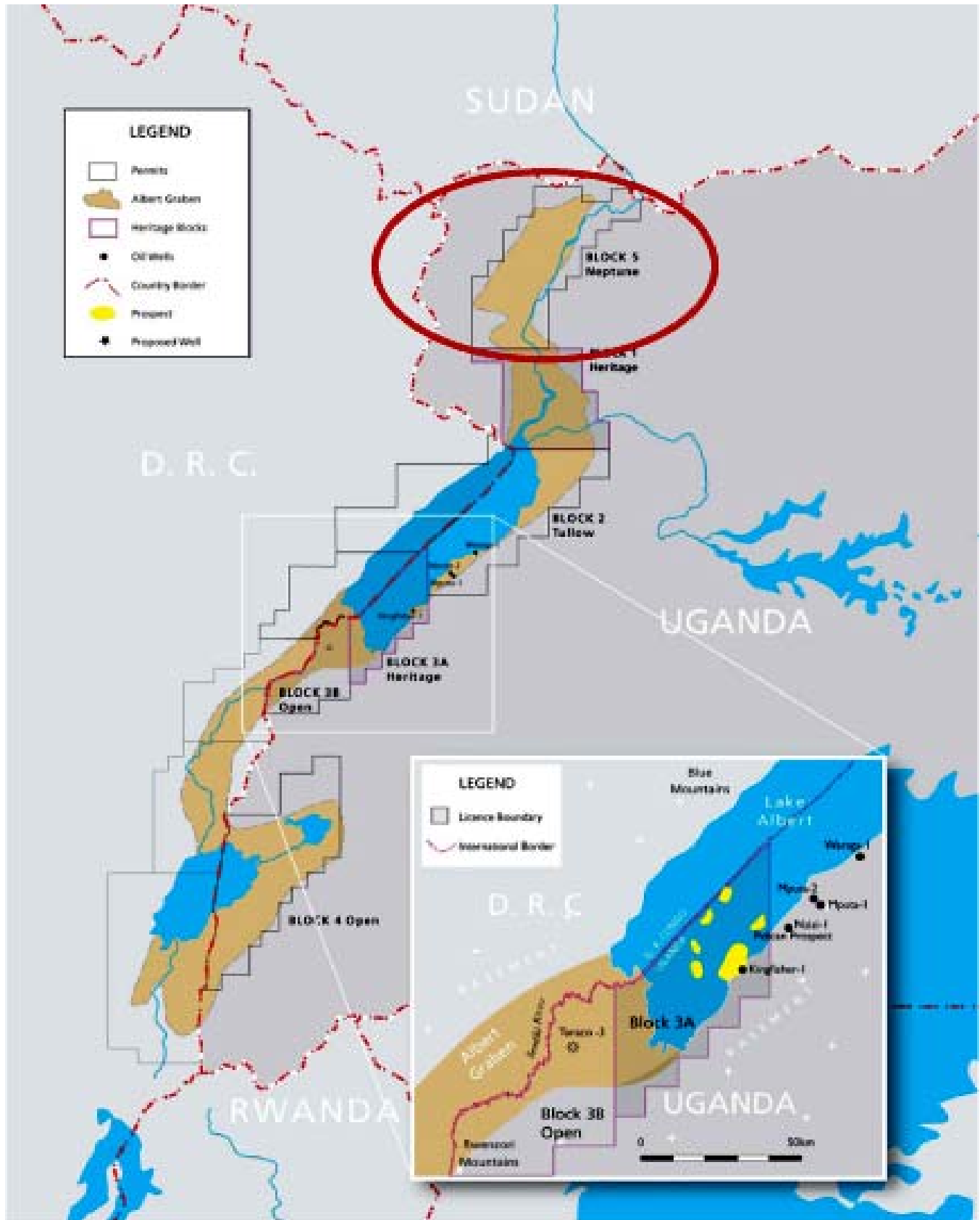
Source: Orca Exploration Group and Haywood Securities

## Uganda – Exposure to Multi 100 mmbbl Exploration Prospects

Recently, we commented on Orca's Ugandan farm-in (see *Radar Flash* of [August 28, 2007](#)). Below, we have summarized our remarks plus the additional information disclosed in the Company's quarterly report. In summary, the Ugandan exploration opportunity, while exposing the Company to a different country's political risk, also provides exposure to what could be multi 100 mmbbl exploration prospects.

Orca has negotiated a farm-in on Exploration Area 5 in northern Uganda with Neptune Petroleum (Uganda) Limited, a wholly owned subsidiary of Tower Resources plc (TRP:London AIM) whereby Orca will earn a 50% working interest in the 6,040-square-kilometre block. Please refer to the map for the location.

**Uganda – Oil and Gas Exploration Blocks**



Source: Heritage Oil

The time frame for activity for a transaction of this type is smaller than we have usually witnessed. Orca will pay 83.33%, up to a maximum of US\$6.0 million, to acquire 250 to 300 kilometres of 2D seismic, with activity expected to begin in November 2007, and will repay Tower for certain costs already incurred on the block. Orca then has the option to earn a 50% interest in the block by funding 83.33% of the cost of two exploration wells, to a maximum of US\$10 million if they are not tested, and to US\$15 million if they are tested. Orca will put a guarantee in place to cover \$15 million of expenditures. Drilling is expected to start by Q3/08. Should Orca exercise its option to earn a 50% interest in the block, Tower will continue to remain operator under the licence for 3 years. However, Orca will assume management responsibility for all drilling activities.

Heritage Oil Corporation (HOC-T) has enjoyed recent drilling successes in Uganda, and by its early estimates, has made a 1.0 billion bbl discovery at Kingfisher on Block 3A. Heritage also has a 50% interest in Block 1, immediately south of Block 5, where it has identified leads that have the potential to contain up to 804 mmbbls on an unrisks basis.

The north part of the country can be characterized as plains and escarpment-type terrain (as opposed to jungle), which facilitates oil and gas exploration. South of Lake Albert, there have been border disputes with the Democratic Republic of Congo (DRC), which recently resulted in an incident between a DRC patrol boat and a Heritage seismic barge. We understand that this situation is contained in the south, although border issues could occur elsewhere.

The relative terms of the production sharing agreement (PSA) are as follows:

- Government royalty of 5% on production up to 2,500 bbls/day, increasing on a sliding scale to 12.5% above 7,500 bbls/day
- Cost recovery up to 50% of the oil production, net of royalties
- Profit sharing is split so that with production of 0 to 5,000 bbls/day, 53% goes to the licensee; ranging to 25% to licensee at rates greater than 40,000 bbls/day.
- The Company is currently in the first of three exploration phases of the contract.
  - Phase 1 expires March 27, 2008, and requires the acquisition of 200 kilometres of seismic. The planned acquisition of 250 to 300 kilometres in November will meet this requirement.
  - Phase 2 expires March 27, 2010, and requires the drilling of two exploration wells and one contingent well.
  - Phase 3 expires March 27, 2012, and requires one more exploration and one more contingent well be drilled.

## Valuation

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Our target price of \$17.00 reflects a price to 2008 CFPS ratio of 8.9 times. This is obviously a premium multiple supported by the extensive reserves that allow the Company to maintain production at peak levels until 2026. While utilization of the cost pool will reduce the Company's share of revenues, we do not expect major erosion to occur until 2010. However, any additional capital expenditures over our assumptions will result in greater growth in the cost pool (owing to the workings of the cost recovery factor). Success at Songo Songo West in particular would add to the reserves and production capability, and extend the stronger cash flow levels past 2010. We note that we have not changed our commodity price expectations at this time. However, we believe that the Company will likely receive higher prices than our forecast, reducing the implied cash-flow multiple.

In addition, while no agreement has been made to date, we fully expect the Company to conclude a transaction involving an oil property, which given the track record of the management team, will likely prove to be accretive to the Company.

Our production and cash-flow forecast does not assume success in the Company's exploration at Songo Songo. More significantly, we have assumed a price increase for natural gas used in power generation of only \$0.10 per mcf starting in 2008. Tanzania has the lowest electricity prices in East Africa (at only two-thirds of the price in Uganda or Kenya) and is under some pressure from the World Bank to enact price increases. A 5% increase has been discussed relative to 2007. However, we have not assumed the same in our forecast. An increase in the amount charged for electricity would result in TANESCO being able to pay a higher price for the Songo Songo natural gas.

## **Investment Profile**

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### ***Risks***

We rate the overall risk of Orca as SPECULATIVE. One of the largest risks to our forecast and the Company's operations is timing. Delays can occur for various reasons that are beyond the Company's control. Nonetheless, the Company's reserves are material and estimated by reliable third-party engineers. The asset valuation will not materially change in the event of the operational delays noted. The Company's cash flow is increasing as both power and industrial contracts are added. However, the timing of planned capital expenditures may require the Company to seek financing through either debt or equity sources. Tanzania has had a relatively stable history and does not have a noticeable level of civil unrest, unlike many other African countries. We view the political risk as moderate.

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- Haywood Securities, Inc. or an Affiliate has managed or co-managed a public offering of securities for Orca Exploration Group Inc. (ORC.B-V) in the last 12 months.
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- n/a

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## Rating Structure \*

*Each company within analyst's universe, or group of companies covered, is assigned a rating to represent how the analyst feels the stock will perform in comparison with the other companies, in that specific sector, over the upcoming 12 month period.*

**SECTOR OUTPERFORM** – Haywood's top rating category. The analyst believes that the security will outperform its sector. Furthermore, the shares are forecast to provide attractive returns measured against alternative investments when considering risk profiles. The rating carries a minimum total return threshold of 15% for equities and 12% for trusts. The rating applies to companies that have tangible underlying assets that give a measure of support to the market valuation. The rating category considers both the absolute and relative values in assigning the highest rating on the security.

**SECTOR PERFORM** – The analyst believes that the security will trade with tight correlation to its underlying sector. Furthermore, the target price (together with any anticipated distributions) is at or above the market price, and forecast risk-adjusted returns are attractive relative to alternative investments.

**SECTOR UNDERPERFORM** – Investors are advised to sell the security or hold alternative securities within the sector. Stocks in this category are expected to underperform relative to their sector. The category also represents stocks with unattractive forecast returns relative to alternative investments.

*The above ratings are determined by the analyst at the time of publication. On occasion, total returns may fall outside of the ranges due to market price movements and/or short term volatility. At the discretion of Haywood’s Management, these deviations may be permitted after careful consideration.*

**Other Ratings**

**TENDER** – The analyst is recommending that investors tender to a specific offering for the company’s stock.

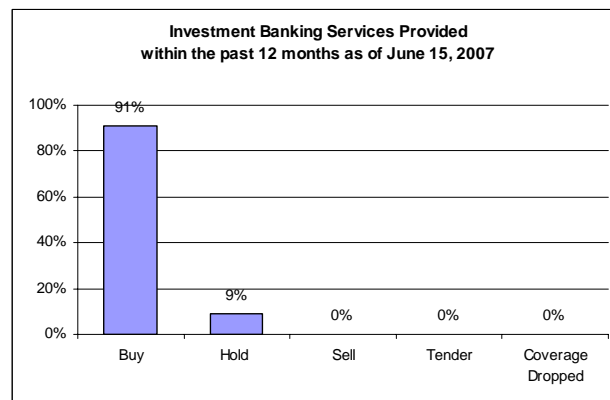
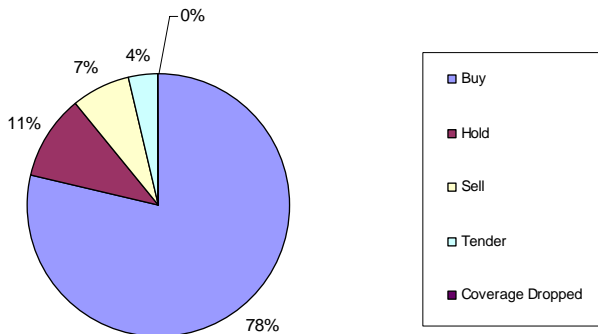
**RESEARCH COMMENT** – An analyst comment about an issuer event that does not include a rating or recommendation.

**UNDER REVIEW** – Placing a stock Under Review does not revise the current rating or recommendation of the analyst. A stock will be placed Under Review when the relevant company has a significant material event with further information pending or to be announced. An analyst will place a stock Under Review while he/she awaits sufficient information to re-evaluation the company’s financial situation.

**COVERAGE DROPPED** – Haywood Securities will no longer cover the issuer. Haywood will provide notice to clients whenever coverage of an issuer is discontinued.

*\* Haywood’s current rating structure (outlined above) does not correlate to the 3-tiered BUY, HOLD, SELL structure required by the NASD and NYSE. Our ratings of Sector Outperform, Sector Perform and Sector Underperform most closely correspond to Buy, Hold/Neutral and Sell respectively however, as described above, our assigned ratings take into account the relevant sector.*

**Rating Distribution March 15 2007 - June 15, 2007**



*Haywood's focus is to search for undervalued companies which analysts believe may achieve attractive risk-adjusted returns. This research coverage on potentially undervalued companies may result in an outweighed percentage of companies rated as Sector Outperform. Management regularly reviews rating and targets in all sectors to ensure fairness and accuracy.*

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**Risk Profile Parameters**

**SPECULATIVE:** – Investment for risk accounts only. Companies within this category carry greater financial and/or execution risk. All junior/venture companies that carry great financial and/or liquidity risk will be tagged “SPECULATIVE”. A stock indicating a SPECULATIVE risk is determined from sector specific criteria outlined below.

## **Risk Profile Parameters – Oil and Gas Sector**

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**Forecast Risk:** *High* – Haywood forecasts are below guidance. The Company has a history of missing targets and/or Haywood expects guidance to be lowered. Limited hedging increases commodity risk beyond peers. To raise expectations requires higher commodity prices or production that is ahead of guidance. *Moderate* – Haywood forecasts are generally in line with guidance. The Company has a history of meeting or exceeding guidance. Forecasts are consistent with current commodity pricing and production guidance. Hedging practices are in line with peers. *Low* – Haywood forecasts exceed guidance. The Company has a history of meeting or exceeding guidance. Forecasts allow for modestly lower commodity pricing or production levels. Commodity hedging lowers volatility relative to peers.

**Financial Risk:** *High* – The capital expenditure program in the current year or the next year of the forecast is not fully funded but requires additional debt and/or equity financing. This categorization does not necessarily predict whether the additional funds will be raised. *Moderate* – The capital expenditure program in the current year or the next year is fully funded with cash flow and limited debt. *Low* – The capital expenditure program in the current year or the next year is fully funded with cash flow and no new debt.

**Political Risk:** *High* – Properties are located in an area with limited petroleum industry activity or infrastructure. An environment unfriendly to the industry makes obtaining permits to drill or produce hydrocarbons challenging. Significant government or local opposition exists. *Moderate* – Properties are located in an area with minimal petroleum industry activity or infrastructure. An environment friendly to the industry makes obtaining permits relatively straightforward. All levels of government are considered indifferent to hydrocarbon activity. *Low* – Properties are located in an area with established petroleum exploration and development activity. Oil and gas Production Sharing Agreements or Exploration Permits are in hand. Government at all levels supports the sector.

**Valuation Risk:** *High* – The current valuation is at the high end of historic levels and/or at a premium to peers. The valuation reflects continued production growth and/or continuing strong commodity prices or further appreciation. Where applicable, the market capitalization exceeds the NAV by more than 30%. *Moderate* – The current valuation is within historic ranges and generally consistent with peers. The valuation reflects reasonable production growth and/or commodity price appreciation. Where applicable, the market capitalization exceeds the NAV by 15% to 30%. *Low* – The current valuation is at the low end of historic ranges and/or at a discount to peer valuations. The valuation reflects limited production growth and/or no commodity price appreciation. Where applicable, the market capitalization exceeds the NAV by less than 15% or falls below the capitalization.

## **Disclaimers**

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- (b) in the event of a dispute, access to the UK's Financial Ombudsman Service;
- (c) protection of money held on your behalf under the FSA's Client Money Rules.