

Orca Exploration Group Inc. (ORC.B-V, \$8.00)

Monday, June 2, 2008

Rating: SECTOR OUTPERFORM
 Target Price: \$14.00
 Return: 75%
 YTD Performance: -24%
 Risk Profile: SPECULATIVE

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O Orca is on the cusp of signing critical gas price agreements and the first of three gas facility expansions that will lock in the growth we have been expecting. While delays have pushed the peak production date out, the asset and its value has increased. An asset that can provide steady to increasing returns up to 2026 is unique in this business.

Q1 as Expected - But Clarity in Growth Schedule

Event: Q1/08 financial and operating results and an operations update were released.

Impact - Neutral: Q1/08 results were in line with expectations.

- **Forecasts** – We have revised our forecast to reflect the latest timing for the facility expansion and expected gas prices to be contracted. CFPS for 2008 and 2009 are now \$0.52 and \$0.97, respectively, down from \$0.97 and \$1.55 – essentially pushing expected growth out one year.
- **Target Price, Ratings** – We maintain our one year target price of \$14.00 our rating of Sector Outperform.

Highlights:

- **Production of 25.3 mmcf/day and CFPS of \$0.08 are in line with expectations.** Both are down slightly from the previous quarter, largely due to seasonality, but production is up 38% and CFPS double Y/Y due to increasing sales.
- **Gas price contracts expected to be signed early Q3/08.** Contracts for 44 mmcf/day, with a take or pay component of 32 mmcf/day, are expected to be signed in early Q3/08. Negotiations to supply gas for a planned 150 MW expansion (could be up to 25 mmcf/day) will commence after that signing.
- **Three step doubling of facility capacity to 140 mmcf/day.** The gas handling at Songo Songo is expected to increase from 70 to 90 mmcf/day by early Q3/08, to 105 mmcf/day by year end and potentially 140 mmcf/day by the end of 2009.
- **Net asset value (diluted) of \$10.93 (NPV10) to \$17.54 (NPV5)** does not take into account the potential at Songo Songo West, which could add \$3.43 to \$5.01. No matter how you look at it – the stock is undervalued currently.

Valuation: Our target price of \$14.00 reflects a price to 2009 CFPS ratio of 15.4 times, a premium multiple that is supported by the extensive reserves that allow the company to maintain production at peak levels with minimal required capital until 2026. We continue to rate Orca as SECTOR OUTPERFORM.

Catalysts: 1) Signing the gas price agreements and facility expansion is critical; 2) A decision on whether to proceed with exploration drilling in Uganda expected by June 2008.

Investment Brief: Orca has already established a material natural gas resource in Tanzania. A steady cash-flow stream and minimal capital commitments provide the opportunity for a steady return to shareholders to 2026.

Forecast Risk	High
Financial Risk	Moderate
Valuation Risk	Moderate
Political Risk	Moderate
52-Week High / Low	\$15.00/\$7.51
Shares O/S	29.6 (Basic) / 32.3 (F/D)
Market Capitalization	\$237 million
Daily Volume	19,100

Company Profile

www.orcaexploration.com

Orca is a natural gas producer with gas operations focused in Tanzania and a new oil exploration initiative in Uganda, both in East Africa.

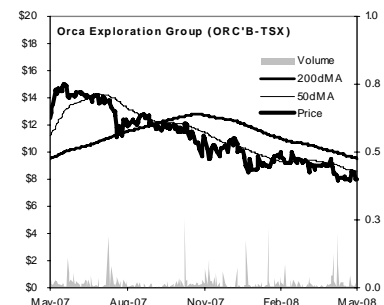
Company CEO - Peter Clutterbuck

Revisions, Date of Record

Rating - Changed to SECTOR OUTPERFORM from Under Review, January 31, 2007.

Target - Reduced to \$14.00 from \$17.00 on December 2, 2007.

Price Performance



Source: Bloomberg



Orca Exploration Group Inc. **TSX-V:ORC.B** **Price \$8.00** **Rating: Sector Outperform**
Dividend: \$0.00 **Yield: 0.0%** **Implied All-in Return: 75%** **Target: \$14.00**

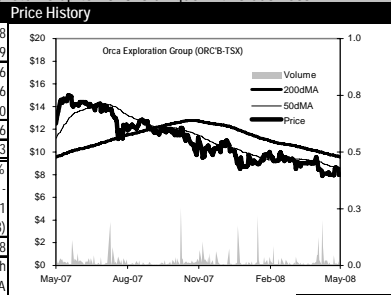
Alpha: Orca is on the cusp of signing critical gas price agreements and the first of three gas facility expansions that will lock in the growth we have been expecting. While delays have pushed the peak production date out, the asset and its value has increased. An asset that can provide steady to increasing returns up to 2026 is unique in this business.

Investment Highlights
 Orca will sign a gas price contract for a total of 44 mmcf/day starting July 1, 2008 and continuing until 2024 that includes a take or pay component for 32 mmcf/day. Two gas plant expansions from the current 70 mmcf/day, one to 90 mmcf/day by mid 2008, a second to 105 mmcf/day expected to be operational by year end 2008, provide the company with the production increase that will allow increased marketing efforts for its gas. The addition of two trains to the facility taking the total to 140 mmcf/day is expected to be signed in Q3/08 and construction completed by the end of 2009. These efforts, while delayed from previous expectations, have nevertheless gone a long way towards firming up the monetization of this valuable asset.

We do not expect the company to exercise its option to earn a 50% interest in Block EA5 in Uganda.

Capital Structure (mm\$)

Class A	1.8
Class B	27.9
Shares O/S	29.6
Options	8.8%
Warrants/Othe	0.0%
Fully Diluted	32.3
D&O % Owned (B/FD)	22%/28%
Liquidity (90dMA)	% EV
Market Capitalizat	104%
Net Debt	-4%
Enterprise Value	100%
Last Financing (Jun 07)	2.5 mm shs @ \$13.80/sh
52 wk HL	#N/A



Financial (\$mm's)

	2006	2007	2008F	2009F	% Chg '09/'08
Revenue	13.8	18.8	24.2	34.9	44%
Cash Flow	6.0	8.7	15.5	27.0	74%
CFPS Basic	\$0.26	\$0.31	\$0.52	\$0.91	75%
CFPS Diluted	\$0.24	\$0.29	\$0.50	\$0.87	74%
Consensus	\$0.24	\$0.29	\$0.75	\$1.53	104%
Earnings (loss)	2.6	1.7	5.1	13.3	161%
EPS Basic	\$0.11	\$0.06	\$0.17	\$0.45	165%
EPS Diluted	\$0.10	\$0.06	\$0.16	\$0.43	169%
Consensus	\$0.10	\$0.06	\$0.49	\$1.12	128%
Capital Expenditures - E&D	6.0	53.7	11.5	18.0	57%
Reinvestment Ratio	1.0x	6.2x	0.7x	0.7x	-10%
Capital Expenditures - incl. acq	6.0	53.7	11.5	18.0	57%
Net Debt	(20.4)	7.3	(20.7)	(29.7)	n/a
Net Debt/CF	n/m	0.8x	n/m	n/m	n/a

Netbacks (\$/boe)

	2006	2007	2008F	2009F	% Chg '09/'08
Revenue	\$17.15	\$14.57	\$13.16	\$14.04	7%
Operating Costs	\$0.98	\$0.93	\$0.69	\$0.55	-20%
Net Operating Revenue	\$16.17	\$13.65	\$12.47	\$13.49	8%
Cash Flow	\$7.40	\$6.75	\$7.37	\$9.32	26%
D&D	\$0.90	\$3.59	\$3.70	\$3.69	0%
Earnings	\$3.20	\$1.35	\$2.44	\$4.69	92%

Cash Flow Sensitivity

	2008F	2009F	% Chg CFPS 2008F	2009F
Industrial Price (\$0.25/mcf)	\$0.010	\$0.018	2.0%	1.9%
Power Price (\$0.25/mcf)	\$0.015	\$0.016	2.9%	1.7%
Addnl Gas - Ind. (1.0 mmcf/d)	\$0.075	\$0.069	14.4%	7.5%
Addnl Gas - Pow. (1.0 mmcf/d)	\$0.018	\$0.020	3.5%	2.2%

Valuation Parameters

	2006	2007	2008F	2009F	% Chg '09/'08
WTTI (US\$/bbl)	30.8x	25.8x	15.4x	8.8x	-43%
Edm LT (\$/bbl)	53.8x	45.2x	26.9x	15.4x	-43%
Bow River (\$/bbl)					
Differential (\$21.94)					
Henry Hub (US\$/mmbtu)					
AECO (\$/mcf)					
FX (US/CD)					
Target Price/CF					
Target EV/boe/d					
Prod/mm shs	82.49	119.12	194.32	271.83	40%
Reserves/sh (2P)	2.6	2.7			
Undeveloped Land/boe/d (net)	0.0	0.0			
Recycle Ratio (2P)	44.5x	2.9x			

Assumptions

	2006	2007	2008F	2009F	% Chg '09/'08
WTTI (US\$/bbl)	\$66.25	\$72.36	\$96.00	\$93.00	-3%
Edm LT (\$/bbl)	\$73.25	\$76.99	\$95.37	\$92.25	-3%
Bow River (\$/bbl)	\$51.30	\$53.09	\$70.51	\$65.02	-8%
Differential (\$21.94)					
Henry Hub (US\$/mmbtu)	\$6.98	\$6.97	\$8.75	\$8.50	-3%
AECO (\$/mcf)	\$6.53	\$6.46	\$7.91	\$7.65	-3%
FX (US/CD)	\$0.88	\$0.93	\$1.00	\$1.00	0%

Areas of Operation
 Orca's operations are focused in Tanzania where it is producing gas for electrical generation and a more recent oil exploration opportunity in Uganda. The company has an option to earn 50% in block EA5 by drilling two exploration wells on the block. At this point the company has noted the risk is higher than originally expected.



Undeveloped Land (net acres)

	2006	2007	% Chg '07/'06	Cur Est	% of Total
Songo Songo, Tanzania	0	0		0	n/a
Uganda Farm-in	0	0		747,450	n/a
Total	0	0		747,450	n/a

Orca will earn 50% in EA5, Uganda, if it elects to drill two exploration wells
 Does not include Songo Songo developed land.

Production

	2006	2007	2008F	2009F	% Chg '09/'08
Gas - Industrial (mcf/d)	4,016	4,121	4,800	7,800	63%
Gas - Power (mcf/d)	9,236	17,060	29,752	40,533	36%
Total (mcf/d)	13,252	21,181	34,552	48,333	40%
Total (boe/d)	2,209	3,530	5,759	8,056	
% Change	98%	60%	63%	40%	

Reserves (bcf)

	2006	2007	% Chg '06/'05	RLI - 2007
Proved Producing	219.5	247.6	13%	4.0
Proved Non-Prod & PUDS	46.3	60.9	32%	1.0
Total Proved	265.8	308.6	16%	5.0
Probable	149.3	165.0	11%	2.7
Proved + Probable	415.1	473.6	14%	7.6
Total (6.1, mboe)	69.2	78.9	14%	7.6

Reserve Metrics

PUD/Proved	17%	17%
Proved/2P	64%	65%
Res. Repl. Cost (2P)	\$0.36	\$4.70
3-year average	\$0.26	\$1.64
Res. Repl. Cost (incl. FDC, 2P)	n/a	n/a
3-year average	n/a	n/a
Times Prod. Replaced (2P)	20.6x	6.9x

Reserve Update & Notes

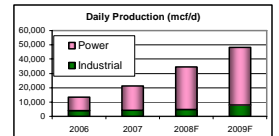
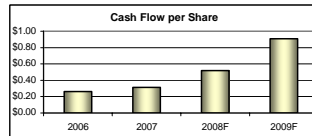
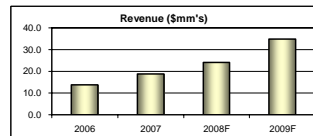
3P reserves were estimated by McDaniel at YE2007 at 781 bcf with a NPV5 value of \$557 million and NPV10 value of \$342. These values are equivalent to \$19.08 and \$11.83 per share, respectively.

Management

Peter R. Clutterback - President, CEO
Nigel A. Friend - Vice President, CFO
James Smith - VP Exploration (Tanzania)
Pierre Raillard - Vice President, Operations
David W. Ross - Corporate Secretary

Directors

W. David Lyons, Chairman
Peter R. Clutterback - President, CEO
Nigel A. Friend - Vice President, CFO
John Patterson
James N. Smith
David W. Ross - Corporate Secretary



Consensus

Average Target	\$13.50
No. Analysts	3
Sector Outperform	3
Sector Perform	0
Sector Underperform	0
Total	3

Potential Upside

Average Target	\$13.50
Potential Upside	69%

Company Website: www.orcaexploration.com
 Operating Office: 255-22-2138737 (Tanzania)

Analyst: Alan Knowles, CFA, CMA - aknowles@haywood.com, 403-509-1931
 Associate: Shane Helwer - shelwer@haywood.com, 403-509-1966





Investment Thesis

Orca has a significant natural gas reserve position (474 bcf on a 2P basis; 781 at 3P) in Tanzania. The primary market for this gas has been related to power generation. While there have been challenges with respect to the timing, in the past six months decisions related to long term pricing contracts, increasing the gas plant throughput capacity and a steady increase in demand for power have all contributed to increasing the productive potential of an asset that could deliver steady to increasing cash flow until 2026 with relatively minimal capital expenditures required – a unique situation within the oil and gas business.

Quarter Results Down Marginally From Q4 Due to Impact of Increased Hydro

Production in Q1/08 averaged 25.3 mmcf/day, a significant 38% increase year over year. Industrial related sales of 3.5 mmcf/day were up slightly from last year (4%) while power related sales increased 45%. New generators installed in the last quarter of 2007 account for the increased year over year power related volumes. Sales volumes were down 7% from the previous quarter average of 27.3 mmcf/day largely due to the impact of the rainy season, which commences mid-quarter, resulting in reduced power related consumption of natural gas in favour of hydro generation. We expect production to increase later in the second quarter and into the third quarter as the rainy season winds down and hydro generation declines.

CFPS was \$0.08 (\$0.08 diluted) in the quarter, double the Q1/07 amount and down \$0.01 from the previous quarter (\$0.00 diluted). Given the impact of increasing hydro power generation with the rainy season we had expected the quarter to post lower production and cash flow than Q4/07. Revenue for the quarter was \$5.3 million, up 38% from last year and down 5% from the previous quarter. The average gas price of \$3.38 per mcf is 6% higher than last year but down 4% from \$3.53 in Q4/07. The price for industrial related sales is indirectly related to the price of heavy fuel oil (which in turn is tied to the price of crude) and hence this price has remained strong. The price for power related sales is per agreement and may vary depending on which of six turbines are being utilized in the quarter. During Q1/08 two turbines were down for maintenance resulting in a decrease in the price paid by Tanesco to \$1.57 per mcf.

Capital expenditures were \$1.4 million in Q1/08, down materially from \$11.1 million in Q1/07 and \$16.8 million in the previous quarter. There were no drilling operations (Tanzania) being carried on or seismic (Uganda) as was the case in the comparable quarters. We expect the company's 2008 capital budget to be approximately \$10.0 million.

At March 31, 2008 the company had a net working capital position of \$8.3 million, a slight increase from the year end 2007 balance of \$7.3 million. Included in the current working capital position at March 31, 2008 is cash of \$12.5 million. The company is currently arranging a \$5.0 million short term overdraft facility. Orca has provided a \$9.4 million bank guarantee with respect to its obligations relative to the potential farm-in of the Uganda block.





Orca Exploration - Quarterly Summary (US\$000's)							ORC.B - TSXV					
							Q1/07	Q2/07	Q3/07	Q4/07	Q1/08	% Chg vs. Q1/07
Oil and Gas Revenue							3,632	3,021	6,363	5,562	5,284	45.5%
Cash Flow							1,173	1,251	3,718	2,698	2,391	103.8%
% Chg - Prev Qtr							-52%	7%	197%	-27%	-11%	
% Chg - Prev Yr							79%	-5%	137%	11%	104%	
CFPS												
Basic \$/sh							\$ 0.04	\$ 0.05	\$ 0.13	\$ 0.09	\$ 0.08	100.0%
Diluted \$/sh							\$ 0.04	\$ 0.04	\$ 0.13	\$ 0.08	\$ 0.08	100.0%
% Chg - Prev Qtr							-60%	0%	217%	-33%	-5%	
% Chg - Prev Yr							51%	-20%	111%	-15%	100%	
Net Earnings (Loss)							128	-608	1,942	283	-143	-211.7%
EPS												
Basic \$/sh							\$ 0.00	\$ (0.02)	\$ 0.07	\$ 0.01	\$ 0.00	0.0%
Diluted \$/sh							\$ 0.00	\$ (0.02)	\$ 0.06	\$ 0.01	\$ 0.00	0.0%
% Chg - Prev Qtr							n/a	n/a	n/a	-87%	n/a	
% Chg - Prev Yr							n/a	n/a	133%	-77%	0%	
Capital Expenditures							11,077	14,989	10,855	16,796	1,436	-87.0%
Net Debt (Working Capital)							(10,570)	3,050	(20,938)	(7,299)	(8,297)	-21.5%
<i>Net Debt/Cash Flow (Annualized)</i>							n/a	0.6	n/a	n/a	n/a	n/a
Production												
Natural Gas - mmcf/day												
Industrial							3.3	4.4	4.8	4.0	3.5	5.8%
Power							15.1	8.2	21.5	23.4	21.8	44.6%
							18.4	12.5	26.3	27.3	25.3	37.6%
<i>Total - boe/day</i>							3,069	2,092	4,377	4,558	4,222	37.6%
Q/Q % Change							6%	-32%	109%	4%	-7%	
% Gas							100%	100%	100%	100%	100%	
Commodity Prices - net of hedges												
Gas (US\$/mcf)												
Industrial							\$ 7.70	\$ 8.61	\$ 9.58	\$ 11.08	\$ 11.55	50.0%
Power							\$ 2.19	\$ 2.17	\$ 2.19	\$ 2.20	\$ 2.05	-6.4%
Total							\$ 3.19	\$ 4.41	\$ 3.54	\$ 3.49	\$ 3.37	5.6%
% Chg - Prev Qtr							-8%	38%	-20%	-1%	-3%	
% Chg - Prev Yr							-2%	4%	-20%	0%	6%	

Source: Orca Exploration Group and Haywood Securities

Potential Doubling of Facility Throughput to 140 mmcf/day by the end of 2009

Through several steps Orca has been working for some time to establish an agreement, and obtain approval, to increase the Songo Songo gas facility throughput capability from the current nameplate capacity of 70 mmcf/day to 140 mmcf/day.

- Two Joule-Thomson valves will be installed that will result in upgrading the throughput capacity of the two existing trains by 20 mmcf/day taking the total to 90 mmcf/day expected to be in place by the end of June this year.
- The second step involves a bypass system for a portion of the gas and allow the total capacity to increase an additional 15 mmcf/day to 105 mmcf/day. The timing depends on approval from Tanesco but is currently expected to be operational by year end 2008.





- The final and more involved step is the addition of two new trains. Tenders were received in Q3/07. This work requires the approval of Songas. Once the approval is received construction will take 15 months. The approval is expected to be received at the same time as the pricing contracts (see below) are signed in Q3/08 which could result in construction being completed by the end of 2009. These trains would take production capability at the Songo Songo facility up to 140 mmcf/day. The six Songo Songo producing wells are capable of producing 225 mmcf/day which means there is a cushion of some 85 mmcf/day should wells have to be taken off line for maintenance or other reasons.

Should Orca be able to establish a market for the maximum capacity of 140 mmcf/day in the near term it would be accretive to the net asset value (see below) of the company today. The current Protected Gas requirement at a 100% load factor is 45 mmcf/day with the most likely case being 37.4 mmcf/day or 83% of the maximum. The Additional Gas maximum would therefore be 102.6 mmcf/day which the McDaniel report does not contemplate reaching until 2016 under the 2P case (2016 2P volume is 100.3 mmcf/day).

Terms of Tanesco Gas Contracts Firmed Up

Orca has at long last firmed up the terms of its gas marketing contracts with Tanesco (Tanzanian electric power utility). The negotiations involved not only Orca and Tanesco, but also EWURA, the energy utility regulator, and the Ministry of Energy and Minerals. The contracts are expected to be signed in Q3/08.

The negotiations were protracted due to the significant increase in gas fired power generation capability in 2007 due to drought conditions in the preceding years. The gas fired power generation utilizing Orca's Additional Gas increased from 90 MW at the end of 2006 to 310 MW at the end of 2007. Of the 220 MW increase 168 MW was classified as so-called emergency generation, some of which is scheduled to be decommissioned in the coming months.

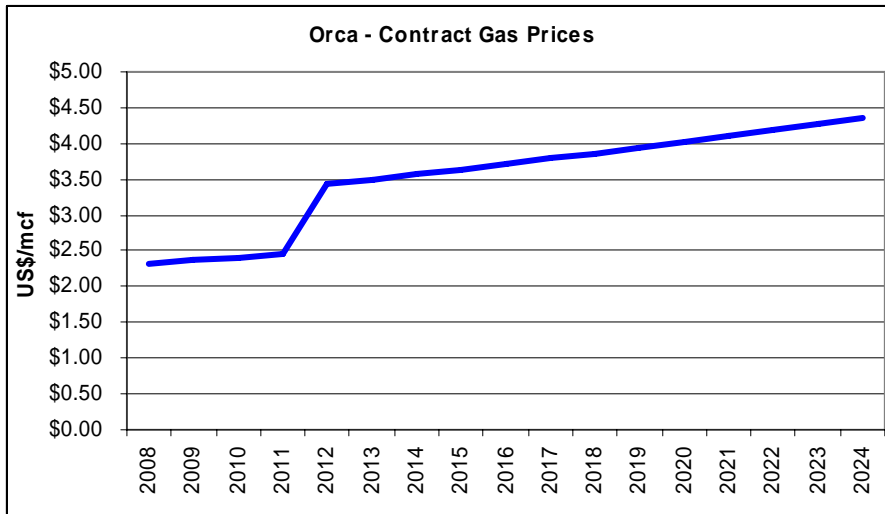
There are two contracts to cover the committed Additional Gas volumes with respect to power generation up to 44 mmcf/day, as follows:

- Sixth turbine at Ubungo (UGT 6) – 8.0 mmcf/day until July 2024, and
- Balance of gas fired generation – maximum of 36 mmcf/day, which includes a take or pay component of 32 mmcf/day until July 2023.

Pricing for both contracts is the same and starts at \$2.32 per mcf, increasing 2% per year until July 2012 when it will move up to \$3.43 per mcf and then increase 2% per year thereafter to July 2024.

The PSC expires in October 2026 which allows Orca some flexibility toward the end of the PSC period as the gas price contracts expire two years before this date. Orca intends to seek to renew the contract but it is premature at this point to estimate the likelihood of successful negotiations.





Approximately 257 bcf of natural gas (54% of the 2P volumes and 33% of the 3P volumes) is contracted over the term of the agreement out to 2024. This will result in gross revenue generation over the period (and assuming the final price continues until the expiry of the contract in October 2026) related thereto of \$962 million, or discounted NPV⁵ of \$610 million and NPV⁸ of \$481 million. These calculations of course do not include the non-contracted sales related to industrial, CNG or incremental power related volumes.

Other Additional Gas Markets Being Developed

Orca has been working for several years now on establishing a CNG (compressed natural gas) market in Tanzania. Much of the groundwork has been laid and the company believes there is the potential for ultimate CNG sales of 15.0 mmcf/day with 4.0 mmcf/day possible by the end of 2009, doubling two years later.

In association with TPDC (Tanzanian Petroleum Development Corporation) four potential markets have been identified, namely: industrials not connected to existing distribution system; hotels; vehicles and institutions. A tender was conducted for the installation of two compressors to be used for vehicle refilling. The capital cost would be \$2.5 mmcf/day for 0.7 mmcf/day of capacity to be installed by year end. Ultimately total capital expenditures approaching \$8.0 million would be required to be in a position to service 15.0 mmcf/day of CNG sales.

Industrial sales, which were 3.5 mmcf/day in Q1/08, are expected to average in the order of 5.0 to 6.0 mmcf/day this year. In addition **Wazo Hill cement plant** has added a new kiln for which Orca is currently negotiating a contract to supply 2.0 mmcf/day of Additional Gas. The plant is overhauling the two existing kilns (the 2.0 mmcf/day is a net increase taking into account the shutdown required to overhaul) in 2009 after which there would be a significant increase in Wazo Hill demand for Additional Gas from Orca.





Guidance on Heels of Signing Gas Price Contract and Facility Expansion is Robust

Given the expected timing for signing of the gas price contracts and increases in facility capacity, discussed above, Orca has provided the following guidance with respect to expected sales, as follows:

2008 – 32.2 to 42.5 mmcf/day;

2009 – 43.0 to 57.0 mmcf/day.

These estimates compare very favourably to 21.2 mmcf/day in 2007. The majority of the overall increase relates to increased power related demand, with lesser volumes coming from increases in industrial and CNG related sales.

Orca Guidance - Potential Additional Gas Sales 2008-2009

	2007A	2008		2009	
		Low	High	Low	High
Industrial	4.1	5.0	7.0	7.0	11.0
Power	17.1	27.0	35.0	35.0	41.0
CNG	0.0	0.2	0.5	1.0	5.0
	21.2	32.2	42.5	43.0	57.0
Chg vs. 2007		52%	100%	103%	169%

Assumes: signing of power contracts in Q3/08.
expansion of Songo Songo capacity to 90 mmcf/day by
June 30, 2008.

Source: Orca Exploration and Haywood Securities

TanESCO's current forecast calls for the creation of an additional 150 MW of power generation by 2011, which could be natural gas fuelled. Orca plans to discuss a contract to supply natural gas for this project after the signing of the current contracts. Any natural gas contracted to the above would not likely be available until after the new trains are installed at the Songo Songo facility and be accretive to the company's guidance.

Uganda Still Being Evaluated – West Africa Exposure Possible

Orca is still evaluating the 300 km of 2D seismic acquired over **Exploration Area 5 in Uganda** late in 2007 as part of its farm in option on Tower. The company has until June to elect to drill two exploration wells and therefore earn a 50% working interest in the block. At year end the company commented that while several potential structures had been identified, the risk related hydrocarbon maturation on this block was greater than originally anticipated. Given this, and that the election deadline is fast approaching we caution investors to be prepared for the company to not proceed with this exploration effort.

In the meantime Orca has been evaluating opportunities in **West Africa**. The company expects to close on a development opportunity before the end of 2008 for an asset that would be capable of having first production within two years.





Net Asset Value Well Above Current Share Price

Orca's ability to monetize its asset base has been the victim of various delays including the expansion of the much needed power generating ability in the country, the expansion of the facility at Songo Songo and of course a signed gas price contract to protect the company's interest. It has been our experience that business in Africa has its own time frame, one that is considerably slower than what we have come to expect in the west. We have not included a value for the company's option to explore in Uganda.

The company's reserve life index on a 2P basis at the end of 2007 (using Q4/07 production as the denominator) was 47.4 years, and on a 3P basis, 78.2 years. There is no doubt Orca has plenty of room to expand its production base as the PSC still has 18 years to run.

In the past four years (2007 vs. 2003) the company's 2P reserves have increased 82% and the 3P reserves are up 31%. While the company completed a workover on SS 9 and drilled SS 10 in 2007, both of these activities had been contemplated as development type activities in each of year's reserve report. The real contributor to growth has been reservoir performance – which has been greater than originally expected.

The value of the reserves has increased at a greater rate than the volumes as the company firmed up its gas price contracts. The price deck used by McDaniel for the year end 2007 was substantially the same as the contracted price discussed above and therefore is for all intents and purposes up to date.

The NPV of the reserves using a 5% discount rate is \$372 million, a 54% increase from last year and a 308% increase over the past four years. The 3P value (NPV5) – which we would argue is a reasonable basis to value this asset given its history – is \$557 million. The comparable values using a 10% discount rate are \$255 million under a 2P basis and \$342 million under a 3P basis.



**Orca Exploration - Reserves Summary - (Gross Before Royalties)**

		To End of Licence - October 2026					% Change	
		2003	2004	2005	2006	2007	'07/'03	'07/'06
		McDaniel	McDaniel	McDaniel	McDaniel	McDaniel		
Independent Engineers		03-12-31	04-12-31	05-12-31	06-12-31	07-12-31		
As At								
Reserves Balance								
Additional Gas (bcf)								
Proved Producing		0.0	124.6	179.8	219.5	247.6		13%
Proved Non-Producing		0.0	0.0	0.0	0.0	0.0		n/a
Proved Undeveloped		85.3	46.6	60.7	46.3	60.9		32%
Proved		85.3	171.2	240.6	266.0	308.6	262%	16%
Probable		174.2	84.2	79.4	149.0	165.0	-5%	11%
2P		259.6	255.4	320.0	415.0	473.6	82%	14%
Possible ⁽¹⁾		335.9				307.1		-9%
3P		595.5				780.7		31%
Engineering Value - Additional Gas (\$USmm)								
5% Proved		17.7	51.7	103.1	154.9	256.8	1352%	66%
2P		91.0	64.7	141.2	241.7	371.6	308%	54%
3P ⁽¹⁾						556.7		
10% Proved		7.6	35.5	67.7	109.0	182.7	2298%	68%
P+P		46.4	43.4	83.8	158.7	254.9	449%	61%
3P ⁽¹⁾						342.0		
Price Assumptions - Additional Gas (2P) US\$/mcf								
Songo Songo	Year 1	\$ 2.50	\$ 3.96	\$ 3.92	\$ 3.51	\$ 3.52	41%	0%
	Year 2	\$ 2.55	\$ 2.75	\$ 3.76	\$ 3.34	\$ 3.74	47%	12%
	Year 3	\$ 2.60	\$ 2.51	\$ 3.01	\$ 3.18	\$ 3.85	48%	21%
	Year 4	\$ 2.65	\$ 2.52	\$ 3.01	\$ 3.13	\$ 3.76	42%	20%
	Year 5	\$ 2.71	\$ 2.56	\$ 3.08	\$ 3.31	\$ 4.12	52%	24%
Reserve Life Index (years)								
Proved			403.0	56.9	41.8	30.9	n/a	-26%
2P			601.2	75.6	65.2	47.4	n/a	-14%
3P						78.2	n/a	n/a
	Q4 Production (mcf/day)		1,164	11,590	17,435	27,348	n/a	50%

(1) 2007 Possible reserves estimate assumes extension of the PSC and hence is life of field vs. life of licence as for 2P.

Source: Orca Exploration and Haywood Securities

These values are significant when reviewed on a per share basis. At a 5% discount rate, the 2P and 3P value per share is, respectively, \$12.83 and \$19.08, and at a 10% discount rate, \$8.89 and \$11.83. At the current price of \$8.00 we would argue that the shares are definitely undervalued against their asset value, especially given the fact that several issues that had previously caused delays in monetizing this asset (discussed above) appear to be resolved and a timetable is in place to accelerate the growth in production.

But the existing reserves at Songo Songo are not the whole story. The company has two more wells on its agenda – one, **Songo Songo North**, is an extension of the existing Songo Songo field, and the second, **Songo Songo West** which is a separate prospect located two km west of Songo Songo. Orca is attempting to source a suitable jack-up rig to drill these two wells. At this point in time we would not expect to see them spud before Q2/09.

Reserves related to Songo Songo North are included in the 3P estimate this year. However Songo Songo West has not been included. The data obtained from drilling SS 10, as well as the





positive results (albeit a smaller discovery) in a nearby block by a competitor have helped the company better understand this prospect and reduced the drilling risk.

The most likely estimate of OGIP (original gas in place) at Songo Songo West is 600 bcf (with the minimum at 93 bcf (still commercial) and the maximum at 1,070 bcf -1.1 tcf). Assuming a 70% recovery factor the most likely case could result in an increase 420 bcf or 89% to the 2007 2P reserves and a 54% increase to the 3P volumes. In our net asset value calculation below we have assumed a 50% chance of success in drilling this well, although the company's estimate would be higher, which would add between \$3.43 and \$5.01 per share to the company's net asset value.

Based on the above we estimate the company's net asset value at \$14.06 using a 10% discount rate and \$22.11 using a 5% discount rate.

Orca - Net Asset Value					
	bcf	<u>\$millions</u>		<u>\$/Share</u>	
		5%	10%	5%	10%
2P Reserves Value per McDaniel	473.6	371.6	254.9	\$ 12.55	\$ 8.61
Net Working Capital at March 31, 2008		8.3	8.3	\$ 0.28	\$ 0.28
Net Asset Value - 2P		379.9	263.2	\$ 12.83	\$ 8.89
Possible Reserves Value per McDaniel	307.1	185.1	87.1	\$ 6.25	\$ 2.94
Net Asset Value - 3P	780.7	565.0	350.3	\$ 19.08	\$ 11.83
Songo Songo West (SSW) Addition					
Potential OGIP, Most Likely Case	600				
Recovery Factor	70%				
	420				
Chance of Success	50%				
	210				
Potential Value of SSW using 90% of Songo Songo per mcf ⁽²⁾		148.3	101.7	\$ 5.01	\$ 3.43
Net Asset Value - including potential of SSW		713.3	452.0	\$ 24.09	\$ 15.26
Shares outstanding (CI A and B; mm's)	29.6				
Stock Options	9.6%	2.8	4.5		
Fully Diluted		32.5	4.5		
Net Asset Value - Fully Diluted		717.8	456.5	\$ 22.11	\$ 14.06
Net Asset Value - Fully Diluted; Excluding SSW		569.5	354.8	\$ 17.54	\$ 10.93

(1) Amounts per McDaniel using forecast prices; Orca does not pay royalties and its share of Profit Gas is increased for any income tax paid, hence the values are both Before and After Tax (i.e. Orca is income tax neutral). The valuation is net of Additional Profits Tax. As minimal capital investment is assumed in this analysis, additional capital investment by Orca will enhance the NPV due to the benefit of being allowed an annual return of 25% plus the annual PPI on its capital invested.

(2) NPV per mcf per McDaniel (US\$/mcf) \$ 0.78 \$ 0.54

(3) McDaniel report is prepared in US\$. We have assumed a CD/US foreign exchange rate of 1.0000.

Source: Orca Exploration and Haywood Securities





Update to Our Forecast

We have updated our forecast in response to firming up the timing of the Songo Songo facility expansion and the gas price contract. The net result is that our 2008 production decreases 27% to 34.6 mmcf/day (from 47.1 mmcf/day) and 2009 production decreases 23% to 48.3 mmcf (from 63.2 mmcf/day). Essentially the expected growth has been pushed out one year.

As a result of the change in production our CFPS forecast is also revised downwards, with 2008F CFPS moving to \$0.52 (diluted \$0.50) from \$0.97 (diluted \$0.92) and 2009F to \$0.91 (diluted \$0.87) from \$1.55 (diluted \$1.48).

Despite the change in our forecast we are maintaining our target price of \$14.00 and our rating of Sector Outperform. The underlying value of the assets has not been eroded, in fact quite the contrary given the gas price contract and plans to expand the Songo Songo facility.





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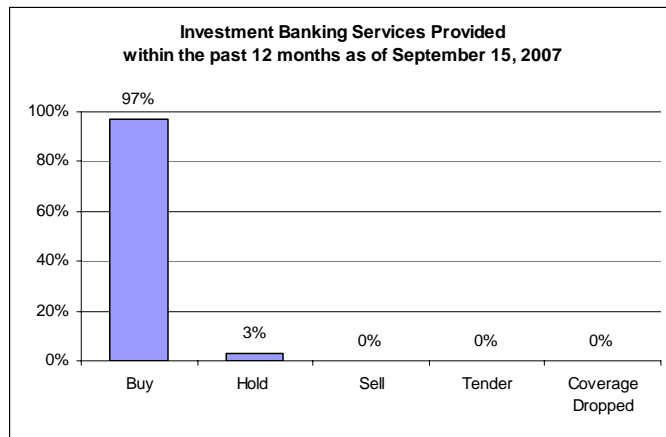
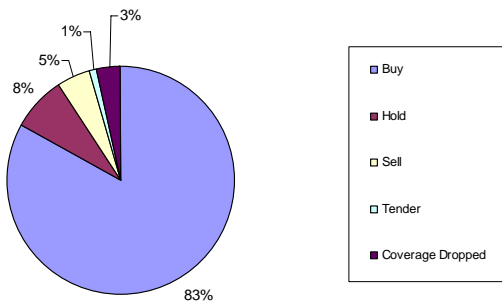
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