

ORCA EXPLORATION GROUP INC.

ORC.B-TSX V: \$6.98 — **BUY**

TARGET PRICE: \$11.50; PROJECTED RETURN: 65%

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PRODUCTION CONTINUES TO GROW IN TANZANIA

EVENT – Q2 RESULTS

Production averaged 14.2 mmcf/d, which was below our estimate of 18.5 mmcf/d. Above-average rains were experienced throughout the quarter, resulting in a higher hydro-generation utilization rate. Natural gas sales to the power sector have rebounded in Q3 with the start of the dry season.

IMPACT – LOWERING PRODUCTION AND CASH-FLOW ESTIMATES

We have lowered our 2008 production estimate from 32.2 mmcf/d to 26.0 mmcf/d and our 2008 cash-flow estimate from \$16.1 million (\$0.52/fd share) to \$13.0 million (\$0.42/fd share). To account for the delay in the expansion of processing facilities, we have lowered our 2009 production estimate from 48.0 mmcf/d to 40.0 mmcf/d and our 2009 cash-flow estimate from \$30.0 million (\$0.97/fd share) to \$25.6 million (\$0.87/fd share).

VALUATION – RISKED NET ASSET VALUE UNCHANGED

Our risked net asset value is based upon the estimated proven and probable reserves adjusted for net working capital or debt, plus risked potential for near-term exploration drilling. Our risked NAV is \$11.47/fd share.

RECOMMENDATION – MAINTAIN BUY AND TARGET PRICE

The market for natural gas is expanding with the power sector, and as a result, we expect that Orca's production will steadily increase for many years. In order to diversify its production mix and opportunity base, Orca continues to evaluate new projects in Sub-Saharan Africa, including a lower risk, potentially early commercialization opportunity offshore West Africa. We maintain our **BUY** recommendation on the B shares and our \$11.50 target price.

VALUATION CATALYSTS – NEW EXPLORATION PROJECT AND EXPLORATION AT SONGO SONGO

We feel that a new exploration project area would drive the story in the short term. In addition, Orca's production should continue to grow with the power market in Tanzania. In Q2/09, Orca plans to drill the high-impact Songo Songo West exploration prospect.

Financial Metrics (C\$)

Shares O/S (mm)*:	29.6	Mkt. Cap (\$ mm):	\$206.7
FD Shares (mm):	32.5	W.Capital (\$ mm)**:	\$6.1
Float (mm)	23.3	Ent.Value (\$ mm):	\$200.6
52-Wk High:	\$13.00	52-Wk Low:	\$6.75

* 27.9 million Class B shares and 1.75 million Class A shares.

**Positive working capital as of June 30, 2008

FY December 31	2007A	2008E	2009E	2010E
Production				
Liquids (bbl/d)	-	-	-	-
Gas (mmcf/d)	21.2	26.2	40.0	57.0
Boe/d (6:1)	3,530	4,369	6,667	9,500
Financials				
Cash Flow (C\$ mm)	\$9.2	\$13.0	\$25.6	\$36.3
CFPS (FD)	\$0.31	\$0.42	\$0.82	\$1.17
EPS (FD)	\$0.06	\$0.22	\$0.56	\$0.82
EV/DACF	24.6x	15.8x	7.0x	4.6x
D/CF	4.3x	0.0x	-1.0x	-1.0x
2008 Quarters				
	Q1A	Q2A	Q3E	Q4E
Liquids (bbl/d)	-	-	-	-
Gas (mmcf/d)	25.3	14.2	28.0	36.5
Boe/d (6:1)	4,217	2,367	4,667	6,083
CFPS (FD)	\$0.08	\$0.05	\$0.12	\$0.17

Target Valuation Parameter

1.0 x Risked NAV/fd share



Courtesy of BigCharts.com

Key Risks

Although the expansion of processing and transportation infrastructure projects is currently on schedule in Tanzania, unforeseen construction issues could delay production and cash-flow growth.

Corporate Profile

Orca Exploration Group Inc. (www.orcaexploration.com) is an international oil and gas exploration and production company that produces and markets natural gas in Tanzania.

Multiple Share Structure

Orca has a two-share structure: 1.75 million Class A shares are outstanding with 20 votes each, and 27.9 million Class B single-voting shares. The Non-Executive Chairman of Orca holds 99.5% of the Class A shares and 17.5% of the outstanding Class B shares.

NATURAL GAS SALES

Industrial demand: During the second quarter, Orca supplied 3.7 mmcf/d of natural gas to industrial customers in Dar es Salaam at an average price of US\$12.97/mcf. The natural gas price for industrial users fluctuates with the price of oil. Orca recently signed new contracts with its largest industrial customers to extend their term for an additional five years. The company also finalized negotiations with Twiga Cement, Tanzania’s largest cement manufacturer, to provide gas to its new kiln at Wazo Hill. The new cement plant is expected to be operational in Q2/09.

Power generation demand: Power sector natural gas sales in Q2 averaged 10.5 mmcf/d. Orca supplied natural gas to the power sector at an average price of US\$2.93/mcf. The TANESCO Wärtsilä 100 MW plant is now commissioned and fully operational, which should increase demand for Orca’s natural gas.

Songo Songo West Exploration: Using existing and new 2D seismic data, Orca identified the Songo Songo West (SSW) exploration prospect, which is located approximately 2 kilometres west of the producing Songo Songo field. Orca estimates that the SSW prospect could have gas in place of 600 bcf. An independent resource assessment is in process and the results are expected to be announced at the end of Q3/08. Orca is in the process of securing a jackup rig and plans to drill the Songo Songo West prospect in the second half of 2009. A substantial portion of drilling materials for this program is already stockpiled on Songo Songo Island.

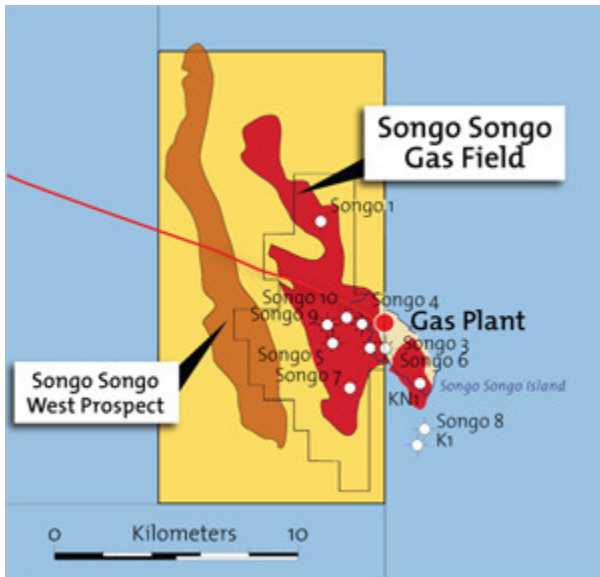


Figure 1. Songo Songo Field
 Source. Company reports

Expanding processing capacity: Orca is currently upgrading the two gas processing trains on Songo Songo Island. Capacity is expected to increase from 70 mmcf/d to 90 mmcf/d later this year. On the longer term, Orca plans to install two new gas processing trains to increase throughput capacity to more than 140 mmcf/d.

Orca elects not to drill in Uganda: Early in 2008, Orca participated in the acquisition of 300 kms of 2D seismic in Exploration Area 5 located in northwestern Uganda. After completion of the technical review of the data, Orca elected not to proceed with a 2-well drilling program and therefore has no further interest in Uganda. The seismic did identify a number of structures; however, Orca felt that the level of risk was too high to warrant the cost of the drilling program. Orca continues to evaluate a number of opportunities in Sub-Saharan Africa, including an offshore West Africa play, which the company regards as lower risk.



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