

### Texalta Petroleum Ltd. (TSX.V: TEX-A) – Initiating Coverage; Exposure to Highly Prospective Underexplored Basin in Northern Territory, Australia

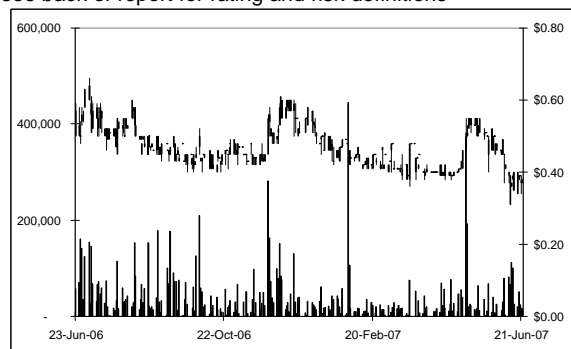
Sector/Industry: Junior Oil & Gas

[www.texalta.com](http://www.texalta.com)

#### Market Data (as of June 27, 2007)

Current Price	C\$0.38
Fair Value	C\$0.60
Rating*	BUY
Risk*	5 (Highly Spec)
52 Week Range	C\$0.31 – C\$0.61
Shares O/S	34,717,365
Market Cap	C\$13.19 mm
Current Yield	N/A
P/E	N/A
P/B	2.41
YoY Return	-32.1%
YoY TSX	21.2%

\*see back of report for rating and risk definitions



#### Investment Highlights

- Texalta holds a 100% interest in two 5 - year exploration permits covering 5.5 million acres of land in the Georgina Basin, located south east of Northern Territory, Australia. The Georgina Basin is a vast, overlooked and largely unexplored area with good shallow oil potential.
- Texalta received the permits in late 2006, and is now reprocessing and interpreting existing 2D seismic data. The company is hoping to identify locations for extensive seismic work and identify wildcat drilling locations for 2008, based on the study.
- The company also has interests in eight prospective areas, covering 9,000 acres, in the greater Carlyle and Alameda areas in southeast Saskatchewan. Texalta has been operating in the area since 1983, and has been producing on a small-scale for a number of years. The company's extensive experience (more than 23 years), combined with seismic information give the company considerable competitive advantages to increase production in the area.
- Texalta is in a good cash position. The company's cash on hand at the end of Q3-2007 (March 2007), and cash from operations will be sufficient to fund the company's current exploration and development program.

#### Risks

- Texalta carries all the risks associated with an exploration and production company.
- The Georgina Basin is an underexplored basin, and we believe Texalta will likely have to joint venture the project.
- Infrastructure is limited in the Northern Territory compared to other major petroleum regions.

#### Key Financial Data (FYE - June 30)

(C\$)	2003	2004	2005	2006	2007E	2008E
Revenue	472,165	582,509	517,753	638,549	1,781,467	3,187,000
Net Income	(60,544)	(8,579)	(131,427)	(24,961)	146,733	489,093
Cash	50,529	47,768	-	1,471,231	3,507,978	3,865,530
Working Capital	14,256	(274,265)	(200,312)	537,408	3,049,867	2,706,210
Total Assets	1,241,711	1,477,415	1,530,084	3,648,341	7,461,606	9,635,932

Texalta Petroleum Ltd. is a junior oil and gas company with some interesting exploration and development projects in the Northern Territory of Australia. The risks associated with exploration are offset by the company's interest in several existing producing wells in southeastern Saskatchewan, Canada.

**Company  
Overview**

Texalta Petroleum Ltd. is a junior oil and gas company with exploration and development projects in Northern Territory, Australia and southeastern Saskatchewan. The project in Northern Territory, Australia, located in the Georgina Basin, is a speculative exploration stage project with a good upside potential. Major companies including Santos (ASX: STO) and Magellan Petroleum Australia have interests in producing fields in similar basins in the Northern Territory. There has been a significant increase in interest in the area recently. According to the Northern Territory Government, about 90% of the territory's prospective onshore basins are currently under license or application, versus less than 10% a few years ago. Texalta strategically offsets the risks associated with exploration through its interests in several existing producing wells in southeastern Saskatchewan, Canada.

Texalta holds a 100% interest in two, 5-year exploration permits (EP 103 and EP 104), covering about 5.5 million acres of land, in the Georgina Basin, located south east of Northern Territory of Australia. The Georgina Basin, which covers most of the central-eastern Northern Territory, is one of the most prospective undeveloped onshore petroleum provinces in the Northern Territory. The basin has no current or historic production, and there have been limited exploration activities in the past. Although the basin has not had any discoveries yet, the location of the basin, and information on the very little exploration work done in the past, including 2D seismic data, suggests the presence of active Cambrian era petroleum systems in the region. Texalta was granted the exploration permits in late 2006. The latter half of 2007 will be a very important period for the company as the company reprocesses and interprets existing 2D seismic data. Texalta hopes to identify locations for extensive seismic work and identify wildcat drilling locations for 2008, based on the study.

Texalta has interests in eight prospective areas in the greater Carlyle and Alameda areas in southeast Saskatchewan covering almost 9,000 acres. The company has been operating in the area since 1983, and has been producing on a small-scale for a number of years. Based on average production of 38 bpd net in this area, Texalta had average revenues of \$0.55 million per year during 2003-06. Currently, two of the eight properties, the Wordsworth and West Queensdale properties, are producing. The company plans to drill a total of five wells on three properties in 2007. We expect 2007 exit production to be about 175 bpd net, and FY2008 average production to be about 140 bpd net (compared to average production of 30 bpd in FY2006). Our revenue forecasts for FY2007, and FY2008, are \$1.78 million, and \$3.18 million, respectively (up from \$0.64 million in FY2006).

The company, based in Calgary, Canada, was incorporated in 1987 and began trading on the Alberta Stock Exchange in 1989. The company currently trades on the TSX Venture Exchange under the symbol TEX.A.

**Investment Highlights:**

- The Georgina Basin project is a speculative project with good upside potential. Texalta is one of the early movers in an underexplored region that has potential to hold significant reserves. According to the Northern Territory Government, individual trapping situations

in the Georgina basin hold about 100 mm boe in oil and gas at 300-900m depths. Although exploration risks are high, we believe, the risk is worth taking, as success in the project will add significant value to the company.

- The company has more than 23 years of geological expertise operating in Saskatchewan, Canada. The company's extensive experience combined with seismic information give the company a considerable competitive advantage in the area. Texalta is planning to drill four more wells in Saskatchewan in 2007. We expect to see a significant increase in production and revenues in FY2008.
- Texalta is in a good cash position. We expect that the company's cash on hand at the end of Q3-2007 (March 2007), and cash from operations, will be sufficient to fund the company's current exploration and development program.
- Our outlook on short-term and long-term oil and gas prices in Canada is positive based on positive supply-demand conditions. However, based on expectations of a natural gas supply surplus in Australia/New Zealand, we expect natural gas prices in Australia to maintain or soften from current price levels while oil prices remain strong. As the company's project in Australia is an oil *and* gas project, and we do not yet know if production will be more heavily weighted towards oil or gas, we cannot determine whether strong oil prices or weak gas prices will have a larger effect on the company.

*Georgina Basin, Australia – Speculative project with good upside*

**Based on our valuation models and analysis of the company's projects, we initiate coverage on Texalta with a BUY rating and a fair value estimate of \$0.60 per share (Risk 5: Highly Speculative).**

The map below shows the location of the Georgina Basin, inclusive of Texalta's EP 103 and EP 104.



Source: Texalta

**Georgina Basin – Highly prospective underexplored basin**

The Northern Territory contains four major onshore sedimentary basins which are prospective for hydrocarbons – the Amadeus, Georgina, Wise and Eromanga/Pedirka Basins. The Amadeus Basin is the only basin that is currently producing, while the Georgina and Pedirka Basins are considered to have good potential to hold significant oil reserves.

The Georgina Basin, which covers most of the central-eastern Northern Territory, is a huge (100,000km<sup>2</sup>), overlooked, and largely underexplored province. The basin is one of the several large intracratonic basins found in central Australia that are filled mainly with Paleozoic and Precambrian sediments (about 1,250 m thick). Intracratonic basins are worldwide in occurrence, and are normally found within continent interiors, and away from plate boundaries. The economic potential for hydrocarbons and coal in the basin is considered to be high. Other famous intracratonic basins are the highly productive Williston Basin (located in North Dakota, Montana and Saskatchewan) and the Parana Basin in South America. Both the Williston and the Georgina basin areas contain massive source rocks. **The Cambrian strata of the Arthur Creek (Georgina Basin) are considered to be similar to the Mississippian succession of Western Canada that has produced more than 10 tcf of gas and 1 billion bbl of oil.**

There is no current or historic production, and petroleum infrastructure is limited in the Georgina Basin. Exploration activities in the past have been very limited (18 wells at a well-density of one per 5,500 sq. km) due to the large size of the basin and lack of infrastructure and information. None of the previous wells tested a valid structural closure. Only 750 km of 2D seismic data exists for a prospective area of 100,000 sq. km.

Although the basin has not had any discovery yet, the location of the basin, and information from the very little exploration work conducted in the past, including 2D seismic data, suggest the presence of active Cambrian era petroleum systems in the region with oil-mature source rocks and reservoirs occurring at shallow depths. The region is supposed to have all the requisites needed for oil/gas entrapment, migration and production. **Individual trapping situations in the Georgina basin hold about 100 mm boe in oil and gas at 300-900 m depth**

**According to the Northern Territory Government, about 90% of the Territory's prospective onshore basins are currently under license or application, versus less than 10% a few years ago.** The significant increase in land area under license or application shows the growing interest in exploration in this area. The Northern Territory government is supportive of exploration initiatives, and we expect infrastructure to improve significantly as new discoveries are made in the area.

**Ownership**

Texalta and three other partners applied to the Department of Primary Industry, Fisheries and Mines of the Northern Territory Government for two exploration Permits, EPA 103 and 104. in 2001. Texalta was initially the operating partner, with a 50% working interest (WI) in the .

The permitting process, however, was delayed, due to long delays in negotiations over the compensation agreement (based on future production revenues) with the Central Land Council, which represents the Australian native groups that hold surface rights throughout the region. In July 2006, after almost five years, the parties signed a Native Title Agreement, including a Tripartite Deed. By October 2006, Texalta and its partners were granted exploration permits for Blocks 103 and 104.

Upon receipt of the permits, Texalta acquired the remaining 50% WI by paying the three partners 0.5 million common shares and 0.5 million warrants with an exercise price of \$1.75 per share (term of 2 years). The 5-year permits include a work program consisting of reprocessing of existing seismic, additional seismic and the drilling of structural test wells.

### Location and Infrastructure

Blocks EP 103 and EP 104, which primarily cover flat deserts and semi-deserts, are located about 250 km to the east of Alice Springs (the closest city). Two highways (Plenty Highway and Sandover Highway) cross the blocks. The map below shows the location of the blocks and the existing pipelines to the closest producing fields in the Amadeus Basin.



Source: NTGS

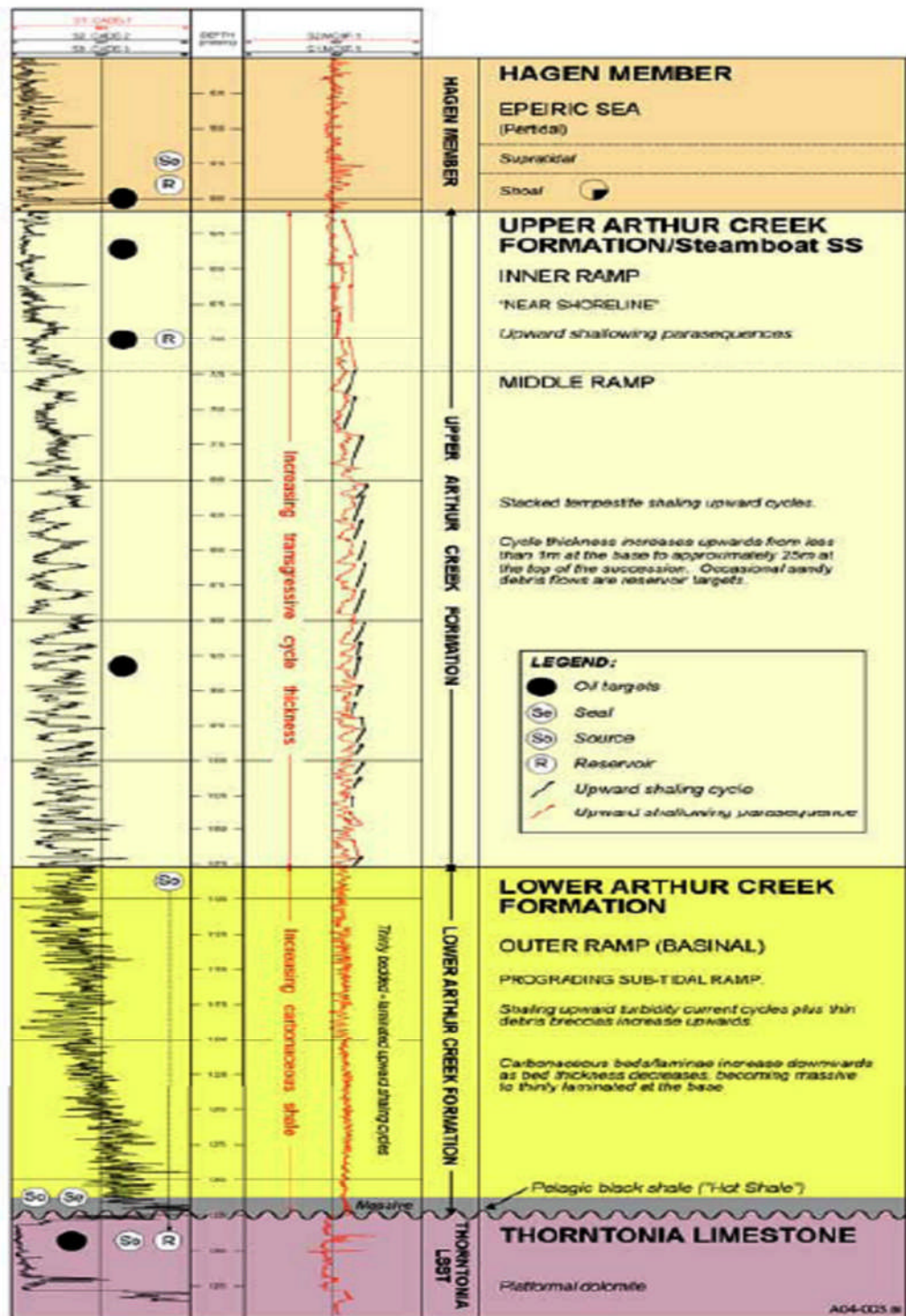
Since there are no producing fields close to Texalta's areas of interest, there is no pipeline that traverses close to EPA 103 and 104. However, a gas pipeline from Ballera to Mount Isa crosses parts of the Georgina basin. Also, a new pipeline has been proposed to transport natural gas from the offshore Northern Territory fields to the Cooper Basin in South Australia. Gas transported to the Cooper Basin will then be connected to the existing distribution system serving Adelaide, Melbourne, Sydney and Brisbane. This proposed pipeline is expected to pass through the northeast portion of Texalta's EPA 104. The produced crude oil will be initially trucked to the facilities at Alice Springs, which is 200km away, until the proposed pipeline into the Cooper Basin comes on stream.

### **Producing Areas in the Amadeus Basin**

The closest producing fields to Texalta's areas of interest are the Palm Valley Field (230 bcf) and the Mereenie Gas and Oil fields (Initial in-place reserves - 185.6 mmbbl oil and 436 bcf gas), located 150 km and 250 km, respectively, west of Alice Springs within the Amadeus Basin. (*Reserves numbers are According to Geoscience Department of Primary Industry, Fisheries and Mines, Northern Territory Government*). Both fields are operated by Santos and Magellan Petroleum Australia. The principal reservoir of both fields is the latest Cambrian-Early Ordovician Pacoota Sandstone, which were sourced from the Early Ordovician Horn Valley Siltstone. The Mereenie Oil and Gas field was the first gas field to be discovered (1964). The Palm Valley field was discovered in 1965. Produced gas is transported to Alice Springs and Darwin by transmission pipeline (as shown in the map on the previous page).

### **Geology**

The basin includes source rocks, reservoirs, and seals (to entrap hydrocarbons and hold oil and gas accumulations). Several potential reservoirs exist within the areas; the major ones being - the highly prospective Thornton Limestone (laterally extensive), upper Arthur Creek Formation (highly porous and permeable grainstone interbeds and lenses), and Hagen Member. (as shown in the picture on the next page).



Source: NTGS

The Georgina basin comprises a succession of Neoproterozoic, Cambrian and Ordovician – Devonian carbonate and clastic sediments, of which the Cambrian succession is the most prospective. The base of the Cambrian succession is marked by coarse siliciclastic rocks which lie beneath a platform of carbonate rocks of Early to Middle Cambrian age. The Middle Cambrian carbonate succession, which comprises the Thornton Limestone and Arthur Creek Formation, provides a reservoir - source/seal couplet. The outer ramp of the lower Arthur Creek Formation and the upper portion of the Thornton Limestone contains the most important source rock. The lower Arthur Creek Formation provides a regional seal to the underlying Thornton Limestone. Similar plays are considered to occur in the Hagen Member zone.

We believe that oil and gas in the field can be recovered with conventional recovery methods.

### Texalta's Work Plan

Texalta has access to all the data related to the 18 wells previously drilled in the basin. Also, the company has data on 75 km of 2D seismic shot in the area. The company hopes to simplify existing stratigraphy based on available electric log data, seismic and newly acquired aeromagnetic data. The closest significant hydrocarbon show to the EPA 103 and 104 blocks was in the Euthabuka-1 well, located a few kilometers east of the Northern Territory - Queensland border. Gas flowed at 6 - 7 cu. m per day (from the Ordovician Kelly Creek sandstone); however, commercial viability was not proved.

Texalta might face challenges in identifying hydrocarbon traps, as the well density in the region is sparse, and the seismic shot in the area only covers a small portion of the land. The table below shows the company's minimum work requirements along with costs for the 5-year permits.

Year of Term Permit	Minimum Work Requirements	Cost <sup>x</sup>
	Seismic Reprocessing, Interpretation of	
2007	Airborne Geophysics	\$100,000
2008	Acquire 100 km seismic	\$500,000
2009	Drill one exploration well	\$500,000
2010	Acquire 100 km seismic	\$500,000
2011	Drill one exploration well	\$500,000
	<b>Total Expenditures</b>	<b>\$2,100,000</b>

x - Minimum cost requirements for each year

The company is currently working on reprocessing and interpreting existing 2D seismic data to identify traps for the already identified reservoir-quality rocks. The study is expected to be completed by the end of summer 2007. Texalta expects to identify locations for extensive seismic work and identify wildcat drilling locations (for 2008) after the study is completed. **We expect Texalta to joint venture the project, once potential drilling locations are identified.**

**Conclusion:** We believe the Georgina Basin project is a speculative project with good upside potential. Texalta is one of the early movers into an under explored region that holds the potential to hold significant reserves. The latter half of 2007 will be a very important period for the company as it tries to determine the long-term potential of the project. We believe that favorable results from the study will add significant value to the company.

***Southeast  
Saskatchewan,  
Canada –  
Producing  
Projects***

Texalta has interests in eight prospective areas in the greater Carlyle and Alameda areas in southeast Saskatchewan covering almost 9,000 acres of oil and gas leases. The map below shows the company's area of operation.



Source: Texalta

Texalta is the operator of most of the projects, with working interests ranging from 25% to 75%. The eight fields of interest are – Wordsworth, West Queensdale, West Wildwood, Willmar North, South Wildwood, East Carlyle, Wauchope and South Queensdale. Texalta drilled its first well in the area in 1983. The company's projects have been producing on a small-scale for a number of years. Based on average production of 38 bpd net, Texalta had average revenues of \$0.55 million during 2003-06. Currently, two of the eight properties, the Wordsworth and West Queensdale properties, are producing. Production in Q3-2007 from these projects was 85 bpd net. (up from 25 bpd net in the comparable period in the previous year)

During FY2006, Texalta participated in the drilling of 3 gross wells. The company plans to drill five wells (it has already drilled one) on these properties in 2007. Texalta has more than 23 years of geological expertise operating in Saskatchewan, Canada. We believe **the company's extensive experience combined with seismic information give it a**

**considerable competitive advantage needed to increase production in the area.**

Although the company's projects in Saskatchewan have lower upside potential compared to the project in NT, Australia, we believe, the company's interest in several producing wells in Saskatchewan offsets some of the risks associated with the company's exploration stage projects in Australia.

**Reserve Estimates:** According to a reserve report prepared by GLJ Petroleum Consultants, the Wordsworth and West Queensdale properties hold about 75,000 bbl of recoverable proved reserves and 70,000 bbl of probable reserves.

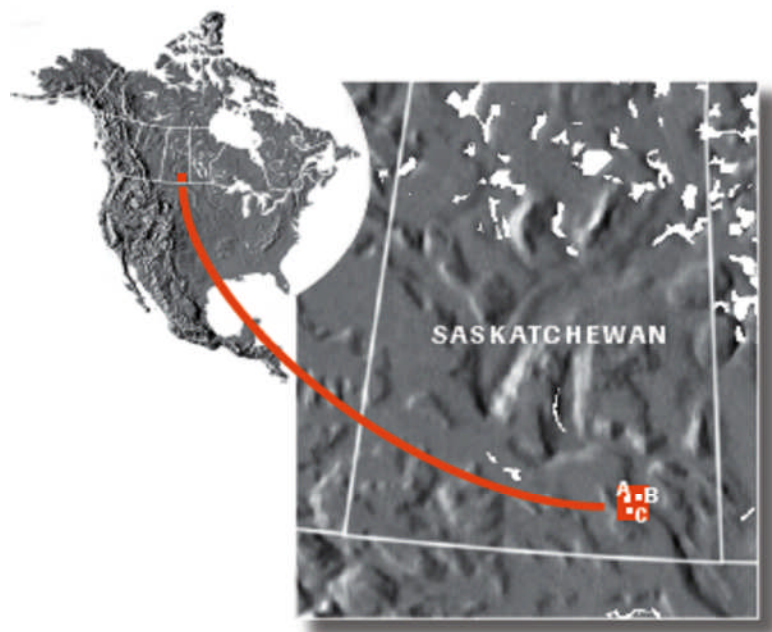
**Horizontal Drilling in Saskatchewan:** Horizontal drilling is very common in the area as it has significantly higher recovery rates compared to vertical wells. The cost of drilling a horizontal well has also dropped to about 1.25 to 1.5 times the cost of drilling a vertical well. Also, the Saskatchewan government provides tax benefits to oil and gas companies drilling horizontal wells, which further encourages E&P companies to pursue horizontal drilling instead of vertical drilling.

Horizontal wells in the area, however, experience rapid decline rates in the first year, after which, the wells continue to produce at a lower flow rate for several years. Long-term sustainable average production per well is normally below 100 bpd in the area. One challenge with horizontal drilling is that flow rates decline as reservoir pressure declines due to other offsetting horizontal wells drilled in the area.

In the next section, we present details on four projects that the company is currently focused on. We believe these have the highest potential at this time.

**Wordsworth – Producing Property**

Texalta is an operating partner with a 47.5% WI in the Wordsworth property that covers 4,000 acres of land. The area, which is defined by seismic, contains a previously abandoned well, which has a 7m thick payzone that was overlooked. The region in the abandoned well is considered to have good reservoir potential based on a sample of oil stained dolomite reservoir rocks and significant electric log anomalies. The map on the next page shows the location of the company's projects.



*A – Wordsworth, B – West Queensdale, C – West Wildwood*

**Discovery well was drilled in May 2006:** The discovery well (a horizontal well) in the area, drilled in May 2006, resulted in a new pool discovery. The well, HZ 2A2-23, drilled to 2,033 m, encountered 300m of potential oil play in the horizontal section. Initial test results gave a flow rate of 800 bpd gross. However, the well was put into production at a much lower rate of 220 bpd gross, which is a typical characteristic of horizontal wells in the area. In order to stabilize production, a permanent hydraulic pumping unit was installed in October 2006. Like other horizontal wells in the area, we believe the well is currently flowing at below 100 bpd gross.

Drilling of the **second well** (located on the north side of the property) began in April 2007. Texalta was expecting the second well to be similar to the discovery well, as the well had encountered two oil-saturated zones that were similar to the ones in the discovery well. However, the well was swab tested at a rate of 250bpd at 8% oil, which is very low for commercial oil production. Even though the well was acidised (with 11 cu. m of 15% of HCl), oil productability was not improved. The company now plans to convert this well to a water injector to dispose salt water from the first well and other future producers. The injector well, when operational, is expected to save about \$8,000 per month in salt water trucking costs for the discovery well. Water injection will also be useful to maintain reservoir pressure and production.

Texalta and partners intend to focus to the south and east of the discovery well to locate the next development wells in this project. The company and its partners are planning to drill up to eight additional horizontal development wells (one in 2007), in addition to additional seismic. Texalta's cost to drill one well in the area is estimated to be \$0.50 million.

**West Queensdale – Producing Property**

Texalta has a 16.05% - 71.6% WI in about 1,440 acres of land in the area. The field has six horizontal wells and seven vertical producing wells. The property has a gas treatment plant (replacement value of \$1 mm). All the oil produced from Texalta and partners are treated and sold in this facility, which is connected to a producer's pipeline.

The most recent drilling in the area involved two horizontal step-out development wells (Texalta has a 25.55% WI), which were drilled close to a producing well, the Alida Oil well (8-25). The Alida well, which was put into production in summer 2005, produces from the Mississippian Alida formation. It had encountered a 10m thick hydrocarbon zone at the top of the Mississippian Alida formation. The payzone of the well is very similar to another of Texalta's producing wells (4-25-602 W2 well), which was drilled in 1983, and has produced 190,000 bbl of oil to date. A very porous vugular dolomite lying 4m above the targeted zone indicated the presence of a good reservoir. The well was producing 30 bpd of oil and 50mcf per day (8.3 boepd) of natural gas, as of September 2006.

The first well (HZ1A9), which was drilled to 1,845 m, started producing in December 2006 at about 120 boepd gross. Since this well is located close to the Alida oil well, the well was tied in immediately to allow for gathering and sales of the associated gas, thereby eliminating transportation costs.

The second well (HZ4A9), which was drilled to 1,770m, and located 0.5 miles north of the first well, was spudded in February 2007. The well was swab tested at rates over 130 bbl/d of oil, and was put into production. However, accurate oil measurement was not possible due to high initial gas production rates. We expect this well to flow at similar rates as the first well (HZ1A9 well).

Texalta is expecting each of the horizontal wells to hold about 300,000 barrels. The company's cost of drilling a horizontal well in the area is approximately \$375,000. Texalta has plans to drill two additional wells (costing Texalta \$700,000) in 2007.

**West Wildwood – Development Stage**

Texalta is the operator of the 800 acre property with a 50% WI. The company is planning to drill a horizontal well in the area, at about 1,100 m southeast of an abandoned well that had a 7m thick pay zone. A 1-mile long southwest-to-northeast trending structural feature with the abandoned well was indicated by seismic. Test data from the abandoned well and core analysis confirm the presence of a good reservoir and oil saturation parameters in the location.

Texalta expects the field to hold 300,000 boe per well. The proposed horizontal well drilling is expected to commence in the first week of July 2007, as a drilling rig becomes available. The company expects to spend about \$0.5 million on the well.

### Willmar North – Development Stage

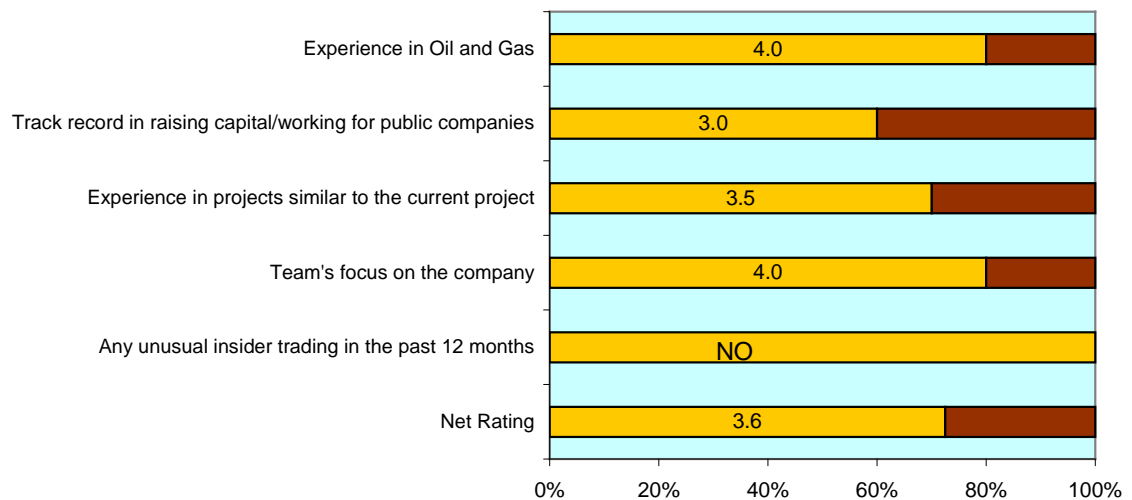
The company is the operator and has a 50% WI in this property, which is a relatively smaller play compared to the other projects. Texalta is targeting the Kisbey sandstone in the field. An analogous reservoir is located 2 miles south, at the Willmar Kisbey Voluntary unit. Production in the pool started in 1965. The previously drilled six wells in the area had long well lives and produced a total of more than 1.2 mmoeb. The company has data on 2D seismic shot in the area, in addition to information on two offsetting wells.

A wildcat drilling location was identified using 2D seismic data. The company and its partners are planning to drill a vertical well (1,200 m) on the identified location. Texalta and partners believe that the well holds about 1 mmoeb.

### Management and Board of Directors

A strong management team is vital for any junior oil and gas exploration and production company. Our rating for Texalta's management is 3.6 (out of 5.0), which we have rated as 'Above Average'. Our proprietary management rating system (shown below) quantitatively assesses the strength of the company's management based on a number of factors, including technical experience, the ability to raise capital, any unusual insider trading by management, and various other factors.

Management Rating



Brief biographies of management and the board of directors, supplied by Texalta, follow.

### William H. Nixon: President, CEO, Oil Exploration Geologist, Member AAPG and CSPG

Mr. William H. Nixon (President and CEO), a professional oil exploration geologist, has been President and a Director of Texalta since 1988. Mr. Nixon is also President and a Director of Petrex Energy Ltd. The two associated companies are active in oil and gas

exploration in Alberta and Saskatchewan, where both companies have successfully located oil and gas reserves. Mr. Nixon is a graduate of Queen's University and is a Professional Geologist whose early career training was obtained by working with California Standard Oil and Esso Overseas in southeast Asia and Europe. President and principal of Petrex Energy Ltd. (incorporated 1970), a private company involved in development and promotion of exploratory plays in Western Canada. Most efforts are directed at central and eastern Alberta. Past President of Medcon Petroleum Ltd., a private company which participated in the management of private drilling funds and successfully located oil and gas deposits which led to the formation of a public company, Medcon Resources Ltd., in 1980. Medcon were participants in the drilling funds and other partners enjoyed profits as a result of the success of Medcon Petroleum Ltd. exploratory programs. Medcon Resources Ltd. was involved with exploration work in Western Australia and participated in the discovery of the Tubridgi Gas Field, a field of about 150 bcf size in the onshore Carnarvon Basin.

**Dr. Peter A. Hiron: Physician, Sault Ste. Marie, Ontario**

A director of Texalta since September of 1988, Dr. Hiron graduated medicine from McGill University in 1969 and is a practicing Physician. Dr. Hiron became involved with Texalta prior to it's becoming a public company as President of Texalta Resources Ltd. and the founder of "Drilling Fund 1", which during the early 1980's was a drilling fund used to explore, drill and develop more than 15 wells in Alberta and Saskatchewan. This fund was the foundation for Texalta in its early stages of growth.

**Richard C. Brown: Professional Geologist, Calgary, Alberta**

A director of Texalta since January 2005, Mr. Brown is a graduate of Queen's University with a B.Sc in Geology whose career has spanned the globe from the Yukon when in 1962 he was a Geologist with Texaco Exploration Canada Ltd. to Australia when in 1975, he became joint owner of Medcon Petroleum Ltd. In 1973, Mr. Brown formed Simcoe Resources Ltd., a privately owned exploration company which he continues to operate today.

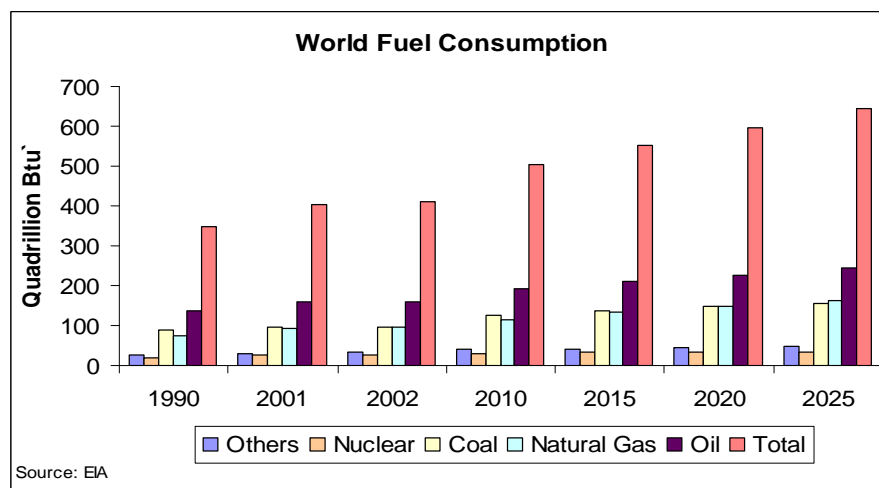
**Hugh S. Klaassen: Professional Engineer, Calgary, Alberta**

Appointed to the Board of Directors in July 2006, from 2000 until 2004, Mr. Klaassen was the Corporate Operating Officer of Paramount Resources Ltd. in Calgary. His 18 year tenure at Paramount involved projects in Northern Alberta, Northeastern British Columbia and Liard / Colville, North West Territories where he managed negotiations with Territorial Governments, Federal and Provincial Regulators and Native communities. Mr. Klaassen is a graduate in Engineering from the University of Alberta (1965) and has worked in the oil industry with several companies as a Drilling Engineer, Project Engineer, Senior Design Engineer and Manager of Operations and was President of OFC Engineering and Construction Ltd. from 1974 to 1982

**Commodity  
Price Forecast**

**Growing World Fuel Consumption:** According to the Energy Information Association (EIA), total world consumption of fuel will increase at an average rate of 2% per annum and reach 503 quadrillion British thermal units (btu) in 2010, and 645 quadrillion btu in 2025, compared to 440 (approx.) quadrillion btu at the end of 2005. Global natural gas

consumption is predicted to increase by 2.3% per annum, while oil consumption is predicted to increase by 1.9% p.a. through 2025. The chart below shows the predicted increase in demand of various fuels through 2025.



Emerging countries in Asia are expected to experience the highest growth at 3.5% per annum, with Africa (2.7% p.a.) and the Middle East (2.5% p.a.) coming next. North American consumption is expected to grow at 1.4% p.a.

### Outlook on Natural Gas

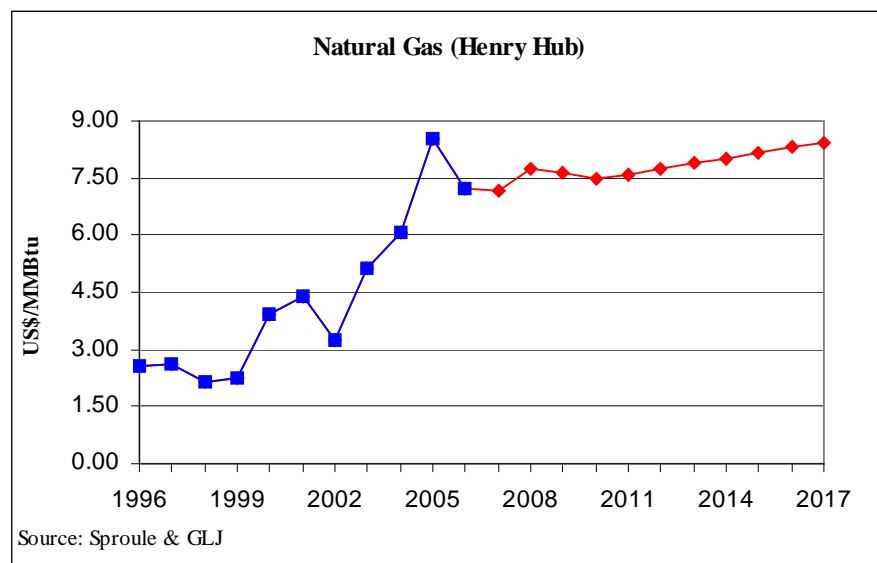
**Supply and Demand of Natural Gas:** Natural gas around the world is priced based on regional fundamentals (supply and demand), i.e., the prices vary from region to region because other than a small amount of LNG, it is hard to arbitrage gas. We believe that a study of supply and demand for natural gas in the regions where Texalta has its properties will help us predict the direction of future natural gas prices applicable to Texalta.

The table below shows the supply and demand forecast of Natural Gas in North America and Australia/New Zealand (NZ), according to the EIA.

Natural Gas Supply and Demand - in trillion cu. feet							
	2003	2010	2015	2020	2025	2030	2003-30 % increase p.a.
<b>North America</b>							
Production	27.1	26.4	28.1	29.3	29.9	30.4	0.4%
Consumption	27.4	29.6	32.7	34.7	35.7	36.6	1.1%
Deficit	-0.3	-3.2	-4.6	-5.4	-5.8	-6.2	
<b>Australia/NZ</b>							
Production	1.4	2.3	3.1	3.8	4.2	4.6	4.5%
Consumption	1.1	1.1	1.3	1.5	1.6	1.7	1.7%
Surplus	0.3	1.2	1.8	2.3	2.6	2.9	

The table shows that there is an expected deficit in the supply of natural gas in North America, whereas a supply surplus is expected in Australia/NZ in the short-term and long-term.

**Price Forecasts:** Lower natural gas prices have led to a decrease in drilling activity. We believe that a relatively milder winter all around the world and short-term inventory surpluses are responsible for the relatively low prices of natural gas compared to 2005. However, prices are still above historical averages. The chart below shows historic and forecast prices for Henry Hub natural gas. Average prices in 2006 were US\$7.23/mmbtu, compared to US\$2.55/mmbtu in 1996, which represents a 183.5% increase. The chart shows that prices are expected to remain above historic average prices (US\$4.37/mmbtu during 1996-2006) through to 2017.



Although Henry Hub prices are different from gas prices in Saskatchewan, Canada and Northern Territory, Australia, we expect gas prices in Saskatchewan, Canada (Alberta AECO – C) to be highly correlated to Henry Hub, based on supply-demand forecasts for North America. However, based on expectations of a supply surplus in Australia/NZ, we expect natural gas prices in Australia to stabilize or soften from current price levels.

### Outlook on Oil

**World Supply and Demand of Oil:** Unlike natural gas, crude oil prices are affected by the worldwide supply and demand of oil. Prices worldwide tend to move in tandem because of the ability to transport oil more readily than natural gas. The section below presents the forecasted world supply and demand of oil till 2030.

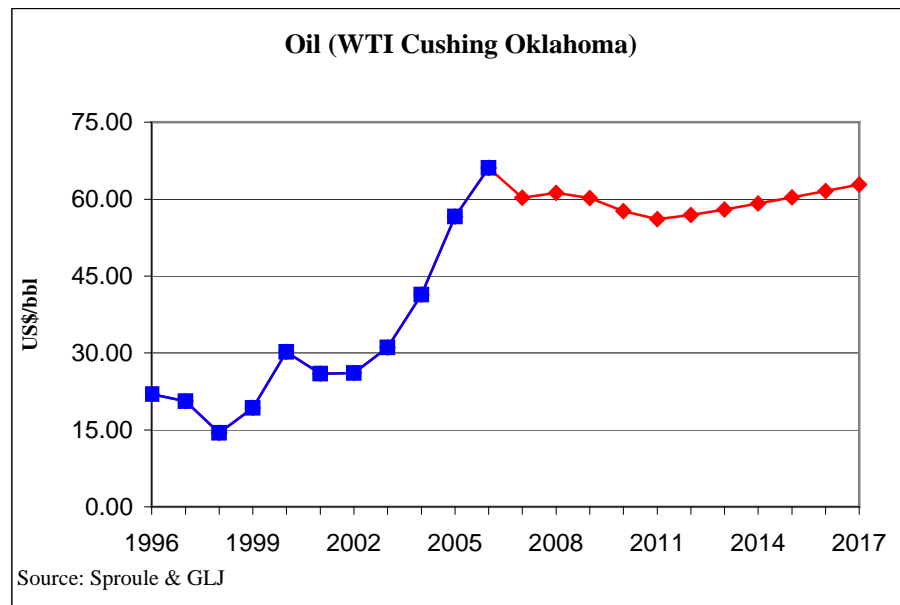
Production is expected to grow at a slower pace than consumption. The table on the next page shows the expected growth in global production. According to the EIA, global production capacity is expected to rise from 82.3 million bpd in 2003, to 123.30 million bpd by 2030 (CAGR of 1.5%). Production capacity is expected to increase at a slightly faster rate in OPEC countries (1.6%), while growth in OECD countries is relatively lower (0.4%).

World Oil Production Capacity (1990 - 2030) - mmbpd								
	1990	2003	2010	2015	2020	2025	2030	CAGR 2003-2030
OPEC	27.10	33.00	39.90	42.80	43.90	46.70	50.70	1.6%
OECD	20.10	23.20	24.30	24.70	25.50	26.00	26.10	0.4%
World	69.5	82.30	94.30	101.60	107.60	114.90	123.30	1.5%

Source: EIA

The global consumption of oil is expected to rise by a CAGR of 1.9% during 2002-2025. The supply-demand forecasts show that prices will likely stay at current levels or appreciate going forward.

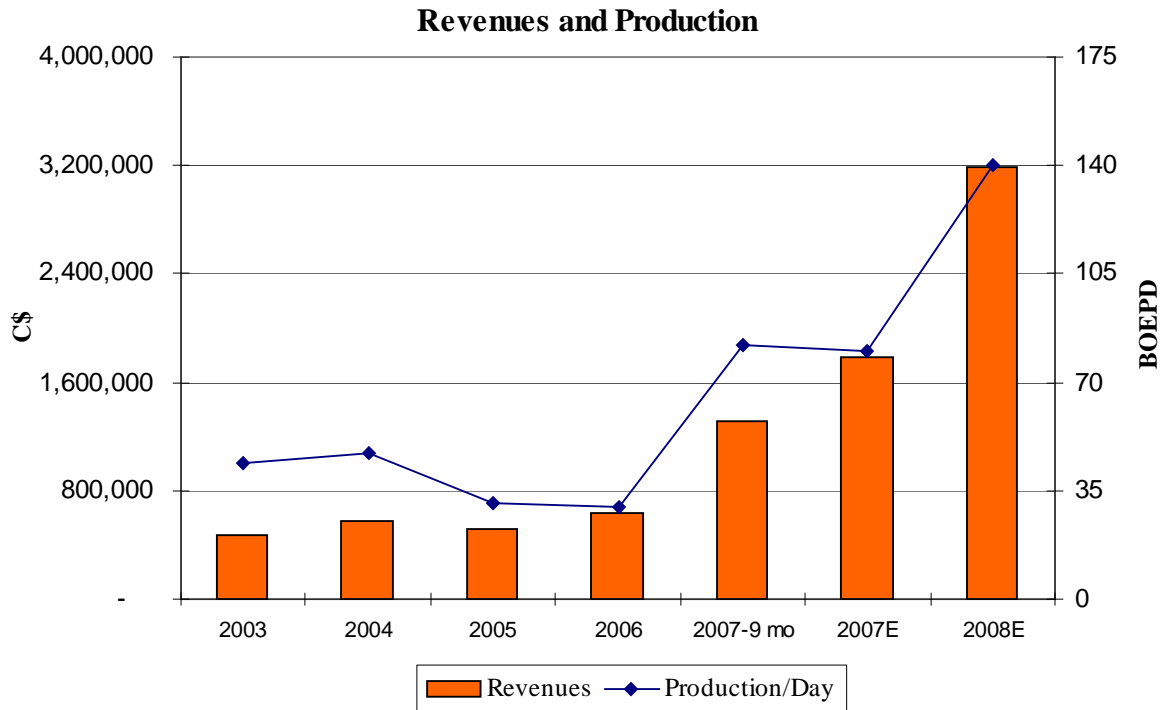
**Price Forecasts:** Based on fundamentals, we expect prices to stay above historical averages (\$32.16/bbl during 1997-2006) through 2017. The chart below shows historic and forecast prices for WTI Crude oil. The average WTI Cushing Oklahoma oil price in 2006 was US\$66.09/bbl, compared to US\$56.58/bbl in 2005, an increase of 16.7%. As of May 29, 2007, WTI crude was US\$63.15/bbl versus an average price of US\$30.22/bbl in 2000. As with Henry Hub natural gas prices, oil prices are expected to remain above historical averages (US\$32.16/bbl during 1996-2006) and stay around US\$60/bbl through 2017.



**Conclusion:** Our outlook on short-term and long-term oil and gas prices in Canada is positive based on positive supply-demand conditions. However, based on expectations of a natural gas supply surplus in Australia/New Zealand, we expect natural gas prices in Australia to maintain or soften from current price levels while oil prices remain strong. As the company's project in Australia is an oil *and* gas project, and we do not yet know if production will be more heavily weighted towards oil or gas, we cannot determine whether strong oil prices or weak gas prices will have a larger effect on the company.

**Financials**

**Revenues:** Texalta has been generating revenues for a number of years through its interest in several producing wells in Saskatchewan. The table below shows the company's revenues and production per day since 2003.



As shown in the chart, revenues and production per day were stable during 2003-2006. However, revenues increased significantly in the first 9 months of FY2007, due to a significant increase in production. Production for the first 9 months of FY2007 was 82 boepd versus 25 boepd in the same period in the previous year. Revenues for the 9-month period in FY2007 were \$1.32 million versus \$0.36 million in the comparable period in the previous year. Production in 2007 increased due to an increase in production on the Wordsworth and West Queensdale properties (1 horizontal well on each property).

The company is planning to drill 4 more wells in 2007 – one on Wordsworth, two on West Queensdale and one on West Wildwood. Since we have more confidence in the West Queensdale project (as both the previous wells were successful and are currently producing at 120 bpd net), our model assumes that only the two wells on the West Queensdale project will be successful. Based on this assumption, we estimate 2007 exit production to be about 175 bpd net, and FY2008 average production to be about 140 bpd net. **Our revenue forecasts for FY2007, and FY2008, are \$1.78 million and \$3.18 million, respectively.**

**Margins:** The table on the next page shows the company's margins since 2003. As shown in the table, margins improved significantly as production increased in the first 9 months of FY2007.

Margins	2003	2004	2005	2006	2006 (9 mo)	2007 (9 mo)	2007E	2008E
Gross	72.1%	78.0%	71.1%	75.7%	71.3%	82.7%	80.0%	75.0%
EBITDA	39.1%	45.3%	24.5%	30.1%	9.0%	55.3%	52.0%	47.0%
EBIT	-16.6%	1.2%	-45.7%	-13.9%	-33.3%	13.6%	12.7%	23.6%
Net	-12.8%	-1.5%	-25.4%	-3.9%	-17.3%	4.2%	8.2%	15.3%

Margins increased primarily due to an increase in operating netback in the first 9 months of FY2007, from \$37/boe to \$46/boe. The table below shows the company's netbacks (per boe) since 2003. As shown in the table, operating netbacks increased due to higher commodity prices per boe, and lower operating costs per boe.

Margins	2003	2004	2005	2006	2006 (9 mo)	2007 (9 mo)
Revenue / boe	27	34	46	56	52	56
Cost / boe	8	7	13	14	15	10
Operating Netback	20	26	33	41	37	46

General and Administrative (G&A) expenses in the 9-month period ended December 2006 were \$0.19 million (14.5% of revenues) versus \$0.14 million (39.5% of revenues) in the comparable period in the previous year.

**EPS Forecasts:** The company reported net income of \$0.05 million in the 9-month period in 2007, versus a net loss of \$0.06 million in the comparable period in the previous year. **Our forecasts for net income in FY2007, and FY2008, are \$0.15 million (eps: \$0.00) and \$0.49 million (eps: \$0.01), respectively.**

**Cash Flows and most recent financings:** In the first 9 months of FY2007, the company spent \$0.58 million on operating activities (working capital investment was \$1.33 million). The company spent an additional \$0.91 million on property and equipment in the first 9 months of FY2007, compared to \$0.13 million in the comparable period in the previous year. All cash for investing and operating activities in the 9-month period in FY2007 was funded through the exercise of warrants. Texalta raised \$2.81 million through the exercise of 7.50 million warrants at a weighted average exercise price of \$0.37 per share during the period. We expect the company to spend approximately \$2.0 million on capital expenditures in FY2007.

**Cash and Liquidity Position:** At the end of Q3-2007, the company had cash and working Capital of \$2.59 million and \$2.99 million, respectively, compared to \$1.47 million and \$0.54 million, at the end of FY2006. The table on the next page shows the company's cash and liquidity position.

Liquidity Position	2003	2004	2005	2006	2007E	2008E
Cash	50,529	47,768	-	1,471,231	3,507,978	3,865,530
Working Capital	14,256	(274,265)	(200,312)	537,408	3,049,867	2,706,210
Current Ratio	1.10	0.22	0.28	1.46	3.61	2.11
Debt	-	-	257,942	-	-	-
Debt / Capital	-	-	16.9%	-	-	-

The company was debt-free at the end of Q3-2007. Texalta has negotiated a revolving credit facility of \$0.3 million bearing interest at prime plus 1.5% per annum, secured by a fixed and floating charge debenture of \$1.0 million over certain assets of the company. At the end of March 2007, no amount was drawn from this credit facility.

**Issuer course bid:** In January 2007, Texalta initiated a normal course issuer bid, intending to acquire up to 1.7 million (5% of outstanding Class A shares as of January 2007) Class A shares. The bid will expire in January 2008. The issuer course bid reflects the company's belief that the fair value of the outstanding stock is higher than the current market price.

**Stock Options and Warrants:** At the end of March 2007, the company had 2.80 million stock options outstanding with exercise prices ranging between \$0.10 - \$0.45 per share, and maturity periods between March 2009 and October 2010. The company had 0.24 million warrants outstanding with an exercise price of \$0.20, and maturing in September 2007. Also, 1.3 million additional warrants were outstanding with an exercise price of \$1.75 per share, and expiring in December 2008.

**Conclusion:** We expect that the company's cash on hand and cash from operations in FY2007 will be sufficient to fund its current exploration and development program.

## Valuation

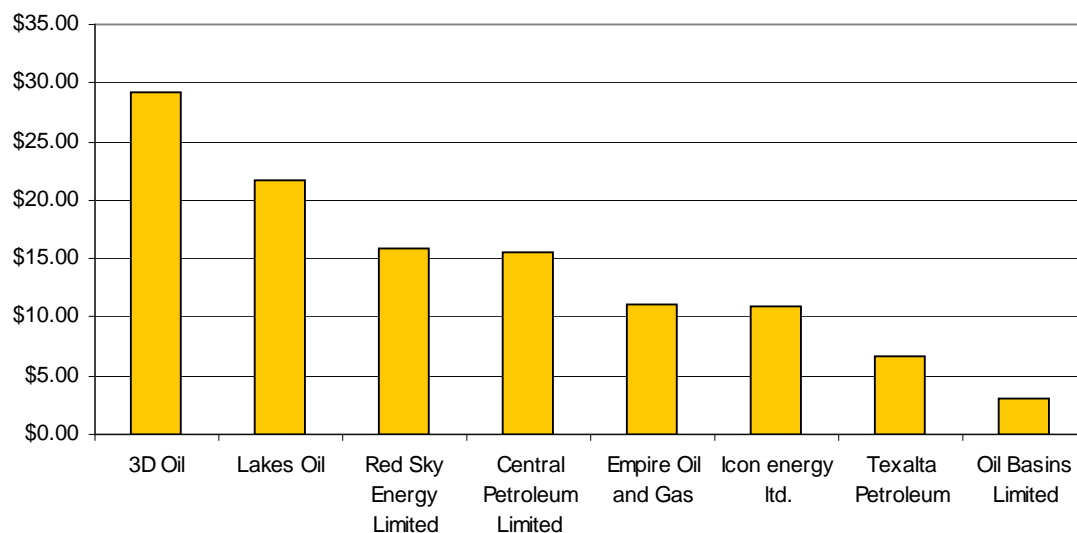
**Valuation of the producing properties in Saskatchewan:** Since only two (the Wordsworth and West Queensdale properties) of the eight properties in Saskatchewan have known reserve estimates at this time, for conservatism, we consider only those two properties in our valuation at this time. We value the two properties based on the average ratio of enterprise value (EV) to reserve estimates (boe) of companies operating in Western Canada.

The two producing properties in Saskatchewan are estimated to have proved and probable reserves of 145,000 bbl. **Based on an average EV/boe of 27.0 (average is based on 12 companies operating in Western Canada), we believe the fair value of the producing properties in Saskatchewan should be \$3.91 million, or \$0.11 per share.**

Company (Ticker Symbol)	EV/BOE
ZCO	9.8
RE	13.1
EXA	20.4
BEN	20.9
STY	20.8
GPP	20.9
IXL	29.9
BVX	34.0
GNY	34.5
ITX	37.8
RSX	37.1
WTL	44.6
<b>Average</b>	<b>27.0</b>

**Valuation of the projects in the Georgina Basin:** Since the company's properties in the Georgina Basin, Northern Territory are in very early stages of exploration and development, we believe the value of the projects at this time should be equal to the average enterprise value (market capitalization + debt – cash) of comparable companies with exploration permits in Australia. The chart below show the enterprise value of comparables compared to the adjusted market valuation of Texalta's Georgina Basin property (market capitalization – cash – our valuation of the company's properties in Saskatchewan).

Enterprise Value of Comparables (in C\$ mm)



*The value of Texalta is the adjusted market valuation of the company's Georgina Basin properties.*

The adjusted market valuation of Texalta's project in the Georgina Basin is lower than six of the seven comparables that we have used in this analysis. Based on an average enterprise

value of \$14.25 million, we believe the fair value of the company's project in the Georgina Basin is \$0.41 per share.

Adding working capital to our fair value estimates of the company's projects, we believe the fair value of Texalta at this time is \$0.61 per share. The table below shows a summary of our valuation.

<b>Valuation Summary</b>	<b>Value per share</b>
Georgina Basin Project	\$0.41
Producing Properties in Saskatchewan	\$0.11
Working Capital	\$0.09
<b>Fair value of the company</b>	<b>\$0.61</b>

### **Rating**

**Based on our valuation models and analysis of the company's projects, we initiate coverage on Texalta with a BUY rating and a fair value estimate of \$0.60 per share.** Our fair value estimate reflects an upside potential of 57.9% from current price levels. We expect the stock to move closer to our fair value estimate as production increases in Saskatchewan and/or the current study on the projects in the Georgina Basin yields favorable results.

### **Risks**

The following risks, though not exhaustive, will cause our estimates to differ from actual results:

- Texalta is exposed to all the risks associated with any other exploration and production company.
- The Georgina Basin is an underexplored basin, and we believe Texalta will likely have to joint venture the project.
- Infrastructure is limited in the Northern Territory compared to other major petroleum regions.
- While we expect the company to have sufficient cash going forward, access to capital is crucial to be able to continue pursuing exploration and development programs.
- Volatility in commodity prices – As revenues are directly related to commodity prices, growth and profitability of the company will depend heavily on oil and gas prices in Canada and Australia.

**Based on the above-mentioned risks we rate the shares Risk 5 (Highly Speculative).**

**APPENDIX****Texalta Petroleum Ltd. - Income Statement  
(in C\$)**

	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007E</b>	<b>2008E</b>
<b>Revenues</b>						
Oil and Gas Sales	541,690	672,187	611,505	693,547	1,875,926	3,391,707
Less: Royalties	(96,647)	(101,653)	(111,490)	(107,524)	(189,911)	(343,362)
Royalty Income	20,142	11,843	17,635	22,877	20,983	37,938
Other Income	6,980	132	103	29,649	74,469	100,718
	<b>472,165</b>	<b>582,509</b>	<b>517,753</b>	<b>638,549</b>	<b>1,781,467</b>	<b>3,187,000</b>
<b>Operating Expenses</b>	131,611	128,101	149,395	155,085	356,293	796,750
<b>Gross Margin</b>	<b>340,554</b>	<b>454,408</b>	<b>368,358</b>	<b>483,464</b>	<b>1,425,174</b>	<b>2,390,250</b>
Stock Based Compensation		17,600	53,000	83,500	231,591	414,310
General and Administrative	155,899	173,215	188,731	207,448	267,220	478,050
<b>EBITDA</b>	<b>184,655</b>	<b>263,593</b>	<b>126,627</b>	<b>192,516</b>	<b>926,363</b>	<b>1,497,890</b>
Depletion, Depreciation and Accretion	262,801	256,682	363,093	281,520	700,620	745,439
<b>EBIT</b>	<b>(78,146)</b>	<b>6,911</b>	<b>(236,466)</b>	<b>(89,004)</b>	<b>225,743</b>	<b>752,450</b>
<b>Income Taxes</b>						
Current	(38,327)	5,830				
Future	22,659	9,660	(105,039)	(64,043)	79,010	263,358
<b>Net Income (Loss)</b>	<b>(60,544)</b>	<b>(8,579)</b>	<b>(131,427)</b>	<b>(24,961)</b>	<b>146,733</b>	<b>489,093</b>
Loss per Share	-	-	(0.01)	-	-	0.01

**Texalta Petroleum Ltd. - Balance Sheet**  
**(in C\$)**

	2003	2004	2005	2006	2007E	2008E
<b>Assets</b>						
<b>Current Assets</b>						
Cash	50,529	47,768	-	1,471,231	3,507,978	3,865,530
Accounts Receivables	101,139	30,979	77,707	235,449	712,587	1,274,800
	<b>151,668</b>	<b>78,747</b>	<b>77,707</b>	<b>1,706,680</b>	<b>4,220,565</b>	<b>5,140,330</b>
Property and Equipment	1,090,043	1,398,668	1,452,377	1,941,661	3,241,041	4,495,602
	<b>1,241,711</b>	<b>1,477,415</b>	<b>1,530,084</b>	<b>3,648,341</b>	<b>7,461,606</b>	<b>9,635,932</b>
<b>Liabilities</b>						
<b>Current Liabilities</b>						
Bank Loan and Advances		-	257,942	-		
Accounts Payable and Accrued Liabilities	137,412	353,012	20,077	1,169,272	1,022,006	2,285,428
Income Taxes Payables			-		148,692	148,692
	<b>137,412</b>	<b>353,012</b>	<b>278,019</b>	<b>1,169,272</b>	<b>1,170,698</b>	<b>2,434,120</b>
Asset Retirement Obligations	65,478	76,478	96,560	116,090	123,590	131,090
Future Income Taxes	224,222	233,882	128,843	472,300	448,010	448,010
	427,112	663,372	503,422	1,757,662	1,742,298	3,013,220
<b>Shareholders' Equity</b>						
Share Capital	1,513,182	1,505,818	1,797,548	2,414,891	6,052,157	6,052,157
Contributed Surplus		15,387	67,703	134,308	365,899	780,209
Purchase Warrants			-	205,030	18,070	18,070
Deficit	(698,583)	(707,162)	(838,589)	(863,550)	(716,817)	(227,724)
	<b>814,599</b>	<b>814,043</b>	<b>1,026,662</b>	<b>1,890,679</b>	<b>5,719,309</b>	<b>6,622,711</b>
<b>Total Liabilities and S.E</b>	<b>1,241,711</b>	<b>1,477,415</b>	<b>1,530,084</b>	<b>3,648,341</b>	<b>7,461,606</b>	<b>9,635,932</b>

**Texalta Petroleum Ltd. - Cash Flow Statement**  
**(in C\$)**

	2003	2004	2005	2006	2007E	2008E
<b>Operating Activities</b>						
<b>Net Income</b>	<b>(60,544)</b>	<b>(8,579)</b>	<b>(131,427)</b>	<b>(24,961)</b>	<b>146,733</b>	<b>489,093</b>
Non-Cash Items:						
Depletions and Depreciation	262,801	256,682	363,093	281,520	700,620	745,439
Stock Based Compensation		17,600	53,000	83,500	231,591	414,310
Gain on Sale of Property and Equipment	(1,934)					
Future Income Taxes	22,659	9,660	(105,039)	(64,043)	(24,290)	-
	<b>222,982</b>	<b>275,363</b>	<b>179,627</b>	<b>276,016</b>	<b>1,054,653</b>	<b>1,648,842</b>
<b>Change in Non-Cash Working Capital Items:</b>						
Accounts Receivable	48,524	29,360	(46,728)	(157,742)	(477,138)	(562,213)
ARTC Receivable	-	4,800				
Income Taxes Receivable	(36,000)	36,000			7,500	7,500
Prepaid Expenses						
Income Taxes Payable	(25,409)				148,692	
Accounts Payable and Accrued Liabilities	(128,679)	215,600	(32,935)	1,149,195	(147,266)	1,263,422
	<b>(141,564)</b>	<b>285,760</b>	<b>(79,663)</b>	<b>991,453</b>	<b>(468,212)</b>	<b>708,709</b>
	<b>81,418</b>	<b>561,123</b>	<b>99,964</b>	<b>1,267,469</b>	<b>586,441</b>	<b>2,357,552</b>
<b>Financing Activities</b>						
Bank Loan						
Payment of Bank Loans and Advances			257,942	(257,942)	(186,960)	
Shares Issued for Cash (net)	35,134		(100)	1,234,547	3,700,000	
Share Issue Costs					(62,734)	
Share Issued for Debt						
Contributed Surplus						
Normal Course Issuer Bids	(10,150)	(9,577)	(8,854)	(21,570)		
	<b>24,984</b>	<b>(9,577)</b>	<b>248,988</b>	<b>955,035</b>	<b>3,450,306</b>	<b>-</b>
<b>Investing Activities</b>						
Acquisition of Property and Equipment	(370,240)	(665,080)	(396,720)	(751,243)	(2,000,000)	(2,000,000)
Others	203,415	110,773				
Short-Term Investments			-	(665,615)		
	<b>(166,825)</b>	<b>(554,307)</b>	<b>(396,720)</b>	<b>(1,416,858)</b>	<b>(2,000,000)</b>	<b>(2,000,000)</b>
<b>Increase(decrease) in Cash</b>	<b>(60,423)</b>	<b>(2,761)</b>	<b>(47,768)</b>	<b>805,646</b>	<b>2,036,747</b>	<b>357,552</b>
Cash (BOP)	110,952	50,529	47,768	-	1,471,231	3,507,978
<b>Cash (EOP)</b>	<b>50,529</b>	<b>47,768</b>	<b>-</b>	<b>805,646</b>	<b>3,507,978</b>	<b>3,865,530</b>

**Fundamental Research Corp. Equity Rating Scale:**

**Buy** – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

**Hold** – Annual expected rate of return is between 5% and 12%

**Sell** – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

**Suspended or Rating N/A**— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

**Fundamental Research Corp. Risk Rating Scale:**

**1 (Low Risk)** - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

**2 (Below Average Risk)** - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

**3 (Average Risk)** - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

**4 (Speculative)** - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

**5 (Highly Speculative)** - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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