

Texalta Petroleum Ltd. (TSX.V: TEX-A) – Increasing focus on Saskatchewan due to the “Bakken Rush” and rising Alberta royalties

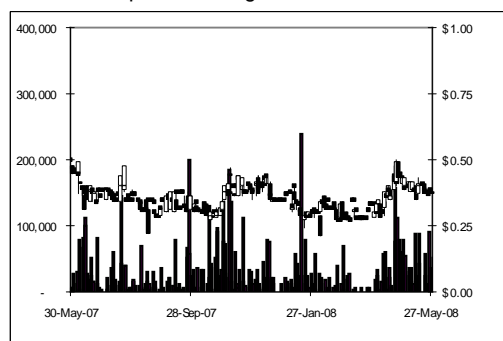
Sector/Industry: Oil & Gas

www.texalta.com

Market Data (as of May 30, 2008)

Current Price	C\$0.37
Fair Value	C\$0.60 (↓)
Rating*	BUY
Risk*	5 (Highly Spec)
52 Week Range	C\$0.21 – C\$0.50
Shares O/S	34,050,365
Market Cap	C\$12.60 mm
Current Yield	N/A
P/E	N/A
P/B	2.40
YoY Return	-17.8%
YoY TSX	-17.4%

*see back of report for rating and risk definitions



Highlights

- Texalta’s interest in Wordsworth contains about 2,000 acres of prospective Bakken rights located below the prolific Mississippian (Alida) pool. The “Bakken Rush”, and the Alberta government’s plans to implement oil/gas royalties, have made projects in Saskatchewan more attractive.
- Texalta continues to produce from three properties in Saskatchewan. Although production rates have declined since our previous report, flow rates seem to have stabilized.
- The company plans to drill four horizontal development wells by October 2008, including two in West Queensdale, and one each in Wordsworth and West Wildwood.
- The wells in the S. Queensdale and N. Wilmar fields were drilled, but both wells were abandoned as flow rates were below expectations.
- In the Georgina Basin, Australia, Texalta has already identified a few targets of interest in the two permits based on information from the existing 750km of seismic data. Texalta is expected to issue a press release identifying the targets of interest shortly.
- On February 2008, the company announced that an initial seismic has been mapped out and that work should commence later this year.

Key Financial Data (FYE - June 30)

(C\$)	2003	2004	2005	2006	2007	2008E	2009E
Revenue	472,165	582,509	517,753	638,549	1,704,449	1,909,041	2,310,739
Net Income	(60,544)	(8,579)	(131,427)	(24,961)	62,260	154,502	275,564
Cash	50,529	47,768	-	1,471,231	1,772,748	1,485,742	1,365,032
Working Capital	14,256	(274,265)	(200,312)	537,408	2,382,160	1,149,746	1,165,968
Total Assets	1,241,711	1,477,415	1,530,084	3,648,341	6,309,509	6,975,529	8,079,047

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.

**Wordsworth –
Producing**

Texalta is an operating partner with a 47.5% working interest (WI) in the Wordsworth property that covers 4,000 acres of land. This property has one producing well. The discovery well (a horizontal well - HZ 2A2-23), which was drilled to 2,033 m, was drilled in May 2006. Although the well was put into production at 220 boepd gross, it is currently producing at about 51 boepd gross (24.4 boepd net for Texalta), according to management.

Note: Declining flow rates are not uncommon for horizontal wells in Saskatchewan. Horizontal wells in the area normally experience rapid decline rates in the first year, after which, the wells continue to produce at a lower flow rate for several years.

The second well on the property, which was drilled in mid 2007, was not put into commercial production, as flow rates were lower than anticipated.

Plans for the next 12 months: Texalta and partners, along with Talisman Energy Inc. (NYSE/TSX: TLM), shot 16km of new 2D seismic in order to identify locations for the next horizontal development well. In May 2008, one horizontal well was drilled on the north side of the prospect. However, the well has been suspended. The company and its partners are now preparing to drill another well on the south side, adjacent to the discovery well.

It is worth noting that Texalta's interest in Wordsworth contains about 2,000 acres of prospective Bakken rights located below the prolific Mississippian (Alida) pool. Texalta acquired an interest in this property prior to the recent "Bakken rush".

About the Bakken oil play: The Bakken oil play, which covers about 200,000 square miles, stretches across Montana, North Dakota and into Southeastern Saskatchewan. According to the US Geological Survey (USGS), the Bakken formation in North Dakota and Montana is estimated to hold about 3.0 to 4.3 billion barrels of undiscovered, technically recoverable oil. This estimate is considered the largest "continuous" oil accumulation ever assessed by the USGS.

The Bakken formation, which lies about 300m below the Mississippian formation, is a formation of siltstone and sandstone. In addition to their high recoverable oil reserve estimates, Bakken wells produce light oil and are typically highly productive – factors which make the formation even more attractive.

The "Bakken rush" has significantly increased current focus on projects in Saskatchewan. Also, the Alberta government's plans to implement significant increases in oil/gas royalties have made projects in Saskatchewan even more attractive.

**West
Queensdale -
Producing**

Texalta has a 16.05% - 71.6% WI in about 1,440 acres of land in the area. This field has six horizontal wells and seven vertical producing wells. The property has an oil and gas treatment plant. All of the oil produced by Texalta and partners are treated and sold in this facility, which is connected to a producer's pipeline. The company drilled two horizontal wells in the past 12 months. Both of them were successful, and flowed initially at 120 boepd

–130 boepd gross (31 boepd –33 boepd net for Texalta). The 13 wells combined are currently producing at 99.5 bpd (gross) and 25.8 (net).

Plans for the next 12 months: In May 2008, one horizontal well was completed and placed in production. Initial test results showed rates of 10 bbls of oil per hour.

Texalta has plans to drill two additional horizontal wells (costing Texalta approx \$0.7 million) within the boundaries of the West Queensdale field in 2008.

***West Wildwood
- Producing***

Texalta is the operator of the 800 acre property with a 50% WI. A horizontal wild cat well drilled in July 2007 resulted in a new pool discovery, the company's second pool discovery in two years. The well, which was drilled 1,100 m southeast of an abandoned well that had a 7m thick payzone, was put into production in July 2007, at an initial rate of 300 boepd fluid, which produced 150 boepd oil. The well was tied in to the 8-26-6-2 Battery (in West Queensdale) in October 2007. However, the pipeline is currently at capacity, and therefore, surplus oil is being trucked to Virden, Manitoba. Management informed us that a new pipeline is currently being built. The well is currently producing at 27.7 bpd (gross) and 13.9 bpd (net).

Plans for the next 12 months: Texalta and its partners have completed seismic work on this field, and think that the structure can accommodate at least four additional horizontal wells. They plan to drill the next horizontal well this summer depending on the timing of joint land negotiations.

***S. Queensdale,
E. Carlyle and
N. Wilmer***

In our previous report, we had discussed the company's plans to drill a well in S Queensdale (50% WI) and two wildcat wells in the E Carlyle and N Wilmar (50% WI) fields. The wells in the S Queensdale and N Wilmar fields were drilled, but both wells were abandoned as flow rates were below expectations. Texalta is actively seeking a JV partner to pursue several deep prospects in the greater Willmar/Carlyle area.

To summarize, the company plans to drill four horizontal development wells by October 2008, including two in West Queensdale, and one each in Wordsworth and West Wildwood.

***Georgina
Basin,
Australia***

On October 24, 2007, Texalta announced they had entered into a Letter of Intent (LOI) with a syndicate of investors represented by Odin Capital Inc. (a private equity firm based in Calgary) with respect to the company's two 5-year exploration permits (EP 103 and EP 104) in the Georgina Basin, Northern Territory, Australia. On January 11, 2008, the company announced that a formal Farmout and Participation Agreement was executed with Officer Basin Energy Pty. Ltd. (now Rodinia Oil Corp.), based in Adelaide, South Australia. Rodinia is a private company actively exploring 18 million acres of exploration permits in South and Western Australia.

According to the agreement, Rodinia has the right to contribute up to \$10 million towards

exploration expenditures over a period of two and a half years to earn up to 60% working interest in both permits. Texalta has already received \$1 million in connection with the agreement. Texalta will remain the operator until Rodinia earns their 60% interest in the project. **We believe this is a very good move by Texalta at this stage, as it lowers their risk, and simultaneously, allows them to participate in the upside potential.**

To meet the requirements, Texalta has to complete at least 200km of seismic shooting in the next 12 months. On February 2008, the company announced that an initial seismic has been mapped out and that work should commence later this year. Texalta has instructed its representative based in Darwin, N.T., to obtain the necessary clearances for sacred sites and the environment. Our discussions with management indicated that the company has to spend close to \$1 million for the 200km vibroseis program in 2008.

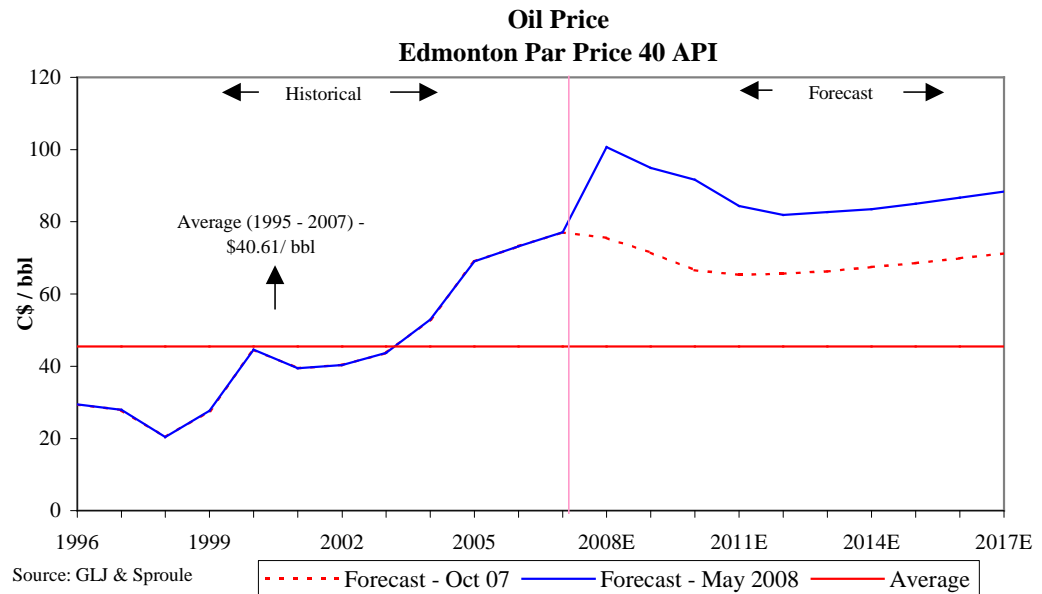
Texalta has already identified a few targets of interest in the two permits based on information from the existing 750km of seismic data, which was shot during 1988 and 1992 by Pacific Oil & Gas Pty Ltd. (oil and gas arm of Rio Tinto PLC; NSE: RTP).

Review of Financials

Production and revenues below expectations: In the first nine months of FY2008 (ended March 2008), the company produced an average of 80 boepd (down from 82 boepd in the comparable period in the previous year). However, an increase in oil prices more than offset the drop in production, and as a result, net revenues increased by 5.1% YOY in the first nine months of FY2008, from \$1.32 million to \$1.39 million. In the first nine months of FY2008, average net revenues per boe increased YOY from \$56/bbl to \$66/bbl. In Q3-2008, net revenues increased from \$0.40 million to \$0.45 million, an increase of 13% YOY.

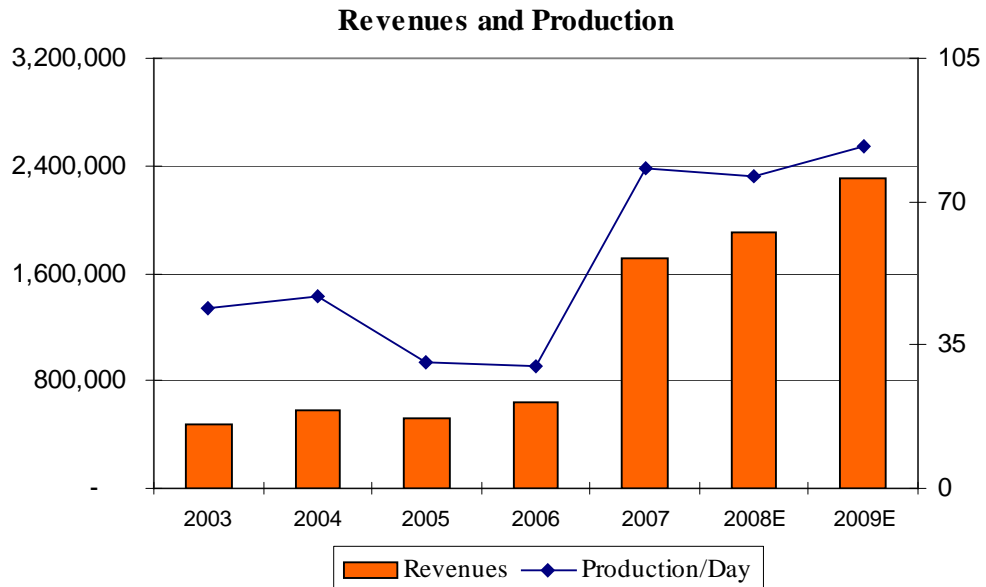
Production forecasts: We have lowered our average production forecasts for FY2008, and FY2009, to 76 boepd net (down from 140 boepd) and 84 boepd net (down from 180 boepd), respectively. Note that, for conservatism, these estimates are based on the assumption that the company will not put any additional wells into production. The company is planning to drill four additional wells by October 2008, in its key areas of Wordsworth, West Queensdale and West Wildwood. Our estimates will vary significantly if any of these four wells turn out to be successful.

Oil Price forecasts: Oil is currently trading at record highs (US\$127/bbl), and is expected to stay above US\$80/bbl through 2017, which is highly encouraging for Texalta. The chart below shows current oil price forecasts (May 2008) versus forecasts as of October 2007.



As shown in the chart, current price forecasts are much higher than forecasts as of October 2007. Note that short and long-term price forecasts are much lower than the current price as, we believe, the fundamentals (global supply and demand) of oil are not strong enough to support current prices.

Revised revenue forecasts: Based on our revised production and commodity price forecasts, we have lowered our revenue forecasts for FY2008, and FY2009, to \$1.91 million (down from \$3.21 million) and \$2.31 million (down from \$3.92 million), respectively. The chart below shows the company's revenues since FY2003, along with our revised forecasts.



Netbacks: The table below shows the company's margins in Q3, and the first nine months of FY2008, along with their comparable periods in the previous year.

	Q3-2007	Q3-2008	2007 (9 mo)	2008 (9 mo)
Revenue / boe	\$52.6	\$76.0	56	66
Op Costs / boe	\$10.2	\$12.1	10	14
G&A costs / boe	\$11.1	\$16.4	\$8.5	\$11.0
Netback	\$31.3	\$47.5	\$37.4	\$40.8

Netbacks improved YOY in Q3 (\$31/bbl to \$48/bbl), and the first nine months of FY2008, (from \$37/bbl to \$41/bbl) primarily due to higher oil prices.

EBITDA improved YOY from \$0.73 million to \$0.87 million due to increased revenues and as the company recorded nil stock based compensation expenses in the first nine months of FY2008, versus \$0.17 million in the comparable period in the previous year. In Q3-2008, EBITDA improved YOY from \$0.25 million to \$0.29 million.

Net Income: For the nine-month period in FY2008, the company reported a net profit of \$69,782 (EPS: \$0.00) versus \$54,851 (eps: \$0.00) in the comparable period in the previous year. Based on all the previously mentioned changes, we have lowered our EPS forecasts for FY2008, and FY2009, to \$0.15 million; EPS: \$0.00 (down from \$0.55 million; EPS: \$0.02), and \$0.28 million; EPS: \$0.00 (down from \$0.65 million; EPS: \$0.02), respectively.

Cash Flows

In the first nine months of FY2008, the company generated \$2.10 million from operations (\$1.23 million came from working capital) versus -\$0.56 million (\$1.33 million was spent on working capital) in the comparable period in the previous year.

The company spent \$1.67 million on capital expenditures versus \$0.91 million in the comparable period in the previous year. Texalta did not pursue any major financing during the period. We have lowered our CAPEX estimate for FY2008 from \$3 million to \$2.25 million.

Cash Position and Liquidity

At the end of Q3-2008, the company had \$2 million in cash and term deposits, and working capital of \$1.39 million, versus \$1.77 million and \$2.38 million, respectively, at the end of FY2007. The table below shows a summary of the company's cash and liquidity position.

Liquidity Position	2004	2005	2006	2007	2008E	2009E
Cash + Term Deposits	47,768	-	1,471,231	1,772,748	1,466,484	1,315,197
Working Capital	(274,265)	(200,312)	537,408	2,382,160	1,134,686	1,120,418
Current Ratio	0.22	0.28	1.46	10.63	2.41	2.47
Debt	-	257,942	-	-	-	-
Debt / Capital	-	16.9%	-	-	-	-

Texalta continues to be debt-free. The company has a revolving line of credit of \$0.50 million (at prime plus 1.5% p.a.). At the end of Q3-2008, no amount was drawn from this credit facility. Texalta commenced a new Normal Course Issuer Bid on January 29, 2008

(that will expire on January 28, 2009) to acquire up to 1.70 million shares (5% of total outstanding) indicating that management continues to believe that Texalta's shares are undervalued at current price levels.

We believe that the company is in a sound cash position, and that cash on hand and cash flow from operations will be able to fund working capital and capital expenditures in FY2008.

Stock Options and Warrants

At the end of Q3-2008, the company had 2.70 million stock options outstanding (1.49 million are currently 'in-the-money' – assuming that none of the outstanding options were exercised since the end of March 2008), with a weighted average exercise price of \$0.26 per share, and maturity periods between March 2009 and April 2013. The company also had 1.50 million warrants outstanding (none of them are currently 'in-the-money'), with an exercise price of \$1.75 per share, and maturing in December 2008.

Valuation

Our revised valuation on the company dropped from \$0.65 per share to \$0.60 per share. About 60% of the drop in valuation was because the company's working capital dropped from \$0.07 per share to \$0.04 per share. A summary of our revised valuation is shown below.

Valuation Summary		
	Previous	Revised
Georgina Basin Project	\$0.47	\$0.46
Producing Properties in Saskatchewan	\$0.11	\$0.10
Working Capital	\$0.07	\$0.04
Fair value of the company	\$0.65	\$0.60

Our valuation on the company's producing projects in Saskatchewan is \$0.10 per share (down from \$0.11 per share).

Company (Ticker Symbol)	EV/boe	EV/boepd
ZCO	\$13.1	\$35,656
GPX	\$14.4	\$42,857
RE	\$15.7	\$42,970
BEN	\$19.1	\$43,050
GNY	\$19.1	\$48,753
ITX	\$29.9	\$70,111
WTL	\$39.5	\$48,276
Average	\$21.5	\$47,382
Fair Value	\$3,232,462	\$3,961,113
Value per share	\$0.09	\$0.11
Average		\$0.10

Our valuation on the company's Georgina basin project dropped slightly from \$0.47 per

share to \$0.46 per share due to a slight drop in the average enterprise value of companies with comparable projects.

Rating **Therefore, based on our revised valuation models, we reiterate our BUY rating, but lower our fair value estimate on the company from \$0.65 per share to \$0.60 per share. Our revised fair value reflects upside potential of 62% from current price levels.**

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

- Texalta is exposed to all of the risks associated with any other exploration and production company.
- The Georgina Basin is an underexplored basin, and Texalta's project in the basin carries significant exploration risks.
- Infrastructure is limited in the Northern Territory compared to other major petroleum regions.
- While we do not expect the company to be in a tight cash position 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.

We have continued to rate the shares Risk 5 (Highly Speculative).

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

	2005	2006	2007	2008E	2009E
Revenues					
Oil and Gas Sales	611,505	693,547	1,776,628	2,194,657	2,656,547
Less: Royalties	(111,490)	(107,524)	(181,562)	(365,328)	(375,186)
Royalty Income	17,635	22,877	25,140	17,486	29,379
Other Income	103	29,649	84,243	62,226	-
	517,753	638,549	1,704,449	1,909,041	2,310,739
Operating Expenses	149,395	155,085	298,845	394,158	519,916
Gross Margin	368,358	483,464	1,405,604	1,514,883	1,790,823
Stock Based Compensation	53,000	83,500	170,000	47,726	115,537
General and Administrative	188,731	207,448	291,849	309,481	374,602
EBITDA	126,627	192,516	943,755	1,157,676	1,300,684
Depletion, Depreciation and Accretion	363,093	281,520	812,095	919,982	876,740
EBIT	(236,466)	(89,004)	131,660	237,695	423,944
Income Taxes					
Current					
Future	(105,039)	(64,043)	69,400	83,193	148,380
Net Income (Loss)	(131,427)	(24,961)	62,260	154,502	275,564

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

	2005	2006	2007	2008E	2009E
Assets					
Current Assets					
Cash	-	805,616	158,324	1,485,742	1,365,032
Term Deposits	-	665,615	1,614,424	-	-
Accounts Receivables	77,707	235,449	856,835	479,842	580,810
	77,707	1,706,680	2,629,583	1,965,584	1,945,842
Property and Equipment	1,452,377	1,941,661	3,679,926	5,009,945	6,133,204
	1,530,084	3,648,341	6,309,509	6,975,529	8,079,047
Liabilities					
Current Liabilities					
Bank Loan and Advances	257,942	-	-	-	-
Accounts Payable and Accrued Liabilities	20,077	1,169,272	247,423	815,838	779,875
Income Taxes Payables	-	-	-	-	-
	278,019	1,169,272	247,423	815,838	779,875
Asset Retirement Obligations	96,560	116,090	148,290	155,705	163,490
Future Income Taxes	128,843	472,300	541,700	624,893	773,274
	503,422	1,757,662	937,413	1,596,436	1,716,638
Shareholders' Equity					
Share Capital	1,797,548	2,414,891	5,905,608	5,724,398	6,316,612
Contributed Surplus	67,703	134,308	253,758	301,484	417,021
Purchase Warrants	-	205,030	14,020	-	-
Deficit	(838,589)	(863,550)	(801,290)	(646,788)	(371,225)
	1,026,662	1,890,679	5,372,096	5,379,093	6,362,409
Total Liabilities and S.E	1,530,084	3,648,341	6,309,509	6,975,529	8,079,047

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

	2005	2006	2007	2008E	2009E
Operating Activities					
Net Income	(131,427)	(24,961)	62,260	154,502	275,564
Non-Cash Items:					
Depletions and Depreciation	363,093	281,520	812,095	919,982	876,740
Stock Based Compensation	53,000	83,500	170,000	47,726	115,537
Gain on Sale of Property and Equipment					
Future Income Taxes	(105,039)	(64,043)	69,400	83,193	148,380
	179,627	276,016	1,113,755	1,205,402	1,416,221
Change in Non-Cash Working Capital Items:					
Accounts Receivable	(46,728)	(157,742)	(621,386)	376,993	(100,968)
Accounts Payable and Accrued Liabilities	(32,935)	1,149,195	(921,849)	568,415	(35,963)
	(79,663)	991,453	(1,543,235)	945,408	(136,931)
	99,964	1,267,469	(429,480)	2,150,810	1,279,290
Financing Activities					
Payment of Bank Loans and Advances	257,942	(257,942)			
Shares Issued for Cash (net)	(100)	1,234,547	2,581,147	3,300	600,000
Normal Course Issuer Bids	(8,854)	(21,570)	(66,990)	(191,116)	
	248,988	955,035	2,514,157	(187,816)	600,000
Investing Activities					
Acquisition of Property and Equipment	(396,720)	(751,243)	(1,783,161)	(2,250,000)	(2,000,000)
Others					
Short-Term Investments	-	(665,615)	(948,809)	150,000	
	(396,720)	(1,416,858)	(2,731,970)	(2,100,000)	(2,000,000)
Increase(decrease) in Cash	(47,768)	805,646	(647,293)	(137,006)	(120,710)
Cash (BOP)	47,768	-	805,616	158,323	171,317
Cash (EOP)	-	805,646	158,323	21,317	50,607

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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