

Ember Resources Inc. Recommendation: Sector Underperform

EBR • \$0.67 • TSX
12 Mo Target Price: \$0.70

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First Quarter Results *Debt Limits Growth Prospects*

Highlights

- Ember reported average production of 4,003 BOE/d, slightly below our expectation (~100 BOE/d), while cash flow of \$0.07 per share was in line with our estimate. Net debt at the end of the period was \$89 MM for a trailing annualized D/CF ratio of 4.5 times. The lines of credit of \$92 MM are currently under review, with a target completion date at the end of the month.
- The company completed a 31 gross (18.7 net) well program in the first quarter, and estimates that corporate production levels were approximately 4,250 BOE/d exiting the winter, having averaged ~4,000 BOE/d in the first quarter of 2010. First quarter production per debt adjusted share was down 19% YoY.
- We continue to believe that the company's net debt of ~\$89 MM as compared to the 2010E cash flow of ~\$14 MM at strip prices will be a significant impediment to executing a capital program of sufficient size to post any material growth.

Summary and Recommendation

Ember's results were generally in line with our expectations, but its net debt still weighs heavily on the capital structure and will impede its ability to grow, and maybe even maintain, production levels. The \$92 MM facility is currently under review, and there exists the possibility that it will be decreased given the current outlook for natural gas prices.

The company has lowered its 2010 capital spending guidance from \$30 MM to \$20 MM, with an associated decrease in the guided average production range from 26-27 MMcf/d to 24-25 MMcf/d. We were already well

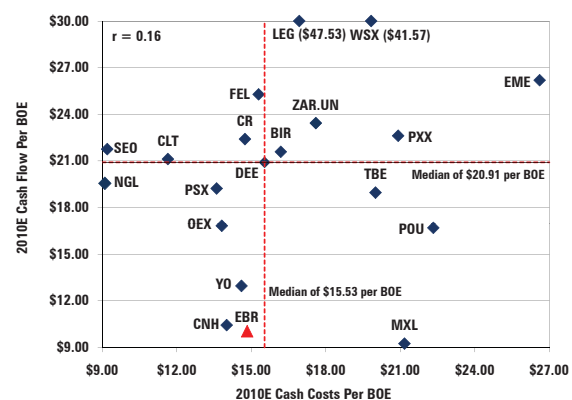
below the prior guidance for spending with an assumption of \$22.5 MM, which we have now reduced to \$20 MM (gross), in line with the company's new guidance. Our 2010 and 2011 production forecasts have decreased by ~3% to 24 MMcf/d and 23.2 MMcf/d, respectively.

We have maintained our recommendation of Sector Underperform with an unchanged target price of \$0.70 per share, based on an FY11 EV/DACF multiple of 5.5 times, also equivalent to a 25% discount to our estimate of the company's NAV (strip prices after tax discounted at 15%).

Forecasts

Ember has lowered its guidance for 2010. Capital spending will now be \$20 MM, down from \$30 MM previously, with the result that its average production forecast of 26-27 MMcf/d (~4,415 BOE/d) has decreased

**Junior Producers
2010E Cash Flow and Cash Costs**



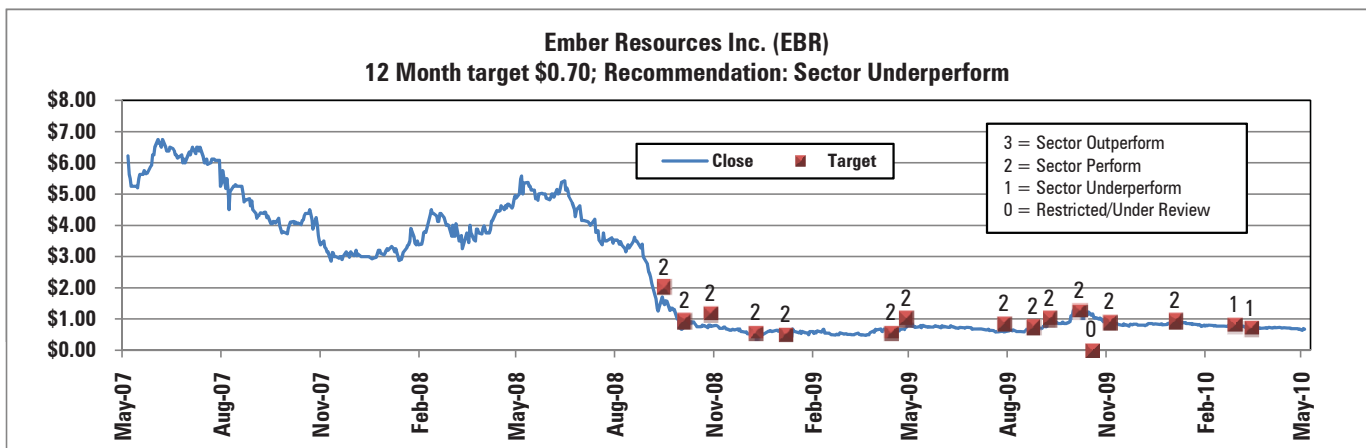
Note: (1) Cash Costs include Operating, Transportation, Interest, and G&A costs. (2) Peters & Co. Ltd. is currently restricted on Iteration Energy Ltd.

to 24-25 MMcf/d (~4,085 BOE/d). However, we had previously reduced our 2010 capital assumption from \$27.5 MM to \$22.5 MM, and have now applied a further reduction to \$20 MM. As a result, our production estimate has only decreased slightly to 4,000 BOE/d due to the front-end loading of the 2010 program additions and the proposed workover program in the second quarter.

Despite the hedging in place (25% of the remainder of 2010 net production at a floor of \$5.00 per Mcf) and very low corporate royalty rates (~6%), Ember's cash flow per BOE of \$9.74 is one of the lowest in our coverage universe and, as a result, we estimate annual 2010 cash flow of only \$14.2 MM. As can be seen in the accompanying cross-plot (page 1), Ember's all-in cash costs are in line with the median of the Junior Peer group, but its lack of oil or liquids weighting results in lower overall realized prices per BOE. Therefore, we forecast that the company will exit 2010 with ~\$88 MM in net debt for a 6.2 times trailing D/CF ratio, thereby leaving it with only ~\$4 MM of excess credit capacity on the current lines of credit.

First Quarter Highlights

- Production averaged 4,003 BOE/d, slightly below our expectation for 4,100 BOE/d
 - Represented a 19% decrease YoY and a 20% decrease QoQ in production per debt adjusted share
- Cash flow of \$5.0 MM, or \$0.07 per basic share
 - In line with our expectation for \$5.0 MM, or \$0.07 per share
 - Cash flow of \$13.81 per BOE, versus \$8.93 per BOE in Q4/09
- Cash costs of \$14.80 per BOE, versus Q4/09 cash costs of \$16.96 per BOE
 - Down 13% QoQ
 - Operating expense of \$8.04 per BOE, down 21% from Q4/09 of \$10.18 per BOE
 - Transportation expense of \$1.23 per BOE
 - G&A expense of \$1.91 per BOE
 - Interest expense of \$3.62 per BOE
- Net capital expenditures over the quarter were ~\$10 MM
 - Drilling consisted of 31 gross (18.7 net) wells
 - Spending represented 200% of cash flow
- Quarter-end net debt was \$88.7 MM
 - Net debt to annualized trailing cash flow ratio of 4.5 times
 - Lines of credit are \$92 MM (review to be completed by May 31, 2010)



EMBER RESOURCES INC.

Analyst: Andrew V. Boland, Ph.D.



Date:	12-May-10	Price:	\$0.67	Recommendation:	Sector Underperform
Ticker:	EBR	12MO Target:	\$0.70	Share Control Block:	0%
	Three Months Ended March 31				
	2009	2010	10/09	FY10E	FY11E
DAILY VOLUMES					
Oil & NGL (B/d)	40	4	-90%	4	4
Natural gas (MMcf/d)	26.9	24.0	-11%	24.0	23.2
BOE/d (6:1)	4,528	4,003	-12%	4,000	3,875
BOE/d per MM share outstanding	88.1	53.4	-39%	53.4	51.7
PRICES					
Average liquids price (\$/bbl)	\$46.03	\$72.92	58%	\$74.81	\$79.39
Average gas price (\$/Mcf)	\$5.53	\$5.14	-7%	\$4.35	\$5.34
FINANCIALS					
Net revenue (\$MM)	12.6	10.3	-18%	35.9	42.8
Cash flow reported (\$MM)	7.3	5.0	-32%	14.2	21.5
Net income (\$MM)	(2.6)	(2.5)	-5%	(21.7)	(13.3)
Capital Spending (\$MM) (5)	6.4	10.3	61%	19.5	20.0
Drilling Credit (\$MM) (5)	0.0	0.5	n/a	1.1	0.3
Equity Issued (\$MM)	0.0	0.0	n/a	0.0	0.0
Net bank debt (\$MM)	103.4	88.7	-14%	87.8	86.0
Other long term debt (\$MM)	0.0	0.0	n/a	0.0	0.0
CFPS reported	\$0.14	\$0.07	-53%	\$0.19	\$0.29
CFPS Diluted Free	\$0.13	\$0.06	-52%	\$0.17	\$0.27
EPS basic	(\$0.05)	(\$0.03)	-35%	(\$0.29)	(\$0.18)
EPS Diluted	(\$0.05)	(\$0.03)	-35%	(\$0.29)	(\$0.18)
Shares O/S basic average	51.4	74.9	46%	74.9	74.9
Shares O/S FD average	51.4	74.9	46%	74.9	74.9
UNIT VALUES					
Average wellhead price/BOE	\$33.29	\$30.88	-7%	\$26.13	\$32.09
Revenue net of royalties/BOE	\$30.98	\$28.65	-8%	\$24.59	\$30.26
Cash costs/BOE (3)	\$13.02	\$14.80	14%	\$14.84	\$15.07
Current taxes/BOE	\$0.00	\$0.04	n/a	\$0.01	\$0.00
Cash flow/BOE	\$17.94	\$13.81	-23%	\$9.74	\$15.19
Net income/BOE	(\$6.42)	(\$6.89)	7%	(\$14.84)	(\$9.41)
COMMODITY ASSUMPTIONS					
	Q1/09	Q1/10	10/09	FY10E	FY11E
WTI (US\$ per barrel)	\$43.18	\$78.68	82%	\$81.97	\$85.96
Gas (NYMEX HH US\$ per MMBtu)	\$4.47	\$4.99	12%	\$4.63	\$5.60
Exchange rate	\$0.80	\$0.96	20%	\$0.97	\$0.97
STOCK VALUATION ANALYSIS					
	Q1/09	Q1/10	10/09	FY10E	FY11E
Share Price (1)	\$0.74	\$0.69	-7%	\$0.67	\$0.67
Market Cap (basic) (\$MM) (1)	\$38.0	\$51.7	36%	\$50.2	\$50.2
P/CF (FD Free) (2)	1.4	2.8	95%	3.9	2.5
EV/DACF (2)	4.3	5.6	29%	7.8	5.4
P/E (FD) (2)	(3.6)	(5.2)	43%	(2.3)	(3.8)
D/CF Ratio	3.5	4.5	26%	6.2	4.0

Note: (1) Valuation multiples calculated using closing market price on date financial results released

(2) Quarterly cash flow, earnings and DACF have been annualized.

(3) Cash costs/BOE do not include current taxes.

(4) All share values have been adjusted for the September 2008 two and a half to one share consolidation.

(5) Capital Spending excludes Drilling Royalty Credit

FIRST CALL ESTIMATES COMPARISON		as at 12-May-10	FY10E	FY11E
CFPS Diluted	High		\$0.26	\$0.46
	Median		\$0.25	\$0.35
	Low		\$0.20	\$0.23
EPS Diluted	High		-\$0.14	-\$0.09
	Median		-\$0.18	-\$0.12
	Low		-\$0.29	-\$0.25

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Ember Resources Inc.

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As of the most recent month-end, did the firm own more than 1% of the securities of the subject company or income trust?	No
As of the most recent month-end, did the analyst or a member of the analyst's household have a financial interest in the subject company or income trust?	No
Does the analyst or the firm have any other material conflict of interest with the subject company or income trust?	No
Is the firm a market maker for the company or income trust?	No
Has the analyst viewed the material field operations of the company or income trust? If yes, what proportion of asset base was represented? If yes, were the expenses reimbursed by the company or income trust?	Yes 40% Yes

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Rating System & Distribution

Rating	Normal	Ratings Distribution			Corporate Finance Services Provided*
		Actual			
		Integrated and E&P	Oilfield Services	Infrastructure Trusts	
Sector Outperform	30%	47%	54%	40%	54%
Sector Perform	40%	31%	43%	60%	26%
Sector Underperform	30%	16%	4%	0%	9%
Restricted/Under Review		6%	0%	0%	100%
Total	100%	100%	100%	100%	

* Corporate Finance Services column shows the percentage of companies within each category from which the firm has received corporate finance revenues within the past twelve months or expects to receive in the next three months.

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