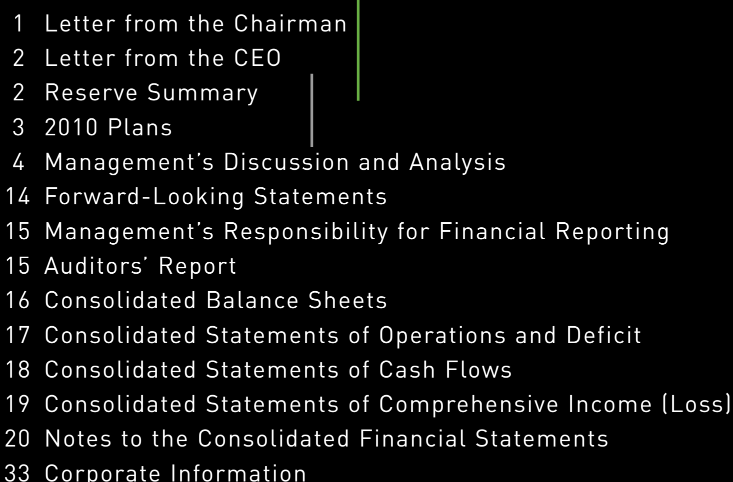
ANNUAL REPORT 2009

**Candax Energy Inc.** ("Candax") is a Canadian independent, international oil and gas exploration, development and production company. The Company's primary objective is to increase shareholder value by building a sustainable, international upstream company.

**Candax's primary area of operations is in Tunisia, where the Company operates mature producing and non-producing fields as well as holding varying interests in three high impact exploration prospects, with upside exposure to over 3 Tcf of prospective resources. Candax also has a 60% working interest in a large exploration permit located onshore Madagascar. Candax's head office is located in Toronto, Canada where the Company is listed on the TSX and trades under the symbol CAX. Candax has two major shareholders, Geofinance N.V. and Actis LLP which collectively own 64% of the outstanding shares of the Company.**

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# Letter from the Chairman

**W. Adrian Loader**
Chairman

2009 was a challenging year for Candax with severe operational difficulties and disappointments in the middle of a major economic downturn. Significant management time and effort went into addressing the major production problems but, regrettably, to no avail. However, management successfully implemented two programs of cost reduction and capital expenditure curtailment, which maintained the financial viability of Candax throughout the year. Additionally, the Board of Directors launched a program to explore strategic options to strengthen Candax for the future.

Following an extensive process, which considered a wide range of potential counter parties and possible portfolio actions, a Letter of Intent was signed with Geofinance in November for a C$13 million capital injection. The consequent transaction was completed on March 31, 2010. Concurrently, Geofinance agreed to provide up to €2,000,000 as a subordinated working capital loan. I would like to thank my colleagues on the Transaction Committee, Murray Grant and Adrian Jackson, for their commitment and contributions to this important process.

When the transaction closed Candax also concluded an amendment to its agreement with the Bank of Scotland on the borrowing base facility, extending its final maturity, rescheduling repayments and splitting the outstanding amount into two tranches. I would like to thank management for their dedication in leading these discussions to this successful outcome. The investment by Geofinance provides Candax with the funding to undertake essential remedial work on the El Bibane field which, combined with the Bank of Scotland facility restructuring, give Candax a significantly enhanced capital base and balance sheet.

**With a stronger business base Candax can re-assess the portfolio, adding value through its high impact exploration assets, and so realize the Company's growth potential in the medium term.**

The Board of Directors saw further changes this year as John Cullen, Adrian Jackson, and Mike Wood departed at the end of March, and were replaced by Steve Drinkwater, Dr. Richard Norris and Thomas Rebilly. Simultaneously, the management team of Mike Wood, Hywel John, John Willis, Don Munn and David Wilson left Candax, and were replaced by Dr. Richard Norris as President & CEO, Matthieu Milandri as CFO and Bertrand Launois as COO. I would like to thank the departing directors and outgoing management team for their contributions, and to wish the incoming directors and management team every success in their new roles. I would also like to recognise the work of the staff in Tunisia, where the team has particular expertise in local oil and gas operations.

I am delighted by Geofinance's investment in Candax, which strengthens the balance sheet and adds technical support. 2010 is a critical year – key short term objectives are to fix the production problems and ensure continued tight cost controls. With a stronger business base Candax can re-assess the portfolio, adding value through its high impact exploration assets, and so realize the Company's growth potential in the medium term.

**Adrian Loader**
Chairman

# Letter from the CEO

**Richard Norris**
CEO

It is with enthusiasm and optimism that I have assumed the management of Candax at this key juncture. There are a number of initiatives that the new management team has commenced and will continue to progress on Candax's asset base to increase production levels and advance our highly prospective Chaal, Deep Triassic and Madagascar exploration plays.

Commencing to rebuild our balance sheet has been a first step. Despite the equity infusion by Geofinance, the Company's financial position remains tight. However, with good planning and good execution we firmly believe that production can be resumed at rates sufficient to re-establish Candax as an active E&P company. The debt, albeit substantial, is manageable and right-sized for a healthy producing E&P company. With renewed production and cash-flow, Candax will be revitalized and forward looking, ready to take on the challenges of unlocking the upside in its existing portfolio, as well as looking for external growth.

**With good planning and good execution we firmly believe that production can be resumed at rates sufficient to re-establish Candax as an active E&P company.**

Geofinance, as major shareholder, clearly believes in the potential of Candax. The injection of new equity, supported by the availability of a €2,000,000 shareholder loan will provide Candax with the cash resources to undertake the necessary remediation work on the El Bibane field and to revalue the whole portfolio of assets. Candax has clear potential for growth that needs to be nurtured and encouraged. Your new management team will be focusing on the pragmatic and achievable steps required to develop this value for all shareholders.

Richard Norris

**Richard Norris**
CEO

# Reserve Summary

Ryder Scott has estimated Candax's total proved plus probable reserves (2P) of oil at 3.5 million barrels and 4.6 million boe. Proved reserves of oil were estimated at 1.1 million barrels and 1.5 million boe as compared to 2008 reserves which were estimated at 2.0 million barrels and 2.9 million boe. The reduction in proved reserves is largely due to the production of reserves during 2009, the continuing technical difficulties experienced on the El Bibane field, the under performance of certain Ezzaouia wells and the delay in the drilling programs of the Ezzaouia and Robbana sidetracks due to equipment availability and a restricted capital expenditure program, respectively. Candax believes that the work that is planned for 2010 will restore reserves to 2008 levels less the production adjustments.

**Summary of oil and gas reserves (Ryder Scott)**
As at December 31, 2009 (Forecast Prices and Costs)

| | Oil | | | Natural Gas | | | Boe | | |
|---|---|---|---|---|---|---|---|---|---|
| Reserves Category | Gross (Mbbl) | Net WI (Mbbl) | Net of royalty (Mbbl) | Gross (MMcf) | Net WI (MMcf) | Net of royalty (MMcf) | Gross (Mboe) | Net WI (Mboe) | Net of royalty (Mboe) |
| Total Proved – all categories | 2,461 | 1,187 | 1,095 | 5,309 | 2,592 | 2,463 | 3,346 | 1,619 | 1,506 |
| Probable | 5,477 | 2,610 | 2,373 | 9,942 | 4,877 | 4,399 | 7,134 | 3,423 | 3,106 |
| Total Proved plus Probable | 7,938 | 4,300 | 3,468 | 15,251 | 10,325 | 6,862 | 10,480 | 5,042 | 4,612 |

**Summary of net present value of future net reserves**
As at December 31, 2009 (Forecast Prices and Costs) – $ Millions

| | Before income tax discounted at | | | | | After income tax discounted at | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Reserves Category | 0% | 5% | 10% | 15% | 20% | 0% | 5% | 10% | 15% | 20% |
| Proved | 65.0 | 58.0 | 52.0 | 46.8 | 42.3 | 58.3 | 52.2 | 46.8 | 42.1 | 38.1 |
| Probable | 162.7 | 130.7 | 107.8 | 90.9 | 78.0 | 136.9 | 110.7 | 91.7 | 77.6 | 66.7 |
| Proved plus Probable | 227.7 | 188.7 | 159.8 | 137.7 | 120.4 | 195.2 | 162.8 | 138.5 | 119.7 | 104.8 |

# 2010 Plans

## PRODUCING

### El Bibane – 73.8% W.I.

The Phase 1 work-over on EBB-3 was a disappointment. Although the failure of the workover has deprived Candax of some short term production and cash flow, the remediation work undertaken in March was intended to be an interim fix. The remediation that is planned for Phase 2 is scheduled for mid-year 2010. A suitable rig has been identified and contract negotiations are underway at the time of writing this annual report. The work that will be undertaken in Phase 2 to return the El Bibane field to full production includes:

- On EBB-3, Candax will replace the production tubing and will extend tubing into the reservoir and will seal off the cap-rock which is thought to be the source of some, if not all, of the water production.
- On EBB-4, Candax will remove the bridge-plugs set in 2009 and will permanently seal off the fracture zone.

### Ezzaouia – 31.4% W.I.

Despite being a mature asset, Ezzaouia has considerable potential which will be harnessed via side-tracks and well work-overs. The long-planned side-track program which has been delayed due to the non-availability of a suitable rig is expected to commence in May with the spudding of the EZZ-5 well to be followed by work-overs on EZZ-2 and possibly two or three optional work-overs.

## APPRAISAL

### Chaal – 18.75% W.I.

On May 10, 2010 Candax entered into a farm-out agreement with SacOil Holdings Limited (SacOil), a private South African company with ties to South Africa's national oil company, Petro SA, providing for SacOil to own a 55% working interest in Chaal and to provide up to US$8 million to drill the Chaal-1 sidetrack. Additionally, the farm-out agreement provides for a payment of back costs of US$5 million to be paid to Candax (US$3.75 million) and la Société de Maintenance d'Installations Pétrolières (SMIP) (US$1.25 million) on the approval by the Tunisian Government of a development plan.

The farm-out of Chaal to a financially solid partner will allow Candax to advance the sidetrack on the promising Chaal-1 well drilled in 2006. Despite the technical challenges, we are excited by the opportunity to explore and develop this potentially large gas discovery which was classified as a Contingent Resource with an un-risked, high case estimate of 1.7 Tcf gas in place and recoverable Contingent Resources of 854 Bcf*.

* Ryder Scott – December 31, 2006

## EXPLORATION

### Madagascar – 60% W.I.

Madagascar is a frontier exploration area that holds enormous promise. The geological and geophysical work undertaken in 2008 and 2009 has significantly increased the interest in Block 1101 and an exploration well will be drilled on the Ambilobe prospect in the fourth quarter of 2010. As Candax's focus remains in the short term on Tunisia, Candax has been in discussions with its partner, EAX (East Africa Exploration Ltd.), to farm-down Candax's interest in the block and to provide operatorship to EAX. Formal documentation will be advanced in the coming months.

## NON-PRODUCING

### Al-Manzah / Belli – 75% W.I. and Robbana – 80% W.I.

Once El Bibane resumes production and Candax is generating positive cash flow, Candax will focus on Al-Manzah and Robbana, both of which have good potential to contribute short and long term to the value of Candax. The Belli block has step-out exploration potential and the shut-in Al Manzah field deserves further study, albeit with small remaining resources. Robbana has demonstrated reserves including a Contingent Resource of 3 million barrels * and requires a side-track to resume production. We will further study this field as it has potential for secondary recovery.

* Ryder Scott – December 31, 2007

The following is a discussion of the consolidated financial condition and results from operations of Candax Energy Inc. ("Candax" or the "Company") for the periods indicated. All references to "year" refer to the year ended December 31, 2009. The following should be read in conjunction with the audited consolidated financial statements and notes. Additional information relevant to the Company's activities, including the Company's Annual Information Form, can be found on SEDAR at www.sedar.com. This information is presented as of March 31, 2010.

## Company Overview

Candax is engaged in the exploration for and the acquisition, development and production of natural gas and crude oil. Its assets are located in Tunisia and Madagascar. Candax also owns a 50% interest in Société d'Electricité d'El Bibane ("SEEB"), a Tunisian power generation company.

## Foreign Exchange Fluctuations

Candax operates primarily in a US dollar-based environment. The majority of the Company's revenues and expenses are paid in US dollars, although Candax is also exposed to Canadian dollar, Pounds Sterling and Tunisian Dinar costs. However, being a Canadian company trading on the TSX, Candax has elected to report its financial results in Canadian dollars. Accordingly, all foreign currency amounts presented in Candax's consolidated statements of operations and deficit and cash flows are converted to Canadian dollars for reporting purposes based on the average Canadian to US dollar exchange rate prevailing during the reporting period. The US to Canadian dollar closing exchange rate on December 31, 2009 was $1.0510 (2008 – $1.2180) and averaged $1.0571 (2008 – $1.2118) during the fourth quarter and $1.1420 (2008 – $1.0660) for the year.

## Capital Structure and Dilution

At December 31, 2008, the Company had 169,261,606 common shares outstanding. No common share capital transactions were conducted since that date and hence the outstanding common shares at March 31, 2010 remain at 169,261,606.

At December 31, 2008, the Company had 13,550,000 stock options outstanding at an average exercise price of $0.79. In May 2009, 100,000 stock options at an exercise price of $0.80 were forfeited; in August 2009, 50,000 options were issued at an exercise price of $0.20 and in the fourth quarter of 2009, 2,800,000 options at an exercise price of $0.80 were forfeited to bring the outstanding stock options at March 31, 2010 to 10,700,000 at an average exercise price of $0.78.

## Business Development Activities

Candax's objective is to build a high-growth international portfolio of oil and gas assets.

## Review of Operations

### EL BIBANE

El Bibane is an oil and gas field offshore Tunisia. Candax is the operator and holds a 73.8% working interest. The field development plan comprised three wells, EBB-3, 4 & 5. Oil production was constrained initially by capacity limitations in the export line, which, as a consequence of higher than expected water production, had prevented simultaneous production from the EBB-3 and EBB-4 wells. Production has been further constrained by mechanical failures in these two wells identified in the course of a barge-based intervention programme in September 2009. Remedial work programs to restore production have been prepared for both EBB-4 and EBB-3 wells. The first of these programmes, to restore production from EBB-3 commenced in March and will be completed in April 2010.

### SEEB

Candax has a 50% equity interest in Société d'Electricité d'El Bibane ("SEEB"), a Tunisian company which owns and operates a gas-fired 27 MW single cycle electricity generation plant. Gas is supplied to SEEB primarily from El Bibane. The generating capacity of the power plant was reduced by 50% from early May to December 2009 as a consequence of the failure of one of the two gas-fired turbines. The damaged turbine has been replaced though operations are presently constrained by the interruption of gas supply form the El Bibane field.

As a result of reduced generating capacity, SEEB has been unable to meet its obligations under bank financing arrangements to make repayments of principal and interest. As a consequence of the payment arrears, SEEB is at risk of being placed in default whereby the loans can be called by the lenders at anytime.

### EZZAOUIA

Ezzaouia is primarily an oil field onshore Tunisia producing small quantities of associated gas. The Ezzaouia field is operated by Maretap, a company owned by the interest holders in the field which include Entreprise Tunisienne d'Activités Pétrolières ("ETAP"), the Tunisian state-owned oil company. Candax owns a 31.4% working interest.

### ROBBANA FIELD

Robbana is an oil field onshore Tunisia. Candax is the operator and holds an 80% working interest. As a consequence of declining well productivity, production from the field was suspended in May 2009 pending drilling and completion of a planned sidetrack of the Robbana-1 well.

### CHAAL

Chaal is an exploration permit onshore Tunisia. Candax is the operator and holds a 60% working interest. The Chaal Permit is located in central Tunisia approximately 50 kilometres west of the city of Sfax, covering an area of 1,200 square kilometres.

An initial exploration well, Chaal-1, was drilled in 2006 but could not be tested due to formation damage caused by the heavy mud weights required to manage the high pressures encountered. Candax and its partners subsequently committed to drill a deviated sidetrack of the Chaal-1 well using managed pressure drilling to further evaluate the commerciality of the gas discovery and as a condition of securing an extension to the Chaal Permit to May 25, 2010.

Drilling of the deviated sidetrack is now dependent upon Candax entering into farm-out arrangements to finance its share of the well costs and reaching an agreement with the Tunisian authorities for a further extension to the expiration date for the Chaal Permit. Candax entered into a non-binding Heads of Agreement on 23 March 2010 with the intention of concluding a definitive farm-out agreement following satisfactory completion of due diligence by both parties. The Tunisian authorities have been informed of situation and a response is awaited as to the possibility of securing an extension to the expiration date of the Permit.

The Company has considered the carrying value of Chaal and, in particular, the imminence of the expiry of the licence term and the uncertainties concerning the nature and timing of drilling operations. Having regard to the circumstances referred to above it has concluded that it is appropriate to record an impairment charge of US$9.7 million in relation to this interest.

In the event that the Company and its partners in the Chaal Permit did not reach agreement with the Tunisian authorities for the Chaal-1 well sidetrack to be drilled then, upon expiry of the permit on May 25, 2010, it is possible that the authorities could seek to impose penalties arising from the non fulfilment of work programme. The Company has been given no indication that the authorities would seek to impose any penalty and the obligations of the Candax subsidiary named as permit holder are not guaranteed by any other Group company.

### MADAGASCAR

Block 1101 is an exploration permit located onshore, northwest Madagascar and covers 14,900 square kilometres. Candax is the operator with a 60% working interest.

Results from the initial geological fieldwork, geochemistry and gravity/magnetics confirmed the excellent exploration potential of Block 1101, indicating up to 9,000 metres of sedimentary section beneath the block together with numerous oil shows. A 2D seismic acquisition program commenced in September 2008 and was completed in November 2008.

In 2009 the Madagascar government approved a twelve-month extension to the licence terms until July 2010 within which time Candax has a commitment to drill an exploration well.

Work has been continuing to identify a drilling location. Two alternative sites have been identified and discussions are continuing between Candax and its partner in the block to reach agreement as to the preferred location. Once this has been determined, contracts will be awarded to allow for completion of an Environmental Impact Assessment as a precondition of Ministry approval for the well programme. It will not be possible to meet the commitment to drill an exploration well by July 2010 and the Madagascar government has been approached to seek a further extension of the licence terms. Initial feedback is encouraging and it is expected that an extension will be secured in due course.

Notwithstanding the circumstances referred to above, the company, has considered the carrying value of Block 1101 and, having regard to the imminence of the expiry of the licence term and the uncertainties concerning the nature and timing of drilling operations, has concluded that it is appropriate to record an impairment charge of US$3.3 million in relation to this interest.

## Taxation

As previously reported in the interim financial statements, the Company made certain provisions for Tunisian back-taxes based on preliminary findings for the period 2004 through 2007. The initial assessment by the Tunisian tax authorities was Tunisian Dinar (TD) 10.7 million. As a result of additional submissions by the Company, the Tunisian tax authorities issued their final tax assessment for approximately TD 1.5 million (US$1.1 million). Candax has made the payment of this amount as full and final settlement on this matter in March 2010.

## Equity Investment

On March 31, 2010 the Company completed an investment agreement with Geofinance NV, an international upstream oil and gas company ("Geofinance"). Under the terms of the Agreement, Geofinance invested C$13,000,000 in the Company to purchase 144,444,444 units of the Company (the "Units") at a price of C$0.09 per Unit, each Unit comprising one common share and 0.6 of one common share purchase warrant (each whole warrant a "Warrant"). The Warrants may be exercised for a period of one year from the date of the closing of the Transaction at a price equal to the current market price (calculated on the basis of a five day volume weighted average trading price for the common shares of the Company) on the date of exercise. At closing, Geofinance owned 144,444,444 common shares of the Company representing approximately 46% of the issued and outstanding shares. If all of the Warrants are exercised, Geofinance will own 231,111,110 common shares in aggregate representing approximately 58% of the issued and outstanding common shares of the Company.

## Bank Loan Restructuring

On March 31, 2010 the Company concluded an Amendment and Restatement Agreement with the Bank of Scotland plc by which the terms of the Borrowing Base Facility Agreement were amended and restated. The Agreement provided for the extension of the final maturity date of the facility to June 30, 2014 and rescheduling of repayments while splitting outstanding amounts into two tranches; the Borrowing Base Amount and an Excess Tranche carrying mezzanine risk. Interest on the Borrowing Base Amount is calculated at US$ LIBOR plus 4% and on the Excess Tranche at US$ LIBOR plus 9.5 %. Restructuring fees are US$900,000 expected to be payable on December 31, 2010.

## Revenue

Sales, net of royalties for the three months ended December 31, 2009, were $9.1 million (2008 – $3.9 million) and for the year ended December 31, 2009 were $28.1 million (2008 – $34.8 million). During the fourth quarter of 2009, the Company sold 114,211 barrels of oil at an average price of US $68.48 (2008 – 32,496 barrels at an average price of US $44.17) and on a year-to-date basis for 2009 the Company sold 423,882 barrels of oil at an average price of US $52.25 (2008 – 317,296 barrels at an average price of US $95.86).

Following the recommencement of gas production from the El Bibane field, SEEB resumed operations and sales of electricity to the Tunisian state-owned utility company. The Company's share of the electricity sales for the fourth quarter of 2009 was $0.5 million (2008 – $0.8 million) and for the year was $2.6 million (2008 – $2.2 million).

## Production

The following table summarizes the quarterly net after royalty production for 2009 and 2008:

Production for the year and fourth quarter of 2009 was lower than the same period in 2008 due to reduced production from the El Bibane field as discussed earlier.

| | Q1 | | Q2 | | Q3 | | Q4 | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| BBLS | **2009** | 2008 | **2009** | 2008 | **2009** | 2008 | **2009** | 2008 | **2009** | 2008 |
| Oil (bbls/day) | **1,063** | 454 | **1,152** | 1,005 | **582** | 1,126 | **483** | 1,624 | **818** | 1,056 |
| Gas (mmcf/day) | **3.5** | – | **2.9** | 3.0 | **1.2** | 2.0 | **2.3** | 3.4 | **2.5** | 2.1 |
| BOEs/day | **1,651** | 454 | **1,627** | 1,502 | **782** | 1,451 | **866** | 2,197 | **1,234** | 1,404 |

Productionfor the year and forth quarter of 2009 was lower than the same period in 2008 due to reduced production from the El Bibane field as discussed earlier.

## Reserves

Summary of Gross and Net Reserves
Escalated Parameters, Forecast Prices and Costs

| | BOE | | Oil | | Natural Gas | |
|---|---|---|---|---|---|---|
| Reserves Category | Gross (Mboe) | Net (Mboe) | Gross (Mbbl) | Net (Mbbl) | Gross (MMcf) | Net (MMcf) |
| Total Proved – All Categories | 3.3 | 1.5 | 2.5 | 1.1 | 5,309.0 | 2,463.0 |
| Probable – All Categories | 7.1 | 3.1 | 5.5 | 2.4 | 9,942.0 | 4,399.0 |
| Total Proved Plus Probable | 10.5 | 4.6 | 7.9 | 3.5 | 15,251.0 | 6,862.0 |

Where amounts are expressed on a barrel of oil equivalent (boe) basis, natural gas volumes have been converted to barrels of oil equivalent at 6,000 cubic feet to one barrel of oil equivalent (6 mcf = 1 boe). This conversion ratio is the convention used in the oil and natural gas industry and is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. The use of boe may be misleading, particularly if used in isolation.

## Operating Costs

Operating costs for the year and three months ended December 31, 2009, were $9.8 million and $3.6 million respectively, compared to $6.3 million and $0.1 million for the same periods in 2008. Operating costs were higher for the year ended December 31, 2009 compared to 2008 due to increased workover activity.

### Depletion, Depreciation and Amortization Expense

For the year and three months ended December 31, 2009, depletion, depreciation and amortization was $45.6 million and $24.5 million, respectively, (2008 – $25.7 million and $14.1 million, respectively). Depletion is calculated using the purchase price of the acquired assets, capital expenditures and proved reserves as at year-end. The significant increase in 2009 over 2008 is due primarily to a higher unit of production DD&A rate resulting from a downward revision to proven reserves as at December 31, 2009 as compared to the position at December 31, 2008.

### Asset Impairment

Asset impairment for the year and three months ended December 31, 2009, was $20.6 million and $19.2 million respectively, (2008 – $1.0 million and $1.0 million, respectively). During 2009 writedowns were taken for Chaal in the amount of $10.2 million, Madagascar $3.5 million and an additional impairment charge of $4.6 million was taken after giving further consideration to potential impairment to the carrying value of its petroleum and natural gas properties by reference to a number of external factors including the market capitalization of the Company and the proposed transaction with Geofinance NV.

### General and Administrative Costs

For the year and three months ended December 31, 2009, general and administrative costs were $6.0 million and $1.7 million, respectively, (2008 – $7.8 million and $2.5 million, respectively). The 2009 costs were lower than the same periods in 2008 due to cost reduction initiatives.

### Interest Expense

Interest expense for the year and three months ended December 31, 2009 was $4.5 million and $1.4 million, respectively, (2008 – $3.2 million and $0.6 million, respectively). The increase in the interest expense in 2009 over the same periods in 2008 is due to the higher borrowing costs on the term loan.

### Foreign Exchange

The unrealized foreign exchange loss for the year and three months ended December 31, 2009 was $2.6 million and $1.3 million respectively (2008 – gains of $0.1 million and $0.1 million, respectively). The increase in the loss was due to the revaluation of the Euro-denominated loan in SEEB.

### Related Party Transactions

During the year the Company had gas sales to SEEB of $0.4 million (2008 – $ 0.4) and as at December 31, 2009 the Company had a receivable from SEEB in the amount of $0.8 million (2008 – $0.8 million).

### Selected Quarterly Financial Data *(unaudited)*

*(in thousands of Canadian dollars except per share amounts)*

| | Q1 | Q2 | Q3 | Q4 | Year |
|---|---|---|---|---|---|
| **2009** | | | | | |
| Sales, net of royalties | **8,288** | **8,548** | **2,181** | **9,123** | **28,140** |
| Loss | **(13,943)** | **(3,129)** | **(3,681)** | **(40,443)** | **(61,196)** |
| Loss per share – basic and diluted | **(0.08)** | **(0.02)** | **(0.02)** | **(0.24)** | **(0.36)** |
| Total assets | **193,256** | **159,745** | **136,576** | **95,518** | **95,518** |
| Long-term financial liabilities | **48,201** | **32,755** | **28,619** | **39,315** | **39,315** |
| 2008 | | | | | |
| Sales, net of royalties | 2,097 | 14,909 | 13,864 | 3,896 | 34,766 |
| Net income (loss) | (2,298) | 2,820 | 1,573 | (15,244) | (13,149) |
| Net income (loss) per share – basic and diluted | (0.01) | 0.02 | 0.01 | (0.09) | (0.08) |
| Total assets | 185,802 | 183,811 | 183,812 | 194,254 | 194,254 |
| Long-term financial liabilities | 38,129 | 39,400 | 40,928 | 52,206 | 52,206 |

Revenue for the fourth quarter of 2009 was higher than the third quarter of 2009 due to the lifting in late December. The loss for the fourth quarter is significantly higher than the previous three quarters due to the asset impairments and related writedown as discussed previously. Revenue for the third quarter of 2009 was lower than each of the first and second quarters of 2009 due to lower production at El Bibane. The long-term financial liabilities were lower in the third quarter due to the stronger Canadian dollar against the US dollar which resulted in a lower liability for the US dollar-based term loan. Revenue for the second quarter of 2009 was consistent with the first quarter of 2009. Revenue for the first quarter of 2009 was higher than the fourth quarter of 2008 due to the timing of the liftings. Revenue for the fourth quarter of 2008 was lower than the third quarter of 2008 due to the timing of liftings. Revenue for the second quarter of 2008 was significantly higher than the first quarter of 2008 due to the start-up of production at the El Bibane field. The long-term financial liabilities for the second quarter of 2009 were lower than the first quarter of 2009 and the fourth quarter of 2008 due to principal repayments made and the increase in the amount recorded in the current portion. The increase in the long-term liabilities in the fourth quarter of 2008 over the first three quarters of 2008 was due to a drawdown in the credit facility.

## Liquidity, Capital Resources and Capital Expenditures

The Company has historically relied on debt and equity financing to raise capital and expects to be able to continue to do so. The Company is also dependent upon sustained cash flow from its operations. A material fall in the oil price or curtailment of production below certain levels would risk compromising the ability of the Company to meet its obligations as they fall due.

As at December 31, 2009, the Company reports cash balances of $9.8 million (December 31, 2008 – $8.9 million) and accounts receivable of $4.1 million (December 31, 2008 – $5.2 million) as compared to accounts payable and accrued liabilities of $17.9 million (December 31, 2008 – $14.9 million). The working capital deficit before financing at December 31, 2009 is, therefore, $4.0 million.

The Company's work programmes for 2010 include well intervention work on the offshore El Bibane field and rig-based prgrammes for the drilling of sidetracks and workovers on the onshore Ezzaouia field. The Company's net share of expenditure associated with these projects is estimated at approximately US$7.0 million. Production from the El Bibane field has been substantially curtailed by the matters referred to above and the objective of the work programme is to restore production from the field.

As noted above, on March 31, 2010 the Company completed an investment agreement with Geofinance NV, an international upstream oil and gas company ("Geofinance") by which Geofinance contributed new equity of $13,000,000 which will be used to finance work programmes and for general working capital purposes.

The Term Loan is provided by Bank of Scotland as sole lender under a Borrowing Base Facility Agreement which is secured by the Company's oil producing assets in Tunisia. The amount that is available to be drawn under this facility is determined by a semi-annual borrowing base review. Prior to the conclusion of an Amendment and Restatement Agreement on March 31, 2010 (see Note 20(b) of the audited consolidated financial statements) the maturity date for the Term Loan was December 31, 2012 and the loan had borne interest at US$ LIBOR +3.25%.

As of December 31, 2009, the maximum amount available under the facility was US $45.0 million. The amount of the Term Loan outstanding at this date was US $43.9 million and an additional US $0.5 million of the facility is being used as security for a letter of credit provided by the Company. On March 31, 2010 the Company entered into an Amendment and Restatement Agreement with the bank which, amongst other matters provided for a new repayment schedule. The timing of the repayment obligations of the Company which amount to US $8 million for the next twelve months will be dependent upon cash flow generated from operations but are required to be paid, in any case, no later than December 31, 2010.

The Company has considered how these conditions have impacted the Company's viability and considers that until the outcome of the matters referred to in Note 1 to the audited consolidated financial statements is known, these factors lend significant doubt about the ability of the Company to continue as a going concern.

## Capital Management and Risk Sensitivities

The Company manages its capital to ensure that the Company and its subsidiaries will be able to continue as a going concern while attempting to maximize the return to shareholders through the optimization of debt and equity financing. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the Company. The capital structure consists of debt, cash and cash equivalents and shareholders' equity excluding accumulated other comprehensive income (loss). Candax monitors its capital through its net cash position calculated as cash less term loan debt. The Company maintains this structure by managing working capital, capital spending programs and debt repayment terms. The Company raises capital, as necessary and the optimal balance between debt and equity may change over time.

| | December 31, 2009 | December 31, 2008 |
|---|---|---|
| Total debt | $ 57,042 | $ 72,204 |
| Less: Cash and cash equivalents | 9,782 | 8,931 |
| Net debt | 47, 260 | 63,273 |
| Shareholders' equity | 28,915 | 89,835 |
| **Total Capital** | $ 76,175 | $ 153,108 |

Included in total debt is $9.1 of limited recourse long term debt relating to the SEEB power generation facility. This debt is serviced from the operating cash flow of SEEB and in the event of default recourse to Candax is limited to US $0.8 million.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There were no changes in the Company's approach to capital management during the year ended December 31, 2009 compared to the year ended December 31, 2008.

## Sensitivity Analysis

Based on management's knowledge and experience of the financial markets, the Company believes the following movements are "reasonably possible" over a one year period:

- Cash and cash equivalents include deposits which are at variable interest rates. Term debt and non-recourse project financing are also at variable interest rates. Sensitivity to a plus or minus 1% change in rates would affect net loss by $0.5 million for the one year period ended December 31, 2009.
- The Company does not hold significant balances or debt in currencies other than the US dollar to give rise to exposure to significant foreign exchange risk.
- The Company is exposed to changes in oil prices. Sensitivity to a plus or minus $1.00 change in the price of crude oil would affect net loss by $0.5 million for the one year period ended December 31, 2009.

## Commitments and Contingencies

Under the provisions of the hydrocarbon law of Tunisia, 20% of the Company's oil production must be sold to ETAP. The Company receives 90% of the export sales price achieved by ETAP on sale of such production.

As at December 31, 2009, the Company had provided a standby letter of credit in the amount of US $0.5 million in favour of Madagascar Ministry of Industry and Mines in accordance with the terms of the production sharing agreement entered into in November 2006. The letter of credit will be released when the Company has satisfied the commitments as outlined in the agreement.

One of the Company's joint venture partners has initiated arbitration proceedings in connection with claims that it is seeking to assert arising from its audit of the costs of the El Bibane redevelopment programme. The Company has accrued US $0.8 million in this regard.

The Company's joint venture partners in the Chaal permit have submitted reports arising from their audit of the expenditures associated with the initial Chaal exploration well. Amongst other matters, the reports assert claims for credit which, if sustained would result in the Company incurring additional liability of US$0.3 million. The Company is presently assessing the reports and will respond to partners in due course. It is not anticipated that any additional material liability will be incurred and, accordingly no amounts have been accrued for in this regard.

Contractual Obligations and Other Commitments as at December 31, 2009:

| | Total | Within 1 year | 1 to 3 years | 3 to 5 years | Over 5 years |
|---|---|---|---|---|---|
| Long term debt obligations | 46,146 | 8,408 | 23,122 | 14,616 | Nil |

Obligations under the limted recourse long-term debt are not included as discussed above.

## Critical Accounting Estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates relate primarily to the future development costs associated with proved undeveloped reserves, reserve volumes, future production and revenues, and future costs associated with asset retirement obligations. The Company has its oil and gas reserves, future development costs and future cash flows from those reserves evaluated and reported on by Ryder-Scott Company Petroleum Consultants, independent petroleum reserve engineering consultants. The estimation of these amounts is a subjective process, based on engineering data, forecasted prices and production levels and the timing of expenditures. All of these estimates are subject to numerous uncertainties and various interpretations, and consequently will change over time to reflect updated information as it is received.

Candax follows the full cost method of accounting, whereby all costs incurred in exploring for and developing oil and gas reserves are capitalized. Such expenditures include geological and geophysical expenses, carrying charges for unproved properties, costs of drilling both productive and non-productive wells, gathering and production facilities and general and administrative costs directly related to exploration and development activities. Capitalized costs are accumulated on a country-by-country basis and are amortized and depleted using the unit-of-production method based upon estimated proved reserves. For those properties that are still in the development stage, related costs are capitalized until either commercial production commences or it is determined that the invested amounts will never be recovered.

Natural gas reserves are converted to equivalent barrels of oil on the basis of their relative energy content (6 mcf equals 1 barrel). Costs directly associated with the acquisition and evaluation of unproved properties are initially excluded from the computation of depletion. These unproved properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered impaired, the cost of the property or the amount of the impairment is added to all other capitalized costs subject to amortization and depletion.

The Company calculates a ceiling test whereby the net capitalized costs of properties cannot exceed discounted cash flows from proved and probable reserves. Cash flows are calculated based on third-party quoted forward prices and adjusted for the Company's contracted prices and quality differentials. If there is impairment, the magnitude of it would be calculated by comparing the carrying amount of property, plant and equipment to the estimated net present value of future cash flows from proved plus risked probable reserves. A risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying value above the net present value of future cash flows would be recorded as a permanent impairment and charged as additional depletion expense in the consolidated statements of operations and deficit.

Sales of oil and gas properties are accounted for as adjustments to capitalized costs, with no gain or loss recognized unless such adjustments would alter the rate of depletion and amortization by more than 20%.

## Business Risks

A comprehensive assessment of the Company's business risks is set out in the 2009 Annual Information Form. There are a number of inherent risks associated with oil and gas operations and development. Many of these risks are beyond the control of the Company. The following outlines some of the principal risks and their potential impact on the Company:

### EXPLORATION, DEVELOPMENT AND PRODUCTION RISKS

A portion of the current working capital of Candax will be expended on petroleum and natural gas exploration, exploitation and development activities, which are high-risk ventures with uncertain prospects for success. Oil and gas exploration involves a high degree of risk and there is no assurance that expenditures made on future exploration activities by the Company will result in new discoveries of oil, condensate or natural gas that are commercially viable or economically producible. Holders of securities of the Company must rely on the ability, expertise, judgment, discretion, integrity and good faith of management of the Company. It is difficult to project the costs of implementing any exploratory or developmental drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over-pressured zones and tools lost in the hole and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof. Few properties that are explored are ultimately developed into new reserves. In certain instances, the Company may be precluded from pursuing an exploration program or decide not to continue with an exploration program and such an occurrence may have a negative effect on the value of the securities of the Company.

Future oil exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include: delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

### PETROLEUM AND NATURAL GAS RESERVES

All evaluations of future net revenues are before consideration of indirect costs such as administrative overhead, other miscellaneous expenses and income taxes. The future net revenues may not be representative of the fair market value of the reserves. There is no assurance that the forecast price and cost assumptions contained in the year end 2009 Ryder Scott Report will be attained and variances may be material. There are numerous uncertainties inherent in estimating quantities of proved and probable reserves, including many factors beyond the control of the Company. The reserves data and net present value of future cash flows set forth represent estimates only.

In general, estimates of economically recoverable petroleum and natural gas reserves and the future net revenues therefrom are based upon a number of variable factors and assumptions, such as historical production from the properties, commodity prices, the assumed effects of regulation by governmental agencies and future operating costs, each of which may vary considerably from actual results. Estimates of the economically recoverable petroleum and natural gas reserves attributable to any particular group of properties, classification of such reserves based on risk of recovery and estimates of future net revenues expected therefrom, prepared by different engineers or by the same engineers at different times, may vary substantially.

### FLUCTUATION OF COMMODITY PRICES

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors all of which are beyond the control of the Company. Crude oil price is influenced by many factors, including the world economy, OPEC's ability to adjust supply to demand and political events. Where natural gas prices are not legislated to be linked to the price of oil, they are characterized more by regional supply and demand considerations, as in North America, Europe, and the Middle East, where pipeline infrastructure between producing and consuming nations plays a key role in price setting. More recently, LNG cargoes are setting the marginal cost for trans-ocean supply from gas rich producing nations when pipeline delivery is impossible. Based on concerns for future oil supply and huge undeveloped gas reserves, natural gas demand growth is transforming economics for both export and domestic markets around the world.

World prices for oil and natural gas have fluctuated widely in recent years. Future price fluctuations in world prices may continue and may have a significant impact upon the projected revenue of the Company, the projected return from its existing and future reserves and the general financial viability of the Company.

The oil and natural gas prices realized by the Company are affected by factors such as supply and demand, oil quality and transportation adjustments. The Company expects to market its oil and natural gas production in a manner consistent with past practices. In the case of natural gas, the Company has fixed rate sales contracts. The Company's current natural gas production is subject to the provisions of the Petroleum Law, which provides for sales into the Tunisian domestic market at rates less than those which would be realized in the international market. While the Company sells the majority of its Tunisian oil to arms-length purchasers priced on a sale by sale basis at prevailing market conditions, a portion of the oil produced by the Company is required to be sold domestically in Tunisia at rates less than those which would be realized in the international market. There is no assurance that the price paid for the oil produced by the Company will remain at current levels. A decrease in the price obtained for its oil may have a material adverse effect on the financial condition of the Company and its future operations.

### ASSET IMPAIRMENT RISK

As discussed above, future additional declines in commodity prices and uncertainty in the capital markets could lead to additional impairments of the carrying value of the oil and gas assets held by the Company and thus may require a future significant charge to earnings and could potentially lead to a reduction of the Company's borrowing capacity.

### FOREIGN CURRENCY EXCHANGE RATES

The Company's reporting currency is the Canadian dollar and its functional currency is the US dollar as all major business dealings are transacted in US dollars. The Company sells its oil production pursuant to marketing agreements that are denominated in US dollars. Many of the operational and other expenses incurred by the Company are paid in US dollars or in local currency of the country where operations are performed. The Company funds the majority of its transactions using US dollar currency from its US dollar bank account held with a European bank. The term loan debt is also US dollar denominated. Management believes the foreign exchange risk derived from currency conversions is negligible and therefore does not hedge its foreign exchange risk. The reported assets and liabilities of the Company (including reserve information) are recorded in Canadian dollars. As a result, fluctuations in the US dollar against the Canadian dollar and each of these currencies against local currencies in jurisdictions where properties of the Company are located could result in unanticipated and material fluctuations in the reported accounting financial results of the Company.

### COMPETITION

A number of other oil and gas companies operate and are allowed to bid for exploration and production licenses and other services in countries in Africa and the Middle East which are the focus of the business and operations of the Company, thereby providing competition to the Company. Larger companies may have access to greater resources than the Company, may be more successful in the recruitment and retention of qualified employees and may conduct their own refining and petroleum marketing operations, which may give such companies a competitive advantage over the Company. Some of these companies have been conducting operations in Tunisia for considerably longer periods of time than has the Company and thus these companies may be more familiar with the political and business landscape in Tunisia than the Company. In addition, actual or potential competitors may be strengthened through the acquisition of additional assets and interests.

### ENVIRONMENTAL REGULATION

The current and future operations of the Company that are conducted in Tunisia are subject to environmental regulations enforced by the Government of Tunisia. Should the Company initiate operations in other countries, such operations will be subject to environmental legislation in such jurisdictions. Current environmental legislation in Tunisia provides for restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil, condensate and natural gas operations. In addition, certain types of operations may require the submission and approval of environmental impact assessments. The existing operations of the Company are subject to such environmental policies and legislation. Environmental legislation and policy is periodically amended. Such amendments may result in stricter standards and enforcement and in more stringent fines and penalties for non-compliance. Environmental assessments of existing and proposed projects carry a heightened degree of responsibility for companies and their directors, officers and employees. The costs of compliance associated with changes in environmental regulations could require significant expenditures, and breaches of such regulations may result in the imposition of material fines and penalties. In an extreme case, such regulations may result in temporary or permanent suspension of production operations. There can be no assurance that these environmental costs or effects will not have a material adverse effect on the future financial condition or results of the operations of the Company.

### POLITICAL RISKS

Tunisia has experienced relative prosperity and stability under the leadership of President Ben Ali over the past two decades. Notwithstanding this relative stability, in the past, Tunisia has been affected by extremist Islamic militant activity. Tunisian authorities have implemented anti-terrorism policies and security precautions. By law, parties organized on the basis of religion, region, race or language are forbidden. Despite this, there are groups in Tunisia dedicated to turning the country into an Islamic republic. The Tunisian government has taken steps to prevent the Islamic militant struggle in neighbouring Algeria from affecting Tunisia by increasing its military presence along the Tunisia/Algeria border, imposing visa restrictions and imposing strict controls on local militants. Tunisia is bordered by both Algeria and Libya. Both countries have experienced periods of civil, political and militant unrest and Libya has been the subject of international sanctions; future unrest in any of the neighbouring countries could affect Tunisia.

In addition to the political risks, the Company is also subject to the laws of the various levels of government in the countries in which it conducts business. Such legislation may be changed from time to time in response to economic or political conditions, and the implementation of new legislation or modification of existing legislation affecting the oil and gas industry could change the Company's revenues and/or costs and have a material adverse impact on the business, results of operations, financial condition and liquidity.

### INTERNAL CONTROL OVER FINANCIAL REPORTING

Internal controls over financial reporting are procedures designed to provide reasonable assurance that transactions are properly authorized, assets are safeguarded against unauthorized or improper use, and transactions are properly recorded and reported. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance with respect to the reliability of financial reporting and financial statement preparation.

#### Evaluation of Disclosure Controls and Procedures and Internal Control over Financial Reporting

The Canadian Securities Administrators have issued National Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings which requires public companies in Canada to submit annual and interim certificates relating to the design and effectiveness of the disclosure controls and procedures that are in use at the company. Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported on a timely basis to senior management, including the Company's Chief Executive Officer and Chief Financial Officer, to enable this information to be reviewed and discussed so that appropriate decisions can be made regarding the timely public disclosure of the information.

As of December 31, 2009, management has evaluated the effectiveness of the design and the operating effectiveness of the disclosure controls and procedures as defined by National Instrument 52-109. This evaluation was performed under the supervision of and with the participation of the Company's Chief Executive Officer and Chief Financial Officer. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the design and operation of the disclosure controls and procedures were effective as of December 31, 2009.

#### Internal Control over Financial Reporting

National Instrument 52-109 also requires public companies in Canada to submit an annual certificate relating to the design and operating effectiveness of internal control over financial reporting ("ICFR"). ICFR is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. Management is responsible for establishing and maintaining ICFR and management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the design and tested the effectiveness of the ICFR at December 31, 2009. Based on this evaluation, management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has concluded that the design and operating effectiveness of ICFR was effective as of December 31, 2009. The Company has continued to use the COSO framework to design its ICFR. Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis as such systems can only be designed to provide reasonable as opposed to absolute assurance. Also projections of any evaluation of the effectiveness of ICFR to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

## Changes in Internal Control over Financial Reporting

National Instrument 52-109 also requires public companies in Canada to disclose in their MD&A any change in ICFR during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting. There were no changes in ICFR during the quarter ended December 31, 2009 that materially affected or are reasonably likely to materially affect the Corporation's internal control over financial reporting.

**RECENT ACCOUNTING CHANGES AND EFFECTIVE DATES**

## Goodwill and Intangible Assets

In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3064 – "Goodwill and Intangible Assets" which replaces "Goodwill and Other Intangible Assets." This new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. It ensures that intangible assets meet the definition of an asset, and eliminates the "matching" principle, whereby certain costs were being deferred and expensed to match with revenue earned. Concurrent with the introduction of this standard, the CICA withdrew EIC 27, Revenues and Expenses during the pre-operating period. This change has no impact on the Company since it does not apply to extractive industries.

## Credit Risk and Fair Value of Financial Assets and Liabilities

In January 2009, the CICA issued EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities." The EIC provides guidance on how to take into account credit risk of an entity and counterparty when determining the fair value of financial assets and financial liabilities, including derivative instruments.

This standard is effective for the Company's fiscal year beginning January 1, 2009. Adoption of this EIC did not have a significant effect on the Company's financial statements.

The CICA amended Section 3855 "Financial Instruments" to clarify that, upon reclassification of a financial instrument out of the trading category, an assessment must be completed to determine whether an embedded derivative is required to be bifurcated. In addition, the amendment prohibits the reclassification of a financial instrument out of trading when the derivative embedded in the financial instrument cannot be separately measured from the host contract. The amendment is applicable to all reclassifications occurring after July 1, 2009. Adoption of this standard did not have any material effect on the financial statements.

In August 2009, the CICA issued further amendments to Section 3855. The amendments changed the definition of a loan such that certain debt securities may be classified as loans if they do not have a quoted price in an active market and the Company does not have the intent to sell the security immediately or in the near term. As a result, debt securities classified as loans will be assessed for impairment using the incurred credit loss model of Section 3025 to reduce the carrying value of a loan to its estimated realizable amount. Loan impairment accounting requirements are also applied to held-to-maturity financial assets as a result of the amendments. Debt securities that are classified as available-for-sale continue to be written down to their fair value when the impairment is considered to be other than temporary. However, the impairment loss can be reversed if the fair value substantially increases and the increase can be objectively related to an event occurring after the impairment loss was recognized. Adoption of this standard did not have any material effect on the financial statements.

In June 2009, the CICA amended Section 3862 "Financial Instruments – Disclosures" to require enhanced disclosure about the fair value assessments of the financial instruments. The new disclosures are based on a fair value hierarchy that categorizes financial instruments measured at fair value at one of three levels according to the reliability of the inputs used to estimate the fair values. The amendments apply to annual financial statements for fiscal years ending after September 30, 2009. The Company has adopted these disclosures effective in the December 31, 2009 annual financial statements.

## International Financial Reporting Standards

On February 13, 2008, the CICA Accounting Standards Board announced the adoption of International Financial Reporting Standards ("IFRS") for publically accountable enterprises. IFRS will replace Canadian GAAP. The implementation will apply to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011.

In 2008, the Company undertook an IFRS diagnostic study with a view to assessing the impact of the transition to IFRS on the Company's accounting policies and to establish a project plan to implement IFRS. A number of key accounting areas where IFRS differs from current accounting policies and accounting alternatives in those and other key accounting areas were reviewed. While an analysis will be required for all current accounting policies, the initial key areas of assessment included:

- Evaluation of full-cost oil and gas accounting;
- Exploration and development expenditures;
- Property, plant and equipment (measurement and valuation);
- Provisions, including asset retirement obligations;
- Stock-based compensation;
- Accounting for joint ventures;
- Accounting for income taxes; and
- First-time adoption of International Financial Reporting Standards (IFRS 1)

The IFRS diagnostic study also identified key system and business process areas that will be addressed as part of the conversion project. These include: the development of an accounting policy manual that defines the Company's IFRS accounting policies; identification of the significant financial data required from the Company's financial systems in order to define the transition adjustments and produce IFRS financial statements on an on-going basis; possible system modifications; and maintenance of effective disclosure controls and controls over financial reporting throughout the IFRS transition period.

The table below summarizes the expected timing of activities related to the Company's transition to IFRS.

| Activity | Timing |
|---|---|
| Initial analysis of key areas for which changes to accounting policies may be required. | **Completed during 2008** |
| Detailed analysis of all relevant IFRS requirements and identification of areas requiring accounting policy changes or those with accounting policy alternatives. | **Q2 2010** |
| Assessment of first-time adoption (IFRS 1) requirements and alternatives. | **Q2 2010** |
| Final determination of changes to accounting policies and choices to be made with respect to first-time adoption alternatives | **Q4 2009 – Q3 2010** |
| Resolution of the accounting policy change implications on information technology, internal controls and contractual arrangements | **Q4 2009 – Q3 2010** |
| Management and employee education and training | **Throughout the transition process** |
| Quantification of the Financial Statement impact of changes in accounting policies | **Throughout 2010** |

## Forward-Looking Statements

This Management's Discussion and Analysis includes "forward-looking statements", within the meaning of applicable securities legislation, which are based on the opinions and estimates of Management and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar words suggesting future outcomes or statements regarding an outlook. Such risks and uncertainties include, but are not limited to, risks associated with the oil and gas industry (including operational risks in exploration development and production; delays or changes in plans with respect to exploration or development projects or capital expenditures; the uncertainty of reserve estimates; the uncertainty of estimates and projections in relation to production, costs and expenses; the uncertainty surrounding the ability of Candax. to obtain all permits, consents or authorizations required for its operations and activities; and health safety and environmental risks), the risk of commodity price and foreign exchange rate fluctuations, the ability of Candax to fund the capital and operating expenses necessary to achieve the business objectives of Candax, the uncertainty associated with commercial negotiations and negotiating with foreign governments and risks associated with international business activities, as well as those risks described in public disclosure documents filed by Candax. Due to the risks, uncertainties and assumptions inherent in forward-looking statements, prospective investors in securities of Candax should not place undue reliance on these forward-looking statements. Statements in relation to "reserves" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described can be profitably produced in the future.

Readers are cautioned that the foregoing lists of risks, uncertainties and other factors are not exhaustive. The forward-looking statements contained in this MD&A are made as of the date hereof and the Company undertakes no obligation to update publicly or revise any forward-looking statements contained in this MD&A or in any other documents filed with Canadian securities regulatory authorities, whether as a result of new information, future events or otherwise, except in accordance with applicable securities laws. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

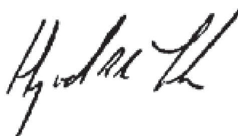
## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements are the responsibility of, and have been prepared by, the management of Candax Energy Inc. To fulfill this responsibility, the Company maintains appropriate systems of internal control, policies and procedures. These systems of internal control, policies and procedures help ensure that the Company's reporting practices and accounting and administrative procedures provide reasonable assurance that the financial information is relevant, reliable, and accurate, and that assets are safeguarded and transactions are executed in accordance with proper authorization. These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Where appropriate, these consolidated financial statements reflect estimates based on judgments of the management.

PricewaterhouseCoopers LLP, the independent auditors, have examined the consolidated financial statements of the Company. The independent auditors' responsibility is to express a professional opinion on the fairness of the consolidated financial statements. The auditors' report outlines the auditors' opinion and the scope of their examination and their report follows.

The consolidated financial statements have also been reviewed by the Directors of Candax Energy Inc. and by its Audit Committee. The Audit Committee is comprised of independent directors, and meets periodically during the year with the independent auditors and the management. The independent auditors have full and unrestricted access to the Audit Committee.

Michael I.T. Wood
President and Chief Executive Officer



Hywel John
Chief Financial Officer

March 31, 2010

## AUDITORS' REPORT

### To the Shareholders of Candax Energy Inc.

We have audited the consolidated balance sheets of Candax Energy Inc. (the Company) as at December 31, 2009 and 2008 and the consolidated statements of operations and deficit, cash flows and comprehensive loss for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers, LLP
Chartered Accountants, Licensed Public Accountants
Toronto, Ontario

March 31, 2010

## CONSOLIDATED BALANCE SHEETS

*As at December 31 (in thousands of Canadian dollars)*

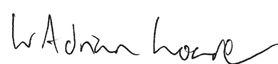
| | | 2009 | | 2008 |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current** | | | | |
| Cash and cash equivalents | $ | **9,782** | $ | 8,931 |
| Restricted investment *(Note 4)* | | **–** | | 945 |
| Accounts receivable | | **4,089** | | 5,174 |
| Inventory *(Note 5)* | | **137** | | 4,465 |
| Deposits and prepaids | | **505** | | 919 |
| | | **14,513** | | 20,434 |
| Deferred financing fees *(Note 20 (a))* | | **163** | | – |
| Petroleum and natural gas properties *(Note 6)* | | **69,699** | | 161,671 |
| Property, plant and equipment *(Note 6)* | | **11,143** | | 11,784 |
| Long-term receivable *(Note 7)* | | **–** | | 365 |
| | $ | **95,518** | $ | 194,254 |
| **Liabilities** | | | | |
| **Current** | $ | **17,886** | $ | 14,899 |
| Accounts payable and accrued liabilities | | | | |
| Current portion of term loan *(Note 8)* | | **8,408** | | 7,935 |
| Current portion of long-term debt *(Note 7)* | | **210** | | – |
| Limited recourse lon-term debt *(Note 9)* | | **9,109** | | 12,063 |
| | | **35,613** | | 34,897 |
| Term loan *(Note 8)* | | **37,738** | | 49,197 |
| Long-term debt *(Note 7)* | | **1,577** | | 3,009 |
| Asset retirement obligation *(Note 10)* | | **1,945** | | 1,449 |
| Future income tax liability *(Note 11)* | | **3,257** | | 4,746 |
| | | **80,130** | | 93,298 |
| **Shareholders' Equity** | | | | |
| Capital stock *(Note 12)* | | **111,791** | | 111,791 |
| Contributed surplus *(Note 12)* | | **3,513** | | 3,237 |
| | | **115,304** | | 115,028 |
| Accumulated other comprehensive income (loss) *(Note 15)* | | **(13,527)** | | 11,121 |
| Deficit | | **(86,389)** | | (25,193) |
| | | **(99,916)** | | (14,072) |
| | | **15,388** | | 100,956 |
| | $ | **95,518** | $ | 194,254 |

Going conern *(Note 1)*

Commitments *(Note 17)*

*The accompanying notes are an integral part of these financial statements.*

**Approved on behalf of the Board of Directors**



**Adrian Loader**
**Director**

**Murray Grant**
**Director**

## CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

*For the year ended December 31 (in thousands of Canadian dollars except for per share amounts)*

| | | 2009 | | 2008 |
|---|---|---|---|---|
| **Revenues** | | | | |
| Sales, net of royalties | $ | 28,140 | $ | 34,766 |
| Interest and other income | | 2,536 | | 700 |
| | | 30,676 | | 35,466 |
| **Expenses** | | | | |
| Operating costs | | 9,841 | | 6,320 |
| Depletion, depreciation and amortization | | 45,558 | | 25,670 |
| Asset impairment | | 20,629 | | 986 |
| General and administrative | | 6,045 | | 7,832 |
| Interest | | 4,548 | | 3,203 |
| Foreign exchange (gain) loss | | 2,558 | | (137) |
| Stock-based compensation *(Note 12)* | | 277 | | 828 |
| Accretion on asset retirement obligation and closure costs *(Note 10)* | | 137 | | 179 |
| | | 89,593 | | 44,881 |
| **Loss for the year before current and future income taxes** | | (58,917) | | (9,415) |
| Current income tax expense | | 3,409 | | 2,164 |
| Future income tax expense (recovery) | | (1,130) | | 1,570 |
| | | 2,279 | | 3,734 |
| **Loss for the year** | $ | (61,196) | $ | (13,149) |
| Deficit, beginning of year | | (25,193) | | (12,044) |
| **Deficit, end of year** | $ | (86,389) | $ | (25,193) |
| **Loss per share – basic and diluted** | | (0.36) | | (0.08) |
| **Weighted average number of shares outstanding – basic and diluted** | | 169,261,606 | | 169,247,140 |

*The accompanying notes are an integral part of these financial statements.*

## CONSOLIDATED STATEMENTS OF CASH FLOWS

*For the year ended December 31 (in thousands of Canadian dollars)*

| | 2009 | 2008 |
|---|---|---|
| **Operating Activities** | | |
| Loss | $ (61,196) | $ (13,149) |
| Items not affecting cash | | |
| Write-down of spare parts inventory | – | 350 |
| Stock-based compensation | 277 | 828 |
| Depletion, depreciation and amortization | 45,558 | 25,670 |
| Asset impairment and write-off of property appraisal costs | 20,629 | 986 |
| Future income tax expense (recovery) | (1,130) | 1,570 |
| Accretion on asset retirement obligation | 137 | 179 |
| | 4,275 | 16,434 |
| Net change in non-cash working capital *(Note 19)* | 7,456 | (2,823) |
| | 11,731 | 13,611 |
| **Investing Activities** | | |
| Investment in long-term receivable | – | 100 |
| Additions to petroleum and natural gas properties | (5,651) | (66,209) |
| Additions to property, plant and equipment | (1,688) | – |
| | (7,339) | (66,309) |
| **Financing Activities** | | |
| Proceeds from credit facility | – | 30,914 |
| Deferred share issuance costs | (163) | – |
| Issuance of common shares | – | 28 |
| | (163) | 30,942 |
| Foreign currency translation | (3,378) | 8,488 |
| **Net decrease in cash and cash equivalents** | 851 | (13,268) |
| Cash and cash equivalents, beginning of year | 8,931 | 22,199 |
| **Cash and cash equivalents, end of year** | $ 9,782 | $ 8,931 |
| **Cash and cash equivalents are comprised of:** | | |
| Cash | $ 9,782 | $ 8,931 |
| Interest paid during the year | $ 3,006 | $ 2,649 |
| Income taxes paid during the year | $ 1,097 | $ 4,150 |

*The accompanying notes are an integral part of these financial statements.*

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

*As at December 31 (in thousands of Canadian dollars)*

| | | 2009 | | 2008 |
|---|---|---|---|---|
| Loss for the year | $ | (61,196) | $ | (13,149) |
| Other comprehensive income (loss): | | | | |
| Unrealized foreign exchange gain (loss) on translation of self-sustaining foreign operations | | (24,648) | | 34,853 |
| Income taxes | | – | | – |
| Other comprehensive income (loss): | | (24,648) | | 34,853 |
| Comprehensive income (loss) | $ | (85,844) | $ | 21,704 |

*The accompanying notes are an integral part of these financial statements.*

## 1. GOING CONCERN AND BASIS OF PRESENTATION

These consolidated financial statements include the accounts of Candax Energy Inc. ("Candax" or the "Company") and its subsidiaries and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") applicable to a going concern, which assumes that the Company will be able to settle its liabilities in the normal course of business as they come due and continue its operations for a period of at least twelve months from the reporting date. Accordingly, the accompanying consolidated financial statements do not include any adjustments to the carrying values of assets and liabilities, the revenues, the reported expenses, and the balance sheet classifications used, that might be necessary if the Company was unable to realize its assets and settle its liabilities as a going concern in the normal course of business. Such adjustments could be material.

The Company has a Term Loan provided by Bank of Scotland (the "bank") as sole lender under a Borrowing Base Facility Agreement which is secured by the Company's oil producing assets in Tunisia. On March 31, 2010 the Company entered into an Amendment and Restatement Agreement with the bank which, amongst other matters provided for a new repayment schedule such that the Company would be required to make a repayment of US $8 million on December 31, 2010.

In 2010, the Company is planning capital projects for the Ezzaouia field and remediation programmes in the El Bibane field to restore and optimise oil production from these wells.

The ability of the Company to meet its estimated repayment obligations to the bank or fund the above capital programmes from forecast cash flows generated by operations is dependent upon the successful outcome of the programmes. These factors lend significant doubt about the ability of the Company to continue as a going concern.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The significant accounting policies are summarized below:

### Consolidation

The consolidated financial statements include the accounts of Candax together with its wholly owned subsidiaries, Ecumed Petroleum Grombalia, Ltd., Ecumed Petroleum Tunisia, Ltd., Ecumed Petroleum Zarzis, Ltd. and Falcan Chaal Petroleum, Ltd. (known collectively as the "Tunisian properties"), Candax Energy Limited ("CEL"), Candax Energy Services Limited ("CESL") and the proportionate share of its 50% investment in Société d'Electricité d'El Bibane ("SEEB"). All significant intercompany balances and transactions have been eliminated.

### Joint ventures

Substantially all of the Company's exploration and operating activities, including electricity generation, are conducted jointly with others. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

### Measurement uncertainty

Management has made estimates and assumptions regarding certain assets, liabilities, revenues and expenses in the preparation of the consolidated financial statements. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. Accordingly, actual results may differ from estimated amounts.

Depletion and amortization, and amounts used for ceiling test calculations are based on estimates of oil and natural gas reserves and commodity prices, production expenses and capital costs required to develop and produce those reserves. The Company's reserve estimates are evaluated annually by Ryder-Scott Company Petroleum Consultants, independent petroleum reserve engineering consultants. By their nature, estimates of reserves and the related future cash flows are subject to measurement uncertainty, and the impact of differences between actual and estimated amounts on the consolidated financial statements of future periods could be material.

The calculation of the asset retirement obligation includes estimates of the future costs to settle the asset retirement obligation, the timing of the cash flows to settle the obligation, and the future inflation rates. The impact of differences between actual and estimated costs, timing and inflation on the consolidated financial statements of future periods could be material.

### Cash and cash equivalents

Cash and cash equivalents comprise cash and short-term market investments with maturities of three months or less at the date of acquisition.

### Restricted investment

Restricted investments represent amounts which have been pledged as security for transactions entered into by the Company. The investments are held by third parties and as such are not available for the Company's own use. (See Note 4.)

### Petroleum and natural gas properties and related depletion and amortization

Candax follows the full cost method of accounting, whereby all costs incurred in exploring for and developing oil and gas reserves are capitalized. Such expenditures include geological and geophysical expenses, carrying charges for unproved properties, costs of drilling both productive and non-productive wells, gathering and production facilities and general and administrative costs directly related to exploration and development activities. Capitalized costs are accumulated on a country-by-country basis and are amortized and depleted using the unit-of-production method based upon estimated proved reserves. For those properties that are still in the development stage, related costs are capitalized until either commercial production commences or it is determined that the invested amounts will never be recovered.

Natural gas reserves are converted to equivalent barrels of oil on the basis of their relative energy content (6 mcf equals 1 barrel). Costs directly associated with the acquisition and evaluation of unproved properties are initially excluded from the computation of depletion. These unproved properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered impaired, the cost of the property or the amount of the impairment is added to all other capitalized costs subject to amortization and depletion.

The Company calculates a ceiling test whereby the net capitalized costs of properties cannot exceed discounted cash flows from proved and probable reserves. Cash flows are calculated based on third-party quoted forward prices and adjusted for the Company's contracted prices and quality differentials. If there is impairment, the magnitude of it would be calculated by comparing the carrying amount of property, plant and equipment to the estimated net present value of future cash flows from proved plus risked probable reserves. A risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying value above the net present value of future cash flows would be recorded as a permanent impairment and charged as additional depletion expense in the consolidated statements of operations and deficit.

Sales of oil and gas properties are accounted for as adjustments to capitalized costs, with no gain or loss recognized unless such adjustments would alter the rate of depletion and amortization by more than 20%.

### Foreign currency translation

The Tunisian subsidiaries are considered self-sustaining operations and exist in a business environment where the US dollar is their functional currency. The financial statements of self-sustaining operations are translated into Canadian dollars from their functional currency using the current rate method. Under this method, assets and liabilities are translated into Canadian dollars using the exchange rate in effect at the consolidated balance sheet date. Revenues and expenses are translated into Canadian dollars at the average exchange rate for the period. All resulting exchange gains and losses are recorded in shareholders' equity in the accumulated other comprehensive income (loss) account.

CEL and CESL are considered integrated foreign operations and as such, their financial statements are translated using the temporal method. Under this method, monetary assets and liabilities denominated in foreign currency are translated into Canadian dollars at the exchange rate in effect at the consolidated balance sheet date and non-monetary assets and liabilities are translated into Canadian dollars at the exchange rate in effect on the transaction date. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the average exchange rate for the period. All resulting exchange gains and losses are recorded in the consolidated statements of operations and deficit.

### Inventory valuation

The crude oil inventory and the material and supplies inventory are valued at the lower of cost and net realizable value.

### Asset retirement obligation

The Company recognizes the fair value of an asset retirement obligation ("ARO") in the period in which it is incurred when a reasonable estimate of fair value can be made. The fair value of the estimated ARO is recorded as a long-term liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is amortized to expense through depletion over the life of the asset. The liability amount is increased each reporting period due to the passage of time and the amount of this accretion is charged to earnings in the period. Revisions, if any, to the estimated timing of cash flows or to the original estimated undiscounted cost, if any, also result in an increase or decrease to the ARO and the related asset. Actual costs incurred upon settlement of the ARO are charged against the ARO to the extent of the liability recorded. Any difference between the actual costs incurred upon settlement of the ARO and the recorded liability is recognized as a gain or loss in the Company's earnings in the period in which the settlement occurs.

### Stock-based compensation plan

The Company has an incentive stock option plan which is described in Note 12. The Company accounts for its stock-based compensation plan using the fair value method. The fair value of stock options is determined on their grant date and recorded as compensation expense over the period that the stock options vest, with a corresponding increase in contributed surplus. When stock options are exercised, the proceeds, together with the amount recorded in contributed surplus, are recorded in capital stock. The calculation of this expense is described in Note 12.

### Financial Instruments

Financial instruments have been classified into one of the following five categories: held for-trading assets or liabilities, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in accumulated other comprehensive income until the instruments are derecognized or impaired. Loans and receivables, investments held-to-maturity and other financial liabilities are measured at cost.

The Company made the following classifications:

| | |
|---:|---|
| Cash and cash equivalents | Held for trading |
| Restricted investment | Held for trading |
| Accounts receivable | Loans and receivables |
| Long-term receivable | Loans and receivables |
| Accounts payable | Other financial liabilities |
| Term loan | Other financial liabilities |
| Limited recourse long-term debt | Other financial liabilities |

Transaction costs are expensed for all financial instruments.

### Revenue Recognition

Oil production from the El Bibane, Ezzaouia and Robbana fields is blended and accumulated in a storage tank owned by the Ezzaouia JV and periodically lifted in marketable cargo sizes. The Tunisian state-owned company Entreprise Tunisienne d'Activités Pétrolières ("ETAP"), with respect to its 55% participating interest in Ezzaouia field production and on behalf of the Government with respect to the royalty and domestic market delivery obligations, and the other partners in those fields acting in consortium have an agreement to lift in turn to optimize tanker lifting volumes. As a result of this practice, a short-term volumetric imbalance may arise through an "under/over" lift position. Overlift and underlift are in effect a sale of oil at the point of lifting by the underlifter to the overlifter. As the criteria for revenue recognition is considered to have been met, no deferred revenue is recorded. The Company treats an overlift as a purchase of oil at market price with an associated liability also recorded; conversely, an underlift is treated as a sale of oil at market price with an associated asset also recorded.

### Income taxes

The Company follows the liability method of accounting for income taxes. Under this method future tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Future tax liabilities and assets are measured using enacted tax rates. The effect on future tax liabilities and assets of a change in tax rates is recognized in the period that the change occurs.

### Net income (loss) per common share

Net income (loss) per common share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period. For the purposes of the weighted average number of common shares calculation, common shares are determined to be outstanding from the date they are issued. Diluted income (loss) per common share is calculated using the treasury stock method, which assumes that all outstanding stock option grants are exercised, if dilutive, and the assumed proceeds are used to purchase the Company's common shares at the average market price during the year.

### Recent Accounting Pronouncements

The CICA has issued the following accounting standards effective for the fiscal years beginning on or after January 1, 2010:

CICA Handbook Section 1582 "Business Combinations", Section 1601 "Consolidated Financial Statements" and Section 1602 "Non-Controlling Interests" which replace the former CICA 1581 "Business Combinations" and CICA 1600 "Consolidated Financial Statements" and establish a new section for accounting for a non-controlling interest in a subsidiary. These sections provide the Canadian equivalent to FASB Statements No.141(R) "Business Combinations" and No.160 "Non-Controlling Interests in Consolidated Financial Statements". CICA 1582 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period after January 1, 2011. CICA 1601 and CICA 1602 apply to interim and annual consolidated financial statements relating to years beginning on or after January 1, 2011 although early adoption is permitted. CICA 1582, which replaces Handbook Section 1581, Business Combinations, establishes standards for the measurement of a business combination and the recognition and measurement for assets acquired and liabilities assumed. CICA 1601, which replaces Handbook Section 1600, carries forward the existing Canadian guidance on aspects of the preparation of consolidated financial statements subsequent to acquisition other than non-controlling interests. CICA 1602 establishes guidance for the treatment of non-controlling interests subsequent to acquisition through a business combination.

## 3. CHANGES IN ACCOUNTING POLICIES

### Goodwill and Intangible Assets

In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3064 – "Goodwill and Intangible Assets" which replaces "Goodwill and Other Intangible Assets." This new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. It ensures that intangible assets meet the definition of an asset, and eliminates the "matching" principle, whereby certain costs were being deferred and expensed to match with revenue earned. Concurrent with the introduction of this standard, the CICA withdrew EIC 27, Revenues and Expenses during the pre-operating period. This change has no impact on the Company since it does not apply to extractive industries.

### Credit Risk and Fair Value of Financial Assets and Liabilities

In January 2009, the CICA issued EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities." The EIC provides guidance on how to take into account credit risk of an entity and counterparty when determining the fair value of financial assets and financial liabilities, including derivative instruments.

This standard is effective for the Company's fiscal year beginning January 1, 2009. Adoption of this EIC did not have a significant effect on the Company's financial statements.

The CICA amended Section 3855 "Financial Instruments" to clarify that, upon reclassification of a financial instrument out of the trading category, an assessment must be completed to determine whether an embedded derivative is required to be bifurcated. In addition, the amendment prohibits the reclassification of a financial instrument out of trading when the derivative embedded in the financial instrument cannot be separately measured from the host contract. The amendment is applicable to all reclassifications occurring after July 1, 2009. Adoption of this standard did not have any material effect on the financial statements.

In August 2009, the CICA issued further amendments to Section 3855. The amendments changed the definition of a loan such that certain debt securities may be classified as loans if they do not have a quoted price in an active market and the Company does not have the intent to sell the security immediately or in the near term. As a result, debt securities classified as loans will be assessed for impairment using the incurred credit loss model of Section 3025 to reduce the carrying value of a loan to its estimated realizable amount. Loan impairment accounting requirements are also applied to held-to-maturity financial assets as a result of the amendments. Debt securities that are classified as available-for-sale continue to be written down to their fair value when the impairment is considered to be other than temporary. However, the impairment loss can be reversed if the fair value substantially increases and the increase can be objectively related to an event occurring after the impairment loss was recognized. Adoption of this standard did not have any material effect on the financial statements.

In June 2009, the CICA amended Section 3862 "Financial Instruments – Disclosures" to require enhanced disclosure about the fair value assessments of the financial instruments. The new disclosures are based on a fair value hierarchy that categorizes financial instruments measured at fair value at one of three levels according to the reliability of the inputs used to estimate the fair values. The amendments apply to annual financial statements for fiscal years ending after September 30, 2009. The Company has adopted these disclosures effective in the December 31, 2009 annual financial statements (see note 14).

## 4. RESTRICTED INVESTMENT

| | 2009 | 2008 |
|---|---|---|
| Security Deposit | $ 0 | $ 945 |

Restricted investment represents a $1.0 million deposit (US $0.9 million) in a debt service reserve account held by the Arab Banking Corporation as security for principal and interest payments payable by SEEB in relation to its limited recourse bank financing (see Note 9).

During the current year, the amount was written off in recognition of the risk that SEEB will not be able to meet its payment obligations and that the security deposit would not be recoverable.

## 5. INVENTORY

| | 2009 | 2008 |
|---|---|---|
| Crude Oil | $ – | $ – |
| Materials and supplies | 137 | 760 |
| | $ 137 | $ 4,465 |

During 2009, crude oil net inventory changes (opening less closing values) of $0.9 million (2008 – $6.4 million) were expensed which includes write-downs of inventories of $ nil (2008 – $5.6 million).

During 2009, materials and supplies inventory in the amount of $0.5 million was written off due to obsolescence.

## 6. CAPITAL ASSETS

| 2009 | Cost | Accumulated Amortization | Carrying Value |
|---|---|---|---|
| Petroleum and natural gas properties | $ 160,561 | $ (90,862) | $ 69,699 |
| Property, plant and equipment | 19,241 | (8,098) | 11,143 |
| | $ 179,802 | (98,960) | $ 80,842 |
| 2008 | | | |
| Petroleum and natural gas properties | $ 206,890 | $ (45,220) | $ 161,671 |
| Property, plant and equipment | 17,659 | (5,875) | 11,784 |
| | $ 224,549 | $ (51,095) | $ 173,455 |

### Exploration and Appraisal

The Company has considered the carrying values of its interests in the Chaal Permit in Tunisia and of Block 1101 in Madagascar having regard, in particular, to the imminence of the expiry of the licence terms and the uncertainties concerning the nature and timing of drilling operations. Accordingly, it has concluded that it is appropriate to record impairment charges of $10.2 million and $3.5 million respectively in relation to these interests. Neither of these properties was included in the depletion calculations.

### Producing Assets

In addition to the annual ceiling test described in Note 2 and undertaken as at December 31, 2009, the Company has given further consideration to potential impairment to the carrying value of its petroleum and natural gas properties by reference to a number of external factors including the market capitalization of the Company and the proposed transaction with Geofinance NV. Having regard to such factors, the Company has recorded an additional impairment charge of $4.6 million.

As at December 31, 2009:

- there are no amounts of capitalized head office general and administrative costs included in the cost of properties (2008 – $0.3 million).
- the prices used in the ceiling test evaluation of the Company's crude oil and natural gas reserves were:

| | Natural Gas Price US$/Mcf | Crude Oil and Natural Gas Liquids $US/Bbl |
|---|---|---|
| 2010 | 0.41 | 74.40 |
| 2011 | 0.42 | 78.31 |
| 2012 | 0.54 | 80.28 |
| 2013 | 0.55 | 82.22 |
| 2014 | 0.56 | 84.17 |
| Average therafter | 0.60 | 93.46 |

## 7. LONG-TERM DEBT

Effective March 31, 2006, the Company entered into an agreement with Caterpillar Power Ventures International Ltd. ("Caterpillar") to purchase, over time, 50% of Caterpillar's US $5 million loan to SEEB, a Tunisian power generation company in which the Company and Caterpillar each have a 50% interest. Under the terms of the agreement, the Company was obligated to increase its participation in Caterpillar's loan to SEEB from zero to US $2.5 million through payments made to Caterpillar. The Company is required to pay Caterpillar US $0.2 million annually on or before March 31 of each year and made the first such payment in April 2006. In addition, any amount collected by the Company from SEEB on account of the gas receivables which were outstanding on March 31, 2006, in the amount of US $0.7 million would be required to be applied in accelerating the fulfilment of the Company's payment obligations to Caterpillar.

In June 2009, the Company and Caterpillar agreed that the US$5 million loan to SEEB should be converted from debt to equity and that new shares issued by SEEB should be allotted equally between the Company and Caterpillar. Upon the debt to equity conversion, the Company became unconditionally liable to Caterpillar for the remaining balance of the US$2.5 million which at December 31, 2009 amounted to US $1.7 million, of which US $0.2 million is current. The Company's payment obligations were unchanged.

In 2008, the payments made to Caterpillar were classified as a long-term receivable as this amount was owed to the Company by SEEB as part of its US $5 million loan payable to Caterpillar.

## 8. TERM LOAN

| | Rate | ($000s) | |
|---|---|---|---|
| | | December 31, 2009 | December 31, 2008 |
| Term Loan | LIBOR +3.25% | $ 46,146 | 57,132 |
| Less: current portion | | (8,408) | (7,935) |
| | | $ 37,738 | $ 49,197 |

The Term Loan is provided by Bank of Scotland as sole lender under a Borrowing Base Facility Agreement which is secured by the Company's oil producing assets in Tunisia. The amount that is available to be drawn under this facility is determined by a semi-annual borrowing base review. Prior to the conclusion of an Amendment and Restatement Agreement on March 31, 2010 (see Note 20(b)) the maturity date for the Term Loan was December 31, 2012 and the loan had borne interest at US$ LIBOR +3.25%.

As of December 31, 2009, the maximum amount available under the facility was US $45.0 million. The amount of the Term Loan outstanding at this date was US $43.9 million and an additional US $0.5 million of the facility is being used as security for a letter of credit provided by the Company (see Note 17(b)).

For the year ended December 31, 2009, interest expense in the amount of $3.2 million (2008 – $1.9 million) has been recorded in the consolidated statements of operations and deficit.

Repayments of the term loan are due as follows:

| | |
|---|---|
| 2011 | $ 12,612 |
| 2012 | 10,510 |
| 2013 | 10,510 |
| 2014 | 4,107 |

The repayment schedule is determined by the semi-annual borrowing base review as described above.

## 9. LIMITED RECOURSE LONG-TERM DEBT

| | Rate | ($000s) | |
|---|---|---|---|
| | | December 31, 2009 | December 31, 2008 |
| Limited recourse SEEB debt | | | |
| Project financing (US$ based) | LIBOR +2.25% +2% default margin* | $ 3,210 | $ 4,315 |
| Project financing (Euro based) | ADB** +2.25% +2% default margin* | 5,899 | 7,647 |
| Due to Caterpillar Power Ventures Inc. | 13% | – | 2,839 |
| Due to Caterpillar Power Ventures Inc. | LIBOR +0.4% | – | 271 |
| | | 9,109 | 15,072 |
| Amounts due within one year | | | |
| Due to Caterpillar Power Ventures Inc. | | – | (101) |
| Project financing (US$ based) | | (3,210) | (4,315) |
| Project financing (Euro based) | | (5,899) | (7,647) |
| | | (9,109) | (12,063) |
| | | $ – | $ 3,009 |

* *The 2% default margin commenced August 2009 as principal payments were deferred and the loans were technically in default.*

** *African Development Bank Base Rate.*

Limited Recourse Long-Term Debt represents the indebtedness of SEEB. The indebtedness comprises limited-recourse bank financing, denominated in separate tranches of US dollars and Euros. Security for the bank financing is limited to the project assets, the Company's shareholding in SEEB and a fully collateralized non-performance guarantee from the Company of US $0.8 million.

Due to an extended interruption to production from the El Bibane field from August 2005 to April 2008, SEEB was unable to meet interest and repayment obligations to the lending banks. On February 20, 2009, an Amendment and Restatement Agreement was signed between SEEB and the lending banks to allow for the restructuring of repayments of principal and interest subject to a number of conditions precedent the last of which was satisfied June 26, 2009 and the new financing declared to be closed as of June 26, 2009.

Reduced generating capacity between May and December 2009 and the extended interruption to gas supply from the El Bibane field SEEB has been unable to meet repayments of principal due under the provisions of the Amendment and Restatement Agreement. As a consequence of the payment arrears, SEEB has received formal notice from the lending banks that it is in default such that the loans can be called by the lenders at anytime and therefore the entire amount of the limited-recourse loans is considered current.

For the year ended December 31, 2009, interest expense in the amount of $0.6 million (2008 – $1.3 million) has been recorded in the consolidated statements of operations and deficit.

## 10. ASSET RETIREMENT OBLIGATION

| | 2009 | 2008 |
|---|---|---|
| Balance at January 1 | $ 1,449 | $ 1,842 |
| Accretion expense | 137 | 179 |
| Foreign exchange | (210) | 446 |
| Revision in estimate | 569 | (1,018) |
| Balance at December 31 | $ 1,945 | $ 1,449 |

The total undiscounted amount of estimated cash flows required to settle the obligation is $5.7 million at December 31, 2009, which has been discounted using a credit-adjusted risk-free rate of 9%. Most of these obligations are not expected to be paid until 2020.

## 11. INCOME TAXES

The future tax liability of $3.3 million at December 31, 2009, relates to the difference in the unclaimed tax deductible costs of capital assets in Tunisia and the related carrying value. The carrying value is based on the fair value of net assets acquired in the acquisition. When the assets are amortized there will be an associated tax benefit for accounting purposes. The liability is based on consolidated accounting values and any cash liability for income tax purposes is not triggered unless the underlying assets are sold. The approximate value of tax pools available in Tunisia is $123.4 million (2008 – $138.4 million).

| | 2009 | 2008 |
|---|---|---|
| Loss before income taxes | $ (58,917) | $ (9,415) |
| Canadian corporate tax rate | 33.00% | 33.50% |
| Calculated income tax provisions | (19,443) | (3,154) |
| Effect on taxes from foreign tax rate differential | (10,016) | (1,553) |
| Expenses incurred with no recognized tax benefit | 31,738 | 8,441 |
| | $ 2,279 | $ 3,734 |

Future income taxes have been provided for on the following temporary differences:

| Future tax (assets) liabilities | 2009 | 2008 |
|---|---|---|
| Capital assets | $ 3,257 | $ 4,746 |
| Non-capital loss carryforwards | (2,912) | (3,092) |
| Valuation allowance | 2,912 | 3,029 |
| Net future tax liability | $ 3,257 | $ 4,746 |

At December 31, 2009, the Company had non-capital tax losses available to offset future income for tax purposes in Canada. The losses expire in the years as noted:

| | | |
|---|---|---|
| 2014 | $ | 404 |
| 2015 | | 2,562 |
| 2026 | | 1,107 |
| 2027 | | 3,957 |
| 2028 | | 1,981 |
| 2029 | | 1,639 |
| | | 11,650 |

The Company has not recognized a future tax asset for Canadian non-capital losses carried forward. In addition, the Company has not recognized a future tax asset of $23.2 million relating to the Tunisian properties. These assets have not been recognized since it is not, more likely than not, that such assets will be utilized in the foreseeable future.

## 12. CAPITAL STOCK

### Common shares

Candax is authorized to issue an unlimited number of common shares without par value. The Company's issued and outstanding common shares consist of the following:

| | | | |
|---|---|---|---|
| **Balance at December 31, 2007** | **169,231,606** | **$** | **111,753,046** |
| Issuance of shares under share incentive Plan | 30,000 | | 38,400 |
| **Balance at December 31, 2008 and 2009** | **169,261,606** | **$** | **111,791,446** |

During the year ended December 31, 2009, no common shares (2008 – 30,000) were issued under the share incentive plan. The average price of the common shares issued in 2008 was $0.94.

**Contributed Surplus**

| | | |
|---|---|---|
| **Balance at December 31, 2007** | **$** | **2,419** |
| Stock-based compensation | | 828 |
| Exercise of stock options | | (10) |
| **Balance at December 31, 2008** | **$** | **3,237** |
| Stock-based compensation | | 276 |
| **Balance at December 31, 2009** | **$** | **3,513** |

## Stock Options

In April 2005, the Board of Directors established a share incentive plan to provide additional incentive to its directors, officers, employees and consultants for their efforts on behalf of the Company in the conduct of its affairs. The maximum number of common shares reserved for issuance under the share option plan comprising part of the share incentive plan may not exceed 10% of the number of common shares outstanding. Under the terms of the plan, all options vest immediately, unless otherwise specified. All options granted under the plan expire no later than the tenth anniversary of the grant date.

A summary of the status of the plans as of December 31, 2009 and 2008 and changes during the years ending on those dates is presented as follows:

| | 2009 | | 2008 | |
|---|---|---|---|---|
| | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price | Number of Options |
| Outstanding – beginning of period | $ 0.79 | 13,550,000 | $ 0.78 | 12,067,500 |
| Transactions during the period: | | | | |
| Granted | 0.20 | 50,000 | 0.83 | 2,075,000 |
| Exercised | – | – | 0.94 | (30,000) |
| Expired | – | – | 1.16 | (60,000) |
| Forfeited | 0.80 | (2,900,000) | 0.80 | (502,500) |
| Outstanding – end of period | $ 0.78 | 10,700,000 | $ 0.79 | 13,550,000 |

| Price Range | Options Outstanding | Weighted Average Remaining Life on Outstanding Options in Months | Options Exercisable |
|---|---|---|---|
| $0.20–$1.13 | 10,700,000 | 10 | 9,725,000 |

Using the fair value method, the compensation expense is amortized over the three-year vesting period of the options. For the year ended December 31, 2009, the Company recorded a stock-based compensation expense of $0.3 million (2008 – $0.8 million) relating to share options. The portion of the fair value charge to be recognized in future periods is $0.1 million.

The fair value was estimated on the date of the grant using the Black-Scholes fair value option-pricing model and the following assumptions:

| | 2009 | 2008 |
|---|---|---|
| Expected volatility | 75% | 75% |
| Risk-free interest rate | 1.50% | 3.76% |
| Term | 5 years | 5 years |
| Dividend yield | nil | nil |

## 13. CAPITAL MANAGEMENT

The Company manages its capital to ensure that the Company and its subsidiaries will be able to continue as a going concern while attempting to maximize the return to shareholders through the optimization of debt and equity financing. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the Company. The capital structure consists of debt, (Notes 8 and 9), cash and cash equivalents and shareholders' equity excluding accumulated other comprehensive income (loss). Candax monitors its capital through its net cash position calculated as cash less term loan debt. The Company maintains this structure by managing working capital, capital spending programs and debt repayment terms. The Company raises capital, as necessary and the optimal balance between debt and equity may change over time. The Company is not subject to externally imposed capital requirements.

| | December 31, 2009 | December 31, 2008 |
|---|---|---|
| Total debt | $ 57,042 | $ 72,204 |
| Less: Cash and cash equivalents | 9,782 | 8,931 |
| Net debt | 47,260 | 63,273 |
| Shareholders' equity | 28,915 | 89,835 |
| **Total Capital** | 76,175 | 153,108 |

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There were no changes in the Company's approach to capital management during the year ended December 31, 2009 compared to the year ended December 31, 2008.

## 14. FINANCIAL INSTRUMENTS RISK

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

### Credit risk

Credit risk is the risk of loss associated with a counterparty's inability to fulfil its payment obligations. The Company's credit risk is primarily attributable to accounts receivable. The Company has no significant concentration of credit risk arising from operations. Cash consists of funds that have been invested with reputable financial institutions and management believes the risk of loss to be remote. Accounts receivable consists of letter of credit secured amounts on the sale of oil cargoes, amounts due from the Tunisian government relating to electricity sales and value added tax due from governments. Management believes that the credit risk with respect to accounts receivable is low.

### Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient funds to meet liabilities as they come due. As at December 31, 2009, the Company had a cash balance of $9.8 million (December 31, 2008 – $8.9 million) and accounts receivable of $4.1 million (December 31, 2008 – $5.2 million) to settle current liabilities, excluding current portion of limited recourse long-term debt of $26.5 million (December 31, 2008 – $22.8 million). The maturities of the Company's accounts payable and accrued liabilities are within 1 year.

### Interest rate risk

The Company has cash balances and interest-bearing debt. The Company's current policy is to invest excess cash in highly rated short-term deposits issued by a large European banking institution. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks. Changes in interest rates will result in a change in the amount of interest charged on the Company's term loan. Given the current levels of interest rates and the economic conditions throughout the world, Management believes that the risk of material changes to interest rate in the short to medium term is remote and therefore does not hedge its interest rate risk.

### Foreign currency risk

The Company's reporting currency is the Canadian dollar and its functional currency is the US dollar as all major business dealings are transacted in US dollars. The Company funds the majority of its transactions using US dollar currency from its US dollar bank account held with a European bank. The term loan debt is also US dollar denominated Management believes the foreign exchange risk derived from currency conversions is negligible and therefore does not hedge its foreign exchange risk.

### Price risk

The Company is exposed to price risk with respect to oil. The price of oil has been subject to substantial volatility in recent years. Future price declines could cause continued reported accounting losses and future exploration to be uneconomical.

### Sensitivity analysis

Based on management's knowledge and experience of the financial markets, the Company believes the following movements are "reasonably possible" over a one year period:

- Cash and cash equivalents include deposits which are at variable interest rates. Term debt and non-recourse project financing are also at variable interest rates. Sensitivity to a plus or minus 1% change in rates would affect net loss by $0.5 million for the one year period ended December 31, 2009.
- The Company does not hold significant balances or debt in currencies other than the US dollar to give rise to exposure to significant foreign exchange risk.
- The Company is exposed to changes in oil prices. Sensitivity to a plus or minus $1.00 change in the price of crude oil would affect net loss by $0.5 million for the one year period ended December 31, 2009.

### Fair Value Estimation

The fair values of cash and cash equivalents, trade and other receivables and accounts payable and accrued liabilities approximate their carrying values because of the short-term nature of these instruments.

The fair values of the Company's restricted cash and investments approximate carrying values.

The fair value of the Company's debt obligations approximate their carrying value because substantially all of the total obligation is debt-priced at close to current interest rate levels.

## 15. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The balance in accumulated other comprehensive loss represents the cumulative amount of unrealized foreign exchange gains (losses) on translation of self-sustaining foreign operations.

## 16. RELATED PARTY TRANSACTIONS

As described in Note 7, the Company has a 50% interest in SEEB. During the year the Company had gas sales to SEEB of $0.4 million (2008 – $0.4) and as at December 31, 2009 the Company had a receivable from SEEB in the amount of $0.8 million (2008 – $0.8 million).

## 17. COMMITMENTS AND CONTINGENCIES

(a) Under the provisions of the hydrocarbon law of Tunisia, 20% of the Company's oil production must be sold to ETAP. The Company receives 90% of the export sales price achieved by ETAP on sale of such production.

(b) As at December 31, 2009, the Company had provided a standby letter of credit in the amount of US $0.5 million in favour of Madagascar Ministry of Industry and Mines in accordance with the terms of the production sharing agreement entered into in November 2006. The letter of credit will be released when the Company has satisfied the commitments as outlined in the agreement.

(c) One of the Company's joint venture partners has initiated arbitration proceedings in connection with claims that it is seeking to assert arising from its audit of the costs of the El Bibane redevelopment programme. The Company has accrued US $0.8 million in this regard.

(d) The Company's joint venture partners in the Chaal permit have submitted reports arising from their audit of the expenditures associated with the initial Chaal exploration well. Amongst other matters, the reports assert claims for credit which, if sustained would result in the Company incurring additional liability of US$0.3 million. The Company is presently assessing the reports and will respond to partners in due course. It is not anticipated that any additional material liability will be incurred and, accordingly no amounts have been accrued for in this regard.

## 18. SEGMENTED INFORMATION

| | Oil and Gas Operations | | Electricity Generation Operations | | Total | |
|---|---|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 | **2009** | 2008 |
| **For the year ended December 31** | | | | | | |
| Sales (net of royalties) | **$ 25,514** | $ 32,603 | **$ 2,626** | $ 2,163 | **$ 28,140** | $ 34,766 |
| Depletion, depreciation and amortization | **44,917** | 24,695 | **641** | 975 | **45,558** | 25,670 |
| Intereste expense | **3,917** | 1,919 | **631** | 1,284 | **4,548** | 3,203 |
| Loss | **(60,924)** | (11,586) | **(272)** | (1,563) | **(61,196)** | (13,149) |
| **Capital assets as at December 31** | **69,699** | 161,671 | **11,143** | 11,784 | **80,842** | 173,455 |

## 19. CHANGES IN NON-CASH WORKING CAPITAL

| | **2009** | 2008 |
|---|---|---|
| Accounts receivable | **$ 1,085** | $ 386 |
| Inventory | **4,328** | (2,127) |
| Deposits and prepaids | **414** | (518) |
| Long-term receivable | **365** | – |
| Restricted investment | **945** | – |
| Accounts payable and accrued liabilities | **319** | (564) |
| | **$ 7,456** | $ (2,823) |

## 20. SUBSEQUENT EVENTS

(a) On March 31, 2010 the Company completed an investment agreement with Geofinance NV, an international upstream oil and gas company ("Geofinance"). Under the terms of the Agreement, Geofinance invested C$13,000,000 in the Company to purchase 144,444,444 units of the Company (the "Units") at a price of C$0.09 per Unit, each Unit comprising one common share and 0.6 of one common share purchase warrant (each whole warrant a "Warrant"). The Warrants may be exercised for a period of one year from the date of the closing of the Transaction at a price equal to the current market price (calculated on the basis of a five day volume weighted average trading price for the common shares of the Company) on the date of exercise. At closing, Geofinance owned 144,444,444 common shares of the Company representing approximately 46% of the issued and outstanding shares. If all of the Warrants are exercised, Geofinance will own 231,111,110 common shares in aggregate representing approximately 58% of the issued and outstanding common shares of the Company. The Company has deferred financing fees in the amount of $0.2 million.

(b) On March 31, 2010 the Company concluded an Amendment and Restatement Agreement with the Bank of Scotland plc by which the terms of the Borrowing Base Facility Agreement were amended and restated. The Agreement provided for the extension of the final maturity date of the facility to June 30, 2014 and rescheduling of repayments while splitting outstanding amounts into two tranches; the Borrowing Base Amount and an Excess Tranche carrying mezzanine risk. Interest on the Borrowing Base Amount is calculated at US$ LIBOR plus 4% and on the Excess Tranche at US$ LIBOR plus 9.5 %. Restructuring fees are US$900,000 expected to be payable on December 31, 2010.

# Corporate Information

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**Richard J. H. Norris**[4]
President, CEO & Director

**Stephen Drinkwater** [2] [3]
Director

**J. Murray Grant** [1] [2]
Director

**Christopher O. Irwin** [1] [3]
Director

**Thomas Rebilly** [1] [2] [3]
Director

**Matthieu Milandri** [4]
Chief Financial Officer

**Bertrand Launois**
Chief Operating Officer

**Karim Gaoua**
General Manager, Tunisian Operations
Ecumed Petroleum Corporation

**Charlotte M. May** [4]
Corporate Secretary

(1) Audit Committee member.
(2) Compensation Committee member.
(3) Governance Committee member.
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## ANNUAL GENERAL MEETING

Tuesday, June 22 at 9 am at Le Meridien
King Edward Hotel, 37 King Street East,
Toronto, Ontario, Canada M5C 1E9

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