

# Candax Energy Inc. (CAX-T, \$0.92)

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**Investment Brief** – Candax Energy Inc. is a public junior international oil and gas company that is approximately one year old. Run by an internationally experienced management team, Candax is carrying out a strategy that uses all its business and technical expertise to develop and produce oil and gas assets in North Africa and the Middle East.

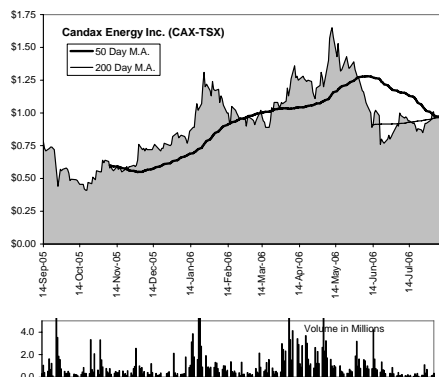
<b>Rating</b>	<b>SECTOR OUTPERFORM</b>
<b>Risk</b>	<b>SPECULATIVE</b>
<b>Target Price</b>	<b>\$1.15</b>

Current Price	\$0.92
Return (incl. dividend)	25%
52-Week High / Low	\$1.73 / \$0.39
Shares O/S	168.9M (basic) / 180.4M (F/D)
Market Capitalization	\$155 million
Enterprise Value	\$105 million
Daily Volume (3-mo. avg.)	1.31 million
Currency	C\$ unless noted
Company CEO	Michael Wood
Company Web Site	<a href="http://www.candax.com">www.candax.com</a>

Financial Forecast	2005	2006E	2007E	2007E/2006E
Liquids (bbl/d)	587	1,000	2,200	120%
Natural Gas (mmcf/d)	1.8	0.5	4.5	800%
Total (boe/d)	879	1,083	2,950	172%
% Liquids	67%	92%	75%	(19%)
Cash Flow (\$M)	5.3	18.3	45.6	148%
F/D CFPS	\$0.04	\$0.10	\$0.25	152%
F/D EPS	(\$0.03)	\$0.04	\$0.16	269%
Capital Expenditures (\$M)	45.5	25.0	35.0	40%
Net Debt (\$M)	(11.4)	(47.2)	(57.8)	22%
WTI (US\$/bbl)	\$56.54	\$67.50	\$65.00	(4%)
AECO (\$/GJ)	\$8.37	\$6.67	\$7.51	13%
<b>Valuation Parameters</b>				
Price/CFPS (multiple)	24.0	9.2	3.6	(60%)
Price/EPS (multiple)	(27.5)	21.4	5.8	(73%)
EV/boe/d		\$97,130	\$35,669	(63%)

Source: Candax Energy and Haywood Securities

## Price Performance



Source: Bloomberg

## Candax Reports Q2 Results

### Q2/06 results

There were no surprises in the Q2 results released on August 10, 2006. Production for the quarter averaged 578 bbl/d. However, sales volumes were lower at 188 bbl/d owing to the production of oil into storage. The Company still sits in excellent financial shape to execute its 2006 plans.

### No resolution yet on Chaal

Operational difficulties plagued the first round of testing on the Chaal-1 exploration well, resulting in what the Company stated as only “modest” flow rates. Management expects that more decisive results will come from further testing, which has just commenced. Results from this new testing program with the coiled tubing unit are expected before the end of August.

### El Bibane production expected in Q4/06

Candax management expects the drilling barge that is being retrofitted for the El Bibane redevelopment work will sail in September with the first well to spud approximately two weeks after the barge leaves the shipyard. With this schedule, production from the redeveloped field is still expected in late Q4/06.

### Board of Directors changes

Announced in the Q2/06 report, but effective August 4, 2006, was the resignation of Ben McKeown from the Board of Directors of Candax Energy. His replacement is Murray Grant, a partner with Actis, who is responsible for managing Actis in North Africa.

**Expectations** – We expect that the testing of the Chaal-1 exploration well could result in reserves and value that exceed our estimates in our net asset value calculation. However, we note that there is no guarantee as to the production potential of the well, and this potential will not be realized until the completion of the well test sometime this summer.

**Valuation** – Our target price of \$1.15 includes the engineering value of 36 bcf proven plus probable net to Candax from Chaal, plus the Company’s current assets. In the event that Chaal proves to be uneconomic, we still believe that the current valuation of Candax is more than supported by the Company’s remaining assets and cash-flow prospects.

**Catalysts** – Our 2007 forecast is based on successful redevelopment at El Bibane, with an expected oil production rate limited by the reservoir characteristics. Better than expected production results or exploration success would have a positive effect on our view of Candax.

### Industry & Company Profile

Oil and Gas – Candax is a junior oil and gas exploration company focused on oil and natural gas exploration and production in North Africa and the Middle East.

### Revisions, Date of Record

Rating – SECTOR OUTPERFORM from UNDER REVIEW, June 21, 2006  
 Target – \$1.15 from UNDER REVIEW, June 21, 2006  
 Forecast – Revised 2006 production forecast, June 21, 2006

### Risk Profile

Forecast Risk	Moderate
Financial Risk	Moderate
Valuation Risk	Moderate
Political Risk	Low

Please see rating structure, important disclosure, risk profile parameters, disclaimers, and notes on pages 5-8 of this report.

**Candax Energy Inc. (CAX-T)**

<b>Rating:</b>	<b>SECTOR OUTPERFORM</b>		<b>One-Year Target Price:</b>	<b>\$1.15</b>
Current Price	\$0.92		Market Capitalization (\$M)	155.4
Current Shares Outstanding (million)	168.9	<u>Dilution</u>	Current Net Debt (est.) (\$M)	(50.1)
Fully Diluted Shares Outstanding (million)	180.4	6.8%	Enterprise Value (\$M)	105.2
Book Value (\$M)	105.5		EV / BV (times)	1.0

Production	2004	2005	2006E	2007E	2006E / 2005	2007E / 2006E
Liquids (bbl/d)		587	1,000	2,200	70%	120%
Natural Gas (mmcf/d)		1.8	0.5	4.5	(71%)	800%
<b>Total (boe/d)</b>		<b>879</b>	<b>1,083</b>	<b>2,950</b>	<b>23%</b>	<b>172%</b>
Percent Liquids		67%	92%	75%	38%	(19%)
Percent Natural Gas		33%	8%	25%	(77%)	231%

<b>Revenue (\$M)</b>	<b>12.9</b>	<b>27.0</b>	<b>58.6</b>	<b>109%</b>	<b>117%</b>
<b>Cash Flow (\$M)</b>	<b>5.3</b>	<b>18.3</b>	<b>45.6</b>	<b>245%</b>	<b>148%</b>
CFPS Basic	\$0.06	\$0.12	\$0.27	85%	128%
CFPS Fully Diluted	\$0.04	\$0.10	\$0.25	161%	152%

		<u>\$/FD Share</u>	<u>% of CF</u>
<b>CFPS Sensitivity</b>	Oil (US\$1.00/bbl)	\$0.004	1%
	Gas (\$0.25/mcf)	\$0.002	1%
	100 bbl/d	\$0.004	2%
	1.0 mmcf/d	\$0.006	2%

<b>Earnings (\$M)</b>	<b>(1.5)</b>	<b>7.9</b>	<b>28.6</b>	<b>(623%)</b>	<b>263%</b>
EPS Basic	(\$0.02)	\$0.05	\$0.17	(373%)	244%
EPS Fully Diluted	(\$0.03)	\$0.04	\$0.16	(229%)	269%
<b>Capital Expenditures (\$M)</b>	<b>45.5</b>	<b>25.0</b>	<b>35.0</b>	<b>(45%)</b>	<b>40%</b>
Reinvestment Ratio	856%	136%	77%	(84%)	(44%)
<b>Net Debt (\$M)</b>	<b>(11.4)</b>	<b>(47.2)</b>	<b>(57.8)</b>	<b>315%</b>	<b>22%</b>
Debt / Cash Flow - Trailing (years)	(2.1)	(2.6)	(1.3)	20%	(51%)

Per BOE Analysis (\$/boe)					
Revenue	\$40.15	\$68.21	\$54.42	70%	(20%)
Operating/Transportation Expense	\$8.36	\$9.22	\$5.00	10%	(46%)
Net Operating Revenue	\$31.79	\$54.79	\$43.98	72%	(20%)
G&A	\$15.15	\$10.12	\$4.09	(33%)	(60%)
Cash Flow	\$11.30	\$44.54	\$42.34	294%	(5%)
DD&A	\$12.94	\$17.46	\$15.00	35%	(14%)
Earnings	(\$7.95)	\$17.15	\$26.54	(316%)	55%

Valuation Parameters					
Current Price / F/D CFPS (multiple)	24.0	9.2	3.6	(62%)	(60%)
Debt-Adjusted CF Multiple		5.7	2.3		(60%)
Target Price / F/D CFPS (multiple)	29.9	11.5	4.6	(62%)	(60%)
Current Price / F/D EPS (multiple)	(27.5)	21.4	5.8	(178%)	(73%)
EV / boe/d		\$97,130	\$35,669		(63%)
Target EV / boe/d		\$135,719	\$46,250		(66%)

Price Assumptions						
Crude Oil WTI (US\$/bbl)	\$41.46	\$56.54	\$67.50	\$65.00	19%	(4%)
Company Average (C\$/bbl)		\$56.93	\$73.62	\$73.19	29%	(1%)
AECO (C\$/GJ)	\$6.26	\$8.37	\$6.67	\$7.51	(20%)	13%
Company Average (C\$/GJ)		\$0.41	(\$0.10)	(\$0.10)	(124%)	4%

Source: Haywood Securities

## Investment Thesis

Candax Energy's management is a well-experienced, hands-on team that has founded, run, and sold private and public oil and gas companies. Combining the international expertise of senior management and its advisers with the technical skills of the remainder of the team, Candax should be able to deliver meaningful exploration-driven production growth with risked production potential that could more than double the Company's cash flow. We recommend the Company to investors for this exposure, and rank the overall risk profile as moderate. We are maintaining our SECTOR OUTPERFORM rating of Candax Energy Inc. (CAX-T) and our 12-month target price of \$1.15 per share.

## Q2/06 Results

**Q2 had no surprises, but we await the results of the pending El Bibane field redevelopment and production testing on the Chaal-1 well.** Candax had production in the quarter of 578 bbl/d; however, Candax had sales volumes of only 188 bbl/d in the quarter owing to production into storage. Candax's balance sheet is well situated for the upcoming redevelopment work with approximately \$50 million of available working capital at the end of Q2/06.

### Q2/06 Results

	Q2			Q1	
	2006	2005	%	2006	Q2 vs. Q1
<b>Production</b>					
Liquids (bbl/d)	188	1,062	(82%)	1,499	(87%)
Gas (mmcf/d)	0.0	4.4	(100%)	0.0	0%
<b>Total (boe/d)</b>	<b>188</b>	<b>1,795</b>	<b>(90%)</b>	<b>1,499</b>	<b>(87%)</b>
<b>Sales Price</b>					
Liquids Price (\$/bbl)	\$77.47	\$51.23	51%	\$65.90	18%
Gas (\$/mcf)	\$0.00	\$0.43	(100%)	\$0.00	n/a
Equivalent (\$/boe)	\$66.61	\$13.67	387%	\$68.15	(2%)
<b>Financials</b>					
Cash Flow (\$M)	(1.1)	1.0	(208%)	5.9	(119%)
<b>F/D CFPS</b>	<b>(\$0.01)</b>	<b>\$0.01</b>	<b>(155%)</b>	<b>\$0.03</b>	<b>(120%)</b>
Earnings (\$M)	(0.5)	(0.2)	147%	1.6	(128%)
<b>F/D EPS</b>	<b>(\$0.00)</b>	<b>(\$0.01)</b>	<b>(46%)</b>	<b>\$0.01</b>	<b>(133%)</b>
Net Debt (\$M)	(50.1)	(11.2)	347%	(15.5)	224%
Trailing D/CF (multiple)	11.5	(2.8)	(513%)	(0.7)	(1850%)
Capital Expenditures (\$M)	6.8	44.0	(85%)	2.4	184%

Source: Candax Energy and Haywood Securities

**The deep gas exploration well at Chaal-1 was drilled in the quarter, and production tests were attempted.** Drilling results were positive, as the well found approximately 90 metres of net pay over a 200-metre interval with a bottom hole pressure of more than 11,000 psi. Owing to high-pressure gas kicks encountered during drilling, the Company had to wait approximately 2 weeks for

a higher pressure Blowout Preventor (BOP) stack to be installed on the well, before testing could begin. Throughout this time, the well sat with heavy-weight mud in the hole, being cooked by the high bottom hole temperature. This likely caused formation damage and restricting the flow rates for the test. The Company quoted “modest” flow rates but did not disclose any production test volumes. The coiled tubing unit recently arrived in Tunisia and the workover and testing program is now underway. Results are expected by the end of August.

**The El Bibane field redevelopment project is still expected to begin in September.** The Company issued an update on the El Bibane redevelopment work on June 23, 2006, stating that it expected work to begin in September 2006. The Company reiterated this expectation in its Q2/06 report. Delays have beset the redevelopment of the El Bibane offshore field as a result of delays in the reconstruction of the offshore drilling barge. Despite Candax having its own engineering staff in the shipyard where the drilling barge work is being conducted, the process has been slowed by numerous construction and procurement issues. Our estimates, as revised in June, and Company expectations call for production from El Bibane to begin in Q4/06.

## **Valuation**

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**Should the Chaal well prove uneconomic, the short-term potential of the prospect would likely be eliminated, and our value and target price for Candax may decrease marginally.** However, until such a possibility is definitively established, we are maintaining our target price and recommendation. Also, should a prospect size of more than 120 bcf be proven, it would cause us to review our target price with a positive view. We also note that while the market is looking for the Chaal prospect as a catalyst to value Candax, our assumption of cash flow in 2007 from the Company’s current assets supports our target price.

**The redevelopment of El Bibane should soon be underway.** Our current production estimates for 2007 include only 1,000 bbl/d from each of the two redeveloped El Bibane wells. Should the production prove to be more in line with management’s estimates of as much as 2,000 bbl/d per well, our cash flow per share for 2007 would increase to as much as \$0.35 per fully diluted share. Once El Bibane is placed onstream later this year, a conservative cash-flow multiple could see us with a higher target price.

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- n/a

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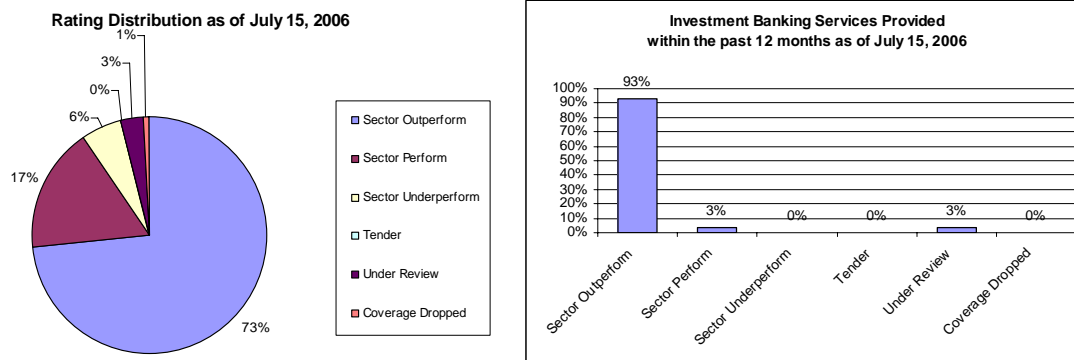
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