

Candax Energy Inc. (CAX-T; \$0.81)

Recommendation: Speculative Buy

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WELLINGTON WEST
Capital Markets Inc.

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All values in C\$ unless otherwise noted.

Current Price	\$0.81
Target Price (12-Month)	\$1.25
Implied Capital Gain	54%

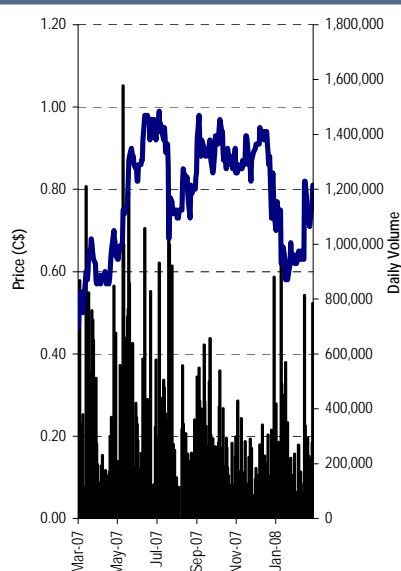
Changes

	Old	New
EPS 2008E	\$0.25	\$0.19
CFPS 2008E	\$0.41	\$0.26
EPS 2009E	n/a	\$0.18
CFPS 2009E	n/a	\$0.26
Recommendation	Spec. Buy	Unch.
Target Price	\$1.25	Unch.

Company Profile

Candax Energy Inc. is a Canadian junior E&P with production and exploration projects in Tunisia. Candax began trading on the TSX on August 29th 2005 under the symbol CAX. We believe the company has the potential to be producing >3,000 bopd in Q2 with more development success at their El Bibane and Ezzaouia fields; current combined production is ~1,600 bopd.

Price Chart



Source: PCQuote

Candax Delivers Long Awaited Production Start Up at El Bibane

- **EBB-4 well comes online at 1,400 bopd gross; EBB-3 tie-in pending**
EBB-3 well expected to raise El Bibane prodⁿ to ~3,000 bopd once tie-in is complete in April; CAX plans to complete EBB-5 well as gas injector.
- **El Bibane prodⁿ driven by 2.4 mmbbls and 13 Bcf in net 2P reserves**
We model Candax exiting 2008 with gross prodn at El Bibane of ~2,700 bopd (CAX has 73.8% W.I.) and carry a risked NPV/sh estimate of \$0.56.
- **Deep Triassic & Chaal drilling to be funded with Tunisia cashflow**
Tunisia could generate US\$58M in cashflow (\$0.34/sh) in 2008 at US\$90 Brent (\$0.26/sh at ~US\$72 Brent in our model) based on our estimates.
- **Speculative Buy rating and \$1.25 target reiterated on 2009E outlook**
2009E CFPS of \$0.26/sh & risked NPV/sh. of \$0.66 drive our \$1.25 target price. Tunisian gas plays offer ~\$8/sh in unrisksed upside.

Financial Summary

Shares O/S (M FD), TSM	171.3	52-Week Trading Range	\$0.43-\$1.00	
Market Capitalization (M)	\$139	Average Weekly Volume	1,560,227	
Net Debt (M)	\$39	Market Float (M)	\$131	
Enterprise Value (M)	\$178	Risked Portfolio NPV/share (FD)	\$0.66	
Forecasts	2006	2007E	2008E	2009E
Production (boe/d) **	527	706	2,357	2,340
% gas **	0%	0%	0%	0%
Wtd Ave Realized Price (\$/boe) **	\$68.60	\$73.35	\$69.25	\$67.50
CapEx (M)	\$26.4	\$30.0	\$30.0	\$30.0
Oil and Gas Revenue (M)	\$13.2	\$18.9	\$60.2	\$58.5
Total Net Revenue (M)	\$16.3	\$19.8	\$59.1	\$57.4
Debt Adjusted Cash Flow (M)	\$10.9	\$10.9	\$45.9	\$45.2
CFPS (FD)	\$0.06	\$0.06	\$0.26	\$0.26
EPS (FD)	(\$0.00)	\$0.03	\$0.19	\$0.18
Valuation	2006	2007E	2008E	2009E
EV/DACF	36.6x	16.2x	3.9x	3.9x
EV/BOE/d (per unit production)	n/m	\$251,617	\$75,388	\$75,933
P/E	n/m	27.0x	4.4x	4.5x

** Excludes 6 mmcf/d in gas production from El Bibane sold to SEEB power facility at ~\$0.40/mcf

Source: Company reports, Wellington West Capital Markets Inc.

Please see disclaimers on the last two pages of this report.

Investment Summary and Outlook

Since late 2004 Candax has shown the ability to leverage relationships and gain access to assets under favourable terms while minimizing their capital at risk. Unfortunately, a series of operational incidents have marred this story since September 2005. The bulk of Candax's current production of ~1,600 bopd comes from their Ezzaouia and El Bibane fields in Tunisia. We project El Bibane and Ezzaouia production to drive 2009 CFPS of \$0.26/sh, which could support a share price of between \$0.78-\$1.04 using a 3x-4x multiple. With uncertainty still surrounding the future of the large Chaal (~600 Bcf net potential) and Deep Triassic (~500 Bcf net potential) upside, we believe Candax offers exposure to positive surprises in the event that either of these opportunities are successful. Going forward, we expect that Candax will continue to seize opportunities for low-risk growth in the international arena with further acquisitions and/or farm-in agreements as they re-deploy current cash flow.

Operations Update – Tunisia

El Bibane puts EBB-4 on production with EBB-3 on deck for April

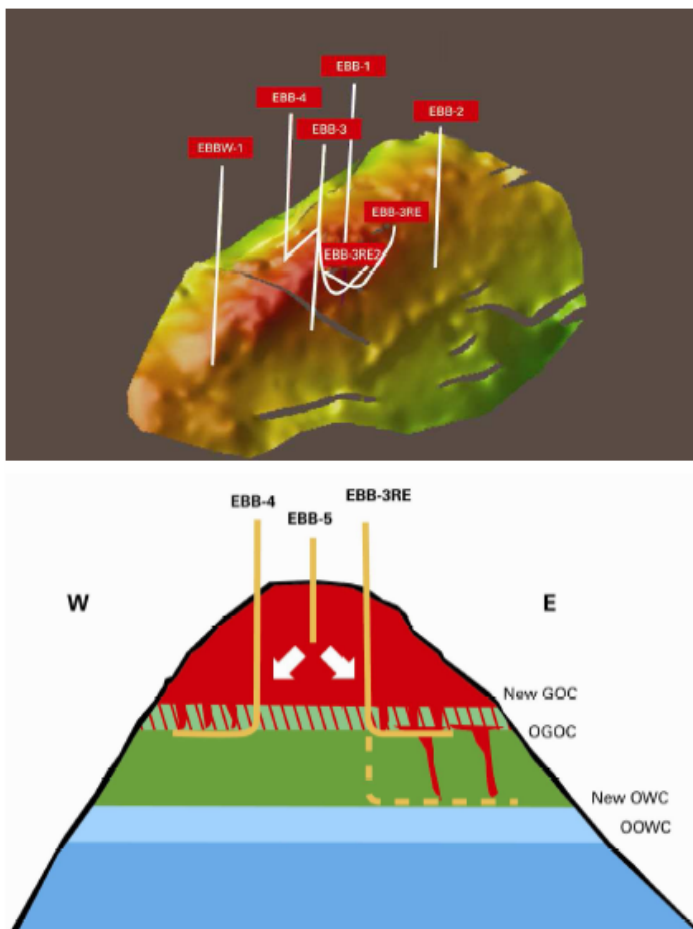
Candax kicked-off production from their El Bibane field early last week with the EBB-4 well coming online at daily peak gross rate of ~1,400 bopd, which is lighter than the ~1,500–2,000 bopd we were expecting (well optimization may rectify this). The company is currently installing the EBB-3 platform and plans to tie the well in and commence production from EBB-3 in April; EBB-5 well is expected to be completed as a gas injector to maintain reservoir pressure (Exhibit 1). We expect the EBB-3 tie-in to bring total gross production from El Bibane to ~3,000 bopd, which we have revised downward from ~4,000 bopd in light of the current production rate from EBB-4. It is possible that Candax may experience further delays bringing the EBB-3 well online as the company did state that onshore plant commissioning and weather delays have been a contributing factor to several shut-downs and the delayed production startup. Candax has a 73.8% interest in the El Bibane concession.

Tunisian production is expected to generate ~US\$45M in cashflow (\$0.26/sh) net to Candax in 2008 based on our peak net production rate estimate of ~3,000 bopd and our model assumption of a US\$71.75 Brent price. This 2008 cashflow estimate could increase to ~US\$58M (\$0.34/sh) if we were to assume an average Brent price of US\$90 for 2008, which is within reach given the recent surge in crude prices. Operating costs are expected to be extraordinarily low at El Bibane, at ~\$2.00 per barrel, and we do not expect Candax to pay taxes on El Bibane production until 2010, at the earliest. We expect Candax to use the El Bibane cashflow to fund drilling of the Deep Triassic and the Chaal prospects. Candax has booked 2.4 mmbbls and 13 Bcf in net 2P reserves at El Bibane (2.3 mmbbls and 11.4 Bcf post-royalties). We currently carry a risked NPV/sh estimate of \$0.56 for El Bibane and a COS of 80% in our model.

We are rolling out our 2009 estimates for Candax and target a combined 2008 exit production rate of ~2,700 bopd (Exhibit 2), driven largely by production from El Bibane and Ezzaouia. With an average combined

production rate estimate of ~2,350 for 2009, we believe Candax is capable of generating CFPS of \$0.26 @ US\$72 Brent (and \$0.34/sh @ US\$90 Brent). We view our 2009E CFPS estimate for Candax as a base case given that crude prices are considerably above the US\$70 Brent price that we currently assume in our model for 2009.

Exhibit 1: El Bibane Redevelopment Plan Schematic – bottom image shows intended gas injection well and 2 horizontal oil producers



Source: Company reports

Exhibit 2: 2007/2008 Candax Updated Production Projections – note that El Bibane and Ezzaouia constitute the bulk of the production going forward

Net Production Projections								
Field	2008				2009			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
El Bibane	180	2200	2090	1986	1886	1792	1702	1617
Ezzaouia	500	750	900	700	650	600	550	500
Robbana	50	40	30	30	25	25	20	20
Total	730	2990	3020	2716	2561	2417	2272	2137

Source: Company reports, Wellington West Capital Markets Inc.

Valuation and Summary Recommendation

We are maintaining our target price of \$1.25 and Speculative Buy recommendation as we revise our production outlook on El Bibane and roll-out our 2009 estimates. We now model the El Bibane field reaching peak gross production of ~3,000 bopd, down from ~4,000 bopd that we originally expected, once the EBB-3 well comes online in April. Our corporate risked NPV/sh of \$0.66 is driven by El Bibane (\$0.56/sh) and Ezzaouia, (\$0.33/sh) and offset by \$0.23/sh in net debt. We maintain our view that high-impact prospects in the Candax portfolio (i.e., Chaal and the Deep Triassic) have the potential to add significant value to the company (\$2.77 and \$5.57, respectively), but at this stage we derive the bulk of our valuation on the risked NPV and projected cash flow from known producing assets.

Our 2009E projected CFPS of \$0.26/sh and risked NPV/sh estimate of \$0.66 drive our \$1.25 target and are weighted equally at 35% in our blended valuation outlined in Exhibit 3. The downward revisions in our 2008E EPS and CFPS estimates (EPS of \$0.25/sh drops to \$0.19/sh and CFPS drops from \$0.41/sh to \$0.26/sh) reflects El Bibane's delayed production startup and our revised production outlook at El Bibane. While we view Chaal and the Deep Triassic as essentially "free options" at this point, we believe the acquisition of new projects is critical to company if projected cash flow is to be successfully reinvested. We also note that management keeps close tabs on the international energy scene through their wide network of contacts within industry and they may have the ability to surprise to the upside with regards to capturing new opportunities.

Exhibit 3: Net Asset Valuation Table

Valuation Matrix	Forecast	Target Multiple	Value	Weighting	Weighted Value
Risked NPV/share	\$ 0.66	1.0	\$ 0.66	35%	\$ 0.23
2009 CFPS Multiple	\$ 0.26	4.0	\$ 1.06	35%	\$ 0.37
Asset EMV/share	\$ 2.74	1.0	\$ 2.74	20%	\$ 0.55
Asset Acquisition Value	\$ 0.38	1.0	\$ 0.38	10%	\$ 0.04
			12 month target price		\$ 1.19

Source: Company reports, Wellington West Capital Markets Inc. estimates

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Candax Energy Inc.	CAX-T	3

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