International Energy

Candax Energy Inc. (CAX-T; $0.14)

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	$0.14
Target Price (12-Month)	$0.60
Implied Capital Gain	400%

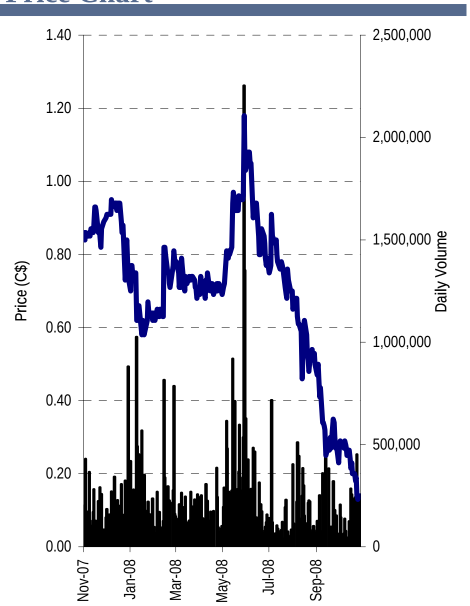
Changes

	Old	New
EPS 2008E	$0.10	$0.05
CFPS 2008E	$0.17	$0.15
EPS 2009E	$0.20	$0.14
CFPS 2009E	$0.27	$0.22
Recommendation	Spec. Buy	Unch.
Target Price	$0.90	$0.60

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 expect the company to exit 2008 with combined oil production of ~1,925 bopd from their El Bibane and Ezzaouia fields. The company's Chaal and Deep Triassic targets have potential to add significant value to the company.

Price Chart



Source: PCQuote

Candax Turns Focus to Cash Preservation as Oil Prices Continue to Slide

- **Q3 prodⁿ of 1,576 boe/d; we see Q4 prodⁿ rising to ~2,425 boe/d**
  Production was light relative to our ~1,640 boe/d estimate due to lower oil prodⁿ at El Bibane and Ezzaouia; gas prodⁿ was 2.7 mmcf/d in Q3.

- **Capital preservation is key; just $7.3mm in capex planned for 2009**
  Chaal-1 sidetrack, postponed to Q4'09, is expected to cost $5mm; CAX has ~$13.9mm in WC, faces debt maturity of ~$23.6mm bank-line in '09.

- **Risk of meeting obligations w/ lower oil prices reflected in capital cost**
  Cost of capital raised to 18% to reflect risk of meeting 2009 obligations & cost of raising debt or equity. We believe US$60/bbl oil is key threshold.

- **Target trimmed to $0.60 from $0.90 on CoC revision; Spec. Buy**
  Our $0.60 target is driven by '09E CFPS of $0.22 & risked NPV/sh of $0.31; risked EMV/sh weighting has decreased to 5% from 20%.

Financial Summary

Shares O/S (M FD), TSM	172.2	52-Week Trading Range	$0.11-$1.18
Market Capitalization (M)	$24	Average Weekly Volume	1,121,635
Net Debt (M)	$52	Market Float (M)	$23
Enterprise Value (M)	$76	Risked Portfolio NPV/share (FD)	$0.31

Forecasts	2006	2007	2008E	2009E
Production (boe/d) **	527	464	1,231	1,747
% gas **	0%	0%	0%	0%
Wtd Ave Realized Price ($/boe) **	$68.60	$77.53	$104.66	$96.00
CapEx (M)	$26.4	$41.8	$53.6	$7.3
Oil and Gas Revenue (M)	$13.2	$13.1	$47.2	$61.9
Total Net Revenue (M)	$16.3	$14.8	$46.6	$59.4
Debt Adjusted Cash Flow (M)	$10.9	($2.7)	$26.7	$38.9
CFPS (FD)	$0.06	($0.02)	$0.15	$0.22
EPS (FD)	($0.00)	($0.05)	$0.05	$0.14

Valuation	2006	2007	2008E	2009E
EV/DACF	n/m	n/m	2.8x	1.9x
EV/BOE/d (per unit production)	n/m	n/m	$61,543	$43,351
P/E	n/m	n/m	2.8x	1.0x

** Excludes 4.7 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.

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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 oil production of ~1,950 bopd comes from their Ezzaouia and El Bibane fields in Tunisia. We project El Bibane and Ezzaouia production to drive 2009E CFPS of $0.22/sh, which could support a share price of $0.88 using a 4x P/CF multiple. With uncertainty still surrounding the future of the large Chaal (~510 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. In the medium term, we expect Candax to preserve cashflow and make minimal capital expenditures in 2009 until the oil and credit markets stabilize. **We are lowering our target price on Candax to $0.60 from $0.90 as we raise our cost of capital to 18% from 10% to reflect the risk of having to raise debt or equity to meet medium-term obligations in a lower oil price environment.**

Operations Update – Tunisia

Q3 Production of 1,576 boepd; Candax Guides Lower for Q4 '08

Candax reported 1,576 boepd of oil and gas production in Q3, which is a little lighter than the ~1,640 boepd we were expecting due to lower Q3 oil production of ~750 bopd and ~350 bopd at El Bibane and Ezzaouia, respectively. Management continues to explore ways to raise oil production from their two El Bibane development wells, EBB-3 and EBB-4, and we plan to monitor their progress closely over the next quarter.

The company expects oil and gas production to average 2,400 boepd in Q4, which is down from their prior guidance of 2,800 boepd. We have lowered our model estimates accordingly and now expect Candax to average production of ~2,425 boepd in Q4 (down from our previous forecast of ~2,940 boepd). Production from the company's EZZ-18 infill well has been delayed to December, from October, due to operational difficulties that were encountered by the field's operator, Maretap, while drilling. We model the EZZ-18 well coming onstream at ~500 bopd gross.

Looking ahead to 2009, we have reduced our average production for the year slightly to ~2,536 boepd from 2,599 boepd and outline the breakdown of our estimates by field in Exhibit 1. Our revised oil production estimates for 2009 are based on Q4 estimated production and an expected production decline curve for each of the two fields.

Exhibit 1: WWCM Updated Production Projections for Candax

Net Production Projections (boe/d)					
Field	2008	2009			
	Q4	Q1	Q2	Q3	Q4
El Bibane	1328	1289	1250	1212	1176
El Bibane (gas)	650	783	783	783	783
Ezzaouia	408	520	495	470	445
Robbana	40	40	38	38	36
Total (incl. gas)	2426	2632	2566	2504	2440
Total (without gas)	1776	1849	1783	1720	1657

Source: Wellington West Capital Markets Inc.

Planning to Preserve Capital Amid Market Turmoil

As the steep and sudden drop in oil prices has forced many E&P juniors to re-evaluate their capital programs, Candax plans to follow suit and make minimal capital expenditures in 2009 in a bid to preserve cashflow. At this time, the company is committing to only spend approximately $7.3mm next year and plans to re-evaluate their capital program over the next three to six months depending on market conditions. The company plans to deploy their 2009 capital by spending: 1) $1.5mm upgrading the water handling capacity at El Bibane, 2) $800k drilling the EZZ-5 development well at Ezzaouia and 3) $5mm drilling the sidetrack of the Chaa1-1 exploration well. The company has postponed the Chaal sidetrack until the second half of 2009.

We believe the company is currently positioned to cover their debt repayment and capital expenditures for 2009 at US$60/bbl oil, although it may be tight and could require deferral of Chaal drilling or renegotiation of the debt repayment with their lenders if oil prices were to hold below $60/bbl for an extended period of time. As of the end of Q3, Candax had $13.9mm in cash, ~US$5.5mm available under their debt facility, and working capital of ~$4.8mm (excluding the current portion of their loans). The company faces debt maturity on their bank-lines in the order of ~US$23.6mm over the next year with US$1.5mm due at the end of this year and equal US$11mm payments due on June 30, 2009 and Dec 31, 2009. At $60/bbl oil and a $0.90 CDN$/US$ exchange rate, we estimate the company will generate ~$26.6mm in cashflow over the next five quarters. With $7.3mm in capex planned for 2009, we expect total obligations for the balance of 2008 and all of 2009 to be close to $34.5mm (using a $0.90 CDN$/US$ exchange rate). Under this oil price and exchange rate scenario, and using available debt and working capital, we estimate the company can cover their obligations through the end of 2009. However at an average oil price of US$55/bbl for 2009, we estimate free cashflow to be tight and the company would have to consider deferring Chaal sidetrack drilling or attempt to renegotiate debt repayment with their lenders. It is important to note that Candax is required to drill the sidetrack before the end of 2009 in order to retain their 60% working interest in the concession.

We are raising the cost of capital in our model to 18% from 10% to reflect the increasing risk that the company would have to raise debt or equity in order to meet their medium-term obligations on-time, in a lower oil price environment. We plan to revisit our cost of capital assumption over the next three to six months as we gain more clarity on the direction of oil prices in 2009 and what the company's cash balance would look like at the end of 2009.

A Look at CFPS Sensitivity to a Falling Oil Price & Stronger US Dollar

Despite the sudden drop in oil prices, we continue to follow GLJ Petroleum Consultant's price deck, which will not be updated until the start of Q1 2009, but believe it is important to illustrate the sensitivity of our Candax CFPS estimates to the price of oil and fluctuations in the CDN$/US$ exchange rate. We currently model CDN$/US$ parity and a US$98.50 Brent oil price for 2009 and expect GLJ's oil price forecast to be lowered when they release their next report in Q1 2009. The sensitivity of our 2009 CFPS to Brent and the CDN$/US$ exchange rate is illustrated in Exhibit 2. We wish to point out that our target price for Candax of $0.60 and 2009E CFPS of $0.22 is highly dependent on GLJ's oil price forecast, which we use to set our price deck.

Exhibit 2: WWCM 2009E CFPS Sensitivity to Brent Oil Price and CDN$ / US$ Exchange Rate

Candax 2009E CFPS Sensitivity

CDN$ / US$ Exchange Rate	2009E Brent Oil Price (US$/bbl)						
	$40.00	$50.00	$60.00	$70.00	$80.00	$90.00	$98.50
$0.75	$0.08	$0.12	$0.16	$0.21	$0.25	$0.29	$0.32
$0.80	$0.07	$0.11	$0.15	$0.19	$0.23	$0.26	$0.30
$0.85	$0.06	$0.10	$0.14	$0.17	$0.21	$0.24	$0.27
$0.90	$0.06	$0.09	$0.12	$0.16	$0.19	$0.22	$0.25
$0.95	$0.05	$0.08	$0.11	$0.14	$0.18	$0.21	$0.24
$1.00	$0.04	$0.07	$0.10	$0.13	$0.16	$0.19	$0.22

Source: Wellington West Capital Markets Inc.

Valuation and Summary Recommendation

We are lowering our target price on Candax to $0.60 from $0.90 and maintaining our Speculative Buy recommendation as we raise the cost of capital in our model to 18% from 10% to reflect the increasing risk that the company cannot make their medium-term obligations on-time, in a lower oil price environment. We estimate that Candax would have sufficient cash available to them, although it would be tight, to meet their obligations through the end of 2009 if oil prices can hold above US$60/bbl for 2009. However, we have adjusted our cost of capital to reflect the impact lower oil prices could have on Candax's ability to meet their 2009 obligations. Our risked NPV/sh estimate drops to $0.31 from $0.42 as a result of the higher cost of capital.

Our 2009E projected CFPS of $0.22/sh and risked NPV/sh estimate of $0.31 (Exhibit 3) drive our $0.60 target and hold weightings of 35% and 40%, respectively, in our blended valuation outlined in Exhibit 5. Our blended valuation for Candax is rounded out by a 5% weighting assigned to our exploration-weighted risked EMV/sh estimate of $1.48 (Exhibit 4) and a 20% weighting given to our asset acquisition estimate of $0.53/sh. We decreased the weighting we assign to our risked EMV/sh estimate from 20% to 5% as we see 2009E CFPS and our risked NPV/sh estimate holding more weight in the current market where development capital for exploration projects is difficult to obtain.

Exhibit 3: WWCM Risked NPV/sh Valuation

Prospect/Field	WWCM Unrisked resource estimate (mmbbls, net)	COS (%)	WWCM Risked resource estimate (mmbbls, net)	Unrisked NPV/sh	Risked NPV/sh
El Bibane	4.1	90%	3.7	$0.43	$0.39
Ezzaouia	1.6	90%	1.4	$0.24	$0.22
Net Debt (cash)				$0.30	$0.30
Total	**5.7**		**5.1**	**$0.37**	**$0.31**

Source: Wellington West Capital Markets Inc.

Exhibit 4: WWCM Exploration-Weighted Risked EMV/sh Valuation

Prospect/Field	WWCM Unrisked Reserves (Gross, mmboe)	Unrisked EMV/sh	COS (%)	Risked EMV/sh
El Bibane	6.0	$0.40	90%	$0.41
Ezzaouia	5.0	$0.24	90%	$0.22
Robbana	0.4	$0.04	100%	$0.04
Chaal	140.0	$1.92	30%	$0.56
Deep Triassic El Bibane	160.0	$2.70	13%	$0.31
Deep Triassic Ezzaouia	480.0	$1.72	13%	$0.19
Madagascar	200.0	$1.04	5%	$0.05
Net Debt (cash)		$0.30		$0.30
Total	**991.4**	**$7.76**		**$1.48**

Source: Wellington West Capital Markets Inc.

Exhibit 5: Net Asset Valuation Table

Valuation Matrix	Forecast		Target Multiple	Value		Weighting	Weighted Value	
Risked NPV/share	$	0.31	1.0	$	0.31	40%	$	0.12
2009 CFPS Multiple	$	0.22	4.0	$	0.88	35%	$	0.31
Asset EMV/share	$	1.48	1.0	$	1.48	5%	$	0.07
Asset Acquisition Value	$	0.53	1.0	$	0.53	20%	$	0.11
						12 month target price	**$**	**0.61**

Source: Wellington West Capital Markets Inc.

Overall, we believe Candax's strategy to preserve cashflow in 2009 is a prudent step by management as they push forward in a lower oil price environment. In our view, survival is key for E&P juniors and Candax is positioned to cover their debt repayment and capital expenditure commitments for 2009 in a US$60/bbl oil price environment. We plan to revisit our model assumptions over the next quarter as we gain more clarity on what a realistic 2009 oil price range is.

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Company Name	Ticker Symbol	Applicable Disclosure
Candax Energy Inc.	CAX-T	-

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