

**Candax Energy Inc. (CAX-T; \$0.61)****Recommendation: Speculative Buy**Kim Page, (416) 847-3400; [kpage@wwcm.com](mailto:kpage@wwcm.com)Kyle Hunter, MBA (416) 640-4953; [khunter@wwcm.com](mailto:khunter@wwcm.com)WELLINGTON WEST  
Capital Markets Inc.

September 8, 2008

All values in C\$ unless otherwise noted.

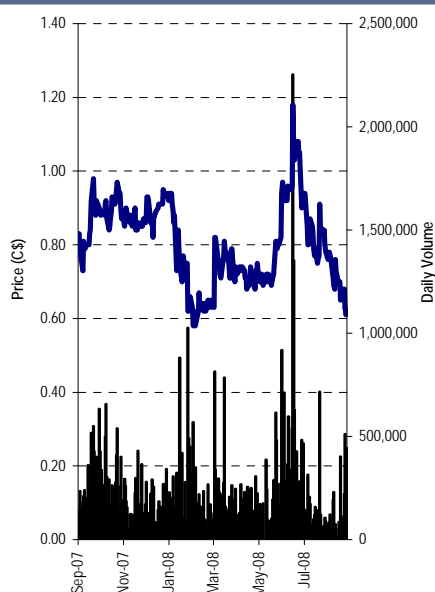
Current Price	\$0.61
Target Price (12-Month)	\$1.15
Implied Capital Gain	89%

**Changes**

	Old	New
EPS 2008E	\$0.33	\$0.14
CFPS 2008E	\$0.40	\$0.22
EPS 2009E	\$0.40	\$0.29
CFPS 2009E	\$0.48	\$0.35
Recommendation	Spec. Buy	Unch.
Target Price	\$1.65	\$1.15

**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 29<sup>th</sup> 2005 under the symbol CAX. We expect the company to exit 2008 with combined production of ~2,150 bopd from their El Bibane and Ezzaouia fields; CAX's current production is ~2,050 bopd. Chaal and Deep Triassic targets have potential to add significant value to the company.

**Price Chart**

Source: PCQuote

**Candax Sets Sights on Turning Cashflow into Fresh Development Opportunities**

- **EZZ-17 well on production; Ezzaouia gross prod<sup>n</sup> rises to 1,700 bopd**  
EZZ-17 is producing ~250 bopd net and is the first of back-to-back infill wells to be drilled in Q3; we expect EZZ-18 to come online at ~300 bopd.
- **El Bibane gross prod<sup>n</sup> has stabilized at 2 kbopd; optimization ongoing**  
El Bibane prod<sup>n</sup> is lighter than we had expected; we now model CAX exiting 2008 with prod<sup>n</sup> rate of 2,800 boepd (down from 3,400 boepd).
- **Chaal appraisal set for Nov. spud; 854 Bcf gross in play (60% W.I.)**  
The well is being drilled as a sidetrack of Chaal-1 by Newtech, an experienced HT/HP operator; we carry a risked EMV of \$0.82/sh.
- **Target trimmed to \$1.15 on revised prod<sup>n</sup> outlook; Spec Buy rating**  
2009E CFPS of \$0.35/sh & risked NPV/sh. of \$0.51 drive our \$1.15 target price. Tunisian gas plays offer ~\$8/sh in unrisked upside.

**Financial Summary**

Shares O/S (M FD), TSM	172.2	52-Week Trading Range	\$0.56-\$1.18	
Market Capitalization (M)	\$105	Average Weekly Volume	1,227,758	
Net Debt (M)	\$55	Market Float (M)	\$99	
Enterprise Value (M)	\$160	Risked Portfolio NPV/share (FD)	\$0.51	
<b>Forecasts</b>	<b>2006</b>	<b>2007</b>	<b>2008E</b>	<b>2009E</b>
Production (boe/d) **	527	464	1,351	1,904
% gas **	0%	0%	0%	0%
Wtd Ave Realized Price (\$/boe) **	\$68.60	\$77.53	\$117.00	\$121.00
CapEx (M)	\$26.4	\$41.8	\$51.3	\$30.0
Oil and Gas Revenue (M)	\$13.2	\$13.1	\$58.0	\$84.8
Total Net Revenue (M)	\$16.3	\$14.8	\$57.3	\$83.1
Debt Adjusted Cash Flow (M)	\$10.9	(\$2.7)	\$37.9	\$61.4
CFPS (FD)	\$0.06	(\$0.02)	\$0.22	\$0.35
EPS (FD)	(\$0.00)	(\$0.05)	\$0.14	\$0.29
<b>Valuation</b>	<b>2006</b>	<b>2007</b>	<b>2008E</b>	<b>2009E</b>
EV/DACF	n/m	n/m	4.2x	2.6x
EV/BOE/d (per unit production)	n/m	n/m	\$118,742	\$84,243
P/E	n/m	n/m	4.4x	2.1x

\*\* 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.

**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 ~2,050 bopd comes from their Ezzaouia and El Bibane fields in Tunisia. We project El Bibane and Ezzaouia production to drive 2009 CFPS of \$0.35/sh, which could support a share price of \$1.05 using a 3x 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. 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

### *Ezzaouia Gross Prod<sup>u</sup> Rises to 1,700 bopd as EZZ-17 Comes Online*

**Candax brought their EZZ-17 well on production at a rate of approximately 800 bopd, which raises gross current production for the Ezzaouia field to 1,700 bopd (~535 bopd net to Candax).** EZZ-17 is expected to experience rapid decline from the initial production rate and exit 2008 at a rate of 350 bopd. The company spudded their EZZ-18 well in late-August and expects to have it completed by early-to-mid October and placed on production at a gross rate of ~300 bopd. Based on management's guidance and lower than expected production from the two infill wells, we expect Candax to now exit 2008 with gross production of 1,600 bopd from Ezzaouia, down from our prior estimate of ~2,100 bopd, and average ~1,450 bopd in 2009, down from ~1,830 bopd. Candax has a 31.4% working interest in the Ezzouia field.

**Based on recent reservoir performance and a revised production outlook, we are taking a more conservative view of the recoverable resource potential we carry for Ezzaouia in our model and are reducing our gross unrisks resource estimate to ~5 mmbbls from ~6.5 mmbbls.** Contingent upon rig availability, we expect Candax to re-complete EZZ-5 in the first half of 2009 and bring the well on production at an initial gross rate of 500 bopd. However, until we have more visibility into future production plans from the Ezzaouia field, we have decided to take a more conservative outlook on the field's ultimate recovery and have based our ~5 mmbbls gross resource estimate on a typical "blowdown" from our 2008 exit rate estimate. We wish to point out that we still believe Candax can exploit their gross 2P reserves at Ezzaouia of 6.2 mmbbls (~1.9 mmbbls net) if future infill drilling is not included in our production profile and water injection proves to be successful. Based on our new production profile for Ezzaouia and higher operating costs of \$7.50/boe (up from \$3/boe), our risked NPV/sh estimate moves to \$0.31 from \$0.44.

### *El Bibane Prod<sup>2</sup> Holding 2,000 bopd as Optimization Efforts Continue*

**Gross production from Candax's El Bibane field has stabilized at rate of 2,000 bopd (~1,475 bopd net to Candax) following a four-week period focused on optimizing combined field production from the EBB-3 and EBB-4 wells.** The steady rate of 2,000 bopd is lower than the 2,500–3,000 bopd range we were expecting; however, the company is continuing their optimization efforts to raise El Bibane production and they expect gross production from the field to average 2,200 bopd in Q4 before entering into decline in Q1. The two wells are currently producing 10,000 bbls/d of fluid, implying an 80% water cut, which is higher than management's, and our original expectations. The higher than expected water cut is largely due to water coming from the cap rock in EBB-3 and water coming from fractures in EBB-4.

**In light of lower than expected steady-state production from the El Bibane field, we are trimming our 2008 and 2009 average production estimates for El Bibane to ~790 bopd (from ~1,400 bopd) and ~1,430 bopd (from ~1,750 bopd), respectively.** We have also taken a more conservative view of the recoverable resource potential at El Bibane and we now carry an unrisks gross recoverable resource estimate of 5.6 mmoeb (down from 6.0 mmoeb); which is more closely aligned with El Bibane's 2P gross reserve estimate of 5.9 mmoeb. As a result of our revised recoverable resource estimate, our risked NPV/sh estimate for El Bibane moves to \$0.52 (90% COS) from \$0.76.

### *Lighter Ezzaouia & El Bibane Prod<sup>2</sup> Trims our Cashflow Estimates*

**Our adjusted production outlook at El Bibane and Ezzaouia has lowered our 2009 production estimate for Candax to ~1,900 bopd (down from ~2,350 bopd), along with much higher operating costs, has resulted in a significant reduction in our CFPS estimates for 2008 and 2009 to \$0.22 (from \$0.48) and \$0.35 (from \$0.48), respectively.** We now model Candax exiting 2008 with net production of ~2,200 bopd (~3,000 boe/d), down from ~3,500 boe/d, which includes 4.7 mmcf/d of gas at El Bibane that is sold to the SEEB power generation plant. Our revised CFPS estimates also reflect an increase in operating costs to \$7.50/boe from \$3/boe based on management's guidance that operating costs are expected to be US\$7mm–US\$8mm in 2009. Our revised net production projections for Candax are outlined in Exhibit 1.

### **Exhibit 1: WWCM Updated Production Projections for Candax**

Net Production Projections (boe/d)						
Field	2008		2009			
	Q3	Q4	Q1	Q2	Q3	Q4
El Bibane	810	1624	1542	1465	1392	1322
El Bibane (gas)	417	783	744	707	672	638
Ezzaouia	375	500	475	475	450	400
Robbana	40	35	35	30	25	25
Total (incl. gas)	1642	2942	2797	2677	2539	2385
Total (without gas)	1225	2159	2052	1970	1867	1747

Source: Wellington West Capital Markets Inc.

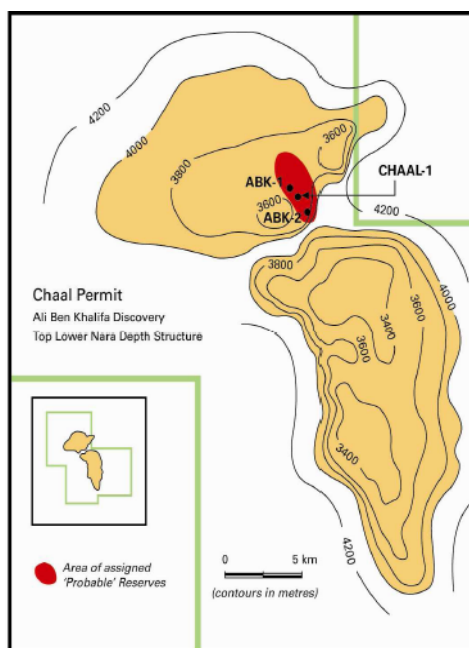
While our 2009 cashflow estimate of ~US\$60.9mm is lighter than the ~US\$83.9mm we were expecting, we maintain our view that Candax’s potential to increase shareholder value is dependent on how cashflow from current production is deployed over the next six to twelve months. Candax has an inventory of high-impact exploration prospects to drill, which includes their Chaal structure in onshore Tunisia and two large Triassic structures that lie below the El Bibane and Ezzaouia fields. Chaal is expected to be Candax’s nearest-term catalyst with current plans to re-enter the Chaal-1 well in early November.

*Candax Puts ~854 Bcf gross in Play with Return to Chaal*

Candax plans to kick-off a 45–60 day program starting in early November by re-entering the Chaal-1 discovery well that was drilled in 2006 (Exhibit 2) and drilling a sidetrack well to evaluate the commercial potential of the gas discovery. The company believes the lack of gas production from the Chaal-1 well was due to formation damage and has engaged New Tech, an experienced high-pressure/high-temperature operator, to drill the sidetrack using the CTF6 rig. At the completion of the sidetrack, Candax plans to perform logging and recover cores, which are to be evaluated as part of an extensive study that could take up to six months to complete. If the results from the study are encouraging, Candax plans to return to Chaal to test the sidetrack well in mid-2009.

We carry a risked EMV/sh of \$0.71 for Chaal in our model and risk our ~854 Bcf gross recoverable resource estimate at 30%, which could be worth \$2.41 in a full success case. The company’s 2008 work program at Chaal is expected to cost \$3.5mm net. Candax has a 60% working interest in the Chaal field.

**Exhibit 2: Chaal Well Location and Structural Map**



Source: Company Reports

## Valuation and Summary Recommendation

We are maintaining our Speculative Buy recommendation and lowering our target price to \$1.15 from \$1.65 as we revise our production outlook at El Bibane and Ezzaouia. We now model the El Bibane field reaching peak gross production of ~2,200 bopd, down from the ~2,500–3,000 bopd that we originally expected, in Q4 as further optimization efforts on the EBB-3 and EBB-4 wells raise production from the current level of 2,000 bopd. At Ezzaouia, we have lowered our 2008 gross exit rate for the company's Ezzaouia field to ~1,600 bopd from our prior estimate of ~2,100 bopd. As a result, we have lowered our 2009E CFPS to \$0.35 from \$0.48. In addition, we have raised the operating costs that we carry in our model to \$7.50/boe (from \$3.00/boe) and have taken a more conservative view of the recoverable production potential from both Ezzaouia and El Bibane, which contributed to our revised risked NPV/sh estimates of \$0.31 (down from \$0.44) and \$0.52 (down from \$0.76), respectively.

**Our 2009E projected CFPS of \$0.35/sh and risked NPV/sh estimate of \$0.51 (Exhibit 3) drive our \$1.15 target and are weighted equally at 35% in our blended valuation outlined in Exhibit 5.** Our blended valuation for Candax is rounded out by a 20% weighting assigned to our exploration-weighted risked EMV/sh estimate of \$1.97 (Exhibit 4) and a 10% weighting given to our asset acquisition estimate of \$0.53/sh.

### 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	\$0.58	\$0.52
Ezzaouia	1.6	90%	1.4	\$0.34	\$0.31
Net Debt (cash)				\$0.32	\$0.32
<b>Total</b>	<b>5.7</b>		<b>5.1</b>	<b>\$0.60</b>	<b>\$0.51</b>

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	\$0.56	90%	\$0.55
Ezzaouia	5.0	\$0.33	90%	\$0.31
Robbana	0.4	\$0.04	100%	\$0.04
Chaal	140.0	\$2.41	30%	\$0.71
Deep Triassic El Bibane	160.0	\$3.39	13%	\$0.39
Deep Triassic Ezzaouia	480.0	\$2.16	13%	\$0.25
Madagascar	200.0	\$1.04	5%	\$0.05
Net Debt (cash)		\$0.32		\$0.32
<b>Total</b>	<b>991.4</b>	<b>\$9.61</b>		<b>\$1.97</b>

Source: Wellington West Capital Markets Inc.

**Overall, we believe the reinvestment of current and future cashflow as being the primary determinant in the direction of Candax's share price over the next six to twelve months.** While we view Chaal and the Deep Triassic as essentially "free options" at this point with potential to add significant value to the share price, we believe the acquisition of new projects is critical to the 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 5: Net Asset Valuation Table

Valuation Matrix	Forecast	Target Multiple	Value	Weighting	Weighted Value
Risked NPV/share	\$ 0.51	1.0	\$ 0.51	35%	\$ 0.18
2009 CFPS Multiple	\$ 0.35	4.0	\$ 1.41	35%	\$ 0.49
Asset EMV/share	\$ 1.97	1.0	\$ 1.97	20%	\$ 0.39
Asset Acquisition Value	\$ 0.53	1.0	\$ 0.53	10%	\$ 0.05
12 month target price					<b>\$ 1.12</b>

Source: Wellington West Capital Markets Inc.

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Company Name	Ticker Symbol	Applicable Disclosure
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