

# Candax Energy Inc. (CAX-T; \$0.75)

## Recommendation: Market Perform

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All values in C\$ unless otherwise noted.

Current Price	\$0.75
Target Price (12-Month)	\$0.90
Implied Capital Gain	20%

### Changes

	Old	New
EPS 2007	\$0.06	\$0.07
DACF/sh FD 2007	\$0.10	\$0.12
EPS 2008E	\$0.12	\$0.15
DACF/sh FD 2008E	\$0.22	\$0.26
Recommendation	Mkt. Perform	unchanged
Target Price	\$0.80	\$0.90

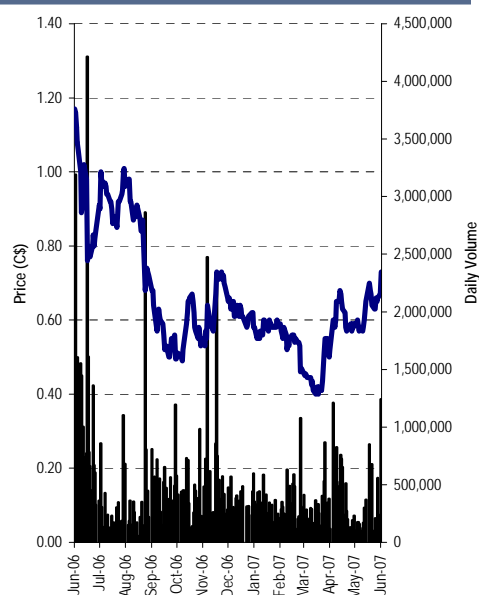
### Company Profile

Candax Energy Inc. is a Canadian junior E&P with both producing and exploration assets in Tunisia. Candax began trading on the TSX on August 29<sup>th</sup> 2005 under the symbol CAX. The company has the potential to be producing ~3,000 bopd by Q4 2007 if the El Bibane Field development is successful. Current Tunisian production is ~1100 bopd.

## Candax Comes Up with a Nice Surprise at Ezzaouia – Field Production Jumps

- Ezsaouia field (31.4% W.I.) flows 3000 bopd after recent workovers**  
 Positive surprise. The field has stabilized at gross flow rates of ~3000 bopd (942 bopd net) in response to recent field optimization work.
- Ezsaouia success doubles current net production to ~1100 bopd**  
 2006 net 2P reserves at Ezzaouia were 2.2mmbbls and 2.6 Bcf of gas. Ezzaouia rates exceed our expectations. We revise our forecast upwards.
- El Bibane rig enroute – drilling targeting 2.4mmbbls and 13 Bcf**  
 Drill start-up is planned for late June / early July. Candax is targeting 2500-3000 bopd net production additions from El Bibane development.
- Target raised to \$0.90 from \$0.80 on prod<sup>n</sup> outlook – Mkt Perform**  
 Projected 2008E DACF of \$0.26/sh (up from \$0.22/sh) & risked NPV/sh of \$0.66 drive our \$0.90 target. CAX also has \$0.26/sh in cash.

### Price Chart



Source: PCQuote

### Financial Summary

Shares O/S (M FD)	180.6	52-Week Trading Range	\$0.46-\$1.73	
Market Capitalization (M)	\$135	Average Weekly Volume	3,657,483	
Net Debt - 2005E (M)	-\$37	Market Float (M)	\$91	
Enterprise Value (M)	\$98	Risked Portfolio NPV/share (FD)	\$0.66	
<b>Forecasts</b>	<b>2005</b>	<b>2006</b>	<b>2007E</b>	<b>2008E</b>
Production (boe/d)	815	527	1,662	3,399
% gas	57%	0%	18%	21%
Wtd Ave Realized Price (\$/boe)	\$55.03	\$68.60	\$58.22	\$56.01
CapEx (M)	\$48.1	\$26.4	\$30.0	\$20.0
Oil and Gas Revenue (M)	\$12.9	\$13.2	\$35.3	\$69.5
Total Revenue (M)	\$13.9	\$16.3	\$38.3	\$70.3
Debt Adjusted Cash Flow (M)	\$7.4	\$10.9	\$29.4	\$44.8
DACFPS (FD)	\$0.04	\$0.06	\$0.12	\$0.26
EPS (FD)	(\$0.01)	(\$0.00)	\$0.07	\$0.15
<b>Valuation</b>	<b>2005</b>	<b>2006</b>	<b>2007E</b>	<b>2008E</b>
EV/DACF	18.5x	20.2x	3.8x	2.2x
EV/BOE/d (per unit production)	n/m	n/m	\$59,013	\$28,857
P/E	n/m	n/m	10.7x	4.9x

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 quality assets under favourable terms while minimizing their capital at risk. Unfortunately, a series of operational incidents have marred this story since September 2005. Production from El Bibane has been shut-in but is expected to build to >2,000 bopd by Q4 2007 now that a new rig contract has been signed with Seadrill, an experienced drilling company. In the event of El Bibane development success, we project 2008 DACF of \$0.26/sh which could support a share price in the \$1.00-\$1.25 range at a 4-5x multiple. With uncertainty still surrounding the future of the large Chaal (360 Bcf net recoverable potential) and Deep Triassic (multi-Tcf potential) upside, we believe Candax offers exposure to “free” positive surprise potential 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 throughout the region with further acquisitions and/or farm-in agreements.

## Investment Highlights

### Operations Update – Tunisia

*Successful Ezzaouia workover program boosts field production to ~3000 bopd*

**Following the completion of a planned field optimization plan, gross production at the 31.4% CAX-owned Ezzaouia field in onshore Tunisia has increased from ~1000 bopd to ~3000 bopd.** The Ezzaouia production increase exceeds our estimates for the field and we have revised our 2007E and 2008E DACF estimates upwards accordingly. Production in the Ezzaouia field has historically been primarily from the Jurassic M’Rabtine sandstone with minor contributions from the Cretaceous Zebbag dolomite. The company has not provided details on which reservoir(s) have contributed to the dramatic production increase at this time.

**Net Candax production is currently ~1100 bopd, which compares favourably with the Q1 average rate of 420 bopd.** In order to account for the increased production volumes, we have revised our 2007 production outlook upwards to 1662 boepd from 1413 boepd and our 2008 forecast to 3339 boepd from 3000 boepd. Our revised production outlook has positively impacted our cash flow estimates.

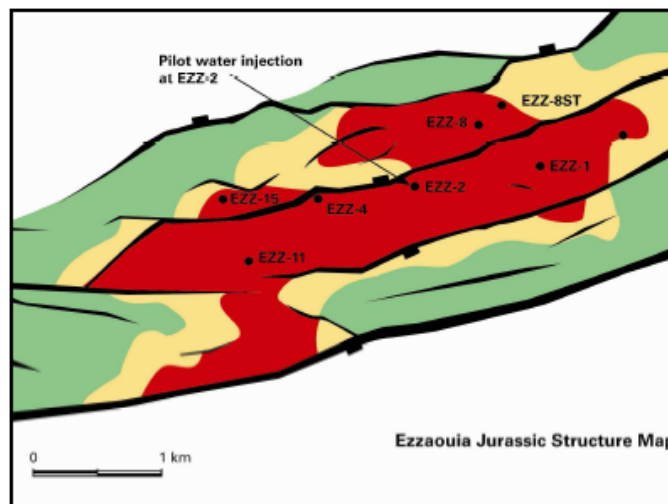
**El Bibane development drilling expected to begin in late June or early July – individual horizontal development well initial rates could be 1500-2500 bopd (gross).** Bahamas-based Seadrill has been contracted to provide the West Titania rig for the El Bibane development drilling. Seadrill is a worldwide operator that has been in the drilling business for over 30 years. Supporting onshore and offshore facilities are 80% completed with production from the previously shut-in field expected to come onstream as early as August. Candax has a 73.8% interest in the El Bibane concession

**Exhibit 1: Candax Tunisian Asset Portfolio Map (Al Manzah, Robbana, El Bibane, Ezzaouia, and Chaal)**



Source: Company reports

**Exhibit 2: Schematic of Ezzaouia Well Locations – Water Injection is Intended to Provide Pressure Support and Increased Oil Recovery**



Source: Company reports

**El Bibane development plans call for 2 horizontal producing wells and 1 gas injector targeting 2.4mmbbls and 13 Bcf of net 2P reserves (2.3mmbbls and 11.4 Bcf post-royalties).** We include a conceptual image of the proposed development in Exhibit 4. We expect both development wells to be producing ~2000 bopd net to Candax by Q4 2007 (Exhibit 3). We carry a risked NPV/sh of \$0.30 (\$0.43 unrisked) for the El Bibane re-development project.

**El Bibane production estimates drive our 2008 DACF of \$0.26/sh – other properties are expected to contribute about 800-1000 bopd to the projected 2008 average production of 3400 boepd.** Current production from the Ezzaouia

and Al Manzah fields is expected to remain relatively stable at ~1000 bopd. Expected El Bibane gas production of ~4-5 mmcf/d is planned to be used in the SEEB power generating facility and is expected to generate minor incremental cash flow (~US\$1 million per year).

**Exhibit 3: 2007/2008 Candax Production Projections – note that El Bibane constitutes the bulk of the production going forward**

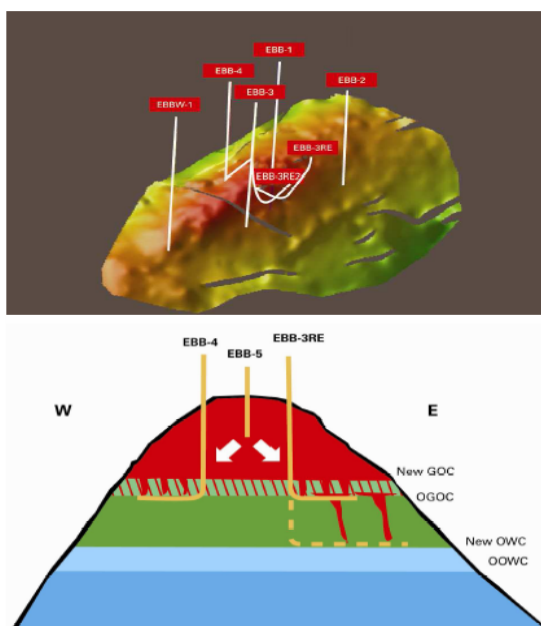
WWCM Candax Modeled Net Oil Production Projections (gas not included)								
Field	2007				2008			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
El Bibane	0	0	350	2000	2000	1850	1700	1600
Ezzaouia	300	525	950	900	850	800	750	700
Al Manzah	175	150	130	120	110	110	100	100
Robbana	25	25	20	20	20	20	20	20
Total	500	700	1450	3040	2980	2780	2570	2420

Source: Company reports, Wellington West Capital Markets Inc.

**High-risk/high-reward Deep Triassic and Chaal potential remain in play**

We calculate risked EMV/sh of only \$0.24 for the Deep Triassic (1-2Tcf gross upside potential below El Bibane and Ezzaouia) and Chaal prospects (60% W.I., ~1Tcf gross upside potential), but we believe that success on either of these heavily-risked plays could significantly change the outlook for the company. Due to the relatively high technical and geologic risk associated with the Chaal and Deep Triassic plays, we assign just a 10% chance of success to each. The company continues to evaluate its options with regards to the technically challenging Chaal appraisal program. Additionally, Candax continues to negotiate with the Tunisian government regarding Deep Triassic contract terms before committing to a deep exploration well on the Ezzaouia permit.

**Exhibit 4: El Bibane Redevelopment Plan Schematic – bottom image shows intended gas injection well and 2 horizontal oil producers**



Source: Company reports

## Valuation and Summary Recommendation

**Our target has been raised to \$0.90 from \$0.80 to reflect the successful workover program at Ezzaouia and associated increased production volumes.** We calculate a corporate risked NPV/sh of \$0.66, most of which is associated with El Bibane (\$0.30/sh) and the company's cash position (\$0.26/sh). We currently carry a 70% chance of Candax recovering their stated net 2P reserves of 2.3mmbbls of oil and 11.4Bcf of gas at El Bibane. We carry equal weightings of 2008E DACF and risked NPV/sh in order to reflect our cautious optimism that El Bibane production will ramp up to the 2000 bopd + 5mmcf/d gas level by the end of 2007. Our target change is driven by increased cash flow projections (revised to \$0.26 in 2008E, up from \$0.22 previously) associated with the boost in Ezzaouia production.

**Our Market Perform recommendation remains, despite a suggested return of ~20% over current prices, reflecting the fact that prior delays have seen production timing targets missed considerably.** Although we maintain our view that several of the prospects in the Candax portfolio could add significant value to the company, prior delays with respect to estimated spud dates have tempered our optimistic outlook and we maintain a Market Perform rating. We view the expected late June / early July El Bibane spud date as positive, but we remain cautious ahead of the drill date.

**Our revised production and cash flow estimates suggest Candax is currently trading at only 2.2x 2008E EV/DACF.** Given the proven reserve base and strong cash position of the company, we believe a compelling argument exists for gaining exposure ahead of El Bibane drilling. 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	\$ 0.66	1.0	\$ 0.66	35%	\$ 0.23
2008 DACF Multiple	\$ 0.26	5.0	\$ 1.32	35%	\$ 0.46
Asset EMV/share	\$ 0.92	1.0	\$ 0.92	20%	\$ 0.18
Asset Acquisition Value	\$ 0.23	1.0	\$ 0.23	10%	\$ 0.02
12 month target price					<b>\$ 0.90</b>

Source: Company reports, Wellington West Capital Markets Inc.

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