

Candax Energy Inc.

CAX : TSX : C\$0.60

SPECULATIVE BUY

Target: C\$1.12

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COMPANY STATISTICS:

52-week Range:	\$0.39-1.08
Avg. Daily Vol. (000):	337
Market Capitalization (M):	\$101.3
Shares Out. (M) basic:	168.9
Shares Out. (M) fd:	168.9

EARNINGS SUMMARY:

FYE Dec	2005A	2006A	2007E	2008E
Equivalent				
Production (boe/d):	1,357	560	1,205	4,025
EPS:	(0.02)	(0.00)	(0.03)	0.10
Operating EPS:	(0.01)	(0.01)	(0.03)	0.10
P/Operating EPS:	(41.2x)	(53.2x)	(21.1x)	5.7x
CFPS:	0.05	0.03	0.03	0.32
P/CF:	11.6x	19.6x	19.6x	1.9x

SHARE PRICE PERFORMANCE:



COMPANY SUMMARY:

Candax Energy Inc. is an international energy company involved in oil and gas exploration and production and power generation. Candax has operations in Tunisia and looks to expand into the Middle East and other parts of North Africa. With an experienced, international oil and gas knowledgeable management team inclusive of Michael Wood, President and CEO, John Clarke, Executive Vice President and Chris Hopkins, CFO; Candax is primed for growth.

All amounts in C\$ unless otherwise noted.

Energy -- Oil and Gas, Exploration and Production

TIMING CAN BE EVERYTHING

Event

Candax Energy reported its Q2/07 financial and operating results last night. Smaller oil liftings, a primary revenue driver, was the main reason for an uneventful second quarter. Reported production and oil liftings (sales) of 513 b/d and 8,099 barrels were below our second quarter estimate of 822b/d and 30,000 barrels, respectively. Oil liftings were significantly lower as there were no domestic market obligation (DMO) liftings from Ezzaouia and total sales of 8,099 were from Al Manzah. Furthermore, production was lower due to a much quicker stabilization of volumes at Ezzaouia, declining from a peak rate of 1,000 b/d to approximately 700 b/d. During the quarter, Candax incurred operating expenses of \$1.4 million, approximately 67% higher than our estimate. A majority of these expenses related to Ezzaouia well workovers that are not allowed to be capitalized per Canadian GAAP.

Impact

Neutral. We believe that Candax is a 2008 cash flow story and the disappointing second quarter results are a temporary hiccup. We expect Candax's stock will recover once production stabilizes at Ezzaouia and the El Bibane field starts producing in October. Adjustments to Candax's oil liftings schedule have changed our profile of near-term cash flow, pushing it out a quarter. As such, we have reduced our 2007E CFPS (fd) and operating EPS (fd) to \$0.03 and (\$0.03) from \$0.08 and (\$0.01), respectively. Despite lower production from Ezzaouia, additional adjustments have resulted in an increase in 2008E CFPS and operating EPS to \$0.32 and \$0.10 from \$0.27 and \$0.04, respectively.

Action

We maintain our SPECULATIVE BUY rating with a C\$1.12 target price.

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Valuation

Our target price of C\$1.12 represents a conservative 3.5 times our forecast 2008 cash flow and 3.4 times on a debt-adjusted basis. Candax remains net debt free with forecast working capital of \$12.1 million at year-end.

EXPLORE, DEVELOP, LIFT

Timing can make a big difference, especially with Candax's oil inventory liftings, where a smaller lifting in the second quarter resulted in lower-than-expected earnings and cash flow for the company. Oil is lifted/sold as inventory accumulates and storage facilities reach capacity. The oil is then transported via crude oil tankers to the local markets. As such, we have made adjustments to Candax's lifting schedule and expect a major equity lifting during the third and fourth quarters, with multiple liftings during 2008. These adjustments have changed our profile of near-term cash flow, pushing it out a quarter. Additional adjustments have resulted in a higher cash flow estimate for 2008, even though Ezzaouia production is slightly lower.

During June 2007, Candax completed its workover program at Ezzaouia and started producing at rates well above our expectations. Production from the field peaked at approximately 1,000 b/d (net to Candax); however, it slowly stabilized down to 700 b/d. We have reduced our production estimates downward to reflect the stabilized rate and expect a gradual production decline from the field going forward. Operating costs of \$1.4 million increased approximately 240% sequentially and 53% year-over-year, primarily due to the workover expenses incurred at Ezzaouia during the second quarter. According to Canadian GAAP, well workovers do not necessarily increase the life of the reserves and, as such, are expensed in the period incurred.

Revisiting our estimates

As a result of the shift in the timing of the inventory liftings as well as lower, stabilized production from Ezzaouia, we have revised our estimates. We have reduced our 2007E CFPS (fd) and operating EPS (fd) to \$0.03 and (\$0.03) from \$0.08 and (\$0.01), respectively. Despite lower production from Ezzaouia, additional adjustments have resulted in an increase in 2008E CFPS and operating EPS to \$0.32 and \$0.10 from \$0.27 and \$0.04, respectively. See Figure 1 for more information on the company's operating and financial results and our estimates.

Figure 1: Financial and operating results and forecast

	Q1/07	Q2/07	Q3/07E	Q4/07E	2007E Old	2007E New	2008E Old	2008E New
Net Income	(894)	(4,541)	2,442	(1,817)	(1,030)	(4,809)	6,258	18,097
Reported EPS (FD)	-0.01	-0.03	0.01	-0.01	-0.01	-0.03	0.04	0.10
Operating EPS (FD)	-0.01	-0.03	0.01	-0.01	-0.01	-0.03	0.04	0.10
Cash Flow	352	3,979	4,513	4,303	13,053	5,189	46,410	55,679
CFPS (FD)	0.00	-0.02	0.03	0.03	0.08	0.03	0.27	0.32
Net Capital Spending	(2,120)	(12,503)	(8,000)	(6,777)	(29,400)	(29,400)	(30,000)	(30,000)
Net Debt/(cash) incl. Working capital	(31,978)	(15,294)	(11,836)	(9,361)	(17,399)	(9,361)	(33,809)	(35,040)
Liquids (b/d)	420	513	824	2,507	1,344	1,066	3,553	3,192
Gas (mmcf/d)	0	0	0	3	1	1	5	5
Equivalent (boe/d)	420	513	824	3,063	1,482	1,205	4,386	4,025

Note: Actual timing of oil inventory liftings may vary from our expectations and may have an impact on cash flows. Source: Company reports, Canaccord Adams estimates

El Bibane development and future exploration

We believe second quarter results were a minor hiccup and that the Candax story remains one of converting cash to cash flow from its oil development at El Bibane and the upside potential from deep drilling at Chaal and the Triassic play onshore at Ezzaouia. Further news is expected on the timing of these high-impact exploration prospects, as well as the potential for new ventures.

On July 31, Candax started drilling EBB-4, the first well in the three-well development program, utilizing the West Titania jack-up drilling rig. The well will take approximately 40 days to drill and an additional two weeks to tie-in the pipeline to the well, with first oil and gas production expected to start during October.

Valuation and conclusion

We believe Candax's shares are relatively inexpensive and, with a current share price of C\$0.60, are trading at approximately 2.0 times 2008E cash flow. The company's financial position remains strong, with no debt and forecast working capital of \$12.1 million at year-end. Candax's operations are starting to turn the corner with strong gains now anticipated in H2/07 and 2008. In our view, the possibility exists for a return to the Chaal prospect as well as the deep Triassic at Ezzaouia, either of which offer potential significant upside. In addition, Candax continues to pursue other investment opportunities in and around its core focus areas in North Africa/Middle East. Our target price of C\$1.12 represents a conservative 3.5 times our forecast 2008 cash flow and 3.4 times on a debt-adjusted basis.

Investment risks

In addition to operating risks inherent in oil and gas exploration and production activities, oil and natural gas price realizations and production may be lower or higher than our forecast. Collectively, these risks could impact the company's valuation and our forecasts.

Candax acquired producing assets that are mature with a relatively short reserve life and a high water cut. There is no guarantee that all future volumes of production will occur in sufficient quantities to make existing fields commercial. Two major fields (El Bibane and Ezzaouia) currently represent greater than 95% of the proved value of Candax. Should either of these fields experience a production-related problem for a prolonged period of time, there could be a material impact on our financial and valuation estimates. Unless new discoveries or assets are acquired, future cash flows from existing assets will decline substantially, which may impact the future valuation of Candax. All producing and potential properties are presently located in Tunisia. Although currently seen as a relatively stable government, the company's operations, financial results, and valuation could be adversely affected by events beyond its control taken by the current or future governments with respect to policy changes regarding taxation, regulation, and other business environment changes.

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Site Visit: An analyst has visited the issuers’ material operations in Tunisia and corporate headquarters in Toronto. No payment or reimbursement was received from the issuers for the related travel costs.

Price Chart:*



Date	Analyst	Rating	Target Price
1) 09/22/05	TP	Speculative Buy	1.50
2) 09/26/05	TP	Speculative Buy	0.83
3) 04/04/06	TP	Speculative Buy	1.33
4) 10/04/06	TP	Speculative Buy	0.88
5) 03/06/07	TP	Speculative Buy	0.78
6) 04/09/07	TP	Speculative Buy	0.81
7) 06/07/07	TP	Speculative Buy	1.00

* Price charts assume event 1 indicates initiation of coverage or the beginning of the measurement period.

Distribution of Ratings:
Global Stock Ratings
(as of 1 August 2007)

Rating	Coverage Universe		IB Clients	
	#	%	#	%
Buy	306	54.9%	41.8%	
Speculative Buy	70	12.6%	71.4%	
Hold	155	27.8%	35.5%	
Sell	26	4.7%	11.5%	
	557	100.0%		

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Company	Disclosure
Candax Energy Inc.	1A, 2, 3, 7, 11 (John Zaozirny)

16 August 2007

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