



Candax Energy Inc – (CAX:TSX, \$0.63)

Rig Contract for El Bibane Awarded, but Uncertainties Remain

Jamie Somerville, 403-705-3027 jsomerville@mgisecurities.com
Allison Morley, Associate 403-705-3035 amorley@mgisecurities.com

April 23, 2007

Stock Rating: Hold (previously Spec. Buy)

Target Price: \$0.75

C\$000 Yr end Dec. 31	F2006A	F2007E	F2008E
Oil and Liquids (bbls/d)	559	985	2,404
Natural Gas (mcf/d)	0	1,000	4,575
BOEPD (boe/d 6:1)	559	1,152	3,166
CFPS, f.d.	\$0.03	\$0.06	\$0.13
Net Debt (MM)	(\$34.3)	(\$3.6)	(\$4.5)
Enterprise Value (MM)	\$118	\$103	\$102
EV/BOEPD	\$210,274	\$89,241	\$32,187
Risked NAV (\$/f.d. share)	\$0.93	\$1.06	
P/NAVPS	1.0	0.6	
Projected Return			19.0%
Shares O/S Basic (MM)			168.9
Shares O/S F.D. (MM)			180.4
Market Cap. (MM)			\$106.4

Source: MGI Securities & Company Reports

Candax Energy Inc. is an international oil and gas company with operated producing properties and exploration interests in Tunisia, as well as a 60% operated interest in a large exploration license in Madagascar. The majority of the company's Tunisian assets were acquired during 2005 to provide a production base with upside potential to support the company's efforts to build a portfolio of assets across North Africa and the Middle East. Candax continues to pursue opportunities to acquire additional interests in the region.

Candax Energy announced on April 20 that it had signed a contract with Seadrill Ltd. for the utilization of the West Titania jack-up rig for the company's El Bibane re-development program in Tunisia. This contract significantly reduces the level of uncertainty with regards to likely start-up from the El Bibane redevelopment.

Rig Contract Signed

The newly announced contract for the West Titania jack-up rig will allow Candax to complete its planned three well re-development drilling program. Seadrill is a Bermuda-based international offshore drilling contractor, which owns and operates a fleet of some twenty rigs, including semi-submersibles, jack-ups, shallow and deepwater rigs and deepwater drillships. Its clients include many of the world's major offshore operators.

The West Titania was built in 1981 and is therefore one of the older rigs in Seadrill's fleet. To our knowledge, it was sitting idle in Cameroon since completing a two-well program on the Okoru field in Nigeria in December 2006. The rig will be towed from its current location in West Africa using the heavy lift vessel, Gavea Lifter. Mobilization of the heavy lift vessel from southern Africa is already underway, such that mobilization of the West Titania should be able to commence before end-April. Assuming mobilization proceeds as planned, CAX expects drilling at El Bibane to start in June.

Comments

Since our last update on CAX, we have been able to meet with management and review the company's reserves statements and Annual Information Form (published April 5). We are encouraged by the measures taken following a full review by management of the company's development options (both internally and also using external well service contractors). The company's Tunisian management appears increasingly focused on ensuring work is carried out in a thorough manner. Following very disappointing issues with previous contractors, we welcome the company's signing a rig contract with a reputable contractor.

However, substantial challenges remain to ensure that full value is realized from the company's assets in Tunisia, and a rig contract alone does not guarantee development success. Operational risk remains significant with regard to incremental developments where exact reservoir performance is difficult to predict. Of course, the flip-side of this operational risk is that we believe it has been accounted for in the company's reserves assessments, and significant potential also exists for the core assets (El Bibane and Ezzaouia) to outperform expectations. However, in the absence of fully updated guidance (that takes into account this new rig contract), we are continuing to err on the side of caution with regard to likely costs, timing and production from the company's core assets in Tunisia.

The details of the announced rig contract are not being released for competitive reasons. However, we note that Seadrill has quoted a dayrate of US\$130,000 for recent use of the rig, which we take to be a good guide for the rate

that CAX is likely to be paying. Based on an assumption of approximately 120 days of drilling (which for a three-well program leaves little room for technical hiccups), we would therefore estimate a cost to CAX (73.8% working interest) of around \$13mm for rig services alone, excluding mobilization/demobilization. Based on this insight, together with a review of the cost assumptions used by third party engineers prior to the rig contract being signed, we are compelled to again increase our capital expenditure assumptions for 2007 from \$34mm to approximately \$43mm. If we were to assume that drilling of the company's exploration and appraisal prospects (at Chaal and in the Deep Triassic) was definitely going to proceed in late 2007, this number would likely be even higher. However, we continue to assume a relatively low likelihood of drilling at either Chaal or for the Deep Triassic prospects beginning soon enough to be completed by end-year.

In fact, as the company now requires substantial portions of its cash reserves to complete development projects, we increasingly suspect that the company will either be forced to delay drilling of its higher risk prospects until it has replenished its cash from operations or raise financing through debt or equity. New financing would either increase financial risk or likely dilute existing shareholders' interest in the long-term upside potential.

Timing of any high-impact drilling therefore appears uncertain. Timing of any new business development activity is effectively impossible to predict (although we continue to like CAX for its sound transactional record, even if deals have been slower to materialize than we would have hoped). We are therefore very uncertain as to when any events might occur that would lead market valuation to include upside potential from either higher risk prospects or potential business development activities.

Valuation

We have updated our valuation of the company's base assets in Tunisia to reflect updated reserves assessments (while overview reserves estimates had been published at the time of our last update, we have now been able to review the full NI-51-101 reserves report). Mainly due to further increases in our cost assumptions for developments at El Bibane, our end-2006 NAV estimate is reduced, but our end-2007 estimate has actually increased as we have changed the assumed cost and production profiles slightly (bringing costs and production forward in time and therefore reducing the impact of the 10% nominal discount factor). On balance we do not see anything in these minor adjustments that would lead us to adjust our target price.

Note that we have also made a very minor adjustment to our price deck. We now assume an average Brent oil price for 2007 of US\$59.00/bbl (previously US\$58.50/bbl), which is increased due to strong recent performance of Brent (in particular in comparison to WTI). Our assumptions remain conservative and below both the current futures strip and reserves engineers' price decks. This minor adjustment is not yet included our assumptions for other companies in our coverage universe, but will be worked in on an ongoing basis.

Updated NAV Calculations

	Working Interest	Prob. of Success	As at Dec. 31, 2006			As at Dec. 31, 2007		
			Remaining Resource Estimate	PV10	NAV / Share (f.d.)	Remaining Resource Estimate	PV10	NAV / Share (f.d.)
			<i>mmboe</i>	<i>\$mm</i>	<i>\$/share</i>	<i>mmboe</i>	<i>\$mm</i>	<i>\$/share</i>
El Bibane	74%	100%	4.7	48.4	0.27	4.4	75.7	0.42
Other Producing Assets	n/a	100%	2.5	38.9	0.22	2.3	47.7	0.26
Total Assets			7.2	87.3	0.48	6.8	123.4	0.68
Net Debt				(34.3)	(0.19)		(3.6)	(0.02)
Base NAV Estimate				121.6	0.67		127.0	0.70
Proceeds from Options				9.3	0.05		9.9	0.06
Chaal Base Resource	60%	65%	4.6	27.8	0.15	4.6	44.9	0.25
Chaal Resource Upside	60%	20%	2.8	8.4	0.05	2.8	9.2	0.05
Riskied NAV Estimate			14.6	167.1	0.93	7.38	191.1	1.06
Fully Diluted Shares (mm)					180.5			181.6

Source: MGI Securities Inc.

Recommendation

We are changing our short-term recommendation of Speculative Buy to a Hold with an unchanged target price of \$0.75. We are downgrading our recommendation despite the fact that our target price still represents a potential return of 19.0% from the recent closing price of \$0.63.

CAX's share price has again increased since our last update (up \$0.08 from a closing price of \$0.55 on March 30), which we assume was mainly due to anticipation of an operational update or rig contract award. The argument for buying early prior to market valuation approaching a fuller value is therefore slightly reduced. In addition, following a full review of the company's financial and operating outlook, we feel that the level of operational uncertainty is little changed by the announced award of a rig contract.

We continue to expect that the company will have to establish a better operational track record before market valuation will approach our risked NAV estimate of around \$1.00. We still recognize that a speculative investment could potentially pay off handsomely over the next year if CAX performs as per management's targets or closes a significant value-creating acquisition (or if industry recognizes the underlying value of the company and bids to acquire the company at a premium to market valuation). We therefore recommend holding shares of Candax Energy and see only limited downside price risk. However, considering the operational risks and uncertainty regarding timing of potential catalysts to drive share price appreciation, we see better investment opportunities in other stocks in our coverage universe.

MGI Securities Inc ('MGI') Research Disclosures

MGI Securities Rating System:

BUY - The stock is expected to outperform the analyst's coverage universe over the next 12 months.

SPECULATIVE BUY - Rating applies to certain situations where a significant potential return to MGI Securities' target price exists contingent on the company reaching important financial/production goals.

HOLD - The stock is projected to perform in line with the analyst's coverage universe over the next 12 months.

SELL - The stock is expected to underperform the analyst's coverage universe over the next 12 months.

UNDER REVIEW - Pending additional review and or information. No rating presently assigned.

TENDER TO OFFER - The stock has an offer to purchase and the analyst recommends tendering to the offer.

The percentage of recommendations that fall into each of the above ratings categories will be displayed and updated quarterly on the MGI Securities website.

Equity Research Disclosures

3. The analyst has visited the issuers London (UK) and Tunis (Tunisia) offices. No payment or reimbursement was received from the issuer for the associated travel costs.

General Disclosures

The information and opinions contained in this report were prepared by MGI Securities. MGI Securities is a wholly-owned subsidiary of Jovian Capital Corporation, a TSX Venture listed company and is an affiliate as such. The opinions, estimates and projections contained in this report are those of MGI Securities as of the date of this report and are subject to change without notice. MGI Securities endeavours to ensure that the contents have been compiled or derived from sources that we believe to be reliable and contain information and opinions that are accurate and complete. However, MGI Securities makes no representations or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this report or its contents. Information may be available to MGI Securities that is not reflected in this report. This report is not to be construed as an offer or solicitation to buy or sell any security. The reader should not rely solely on this report in evaluating whether or not to buy or sell securities of the subject company.

Definitions

"Analyst" means any partner, director, officer, employee or agent of MGI who is held out to the public as an analyst or whose responsibilities to MGI include the preparation of any written report for distribution to clients or prospective clients of MGI which includes a recommendation with respect to a security.

"Research report" means any written or electronic communication that MGI has distributed or will distribute to its clients or the general public, which contains an analyst's recommendation concerning the purchase, sale or holding of a security (but shall exclude all government debt and government guaranteed debt).

Conflicts of Interest

The research analyst and or associates who prepared this report are compensated based upon (among other factors) the overall profitability of MGI Securities, which may include the profitability of investment banking and related services. In the normal course of its business, MGI Securities may provide financial advisory services for the issuers mentioned in this report. MGI Securities may buy from or sell to customers the securities of issuers mentioned in this report on a principal basis.

Analyst's Certification

Each MGI Securities research analyst whose name appears on the front page of this research report hereby certifies that (i) the recommendations and opinions expressed in the research report accurately reflect the research analyst's personal views about the issuer and securities that are the subject of this report and all other companies and securities mentioned in this report that are covered by such research analyst and (ii) no part of the research analyst's compensation was, is, or will be directly or indirectly, related to the specific recommendations or views expressed by such research analyst in this report.

Analyst's Ethics

As a condition of employment, analysts are required to adhere to the Code of Ethics and Standards of Professional Conduct of the Association for Investment Management and Research (CFA Institute, formerly 'AIMR').

Analyst Trading

MGI Securities permits analysts to own and trade in the securities and or the derivatives of the issuer under their research coverage, subject to the following restrictions. No trades can be executed in anticipation of coverage for a period of 30 days prior to the issuance of the report and 5 days after the dissemination of the report to our clients. For a change in recommendation, no trading is allowed for a period of 24 hours after the dissemination of such information to our clients. A transaction against an analyst's recommendation can only be executed for a reason unrelated to the outlook of the stock for the issuer and with the prior approval of the Director of Research and the Chief Compliance Officer.

Dissemination of Research

MGI Securities uses its best efforts to disseminate its equity research to all clients who are entitled to receive the firm's research reports, contemporaneously on a timely and effective basis in electronic form, via fax or mail. Selected research reports will also be posted on the MGI Securities website.



For Canadian Residents: This report has been approved by MGI Securities which accepts responsibility for this report and its dissemination in Canada. Canadian clients wishing to effect transactions in any such issuer discussed should do so through a qualified salesperson of MGI Securities in their particular jurisdiction.

For US Residents: MGI Securities (USA) Inc (MGI USA), a US registered broker dealer, accepts responsibilities for this report and its dissemination in the United States. This report is intended for distribution in the United States only to certain US Institutional investors. US clients wishing to affect transactions in any security discussed should do so through a qualified salesperson of MGI USA.

Copyright

All rights reserved. All material presented in this document may not be reproduced in whole or in part, or further published or distributed or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of MGI Securities Inc.