

Candax Energy Inc. (CAX-T; \$0.62)

Recommendation: Market Perform

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All values in C\$ unless otherwise noted.

Current Price	\$0.62
Target Price (12-Month)	\$0.85
Implied Capital Gain	37%

Changes

	Old	New
EPS 2006E	\$0.04	\$0.01
DACF/sh FD 2006E	\$0.08	\$0.06
EPS 2007E	\$0.16	\$0.13
DACF/sh FD 2007E	\$0.25	\$0.20
Recommendation	Market Perform	unchanged
Target Price	\$1.00	\$0.85

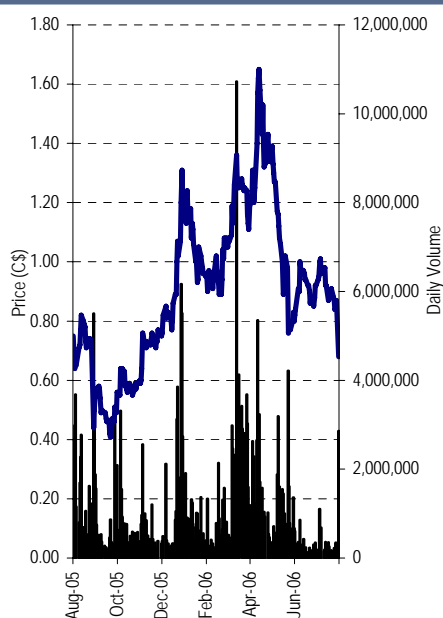
Company Profile

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 29th 2005 under the symbol CAX. The company is expected to be producing more than 2,000 boepd by mid-2007 from the re-instatement of the El Bibane Field.

Rig delays persist; El Bibane production estimates pushed back to early Q2/07

- El Bibane rig is in-country; delays continue with a new barge req'd**
 A jackup support barge is needed v. the current floating variety; our estimates of first production have been pushed back to April from late Jan
- Deep Triassic prospect included in US\$25.4mm '07 capital budget**
 This includes evaluating the 270mmboe gross unrisks Triassic potential at Ezzaouia; we assign an EMV/sh of 8¢/sh risked and 96¢/sh success.
- New exploration acreage in Madagascar adds to EMV estimates**
 Addition of a 15,000km² property in the north of Madagascar has added an incremental 8¢ to our EMV/sh; late '07 exploration well possible.
- Tgt lowered to \$0.85 from \$1.00 on lower cash flow estimates**
 Candax is currently trading at only 2.1x our '07E EV/DACF however; Market Perform rating maintained due to continued service delays.

Price Chart



Source: PCQuote

Financial Summary

Shares O/S (M FD)	181.2	52-Week Trading Range	\$0.39-\$1.73
Market Capitalization (M)	\$112	Average Weekly Volume	5,315,702
Net Debt - 2005E (M)	-\$39	Market Float (M)	\$75
Enterprise Value (M)	\$73	Risked Portfolio NPV/share (FD)	\$0.76
Forecasts	2005	2006E	2007E
Production (boe/d)	815	733	2,655
% gas	57%	0%	19%
Wtd Ave Realized Price (\$/boe)	\$65.61	\$60.06	\$57.04
CapEx (M)	\$48.1	\$26.8	\$30.0
Oil and Gas Revenue (M)	\$12.9	\$16.1	\$55.3
Total Revenue (M)	\$13.9	\$19.5	\$61.6
Debt Adjusted Cash Flow (M)	\$7.4	\$9.6	\$36.3
Shares Outstanding (M)	77.1	170.0	181.2
DACFPS (FD)	\$0.04	\$0.06	\$0.20
EPS (FD)	(\$0.01)	\$0.01	\$0.13
Valuation	2005	2006E	2007E
EV/DACF	13.8x	8.8x	2.1x
EV/BOE/d (per unit production)	\$89,773	\$99,726	\$27,546
P/E	(53.9x)	70.4x	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 Q2 2007. A key onshore exploration well at Chaal found thicker than anticipated gas pay, but was damaged and unable to test gas at a commercial rate. We expect that Candax will seize opportunities for low-risk growth throughout the region with further acquisitions and/or farm-in agreements.

Investment Highlights

Jackup rig in-country, further delays to drill program due to barge mismatch

The movement of the rig to the El Bibane well site has been pushed back as the company waits for the arrival of a jackup support barge. Previous estimates for a spud date before the end of 2006 have been pushed back to late-January/early-February for the well, which will likely take ~30 days to drill. The rig is currently undergoing final component construction (installation of feet and the top drive) and subsequent certification. We estimate that the rig will be ready to launch within 2-3 weeks, and suggest that the rig could be on site as early as the end of January, pending the jackup barge arrival. As a result of this delayed timeline we have adjusted our production profile for the company, ultimately impacting our CFPS estimates for 2007. Exhibit 1 summarizes our changes.

Exhibit 1: Summary table; WWCM Estimates

	2006E		2007E	
	Old	New	Old	New
Production (boe/d)	895	733	3,407	2,655
CFPS	\$0.07	\$0.06	\$0.25	\$0.20

Source: Wellington West Capital Markets Inc.

Our projections now assume El Bibane production starting in early Q2/07; pushed back from the previous estimate of late Q4/06. We are estimating that the first well comes on-stream in early April at approximately 1,200b/d of oil and 2.5mmcf/d of gas. The second well, re-entry of EBB-3, would then likely be completed by June with similar initial rates.

New drilling and project management teams have been established in Tunisia with a permanent health, safety and environment manager due to start in January. We suggest that with the addition of these skilled workers, both safety and productivity are likely to increase.

Triassic potential remains with near-term workover program to shore up Ezzaouia declines

The change of senior officials at ETAP earlier in the year signaled an increase in exploration interest bringing visibility to the deep Triassic exploration program. Additionally, we view the stated inclusion of a deep Triassic exploration well in the 2007 budget, subject to government approval and

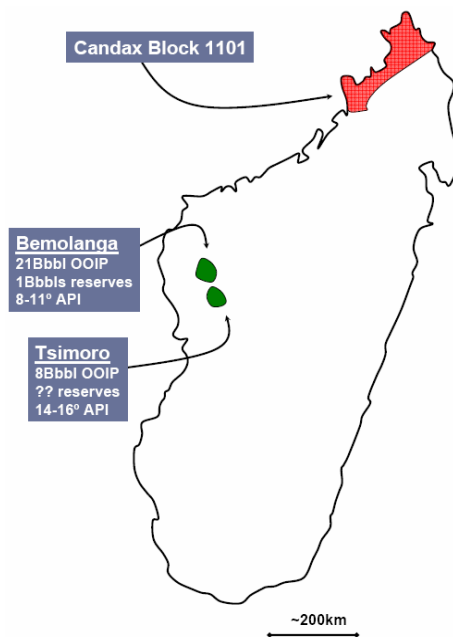
rig availability, as a positive indicator towards evaluating the associated 270mmboe of gross resource potential. Our assumptions for the deep Triassic equity are that ETAP will participate in the well, with Centurion (soon to be Dana Gas PJSC) exercising their right to back-in on up to 50% of Candax’s 31.4% working interest. The ultimate result of these assumptions is an effective 15.7% interest net to Candax, with a 10% chance of realizing 270mmboe of gross potential. The contribution to our risked EMV/sh calculation remains only \$0.08, rising to \$0.96 in the event of a full success case.

A five well workover program is estimated to add ~150b/d of net production, starting in Q1. We suggest that this incremental production will serve to partially backfill the quarterly declines from El Bibane in the near-term. Our model assumes a 25% annual decline rate in the offshore prospect.

Entry into Madagascar – heavy oil potential

Candax has entered into a two-year US\$1.5mm work commitment project, onshore Madagascar which we value at \$0.08/sh in our risked EMV model. Phase I of the work commitment includes geological studies, 100 km of 2D seismic and one 800m exploration well for total estimated costs of \$2.5mm. We are valuing the prospect based on a 5% chance of success in recovering 350mmbbbls gross of heavy oil, valued at \$1.50/bbl. Our low chance of success is due to the early stage of the play, and our ultimate resource potential is based on a conservative notional field consistent with historic resources in-country. Madagascar is an active hydrocarbon province, with significant heavy oil discoveries including the Bemolanga field, containing 21Bbbbls of 8^o-11^oAPI oil at a suggested 5% recovery rate, and the Tsimiroro field, estimated to contain 8Bbbbls of 14^o-16^o API. Additionally, lighter 22^o-40^o API oil has been discovered downdip of heavy oil deposits, with minimal information available as to the size or commerciality of the lighter oil finds.

Exhibit 2: Candax in Madagascar; 60% CAX, 40% EAX (Dubai)



Source: Company Reports, Wellington West Capital Markets Inc.

Valuation and Summary Recommendation

Our target has been reduced to \$0.85 from \$1.00 to reflect additional delays from the El Bibane field, in addition to revisiting our working capital assumptions. Mitigating this drop is an 8¢ increase to our risked asset EMV/sh to reflect the addition of the Madagascar exploration acreage. The most material drop in our four-part blended valuation methodology is our risked NPV/share pullback to \$0.76 from \$0.99. We previously attributed almost \$0.50/sh in working capital; however, at quarter end Candax stated net working capital of just over \$39mm, or approximately \$0.27/sh. This adjustment, combined with production from El Bibane being pushed back another quarter, has precipitated our target change.

Our Market Perform recommendation remains, despite a suggested return of >37% over current prices, reflecting continued delays in bringing production on-stream. Although we maintain our view that several of the prospects in the Candax portfolio could add significant value to the company, the repeated revisions to estimated spud and first production date due to service delays have tempered our optimistic outlook for ultimate monetization. We would view the announcement of drilling, and subsequent testing and tie-in of El Bibane as positive indicators of possible future success.

Even with our revised production and cash flow estimates, Candax is currently trading at only 2.1x our 2007E EV/DACF. A compelling argument exists for gaining exposure ahead of actual drilling activity, but as mentioned above, unforeseeable risks may still remain between now and the start of significant cash flow from near-term production at El Bibane.

Exhibit 3: Net Asset Valuation Table

Valuation Matrix	Forecast	Target Multiple	Value	Weighting	Weighted Value
Risked NPV/share	\$ 0.76	1.0	\$ 0.76	60%	\$ 0.46
2007 DACF Multiple	\$ 0.20	5.0	\$ 1.00	10%	\$ 0.10
Asset EMV/share	\$ 1.08	1.0	\$ 1.08	20%	\$ 0.22
EV/BOE - 2004 Acquisition Value	\$ 0.72	1.0	\$ 0.72	10%	\$ 0.07
			12 month target price		\$ 0.85

Source: Company reports, Wellington West Capital Markets Inc.

Exhibit 4: Income Statement

Millions, except per share amounts	<u>2005A</u>	<u>2006E</u>	<u>2007E</u>
Revenue			
Oil and Gas Revenues	\$ 12.9	\$ 16.1	\$ 55.3
Royalties	\$ -	\$ -	\$ -
	<u>\$ 12.9</u>	<u>\$ 16.1</u>	<u>\$ 55.3</u>
Interest and other income	\$ 1.0	\$ 3.4	\$ 6.3
	<u>\$ 13.9</u>	<u>\$ 19.5</u>	<u>\$ 61.6</u>
Expenses			
Operating	\$ 2.7	\$ 3.7	\$ 3.9
General and Administrative	\$ 3.7	\$ 3.4	\$ 9.3
Stock based compensation	\$ 1.1	\$ 0.4	\$ -
Depletion and depreciation	\$ 4.0	\$ 5.0	\$ 12.1
Accretion of asset retirement obligations	\$ -	\$ -	\$ -
Foreign Exchange Loss (gain)	\$ 0.6	\$ 0.8	\$ -
Write-off of impaired assets	\$ -	\$ -	\$ -
Interest on long-term debt	\$ 0.9	\$ 1.3	\$ 1.2
Non-cash items	\$ 0.2	\$ 0.1	\$ 0.2
	<u>\$ 13.2</u>	<u>\$ 14.8</u>	<u>\$ 26.7</u>
Income before taxes and dispositions	\$ 0.7	\$ 4.7	\$ 34.8
Gain on disposition of oil and gas properties	\$ -	\$ -	\$ -
Income before taxes	\$ 0.7	\$ 4.7	\$ 34.8
Current taxes	\$ 0.8	\$ 1.9	\$ 11.8
Capital taxes	\$ -	\$ -	\$ -
Future taxes	\$ 1.4	\$ 1.3	\$ -
	<u>\$ 2.2</u>	<u>\$ 3.2</u>	<u>\$ 11.8</u>
Net income	<u>\$ (1.5)</u>	<u>\$ 1.5</u>	<u>\$ 23.0</u>
Dividends on common shares	\$ -	\$ -	\$ -
Net income to common	\$ (1.5)	\$ 1.5	\$ 23.0
Retained earnings, beginning of period	\$ (0.4)	\$ (2.0)	\$ (0.4)
Redemption of shares	\$ -	\$ -	\$ -
Retained earnings, end of period	\$ (2.0)	\$ (0.4)	\$ 22.6
Earnings per common share	(\$0.02)	\$0.01	\$0.14
Earnings per fully diluted common share	(\$0.01)	\$0.01	\$0.13

Source: Wellington West Capital Markets Inc.

Exhibit 5: Balance Sheet

Millions, except per share amounts	<u>2005A</u>	<u>2006E</u>	<u>2007E</u>
Assets			
Current Assets			
Cash	\$ 22.6	\$ 33.9	\$ 39.0
Inventory and Other	\$ 6.4	\$ 6.4	\$ 6.4
Accounts Receivable	\$ 1.7	\$ 1.7	\$ 1.7
	<u>\$ 30.7</u>	<u>\$ 42.0</u>	<u>\$ 47.1</u>
Plants, Properties and Equipment	\$ 59.2	\$ 81.0	\$ 98.9
Other Assets	\$ 1.8	\$ 1.2	\$ 1.2
	<u>\$ 61.1</u>	<u>\$ 82.2</u>	<u>\$ 100.1</u>
Total Assets	<u>\$ 91.7</u>	<u>\$ 124.2</u>	<u>\$ 147.2</u>
Liabilities			
Current Liabilities			
Accounts Payable and Accrued Liabilities	\$ 5.9	\$ 5.9	\$ 5.9
Income taxes payable	\$ -	\$ -	\$ -
Current portion of obligations under capital leases	\$ -	\$ -	\$ -
Current portion of long-term debt	\$ 1.2	\$ -	\$ -
	<u>\$ 7.1</u>	<u>\$ 5.9</u>	<u>\$ 5.9</u>
Long-term debt and capital leases	\$ 12.2	\$ -	\$ -
Provision for abandonment and site restoration	\$ 2.3	\$ 3.1	\$ 3.1
Future taxes	\$ 5.6	\$ 5.6	\$ 5.6
	<u>\$ 20.2</u>	<u>\$ 8.7</u>	<u>\$ 8.7</u>
	<u>\$ 27.2</u>	<u>\$ 14.7</u>	<u>\$ 14.7</u>
Shareholders Equity			
Share Capital	\$ 64.7	\$ 108.6	\$ 108.6
Contributed Surplus	\$ 1.1	\$ 1.3	\$ 1.3
Retained Earnings	\$ (2.0)	\$ (0.4)	\$ 22.6
	<u>\$ 64.5</u>	<u>\$ 109.5</u>	<u>\$ 132.5</u>
Total Liabilities and Shareholders Equity	<u>\$ 91.7</u>	<u>\$ 124.2</u>	<u>\$ 147.2</u>

Source: Wellington West Capital Markets Inc.

Exhibit 6: Cash Flow Statement

Millions, except per share amounts	<u>2005A</u>	<u>2006E</u>	<u>2007E</u>
Operating Activities			
Net income	\$ (1.5)	\$ 1.5	\$ 23.0
Items not involving cash			
Depletion and depreciation	\$ 4.0	\$ 5.0	\$ 12.1
Accretion of asset retirement obligations	\$ 0.2	\$ -	\$ -
Write-off of impaired assets	\$ -	\$ -	\$ -
Stock based compensation expense	\$ 1.1	\$ 0.4	\$ -
Disposition of oil and gas properties	\$ 0.1	\$ -	\$ -
Future income taxes	\$ 1.4	\$ 1.3	\$ -
	<u>\$ 5.3</u>	<u>\$ 8.3</u>	<u>\$ 35.1</u>
Change in non-cash working capital items	\$ 1.2	\$ -	\$ -
	<u>\$ 6.5</u>	<u>\$ 8.3</u>	<u>\$ 35.1</u>
Financing Activities			
Debt receipts (repayments), net	\$ (0.9)	\$ (13.4)	\$ -
Issue of common shares	\$ 68.3	\$ 43.9	\$ -
Share issue costs	\$ (3.6)	\$ -	\$ -
Repayments from shareholder	\$ -	\$ -	\$ -
Refundable dividend taxes	\$ -	\$ -	\$ -
Dividends	\$ -	\$ -	\$ -
Other	\$ (3.4)	\$ (0.8)	\$ -
	<u>\$ 60.4</u>	<u>\$ 29.7</u>	<u>\$ -</u>
Cash available for investing activities	<u>\$ 66.9</u>	<u>\$ 38.0</u>	<u>\$ 35.1</u>
Investing Activities			
Oil and gas properties	\$ (48.1)	\$ (26.8)	\$ (30.0)
Other Equipment	\$ -	\$ -	\$ -
Proceeds from sale of properties	\$ -	\$ -	\$ -
Change in non-cash working capital items	\$ -	\$ -	\$ -
	<u>\$ (48.1)</u>	<u>\$ (26.8)</u>	<u>\$ (30.0)</u>
Increase (decrease) in cash	<u>\$ 18.8</u>	<u>\$ 11.3</u>	<u>\$ 5.1</u>
Cash and short-term deposits - beginning of year	\$ 3.8	\$ 22.6	\$ 33.9
Cash and short-term deposits - end of year	<u>\$ 22.6</u>	<u>\$ 33.9</u>	<u>\$ 39.0</u>

Source: Wellington West Capital Markets Inc.

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