BULLETIN #140 – Updated OCT 13, 2015

COMPANY ANALYSIS

CANAMAX ENERGY CAC-TSX; DTEYF-PINK

In the oil and gas business, investing alongside quality management is critical especially for junior producers. When you're investing in these ground floor opportunities you are basically investing in management.

It was having a chance to jump in on the ground floor with a proven operator like Canamax director Kevin Adair that attracted me to the stock.

Adair co-founded and was Vice President Engineering of Spry Energy Ltd. Which was built from nothing to 2,800 boe/day before being sold for $225 million.

When the price of oil collapses you will find that investing alongside a top quality management team isn't enough. You also need to own companies that own assets that can thrive in any commodity price environment.

Canamax management has built up a significant land position in a shallow Montney oil play. This is the kind of asset around which you want to build a junior oil producer.

This is a conventional reservoir, not a resource play that lacks permeability and requires huge and expensive frack loads to create that permeability.

With this Montney oil play (they call it Greater Grimshaw) Canamax believes they can grow production at $50 oil. One of the keys will be how well their first horizontal wells go. The Market will find out the end of October 2015.

Buying a bigger chunk of Grimshaw and buying a cash rich junior transformed the company during the downturn of 2015. They will exit 2015—assuming these two horizontals are successful—at 2100 boepd, no debt, and 70% oil. My back-of-the-napkin math makes them a $1 stock—now trading at 39 cents.

QUICK FACTS

Trading Symbols:	CAC-TSX; DTEYF-PINK
Share Price:	$0.39
Basic Shares Outstanding:	115 million
Market Cap:	$44.85 million
Net Cash:	$1 million
Enterprise Value:	$45.85 million
Production Capability:	1,800 boe/d (57% liquids)
Ent Value / Current Production:	$24,916 per flowing barrel

POSITIVES

- Top tier management
- Depressed oil price has created a buyer's market for assets which a "known" management team can exploit
- Greater Grimshaw asset is a low cost, low decline, high netback property that Canamax can be built around
- Valuation is now dirt cheap
- Sitting with net cash on the balance sheet

NEGATIVES

- Tough capital markets for all small players
- Subject to Canadian commodity prices
- Little room for operational errors, every well is a big one
- Depressed share price hurts ability to issue shares when making acquisitions

BACKGROUND/MANAGEMENT

In the oil and gas business, investing alongside quality management is *CRITICAL,* especially for junior producers. And honestly, when you're investing in these ground floor opportunities—it is management that <u>you are really buying</u>.

That is why I follow the movements of all of the top management groups.

It was having a chance to jump in on the ground floor with a proven operator like Canamax director Kevin Adair that attracted me to the stock.

Adair co-founded and was Vice President Engineering of Spry Energy Ltd.

Spry was built from nothing and using the drill bit reached 2,800 boe/d of production before being sold for $225 million.

Not only did Adair and the Spry team create a lot of shareholder value in a very short period at Spry, but he also carefully selected to whom he would sell the company.

When the company was sold, Spry shareholders received 70% in cash and the other 30% of their selling price in stock of the buyer, Whitecap Resources at $6.80/share. Whitecap traded at over $18 per share prior to the oil collapse this year and still trades at over $12.

Adair made his shareholders a bunch of money (a 25% compounded annual return) and left them with a management group that would make them even more (a subsequent triple at one point).

Prior to founding Spry, Adair was COO and a director of Petrobank. He was one of the main operational personnel in Latin America, and he helped lead that company from 600 Boe/d to 4,000 Boe/d.

Adair knows how to build (and eventually sell) a junior producer.

After selling Spry, like many successful Calgary executives Adair decided to leave the public arena and operate instead in the private realm. In the private realm you get to control who your shareholders are, and at what price you finance.

I personally don't know why even more of the best executives don't choose that route and avoid the hassles of being publicly traded. Can you imagine the phone calls from distressed investors executives of publicly traded companies have to handle in when oil and stock prices are plunging?

Adair's private venture is called **Petrus Resources** where Adair is President and CEO. His partner at Petrus is Don Gray who was a founder of **Peyto (PEY-TSX)** which is the single lowest cost gas producer in Canada. (Don is not involved in Canamax.)

We are lucky that a special set of circumstances now allow us to invest alongside Adair at Canamax where he is a director and Chairman of the Board.

While Petrus is Adair's day job, he is instrumental on what is going on at Canamax.

Adair owns millions of Canamax shares and his interests are fully aligned with Canamax shareholders.

He can get a lot richer with the leverage he has with Canamax. Making big money is the only thing he is after. He isn't there for the paycheque.

Adair brought in the operating team at Canamax and negotiated its first property deal.

The market was completely unaware of Canamax at the time of my first purchase of shares in the fall of 2013. There are now two analysts following the company, so it is still very much under the radar. That will change as this company grows.

When the Market does start looking it won't take long for investors to pick up on the fact that one of the energy patch's top executives (Adair) is calling the shots.

That is important because the stock prices of companies run by top executive teams in Calgary garner premium valuations.

Companies like **Raging River (RRX-TSX)** and **Crescent Point (CPG-TSX/NYSE)** trade at valuations as much as double (or more) than their competitors; the Market trusts the leaders of these companies to create value for shareholders year after year. I think Adair is among this group of top managers.

The general Market just isn't aware that he is running Canamax which is small and under the radar.

As shareholders over time we can look forward to both the growth of Canamax driving the share price higher AND the revaluation of the company when the market becomes aware that Adair is involved.

Before Adair really took charge Canamax was known as Riata Resources Corp. It changed its name to Petroforte International in November 2011 then to Canamax in November of 2013.

Adair and Lead Director Harry Knutson joined Riata shortly before that in July of 2011. Under the direction of Adair and Knutson, Canamax changed its previous focus on South America (hence the original Latin name) to focus instead on Western Canada.

In its first few months of existence Canamax faced a great opportunity as depressed natural gas prices had leveraged balance sheets and created a buyer's market for producing assets in Canada. Adair and his team have great access to Canadian deal flow and get to see all of the best opportunities.

The plan at Canamax from day 1 was to take advantage of the opportunity and they did in late 2013.

The Canamax plan has been to buy small, cheap assets today—but ones with scale--and then sell for much more in future years when the market improves.

In the first half of 2014 prices for assets improved so the deal flow cooled. With the collapse in oil prices obviously connected management teams with good balance sheets (like Canamax) have gotten a chance to be opportunistic again.

POWDER MOUNTAIN ACQUISITION

Before I get into the asset base that Canamax now has I'd like to go through its recent acquisition of Powder Mountain Energy.

This deal was a little different, it was more about Powder Mountain's balance sheet than it was about its assets.

The total purchase price for Powder Mountain (paid through the issuance of 45 million Canamax shares) was $27.35 million. Since the acquisition brought with it $21.5 million in cash it means that the price for Powder Mountain's land and production was only $5.85 million.

Essentially Canamax has raised cash by issuing equity at $0.60 per share and along with that got a big free option on a large piece of land that has potential.

That land and production in the deal involve the Torquay in Southeast Saskatchewan, but those lands aren't going to get any attention without a much higher oil price.

This deal was about bringing in $21.5 million in cash which pays for an acquisition of core Greater Grimshaw land that was made a few weeks earlier and keeps the balance sheet clean as a whistle.

With the Powder Mountain deal Canamax finds itself in the enviable position of having a net cash position (no debt). That is a great place to be in an environment where many companies are just fighting to survive.

The controlling shareholder behind Powder Mountain is a well-respected private equity group called 32 Degrees--who are known for doing great due diligence in their investments. They will now be on the board of directors at Canamax.

An active team like this will attract more deal flow and more cash.

PROPERTIES

When I first bought into Canamax (Petroforte) I was buying management and nothing else.

I mean that literally, because they had no assets.

What a change 18 months makes.

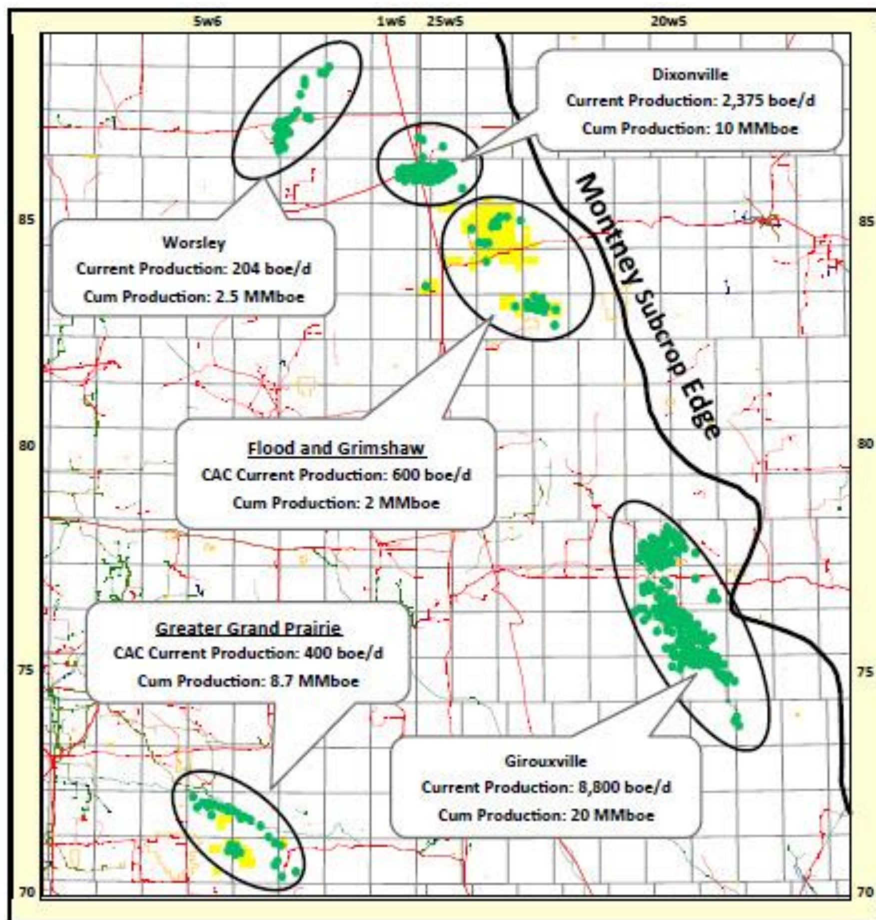
The initial game-plan for Canamax was to be a consolidator of micro-caps. The idea being that they could exploit the inefficiencies of the smaller asset market.

In times of distress there are lots of micro-caps who are desperate sellers, but very few natural buyers. It was a good plan, and has worked out well.

The company focus has now gotten more specific. They aren't just a consolidator of micro-caps, they are more specifically a consolidator of one specific play called Greater Grimshaw.

Property 1 – Greater Grimshaw Alberta

Canamax has just made its second major acquisition near its existing Flood property in the Greater Grimshaw region and this one really helps consolidate the area.



There are three producing pools up there—Grimshaw, Flood and Dixonville, and the first two of them are now owned by Canamax.

The seller was **Storm Resources (SRX-TSX)** and the purchase price was $24 million. Estimated production at closing date was 750 boe/d (54 per cent oil and NGLs) and the decline rate was nice low 12%.

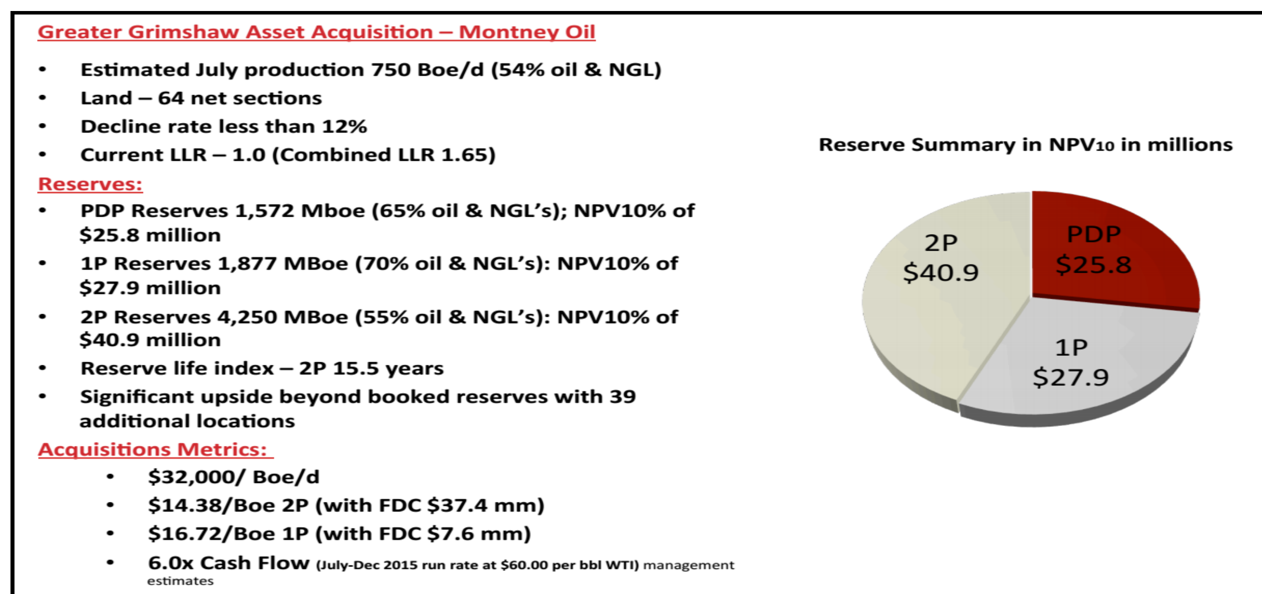
Canamax said that math works out to acquisition metrics of:

1. $32,000 per flowing boe/d,
2. Proved reserves: $12.70/boe
3. Proved plus probable reserves: $5.62/boe

That compares to Eagle Energy's 50% acquisition of Dixonville from Spyglass in December 2014—basically the same asset—which had the following metrics:

1. $80,000 per flowing boe
2. Proved reserves: $12.99
3. Proved plus probable reserves: $9.43

Spyglass was a very motivated seller (major debt problems) so Canamax really got a good deal. Better still they got infrastructure and seismic worth well over $20 million, management said in a quick call after the news.



This recent acquisition looks to be a great deal, but it's got nothing on the deal that Canamax struck to enter the play initially through Flood.

If you want to see what a great management team can do for you in a distressed market just have a look at what Adair and crew did with the Flood property it acquired in late 2013.

At that time there were many companies in financial distress due to low natural gas prices, no micro-cap capital and a lack of quality management teams who know how to bootstrap and build a company from the bottom up.

And there aren't many management teams with the credibility of the Canamax group that is focused on doing deals that are this small.....which was/is a huge advantage.

Canamax took advantage of the distressed environment by buying the assets of Expand Energy out of bankruptcy.

The purchase price for this?

A grand total of $700k for a 100% working interest in 37 sections of land. In early 2014 Canamax added another 5 net sections at Flood plus 50 boe/d for $1.1 million.

At the time of the deal it was pretty clearly a great one. Expand had spent $20 million just putting infrastructure in place on the property.

That means that the infrastructure in the ground alone was worth multiples of the overall purchase price.

A bank just wants its money back, it doesn't care whether the property is worth more than that. That is why Canamax could get such a huge deal.

That and the fact that there is very little capital chasing these deals. A situation that has presented itself again as oil has collapsed and allowed Canamax to add to its Flood position.

When acquired, the acreage had three productive Montney horizontal oil wells and 29 kilometers of recently shot, processed and interpreted 3D seismic. I figure that the value of the seismic alone might be worth more than Canamax paid for the property.

Canamax also obtained a 100% working interest in a new multi-well oil battery with all associated equipment—and like I already mentioned, that equipment alone was worth more than Canamax's purchase price.

The Flood property and this Grimshaw acquisition are perfect for a small company like Canamax.

This is a shallow Montney oil play. What really separates and makes it a good fit for a junior is that it is not an expensive to develop resource play, this is true stackable production.

Because this play is shallow it is both inexpensive to drill and has very high quality reservoir that is both porous and permeable. Shallow reservoirs have much less overburden which means less pressure and less chance that the formation has been squished.

The high level of permeability means that Canamax can use much smaller frack stages which cost a lot less than what is required in a shale well. Where a shale producer would be using a 300 tonne per stage frack, Canamax would be using 3 tonne per stage fracks.

The formation can be developed either with vertical or horizontal wells and like most permeable conventional style reservoirs the decline rates are lower than those that shale producers have to fight.

The conventional nature of the reservoir also sets up perfectly for secondary recovery through waterflooding which will add additional reserves and keep production rates steady.

It has low IP rates which keep the big boys away (no competition for consolidating the play), but very low cost wells with fast payout that make the play economic.

Wells will cost somewhere around $800,000 a pop and have IP rates of 30-50 boepd.

Montney Oil (100% W.I) – Core Area

Consolidating Greater Grimshaw (100% WI)

- 350 boe/d (85% liquids)
- 750 boe/d (54% liquids) acquisition

Total: 1,100 boe/d (65% liquids)

- Avg Vt IP30: 50 bbls/d; Cost: $0.8 mm;
- Avg Hz IP30: 125 bbls/d; Cost: $1.8mm;
- 96 sections & infrastructure;
- All of H2 2015 capex will be spent at Greater Grimshaw
- Greater Grimshaw estimated 2015 Exit 2,080 boe/d (73% liquids); 2016 Exit: 3,640 boe/d (79% liquids)

10 Montney Vertical wells & 5 Hz planned to be drilled in 2015; 3 Verticals and 18 Hz planned in 2016

What you have essentially got with Flood is something very similar to what **Raging River (RRX-TSX; RRENF-PINK**—one of North America's very best producers) has in the Viking. A simple, boring, low cost, yet highly profitable oil play.

Flood - Comparison to Viking play

Company		Raging River	Whitecap	Beaumont	Canamax
Asset		Dodsland	Lucky Hills	Kerrobert	Flood
Assumptions					
Well Cost	*($MM)*	$0.90	$0.93	$0.90	$0.80
IP 30	*(boe/d)*	60	120	85	70
Liquids	*(%)*	95%	80%	96%	86%
Yr1 Decline	*(%)*	60%	80%	80%	50%
Yr2 Decline	*(%)*	10%	20%	8%	10%
Yr3 Decline	*(%)*	5%	5%	3%	9%
Yr4 Decline	*(%)*	5%	5%	3%	9%
EUR	*(mboe)*	49.5	80.0	56.5	75
Liquids Content	*(%)*	96%	80%	98%	85%
Economics					
IRR	*(%)*	85.0%	127.4%	121.9%	137%
NPV(10%)	*($MM)*	$1.2	$1.8	$1.9	$1.7
Payout	*(years)*	1.0	0.5	0.7	1.0
F+D	*($/boe)*	$18.18	$11.63	$15.93	$11.10
Recycle	*(netback/F+D)*	2.8x	3.9x	4.1x	5.4x
Investment Ratio	*(NPV10/inv)*	129%	188%	210%	212%

To again be clear though—while Flood has drilling costs and initial production rates similar to the Viking, it is not a resource play. This is a conventional, vertical, oil play with low decline rates and great water flood potential.

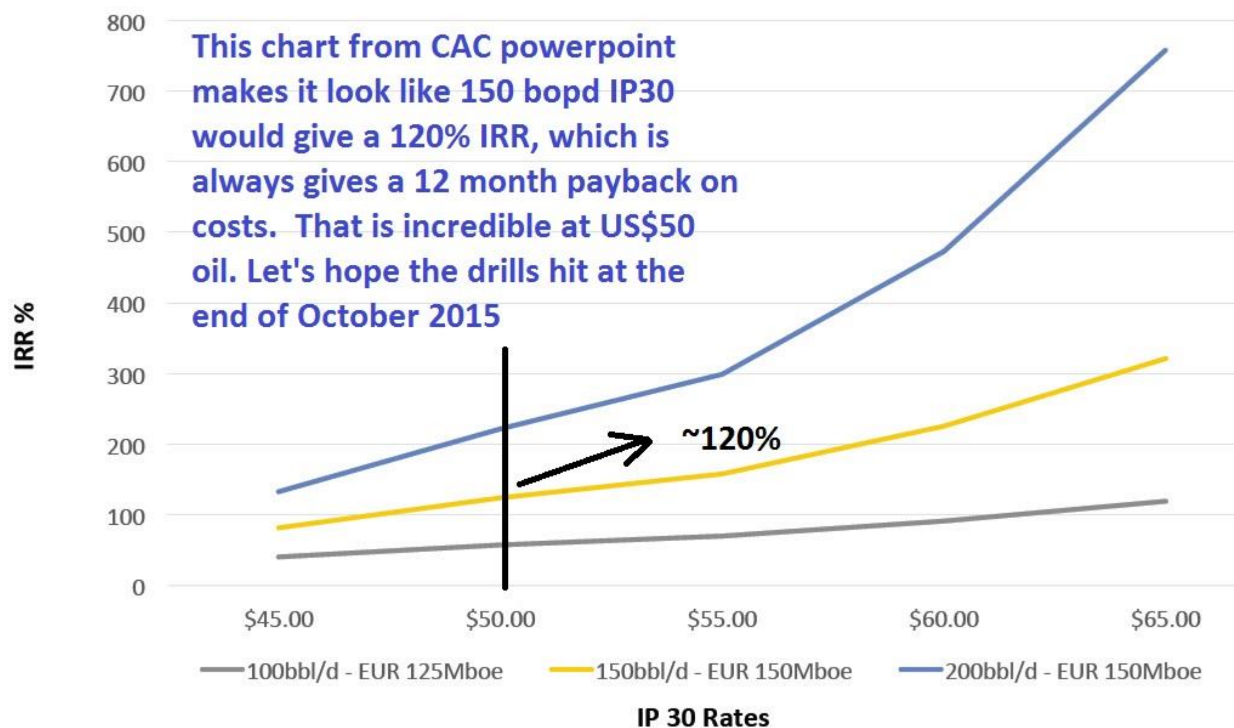
Those lower decline rates mean that Flood has better economics than the Viking. Canamax believes finding and development costs are going to come in at about $11.10 which means that this play is going to work well in a lower oil price environment.

Canamax now has 96 sections of land & 190 drill locations at Greater Grimshaw.

They are drilling their first horizontals at Grimshaw now. The magic number for me is an IRR of 75%. That is the threshold the wells of junior producers have to hit to provide a fast enough payback to get that money recycled into a new well. If management hits their conservative estimates of 125 bopd, on a $1.35 million well, they are at 74%.

Well Type	IP 30 (Bbls/d)	Reserves (Mstb)	WTI US/ Bbl	Capital ($M)	ROR %	Payout (months)	NPV 10 ($M) b/tax
Vertical	50	60	$50	650	51	28	1,221
Vertical	50	60	$60	700	67	21	1.634
Vertical	50	60	$70	750	93	16	2,042
Horizontal	125	125	$50	1,350	74	18	2,796
Horizontal	125	125	$60	1,400	131	11	3,589
Horizontal	125	125	$70	1,500	238	8	4,508

But it wouldn't take much better production to see that IRR skyrocket into double digits—even at US$50 oil:



Source: Canamax powerpoint

Property 2 – Wapiti Cardium

This team won't be doing any drilling anywhere but the Greater Grimshaw area for the rest of 2015.

But they do have additional properties.

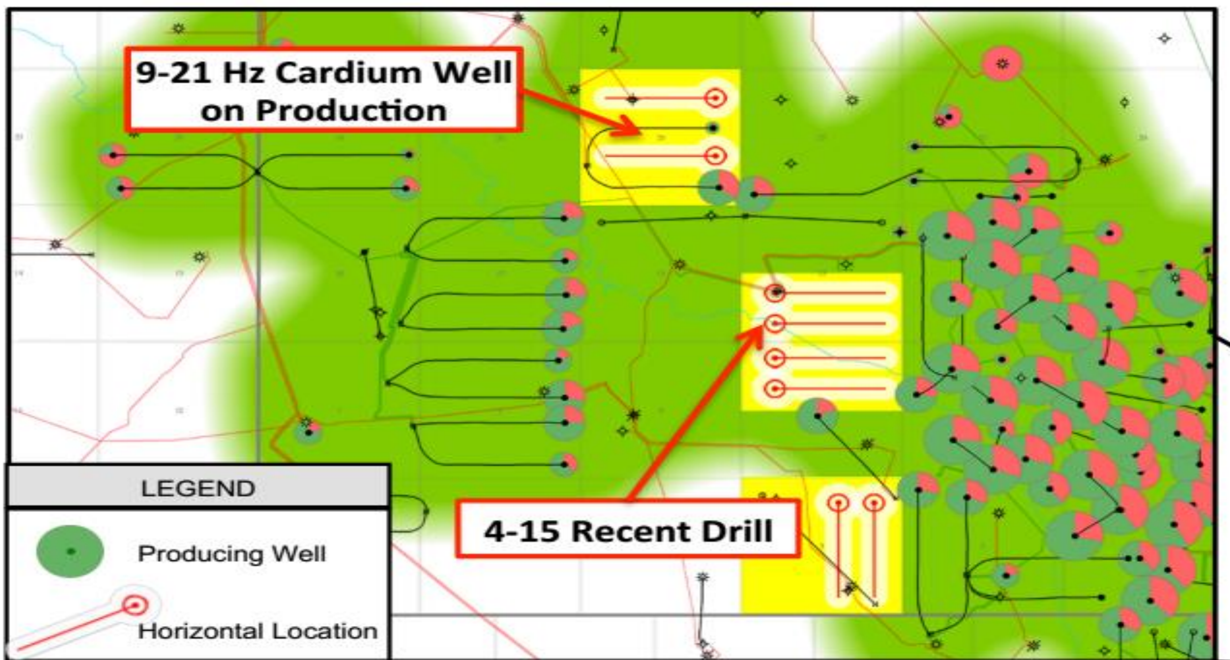
There is a Cardium oil play at Wapiti where Canamax has 2.4 net sections offsetting Husky Energy.

Current production is 175 bopd/day with 86% of that from liquids.

The cost of these horizontal wells is the reason that this play is on the back-burner for now. The all-in cost to drill, complete and equip one of these wells is $3 million, which is more 3x the cost of a Montney oil well at Greater Grimshaw.

Production rates are higher of course, in fact Canamax has the 7th best Cardium well during March 2015 with the well having an IP30 rate of 415 boe/day.

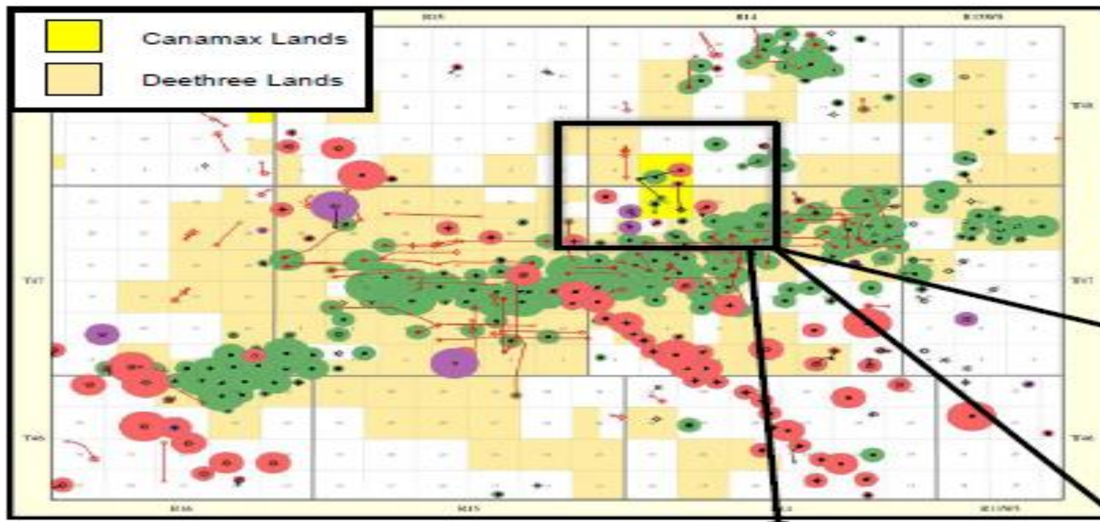
The company believes it has 7.5 net development locations yet to develop at Wapiti.



Property 3 - Belly River – Brazeau

The first property that Canamax moved on after I bought shares was the Belly River property at Brazeau.

I was pumped about this property because I knew the play well, being two sections of land in the middle of where DeeThree Exploration (now Boulder) operates.



This is the play that had helped drive DeeThree's share price from $2 to near $12 prior to the recent market rout.

The importance of Belly River to Canamax has decreased as the size of its Greater Grimshaw asset has increased.

When acquired, DeeThree had drilled wells all around these two sections thereby "de-risking" Canamax's acreage.

Adair managed to turn Canamax's original minority ownership in these two sections from a 6% minority ownership into a 100% working interest at essentially no cost.

Canamax holds a 100% working interest in 3 sections of land that currently have 4 producing wells. Production is roughly 275 boe/day (40% liquids).

The land has multi-zone potential in the Cardium, Middle Belly River (G Zone), the Belly River Basal Zone and the Wilrich.

As per Canamax's recent presentation the company believes that it has 8 drilling locations here.

Property 4 –Retlaw (Ki Exploration Inc Acquisition)

On March 17, 2014 added another property with the acquisition of Ki Exploration Inc.

The purchase price was $6 million that was funded through a combination of issuing Canamax shares and warrants ($3.5 million worth) and taking on Ki Exploration's debt (estimated to be $2.5 million).

In exchange for $6 million, Canamax received assets with the following characteristics:

- 1.8 million boe of proved and probable reserves (55% oil)
- Proved developed producing NPV10 (pre-tax) of $8.1 million
- Proved developed NPV10 (pre-tax) of $10.0 million
- Proved plus probable NPV10 (pre-tax) of $21.3 million
- Current production 330 BOE/D (34% liquids)
- 2013 cash flow of $2.3 million

This was another great deal for Canamax where it was able to take advantage of another capital starved company.

In the press release announcing the deal the following sentence was included:

"Due to Ki's financial condition, only a small amount of maintenance capital has been expended on producing wells over the past year."

The metrics for the deal came in at $18,000 per flowing barrel and 3 times trailing cash flow. As I said it looked like a great deal for Canamax.

Making it even better was that subsequent to August 31, 2014 Canamax sold 50 barrels of production that came with this acquisition for $2.4 million. That made the effective price of the purchase only $3.6 million (<$13,000 per flowing barrel).

You don't see metrics like that outside the micro-cap area.

This is mature production with lower decline rates and lots of producing wells. This is going to win Canamax favor with the banks which are much happier when production isn't concentrated in a small number of wells.

A lot of land came with this deal, 51.1 gross sections (31.9 net) along with 56 square kilometers of 3D seismic.

Current production is 200 boe/d with 40% of that production coming from liquids.

Management has indicated that there have been several acquisitions in the area by competitors with successful follow up drilling.

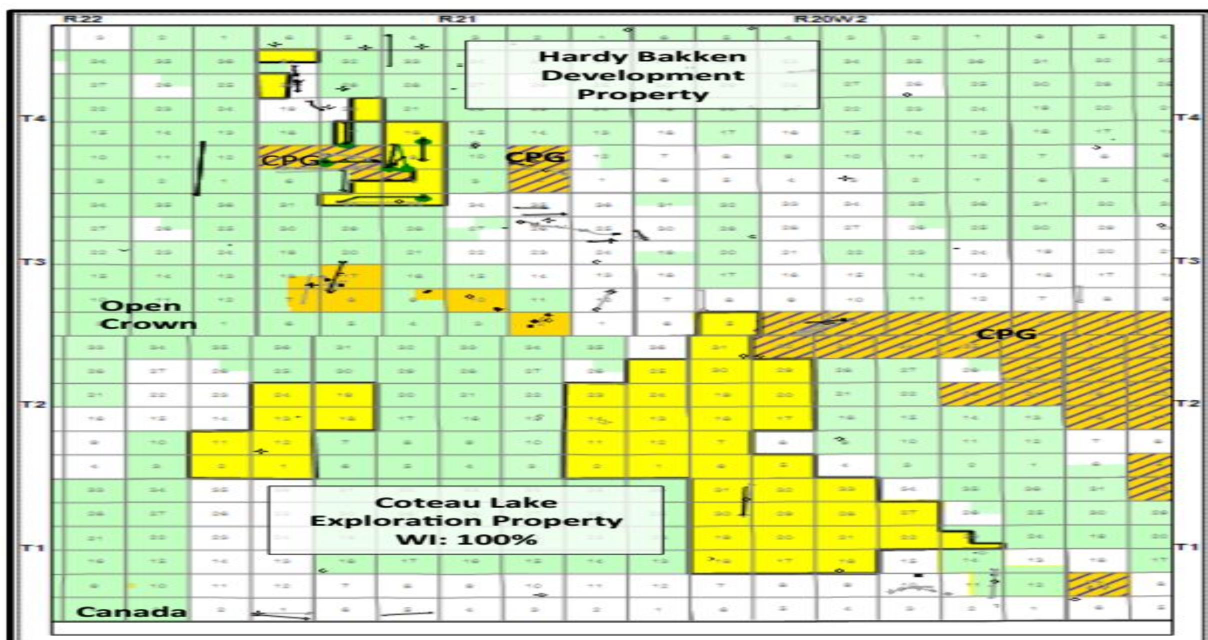
Down the road don't be surprised to see Canamax sell this property and realize a healthy profit from its acquisition cost.

Property 5 – Torquay

As I mentioned when I recapped the deal to acquire Powder Mountain, the value assigned to the land and production in the deal was not much more than $5 million.

For $5 million, Canamax got a lot of land in Southeast Saskatchewan—47.9 net sections to be exact, with the main formations being the Bakken and Torquay.

The Torquay really got some attention in the first half of 2014 when Crescent Point announced that they had quietly built up a major land position in the play and had some very solid initial production results.



You can see from the image above that Crescent Point has some land that offsets the Torquay land that Canamax now holds.

There could be some real potential here over the very long term, but I wouldn't expect to see much action any time soon from Canamax.

The fact that all of these land was acquired for just over $5 million speaks volumes about the interest in the play at this time (almost zero). So I'm going to keep my expectations low until I see something that proves otherwise.

FINANCES AND VALUATION

Things have been happening so fast and furious at Canamax that a guy really has to pay attention.

That hasn't been hard for me to do; I own a lot of stock in this one.

End result of all of the transactions balance sheet wise is that Canamax doesn't have a solid balance sheet, it has a pristine balance sheet.

The company does a good job of laying out the pro-forma impact of the Grimshaw and Powder Mountain transactions in the slide below.

TSX.V – Symbol CAC	Current	Financing	Proforma
Share price – at June 12, 2015	$0.67	$0.60	$0.60
Warrant price – at June 12, 2015 ($2.40 warrants – expire March 2016)	$0.01		$0.01
Capital Structure			
Common stock (basic – assuming $16.2mm gross; $15.0 net financing)	43.5mm	27.0	70.5
(Powder Mountain acquisition)		45.6	116.1
(diluted)*	43.5mm		
(Insider ownership – basic)	10%		
Market Capitalization – Diluted (Diluted shares plus trading warrants)	$29.2mm		$69.8mm
Net Debt – March 31, 2015 / Positive Cash proforma	$8.0mm		($4.5mm)
Bank line / credit facilities **	$10.0mm		**

Operational Overview	Current	Acquisition	Powder Mtn	Proforma
Current Production – (as at April 2015)	950 boe/d	750 boe/d	100 boe/d	1,800 boe/d
Oil & NGL's %	59%	54%	100%	59%
Production Capability – (as at April 2015)	1,100 boe/d			1,950 boe/d
Oil & NGL's %	55%			57%
1P Value (as at Dec 31, 2014)	$38mm	$28mm		
2P Value (as at Dec 31 2014)	$67mm	$41mm		
Undeveloped land (Acres)	~46,800	~38,400	~30,900	~116,100

The share count is going way up. From 43.5 million shares to 115 million shares.

But the balance sheet is going to get better, with the company having a net cash position of $4 to $5 million post completion.

And it also gets some critical mass with production pretty much doubling to 1,800 boe/day.

What matters more to me than where oil is going is that Canamax has a core play that works at current oil prices and a balance sheet that is better than pretty much everyone else.

I can control the quality of assets and balance sheet I buy into, I can't control the commodity.

The company has an enterprise value today of just over $45 million. At exit 2015 production levels Canamax will be trading at just under $20,000 per flowing barrel.

To make that valuation even somewhat reasonable you would be needing the share price to at least double.

On an enterprise value to cash flow basis in 2016 Canamax it is trading at 3x cash flow, vs. a peer group of 7-7.5.

Yes there is risk involved in executing the growth plan, but there is also a big opportunity still in front of this company that has a net cash position in an environment where companies are desperate.

STOCK CHART…next page

CONCLUSION

I bet on a management team when I bought shares in Canamax. I didn't know where they would take me when I jumped in, but nearly two years later I'm very impressed with what has been accomplished.

The company now has an ideal core property, one of the very few that allows them to grow at US$50 oil. And if these first two horizontals at Flood come in as expected, they could grow quickly.

Management has been “un-conventional” in their thinking with the Powder Mountain deal. By doing deals in this market they are one of the few teams the bankers love now, and that will get them a lot of looks at very cheap assets. And they have some cash to work with.

Net cash gives them so much flexibility and freedom—they can shut in production if they want should really low prices return. They can drill more wells is prices increase. And of course the Street always gives higher valuations to net cash companies than even small debt companies.