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Price: C$0.25

Oil & Gas Sector

Canoel International Energy (CIL.V) – revitalising for the sector recovery

With resource markets now appearing to have bottomed, Canoel is revitalising itself. It has successfully put its new Italian gas assets into production and now proposes a major, C$7m programme for its producing Argentinean oil fields. Contingent on available cash resources, Canoel will also undertake a series of expansion projects in Italy, worth C$7m, that offer paybacks between 1.5-3 years. Further projects are in the offering in Libya and Africa. Canoel has recently completed a 1:10 share consolidation in preparation for raising funds.

UPDATE

- ***Revitalising its public listing***
  Key to Canoel's plan will be to revitalise its public listing and raise funds sufficient for its aggressive expansion plan. As a part of its reorganisation Canoel consolidated its shares, warrants and underlying options on a 1-for-10 basis late last year. Management believes the consolidation will aid further cash raises and acquisitions of new projects through stock payments. Further developments are planned to better access the European and Asian capital markets. At the end of the year, Canoel engaged Hong Kong based Somerley to assist with raising C$9m.

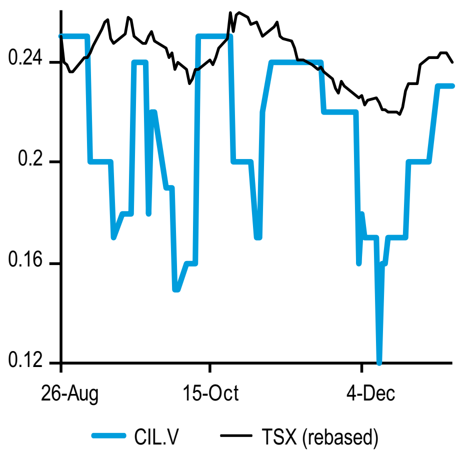
- ***Argentinian oil assets slated for production upgrades***
  Canoel continues to generate oil revenue from its Don Alberto and Don Ernesto producing oil fields in Argentina. The fields, which have proven and probable reserves of two million barrels, yielded 40,695 barrels of oil during the year ended March 31, 2013. The company expects production of 60,000 barrels in 2014 and 75,000 barrels per year in 2015. Argentina operates a controlled domestic oil price, currently set at US$67, although the possibility of a move toward world prices has been raised. The company's costs are approximately C$2m per year. Canoel has identified C$1.1m in upgrades that it expects will increase production by 35,000 barrels per annum. Accordingly, we expect Canoel's Argentinean oil subsidiary to provide increasing cash flow in the short and medium terms.

- ***Success in neighbouring fields points to the possibility of further upside***
  There have been unconfirmed reports that an oil major has recently had success at deep horizons on properties neighbouring Canoel's Don Alberto and Don Ernesto fields. Canoel believes these initial discoveries may be as high as 500 barrels per day. Canoel is investigating the potential at these levels on its own properties and proposes drilling two wells at a total cost of C$5.9m.

- ***New Italian gas assets now in production and aggressive expansion plans***
  Canoel's recently acquired Italian gas properties are now yielding cash flow. Management currently projects monthly revenue of C$165,000 against fixed costs of C$54,000. Contingent on raising cash beyond what will be required for its Argentinean strategy and corporate overhead, Canoel intends to embark on a strategy of phased expansions of these properties. If successfully implemented, these could treble the company's operating natural gas profits over time.

  – The company proposes a C$0.03m improvement at San Teodoro, where it holds a 100-percent working interest. The work, which includes an electronic card repair and site maintenance, is projected to yield C$0.44m in additional annual revenue against an increase of C$0.05m in fixed annual costs, resulting in a payback period of few months. The proposed timing of this work is spring of 2014.

Price chart (C$)



Value of equity	
Expected Value	US$17.3m
Distressed value per share	**C$0.33**
Optimistic Scenario	US$33.8m
Distressed value per share	**C$0.65**

* distressed valuation has been calculated based on planned fund raising being done at current share prices.

Company details	
Quote	
Shares	
- TSX Venture	CIL.V
Hi-Lo last 12-mos. (C$)	C$0.75-0.12
Shares issued (m)	8.9m
Market Cap'n (C$m)	C$2.2m
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Company Update

Fair value summary (US$m)

Scenario	Base	Pessimistic	Optimistic
- Argentinian producing assets*	22.3	10.4	38.8
- Italy	17.6	10.0	27.2
- other	0.6	0.6	0.6
Total	40.6	21.0	66.6
Less: overhead	9.9	9.9	9.9
Expected value of portfolio	30.7	11.1	56.7
Add: other investments	0.0	0.0	0.0
Add: starting cash + new funds	2.0	2.0	2.0
Total current value of firm	32.7	13.1	58.7
Less: bank & other debt	9.1	9.1	9.1
Total value to equity claims	23.6	4.0	49.6
Less: warrants and options	6.3	0.3	15.8
Ordinary equity holders	17.3	3.7	33.8
Value per share (US$)	**1.87**	**0.39**	**3.66**
Value per share (C$)	**2.01**	**0.42**	**3.91**
Distressed valuation**			
Value per share (US$)	**0.30**	**0.05**	**0.60**
Value per share (C$)	**0.33**	**0.06**	**0.65**

* we assume domestic prices will slowly trend to international market prices

** our distressed scenario assumes that Canoel will have to raise its immediate capital requirements at a substantial discount to fair value and close to current shareprices

Expected value of Canoel

Scenario	Risked resources (m bbl)	Argentinian project value (US$m)	CIL Valuation (US$m)	Value per share (C$)	Distressed Value per share (C$)
Base case outlook	**1.1**	**22.3**	**18.6**	**2.01**	**0.33**
Value for scenarios of further exploration success					
Full proved up	2.5	40.1	39.1	4.23	0.70
Optimistic outlook	1.8	38.8	36.2	3.91	0.65
Pessimistic outlook	0.7	10.4	3.9	0.42	0.06

Notes:

- *'fully proven up' scenario assumes that current mineable resource estimates are upgraded to 'Proven' status*

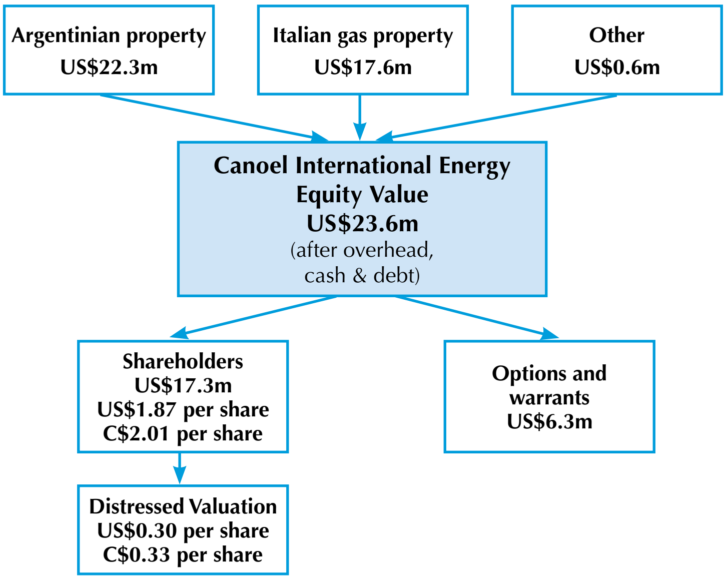
Sensitivity to Argentinian assumption on...

Long run real domestic oil price (US$/bbl)	50	55	**60**	70	80
Value (C$/share)	0.27	0.30	**0.33**	0.38	0.44
Change in value (%)	*-19%*	*-9%*		*+17%*	*+34%*
Time for domestic oil price to revert to mean (years)	8	10	**12**	13	14
Value (C$/share)	0.32	0.32	**0.33**	0.33	0.33
Change in value (%)	*-2%*	*-1%*		*+0%*	*+1%*
Volatility of domestic oil price (%)	*10%*	***15%***	*20%*	*25%*	*30%*
Value (C$/share)	0.31	**0.33**	0.35	0.37	0.40
Change in value (%)	*-4%*		*+6%*	*+14%*	*+24%*
Interest rate (%)	*2.8%*	***3.0%***	*3.2%*	*3.4%*	*3.6%*
Value (C$/share)	0.33	**0.33**	0.32	0.31	0.31
Change in value (%)	*+2%*		*-2%*	*-4%*	*-6%*
Sovereign risk premium (years)	*0.00%*	*1.25%*	***2.50%***	*3.75%*	*5.00%*
Value (C$/share)	0.42	0.37	**0.33**	0.29	0.25
Change in value (%)	*+29%*	*+14%*		*-12%*	*-23%*

Sensitivity to Italian assumption on...

Recovery rate (%)	*50%*	***55%***	*60%*	*65%*	*70%*
Value (US$m)	*17.6*	***17.6***	*17.6*	*18.9*	*20.2*
Change in value (%)	*-0%*		*+0%*	*+7%*	*+14%*
Increase in Capital Cost (%)	***+0%***	*+10%*	*+20%*	*+30%*	*+40%*
Value (US$m)	***17.6***	*17.6*	*17.5*	*17.4*	*17.3*
Change in value (%)		*-0%*	*-1%*	*-1%*	*-2%*

Components of Canoel's entity value



Italy Gas project valuation (US$m)

Scenarios for exploration success	Base	Optimistic	Pessimistic
Net value of production	**60.3**	60.3	60.3
Expected extraction success*	***56%***	*84%*	*36%*
Expected net value of production	**33.9**	50.4	22.0
Add: tax shield on depreciation charge	**3.2**	3.2	3.2
Less: development & operational capex	**3.3**	3.3	3.3
Value of extraction operations	**33.8**	50.2	21.8
Probability of putting into production**	**100%**	*100%*	*100%*
Expected value of deposit	**33.8**	50.2	21.8
Less:			
- expect pre-development costs***	**5.6**	5.6	5.6
- further exploration costs ****	**5.9**	5.9	5.9
Expected value of project	**22.3**	38.8	10.4
effective risk haircut	***44%***	*16%*	*64%*
Ownership	***100%***	*100%*	*100%*
Canoel International Energy's share	**22.3**	38.8	10.4

* portion of proven and probable (2P) reserves likely to be recovered, plus risked possible resources and our risked expectation of further exploration potential

** probability of successfully completing pre-feasibility, full feasibility and required permitting and actual construction in realistic timeframe

*** shown as expected value of being incurred after allowing for likelihood of reaching each development stage

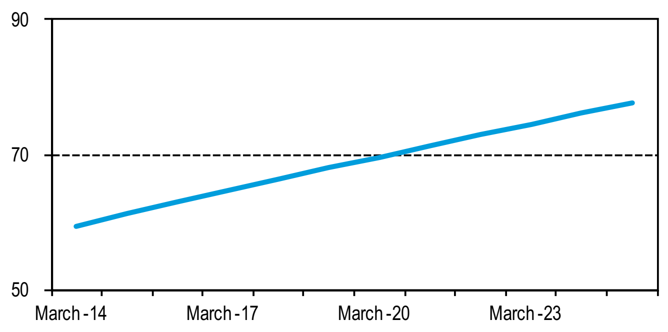
**** present value

Argentinian domestic oil price assumptions

Domestic oil prices are assumed to be mean reverting based on:

Historic long run real level (shown at current prices)	60 US$/bbl
Avg time to revert to mean	12.0 years
Volatility	15%
Inflationary price growth	2.0%

Expected Argentinian domestic oil price (inflation adjusted) (US$/bbl)



- Canoel is also undertaking improvement work at Masseria Petrilli, where it holds a 50-percent working interest. The work, which includes the substitution lines for fiscal measurement, check and relief valves and site maintenance, is projected to yield C$0.14m in additional annual revenue against an increase of C$0.02m in fixed annual costs, resulting in a payback period of about one year. The proposed timing of this work is the summer of 2014.

- A third expansion, targeted for the end 2014, involves a C$0.95m expenditure on the much larger Torrente Vulgano property, where Canoel holds a 100-percent working interest. The company plans permitting and site preparation followed by wireline examination of tubing, static pressure profiling to assess the nature of the existing well-bore fluids (gas, water) and checking of MS5A horizon bottom hole pressure. The company intends to place the well on production after evaluation and the eventual placement of 1″ coiled tubing string. Management projects an incremental increase of C$1.26m to annual gas revenue against an increase of C$0.17m in fixed costs. This would result in an estimated payback period of 1.5 years.

- A fourth and more energetic expansion is also proposed. Canoel proposes a C$2.47m expenditure at Masseria Vincelli for permitting, site preparation, perforation and drilling a new well to a depth of 2,000 metres, casing and completion. Management believes this would increase annual revenues by C$1.30m against an increase of C$0.06m in fixed costs, for a projected payback period of about 2.5 years. The proposed timing of this work is June 2015.

• ***Strategy remains unchanged but now with evidence Canoel can deliver***
The company remains committed to acquiring small or distressed assets with proven or producing reserves that it can substantially enhance with minimal capital. Canoel has a senior board from the Italian energy sector that offers extensive international business and governmental exposure. Its recent acquisition has demonstrated it can turn those connections and experience into productive acquisitions that can be enhanced significantly with the proposed expansion projects.

• ***Opportunities in Libya and Nigeria beckon***
Canoel established an office in Libya early in 2013 and is evaluating potential opportunities. Libya is currently the 7th largest producer of oil in OPEC. We expect they will become recognised traders of crude oil with the Libyan National Oil Company imminently – an important first step in their development plans in the country.

• ***Attractive valuations for current shareholders even in these distress times***
Our valuation model, based on current production augmented with the proposed expansions over the coming year, estimates Canoel to be worth C$2.01 per consolidated share. However, achieving these valuations will require raising considerable capital in very difficult markets. This will likely be highly dilutive and we have reflected the impact of this in our distressed valuation. Based on the necessary dilution to achieve Canoel's development plan, we estimate Canoel to be worth C$0.33 per share to current shareholders. Should management succeed in raising cash for the proposed Argentinean and Italian upgrades as planned, our optimistic assessment values the company at C$0.65 per consolidated share.

While there has been a substantial increase in our valuation of Canoel's Argentinian assets based on their improvement plans and planned drilling programme, the impact of the necessary dilution limits the benefit to current shareholders. Despite this, even after the potential dilution current shareholders will benefit from the planned developments. Should the company successfully raise capital at higher- than expected share prices, our base-case and optimistic valuations would be commensurably higher.

Proforma Argentinian property profit and loss

Proforma P&L (US$m)	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20
Gross revenues	**3.3**	**3.7**	**7.6**	**11.7**	**16.0**	**16.4**	**16.7**
Operating costs	2.4	2.1	2.2	2.3	2.4	2.6	2.7
Operating profit	**0.9**	**1.6**	**5.4**	**9.4**	**13.5**	**13.8**	**14.1**
Depreciation	0.7	0.7	0.8	0.8	0.9	0.9	0.9
Administrative costs	0.3	0.3	0.3	0.3	0.3	0.3	0.3
EBIT	**-0.1**	**0.5**	**4.3**	**8.2**	**12.4**	**12.6**	**12.8**
Assumptions							
Capital costs (US$m)	1.8	2.2	2.3	2.3	2.4	0.9	0.9
Production (000 bbl pa)	55	60	120	180	240	240	240

Source: Objective Capital

Financials

Profit and Loss

Year ending March (C$m)	2012F	2013F	2014F	2015F	2016F
Revenues	**2.0**	**2.3**	**5.0**	**6.6**	**11.7**
COGS	(1.2)	(1.6)	(3.9)	(3.6)	(3.9)
Gross profits	0.7	0.7	1.2	3.0	7.8
Administrative Costs	(2.7)	(2.3)	(2.4)	(2.4)	(2.5)
EBITDTA	**(1.9)**	**(1.6)**	**(1.2)**	**0.6**	**5.4**
Depreciation & amortisation	(0.3)	(0.3)	(0.7)	(1.2)	(1.3)
EBIT	(2.8)	(2.0)	(2.0)	(0.7)	4.0
Interest	(0.6)	(0.7)	(0.2)	(0.2)	(0.2)
EBT	(3.4)	(2.7)	(2.2)	(0.9)	3.8
Tax paid	—	—	0.7	0.3	(1.1)
Earnings	**(3.4)**	**(2.7)**	**(1.5)**	**(0.6)**	**2.7**
Dividends	—	—	—	—	—
Retained earnings	**(3.4)**	**(2.7)**	**(1.5)**	**(0.6)**	**2.7**

Cashflow

Year ending March (C$m)	2012F	2013F	2014F	2015F	2016F
EBIT	(2.8)	(2.0)	(2.0)	(0.7)	4.0
Depreciation	0.3	0.3	0.7	1.2	1.3
Stock-based Compensation	—	—	—	—	—
Gains & Writedowns	0.8	0.5	—	—	—
(Increase) decrease in receivables	(0.1)	0.4	(0.4)	(0.2)	(0.8)
(Increase) decrease in inventory	0.0	0.0	(0.3)	(0.2)	(0.6)
Increase (decrease) in payables	0.8	(0.6)	0.3	(0.0)	0.0
Net cash from Ops	**(0.9)**	**(1.4)**	**(1.6)**	**0.1**	**4.0**
Tax paid	—	—	0.7	0.3	(1.1)
Dividends	—	—	—	—	—
Net interest received (paid)	(0.6)	(0.7)	(0.2)	(0.2)	(0.2)
New equity	0.7	1.6	3.0	7.0	—
New (deposits) borrowings	0.8	(0.1)	2.0	—	—
Capital expenditure	**(0.3)**	**(0.6)**	**(1.9)**	**(4.0)**	**(4.9)**
Net cash from financing	**0.6**	**0.3**	**3.5**	**3.0**	**(6.2)**
Net increase (decrease) in cash	**(0.3)**	**(1.1)**	**1.9**	**3.1**	**(2.2)**

Balance sheet

Year ending March (C$m)	2012F	2013F	2014F	2015F	2016F
Fixed assets at NAV	4.7	4.0	5.2	8.0	11.5
Cash	1.5	0.3	2.2	5.4	3.2
Receivables	1.0	0.6	1.0	1.3	2.0
Inventory	0.1	0.1	0.4	0.6	1.2
Less Payables	(5.5)	(4.9)	(5.2)	(5.2)	(5.2)
Net current assets	**(2.9)**	**(3.8)**	**(1.5)**	**2.1**	**1.2**
Less loans	(3.0)	(2.4)	(4.4)	(4.4)	(4.4)
Capital employed	**(1.2)**	**(2.2)**	**(0.7)**	**5.7**	**8.3**
Represented by					
Shares in issue	6.0	7.8	10.8	17.8	17.8
Add retained profit					
Prior periods	(3.9)	(7.2)	(10.0)	(11.5)	(12.1)
This period	(3.4)	(2.7)	(1.5)	(0.6)	2.7
Shareholders' funds	**(1.2)**	**(2.2)**	**(0.7)**	**5.7**	**8.3**

Source: Objective Capital

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