



## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following Management's Discussion and Analysis ("MD&A") for Candax Energy Inc. ("Candax" or the "Company") should be read in conjunction with the accompanying unaudited interim consolidated financial statements for the three and six months ended June 30, 2006 and the notes thereto, as well as the MD&A and the audited consolidated financial statements for the year ended December 31, 2005. Readers should also refer to a discussion of forward-looking statements contained at the end of this MD&A. Additional information relevant to the Company's activities can be found on SEDAR at [www.sedar.com](http://www.sedar.com). This information is presented as of August 10, 2006.

### **Company Overview**

Candax is a Toronto-based oil and natural gas company engaged in the exploration for, and the acquisition, development and production of, natural gas and crude oil, with emphasis on the Middle East and North Africa. Candax targets mainly oil and natural gas, but also has natural gas liquids in its portfolio. Candax also owns a 50% interest in Societe d'Electricite d'El Bibane ("SEEB"), a Tunisian power generation company. At present, all of the operating assets of the Company are located in Tunisia.

### **Commodity Prices**

Crude oil prices and volatility remained high in the first six months of 2006. A combination of supply factors, transportation limitations, geopolitical concerns and market speculation have combined to support Brent oil prices averaging US \$65 per barrel in the first six months of 2006 while averaging approximately US \$69.50 per barrel during the second quarter of 2006. Brent is currently trading in the US \$75 per barrel range.

### **Foreign Exchange Fluctuations**

Candax operates primarily in a US dollar-based environment. The majority of the Company's revenues and expenses (both capital and operating) are paid in US dollars, although Candax is also exposed to Canadian dollar, Pounds Sterling and Tunisian Dinar expenses. However, being a Canadian company trading on the TSX, Candax has elected to report its financial results in Canadian dollars. Accordingly, all foreign currency amounts presented in Candax's unaudited consolidated statements of operations and deficit and cash flows are converted to Canadian funds for reporting purposes based on the average Canadian to US dollar exchange rate prevailing during the reporting period. The Canadian dollar has continued to rise against the US dollar, reducing the difference between the two currencies. The US to Canadian dollar closing exchange rate on June 30, 2006 was \$1.1162 and averaged \$1.1219 during the second quarter and \$1.1360 for the first six months of 2006.

### **Capital Structure and Dilution**

At December 31, 2005, the Company had 130,677,000 common shares outstanding. During the first quarter, 1,252,500 broker warrants were exercised at \$0.80 and during April 2006, a further 1,447,500 broker warrants were exercised for \$0.80. On April 18, 2006 35,497,106 warrants were exercised at \$1.20 and combined, increase the common shares outstanding to 168,874,106 which is the current amount outstanding.

### **Chaal Licence**

The area comprising the Chaal Permit is located in central Tunisia approximately 50 kilometres west of the City of Sfax. At December 31, 2005, Candax held an 80% working interest in the Chaal Permit with its partner SMIP holding 20% under a production sharing agreement and a petroleum prospecting permit with ETAP signed in April 2005. The Chaal Permit covers an area measuring 1,200 square kilometres. The Company was formally granted its interest in the Chaal Permit on March 17, 2005. The Chaal Permit is valid for a period of two years from the date of the publication of its decree in the Journal Officiel de la Republique Tunisienne, which publication was made on June 14, 2005.

In December 2005, Candax received approval to convert the original prospecting permit into an exploration permit by agreeing with its joint venture partners to drill the Chaal 1 well, avoiding the requirement for seismic testing. The new exploration permit has a period of two years and a financial

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obligation to spend a minimum of US \$3 million in the drilling of an exploration well. The minimum expenditure requirement has been met. Additionally as part of the farm-out agreement dated November 30, 2005, Mitsubishi Corporation ("Mitsubishi") agreed to pay 100% of Candax's net costs for the Chaal-1 well, up to a maximum of US \$8 million, in return for earning a 20% interest in the Chaal Permit. Mitsubishi has an option to acquire, subject to certain conditions, a further 5% interest from Candax in the Chaal Permit prior to the drilling of a second well. In addition, Mitsubishi has agreed to pay Candax certain other cash payments dependent upon receiving government consent to undertake the development of the Chaal project and achieving certain other gas sales-based thresholds.

The Chaal-1 exploration well was spudded on February 5, 2006. During April 2006, the drilling operations were completed and the well was drilled to a total depth of 4,600 metres. The initial results of logging indicate that a total gas bearing section of some 450 metres was penetrated by the well in the Middle/Lower Nara, comprising limestone, argillaceous limestone and shale/claystone. A gross limestone section of approximately 200 metres is present within this gas bearing section, with a net reservoir interval of approximately 90 metres. An analysis of the produced gas confirms that there is high quality gas in Chaal, with over 99% hydrocarbon content, little evidence of CO<sub>2</sub>, N<sub>2</sub> at 0.82% and H<sub>2</sub>S of 0.04%. Due to high mud weights used during drilling as a result of the high pressure, a flow test could not be successfully completed with available equipment. The testing program is expected to be completed by the end of August.

### **Review of Operations**

Candax was incorporated on June 4, 2004 and did not, until the April 26, 2005 purchase of its Tunisian operations, have any revenue generating producing assets. As a result, comparison to the previous year has no analytical value for any of the reported results.

### **Revenue**

Sales, net of royalties for the three months and six months ended June 30, 2006, were \$1.1 million and \$10.3 million, respectively. During the quarter, the Company sold 17,100 barrels of oil at an average price of US \$68.95. On a year-to-date basis, the Company sold 152,000 barrels of oil at an average price of US \$60.38. There was no revenue earned during the first six months of 2006 from gas or electricity sales as the El Bibane well continued to be shut-in and as a result, electricity generating activities continued to be suspended as described below.

### **Production**

The following table summarizes the production for the six months of 2006

<b>BBLS</b>	<b>Qtr1</b>	<b>Qtr2</b>	<b>Total</b>
Oil	58,852	52,576	111,428
Gas	-	-	-
Total BOE's	58,852	52,576	111,428

Where amounts are expressed on a barrel of oil equivalent (boe) basis, natural gas volumes have been converted to barrels of oil equivalent at six thousand cubic feet to one barrel of oil equivalent (6 mcf = 1 boe). This conversion ratio is the convention used in the oil and natural gas industry and is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. The use of boe may be misleading, particularly if used in isolation.

Candax announced on September 1, 2005, that during routine maintenance some unexpected corrosion of the El Bibane 3 wellhead was discovered. In the interests of safety and good environmental practice it was decided to shut-in the well. Efforts to restart the well were unsuccessful and it was announced on September 26, 2005 that restart operations were suspended and the resumption of production would await the previously announced redevelopment program for El Bibane.

A full-field development program had already been planned by Candax to optimize production and recovery of the reserves at El Bibane, and this program will now include reinstating production from El

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Bibane 3. The plan comprises the drilling of a further development well and a gas re-injection well. The implementation of this development program was expected to be initiated late in the fourth quarter of 2005 but due to engineering and certification delays related to the fabrication and construction of the jack-up barge system, has been delayed to September 2006 with full production expected by the end of 2006. When completed, it is expected to lead to higher levels of oil production, more efficient recovery of reserves and also enable remote restart of production in the event of a temporary future shut-in of a well.

The net impact of this shut-in, in addition to incurring \$0.2 million in operating costs during the second quarter; \$0.3 million year-to-date, is the deferral of production to later periods. No production from El Bibane was reported during the year.

The shut-in has also suspended operations at the SEEB power plant. The plant has been placed on care and maintenance mode and all excess staff has been released reducing the carrying costs to an absolute minimum. The Company's share of the operating and maintenance costs for the second quarter was \$0.2 million; year-to-date, \$0.3 million. The plant will restart as soon as gas is produced from El Bibane which is expected to occur in the fourth quarter of 2006. Under the terms of the credit facility, SEEB was required to make regularly scheduled principal and interest payments on or before May 1, 2006 in the amount of \$0.7 million, and to make deferred principal repayments on or before May 2, 2006 in the amount of \$0.8 million, the Company's proportionate share of each was \$0.4 million and \$0.4 million respectively. Due to the lack of production from the El Bibane field, the SEEB power plant has not generated revenues and as a result was unable to meet its current obligations under the credit facility. Negotiations with the lenders are on-going.

The next required debt service payment was scheduled for August 1, 2006 and SEEB had insufficient cash resources to meet this obligation. In order to ensure the on-going operation of SEEB, the Company is prepared to fund its share of SEEB's renegotiated debt repayments, if required, for the period up to March 2007. It is expected that any repayments made by the Company will be repayable by SEEB once normal operations have resumed once the El Bibane Field is redeveloped and gas production resumes which is currently expected in the fourth quarter of 2006. The Company has on deposit with the lender \$1.7 million which can be used to fund these required payments.

The maximum amount of potential future payments which the Company may be required to fund is based on SEEB's debt repayments which are scheduled as follows:

Date	Description	Amount
	Deferred principal payments	\$ 561
August 1, 2006	Regularly scheduled principal and interest payments	615
November 1, 2006	Regularly scheduled principal and interest payments	218
February 1, 2007	Regularly scheduled principal and interest payments	742
Total maximum amount of potential future payments		\$ 2,136

**Operating Costs**

Operating costs for the three and six months ended June 30, 2006 were \$0.9 million and \$2.4 million, respectively. The operating costs for the first six months were significantly lower than expected due to the fact the El Bibane and SEEB operations were not producing.

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**General and Administrative Costs**

General and administrative costs for the three months and six months ended June 30, 2006 were \$1.3 million \$2.3 million respectively.

Candax is developing and evaluating a range of international opportunities as it seeks to develop its international portfolio and thus is incurring proportionately higher general and administrative expenses than might be expected from an equivalent domestic Canadian oil company.

**Interest expense**

Interest expense for the three months and six months ended June 30, 2006 was \$0.3 million and \$0.6 million respectively, representing the interest on the limited recourse long-term debt relating to the electricity generating activities.

**Depletion, Depreciation and Amortization expense**

Depletion, depreciation and amortization expense for the three months and six months ended June 30, 2006 was \$0.8 million and \$3.3 million respectively. This amount is calculated using the purchase price of the acquired assets and the proved reserves information as at December 31, 2005.

**Selected Quarterly Financial Data**

<i>in thousands of Canadian dollars except per share amounts</i>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Year</b>
<b>2006</b>					
<b>Sales, net of royalties</b>	9,193	1,139	-	-	10,332
<b>Net income (loss)</b>	1,638	(460)	-	-	1,178
<b>Net income (loss) per share - basic</b>	0.01	(0.00)	-	-	0.01
<b>Net income (loss) per share - diluted</b>	0.01	(0.00)	-	-	0.01
<b>Total assets</b>	101,894	140,932	-	-	140,932
<b>Long-term financial liabilities</b>	11,773	11,174	-	-	11,174
<b>2005</b>					
<b>Sales, net of royalties</b>	-	2,233	9,202	1,447	12,882
<b>Net income (loss)</b>	(520)	(186)	2,966	(3,762)	(1,502)
<b>Net income (loss) per share - basic</b>	(0.11)	-	0.04	-	(0.02)
<b>Net income (loss) per share - diluted</b>	-	-	0.02	-	(0.02)
<b>Total assets</b>	3,716	89,305	91,051	91,737	91,737
<b>Long-term financial liabilities</b>	-	13,524	11,807	12,225	12,225
<b>2004</b>					
<b>Sales, net of royalties</b>	-	-	-	-	-
<b>Loss</b>	-	(9)	(181)	(259)	(449)
<b>Loss per share</b>	-	(0.09)	(1,806)	(2,590)	(4,490)
<b>Total assets</b>	-	-	483	3,974	3,974

As described earlier, the Company was incorporated on June 4, 2004 but no revenues were earned until the second quarter of 2005 when the Company completed its acquisition. During 2004, general and administrative expenses were incurred with respect to the initial start-up costs. Since the acquisition was not completed until the end of April in 2005, the second quarter only represented two months of revenue and is proportionately less than the third quarter due to the timing of shipments. The revenue in the fourth quarter of 2004 was significantly less than the third quarter of 2004 because of timing of shipments and the suspension of the operations of El Bibane and SEEB as discussed earlier. Revenue for the first quarter of 2006 is similar to that earned in the third quarter of 2005 due to the similar contractual nature of their sales agreements. Revenue for the second quarter of 2006 is significantly lower than that earned in the first quarter of 2006 due to the timing of the shipments.



## **Liquidity, Capital Resources and Capital Expenditures**

As at June 30, 2006, the Company had \$62.4 million in cash and cash equivalents. Of this amount, \$60.4 million has been invested in highly liquid investments with high-quality institutions. The cash will be used to fund working capital requirements and petroleum development activities and/or acquisitions. As discussed in Commitments below, the Company has \$2.5 million in restricted cash as a result of the issuance of a letter of credit. On July 20, 2006, in accordance with the terms of the contract, this letter of credit was drawn in full as payment for goods shipped for the El Bibane redevelopment program.

On April 17, 2006, a total of 35,497,106 warrants were exercised into common shares for total proceeds to the Company of \$42.6 million. These warrants were issued on April 14, 2005 in connection with the Company's private placement of 82,500,000 subscription receipts. In addition 2,700,000 broker warrants, which were issued as part of their commission as underwriters of the financing, were exercised at \$0.80 for proceeds to the Company of \$2.2 million.

On April 13, 2006, the Company signed a bank credit facility with the Bank of Scotland. The initial facility size was for US \$10 million although the assets in Tunisia could support a significantly higher facility if required. The primary purpose of the facility will be the Company's new venture activities although it also provides operational flexibility for the redevelopment of the El Bibane field and potentially the fast-track of new project development activities. The facility bears interest at LIBOR plus 2% and there are no fixed repayment terms. No funds have been drawn on this facility to date.

## **Commitments**

In March 2006, the Company issued a letter of credit in the amount of US \$2.2 million in favour of Aburrah Ltd. in connection with the redevelopment program of the El Bibane field.

Under the terms of an agreement with the Tunisian government, 20% of the Company's oil production must be dedicated to the domestic market. The production sold under this domestic market obligation receives a price equal to 90% of the U.S. dollar price for the Brent-based export sales. Oil production is accumulated in a storage facility until a marketable cargo is achieved. Under this agreement, the state-owned company, ETAP, with respect to its 55% rights on the Ezzaouia field production and on behalf of the Government with respect to the domestic market obligation and the Company's Tunisian entities have agreed to optimize tanker lifting volumes. As a result of this reciprocal practice, a short-term volumetric imbalance may arise through an "under/over" lift position. This short-term situation is corrected from future production allocations.

## **Critical Accounting Estimates**

A discussion of the Company's significant accounting policies is contained in Note 2 to the 2005 audited consolidated financial statements. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates relate primarily to the future development costs associated with proved undeveloped reserves, reserve volumes, future production and revenues, and future costs associated with asset retirement obligations. The Company has its oil and gas reserves, future development costs and future cash flows from those reserves evaluated and reported on by independent petroleum reserve engineering consultants. The estimation of these amounts is a subjective process, based on engineering data, forecasted prices and production levels and the timing of expenditures. All of these estimates are subject to numerous uncertainties and various interpretations, and consequently will change over time to reflect updated information as it is received.



### **Business Risks**

A comprehensive assessment of the Company's business risks is set out in the 2005 Annual Information Form. There are a number of inherent risks associated with oil and gas operations and development. Many of these risks are beyond the control of the Company. The following outlines some of the principal risks and their potential impact on the Company:

#### **Exploration, Development and Production Risks**

A portion of the current working capital of Candax will be, expended on petroleum and natural gas exploration, exploitation and development activities, which are high-risk ventures with uncertain prospects for success. Oil and gas exploration involves a high degree of risk and there is no assurance that expenditures made on future exploration activities by the Company will result in new discoveries of oil, condensate or natural gas that are commercially viable or economically producible. Holders of securities of the Company must rely on the ability, expertise, judgement, discretion, integrity and good faith of management of the Company. It is difficult to project the costs of implementing any exploratory or developmental drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as overpressured zones and tools lost in the hole and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof. Few properties that are explored are ultimately developed into new reserves. In certain instances the Company may be precluded from pursuing an exploration program or decide not to continue with an exploration program, such an occurrence may have a negative effect on the value of the securities of the Company.

Future oil exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include: delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

#### **Petroleum and Natural Gas Reserves**

All evaluations of future net revenues are before consideration of indirect costs such as administrative overhead, other miscellaneous expenses and income taxes. The future net revenues may not be representative of the fair market value of the reserves. There is no assurance that the forecast price and cost assumptions contained in the Ryder Scott Report and the Glendower Report will be attained and variances may be material. There are numerous uncertainties inherent in estimating quantities of proved and probable reserves, including many factors beyond the control of the Company. The reserves data and net present value of future cash flows set forth or in this prospectus represent estimates only and in some cases are a management compilation of the Ryder Scott Report and the Glendower Report. Further, the Chaal Permit, which comprises approximately half of the estimated future net revenue of the Company, has no proved reserves attributed to it in the Glendower Report. The reserves disclosed in the Glendower Report are only at the "probable" level of confidence. As a result, the Chaal Permit must be considered a substantially higher risk prospect for the Company than the properties comprising the Acquired Assets.

In general, estimates of economically recoverable petroleum and natural gas reserves and the future net revenues therefrom are based upon a number of variable factors and assumptions, such as historical production from the properties, commodity prices, the assumed effects of regulation by governmental agencies and future operating costs, each of which may vary considerably from actual results. Estimates of the economically recoverable petroleum and natural gas reserves attributable to any particular group of



properties, classification of such reserves based on risk of recovery and estimates of future net revenues expected therefrom, prepared by different engineers or by the same engineers at different times, may vary substantially. The reserve estimates included in this prospectus may be materially different from the quantities and values ultimately realized.

#### **Fluctuation of Commodity Prices**

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors all of which are beyond the control of the Company. Crude oil is influenced by the world economy and OPEC's ability to adjust supply to world demand. Recently crude oil prices have been kept high by political events causing disruptions in the supply of oil, and concern over potential supply disruptions triggered by unrest in the Middle East. Political events trigger large fluctuations in oil price levels. Natural gas prices are influenced by factors within North America. The continued tight supply demand balance for natural gas is causing significant elasticity in pricing. Despite record drilling activity, a strong economy, weather, fuel switching and demand for electrical generation there still exists a tight supply causing prices to remain high.

World prices for oil and natural gas have fluctuated widely in recent years. Future price fluctuations in world prices are expected and will have a significant impact upon the projected revenue of the Company, the projected return from its existing and future reserves and the general financial viability of the Company.

The oil and natural gas prices realized by the Company are affected by factors such as supply and demand, oil quality and transportation adjustments. The Company expects to market its oil and natural gas production in a manner consistent with past practices. In the case of natural gas, the Company has fixed rate sales contracts. The Company's current natural gas production is subject to the provisions of the Petroleum Law, which provides for sales into the Tunisian domestic market at rates less than those which would be realized in the international market. While the Company sells the majority of its Tunisian oil to arms-length purchasers priced on a sale by sale basis at prevailing market conditions, a portion of the oil produced by the Company is required to be sold domestically in Tunisia at rates less than those which would be realized in the international market. There is no assurance that the price paid for the oil produced by the Company will remain at current levels. A decrease in the price obtained for its oil may have a material adverse effect on the financial condition of the Company and its future results of operations.

#### **Foreign Currency Exchange Rates**

The Company sells its oil production pursuant to marketing agreements that are denominated in US dollars. Many of the operational and other expenses incurred by the Company are paid in US dollars or in local currency of the country where operations are performed. The assets and liabilities of the Company (including reserve information) are recorded in Canadian dollars. As a result, fluctuations in the US dollar against the Canadian dollar and each of these currencies against local currencies in jurisdictions where properties of the Company are located could result in unanticipated and material fluctuations in the financial results of the Company.

#### **Competition**

A number of other oil and gas companies operate and are allowed to bid for exploration and production licenses and other services in countries in North Africa and the Middle East which are the focus of the business and operations of the Company, thereby providing competition to the Company. Larger companies, may have access to greater resources than the Company, may be more successful in the recruitment and retention of qualified employees and may conduct their own refining and petroleum marketing operations, which may give such companies a competitive advantage over the Company. Some of these companies have been conducting operations in Tunisia for considerably longer periods of



time than has the Company and thus may be more familiar with the political and business landscape in Tunisia than the Company. In addition, actual or potential competitors may be strengthened through the acquisition of additional assets and interests.

#### **Environmental Regulation**

The current and future operations of the Company that are conducted in Tunisia are subject to environmental regulations promulgated by the Government of Tunisia. Should the Company initiate operations in other countries, such operations will be subject to environmental legislation in such jurisdictions. Current environmental legislation in Tunisia provides for restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil, condensate and natural gas operations. In addition, certain types of operations may require the submission and approval of environmental impact assessments. The existing operations of the Company are subject to such environmental policies and legislation. Environmental legislation and policy is periodically amended. Such amendments may result in stricter standards and enforcement and in more stringent fines and penalties non-compliance. Environmental assessments of existing and proposed projects carry a heightened degree responsibility for companies and their directors, officers and employees. The costs of compliance associated with changes in environmental regulations could require significant expenditures, and breaches of such regulations may result in the imposition of material fines and penalties. In an extreme case, such regulations may result in temporary or permanent suspension of production operations. There can be no assurance that these environmental costs or effects will not have a material adverse effect on the future financial condition or results of the operations of the Company.

#### **Political Risks**

Tunisia has experienced relative prosperity and stability under the leadership of President Ben Ali. Notwithstanding this relative stability, in the past, Tunisia has been affected by extremist Islamic militant activity. Tunisian authorities have implemented anti-terrorism policies and security precautions. By law, parties organized on the basis of religion, region, race or language are forbidden. Despite this, there are groups in Tunisia dedicated to turning the country into an Islamic republic. The Tunisian government has taken steps to prevent the Islamic militant struggle in neighbouring Algeria from affecting Tunisia by increasing its military presence along the Tunisia/Algeria border, imposing visa restrictions and imposing strict controls on local militants. Should the military-backed regime in Algeria fall, the establishment of an Islamic republic in Algeria is likely to have an impact on regional politics and could lead to increased Islamic extremist activities in Tunisia. The country also borders Libya. Libya has experienced periods of civil unrest and has been the subject of international sanctions. Any future political unrest in Libya could affect Tunisia.

In addition to the political risks, the Company is also subject to the laws of the various levels of government in the countries in which it conducts business. Such legislation may be changed from time to time in response to economic or political conditions, and the implementation of new legislation or modification of existing legislation affecting the oil and gas industry could change the Company's revenues and/or costs and have a material adverse impact on the business, results of operations, financial condition and liquidity.

#### **Forward-Looking Statements**

This Management's Discussion and Analysis includes "forward-looking statements", within the meaning of applicable securities legislation, which are based on the opinions and estimates of Management and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar words suggesting future outcomes or statements

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regarding an outlook. Such risks and uncertainties include, but are not limited to, risks associated with the oil and gas industry (including operational risks in exploration development and production; delays or changes in plans with respect to exploration or development projects or capital expenditures; the uncertainty of reserve estimates; the uncertainty of estimates and projections in relation to production, costs and expenses; the uncertainty surrounding the ability of Candax. to obtain all permits, consents or authorizations required for its operations and activities; and health safety and environmental risks), the risk of commodity price and foreign exchange rate fluctuations, the ability of Candax to fund the capital and operating expenses necessary to achieve the business objectives of Candax, the uncertainty associated with commercial negotiations and negotiating with foreign governments and risks associated with international business activities, as well as those risks described in public disclosure documents filed by Candax. Due to the risks, uncertainties and assumptions inherent in forward-looking statements, prospective investors in securities of Candax should not place undue reliance on these forward-looking statements. Statements in relation to "reserves" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described can be profitably produced in the future.

Readers are cautioned that the foregoing lists of risks, uncertainties and other factors are not exhaustive. The forward-looking statements contained in this press release are made as of the date hereof and the Company undertakes no obligation to update publicly or revise any forward-looking statements contained in this press release or in any other documents filed with Canadian securities regulatory authorities, whether as a result of new information, future events or otherwise, except in accordance with applicable securities laws. The forward-looking statements contained in this press release are expressly qualified by this cautionary statement.



**Candax Energy Inc.**

Interim Consolidated Financial Statements  
*(unaudited)*  
For the period ended June 30, 2006

**Candax Energy Inc.**  
**Consolidated Balance Sheets (unaudited)**

<b>As at (in thousands of Canadian dollars)</b>	June 30, 2006	December 31, 2005
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 62,359	\$ 22,584
Restricted investment (Note 9(a))	2,456	2,326
Accounts receivable (Note 2)	10,577	1,736
Inventory	1,109	2,452
Deposits and prepaids	1,257	1,587
	<u>77,758</u>	<u>30,685</u>
Restricted investment (Note 10)	1,736	1,808
Deferred financing fees	831	-
Petroleum and natural gas properties	45,069	42,891
Property, plant and equipment	15,426	16,353
Long-term receivable (Note 3)	112	-
	<u>\$ 140,932</u>	<u>\$ 91,737</u>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 14,376	\$ 5,933
Current portion of long-term debt (Note 4)	2,068	1,157
	<u>16,444</u>	<u>7,090</u>
Limited recourse long-term debt (Note 4)	11,174	12,225
Asset retirement obligation (Note 7)	2,285	2,282
Future income tax liability (Note 8)	5,540	5,645
	<u>35,443</u>	<u>27,242</u>
<b>SHAREHOLDERS' EQUITY</b>		
Capital stock (Note 5)	111,434	64,699
Warrants	-	2,299
Contributed surplus	1,814	1,136
Cumulative translation adjustment	(6,986)	(1,688)
Deficit	(773)	(1,951)
	<u>105,489</u>	<u>64,495</u>
	<u>\$ 140,932</u>	<u>\$ 91,737</u>

The accompanying notes to the unaudited interim consolidated financial statements are an integral part of these statements.

**Candax Energy Inc.**  
**Consolidated Statements of Operations and Deficit (unaudited)**

<i>(in thousands of Canadian dollars except for per share amounts)</i>	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
<b>Revenues</b>				
Sales, net of royalties	\$ 1,139	\$ 2,233	\$ 10,332	\$ 2,233
Interest and other income	869	147	1,083	147
	2,008	2,380	11,415	2,380
<b>Expenses</b>				
Operating costs	941	432	2,427	432
Depletion, depreciation and amortization	789	1,345	3,252	1,345
General and administrative	1,270	824	2,324	1,334
Interest	261	163	599	163
Foreign exchange	623	56	704	66
Stock-based compensation	88	-	357	-
Accretion on asset retirement obligation	51	50	102	50
	4,023	2,870	9,765	3,390
<b>Income (loss) for the period before current and future income taxes</b>	<b>(2,015)</b>	<b>(490)</b>	<b>1,650</b>	<b>(1,010)</b>
Current income tax expense	-	-	577	-
Future income tax recovery	(1,555)	(304)	(105)	(304)
	(1,555)	(304)	472	(304)
<b>Net income (loss) for the period</b>	<b>\$ (460)</b>	<b>\$ (186)</b>	<b>\$ 1,178</b>	<b>\$ (706)</b>
Deficit, beginning of period	(313)	(969)	(1,951)	(449)
<b>Deficit, end of period</b>	<b>\$ (773)</b>	<b>\$ (1,155)</b>	<b>\$ (773)</b>	<b>\$ (1,155)</b>
<b>Net income (loss) per share - basic and diluted</b>	<b>(0.00)</b>	<b>(0.01)</b>	<b>0.01</b>	<b>(0.04)</b>
<b>Weighted average number of shares outstanding</b>				
- basic	160,296,743	35,117,622	141,244,083	19,898,811
- diluted	180,354,106	35,117,622	180,354,106	19,898,811

The accompanying notes to the unaudited interim consolidated financial statements are an integral part of these statements.

**Candax Energy Inc.**  
**Consolidated Statements of Cash Flow (unaudited)**

<i>(in thousands of Canadian dollars)</i>	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
<b>OPERATING ACTIVITIES</b>				
Net income (loss)	\$ (460)	\$ (186)	\$ 1,178	\$ (706)
Items not affecting cash				
Settlement costs	-	100	-	100
Stock-based compensation	88	-	357	-
Depletion, depreciation and amortization	789	1,345	3,252	1,345
Future income tax recovery	(1,555)	(304)	(105)	(304)
Accretion on asset retirement obligation	51	50	102	50
	(1,087)	1,005	4,784	485
Net change in non-cash working capital	7,322	(2,075)	(1,346)	(1,910)
	6,235	(1,070)	3,438	(1,425)
<b>INVESTING ACTIVITIES</b>				
Acquisition of subsidiary	-	(43,709)	-	(43,709)
Deposit on acquisition	-	500	-	-
Decrease (increase) in restricted investments	2,342	-	(228)	-
Investment in long-term receivable	-	-	(117)	-
Additions to petroleum and natural gas properties	(6,751)	(284)	(9,124)	(771)
	(4,409)	(43,493)	(9,469)	(44,480)
<b>FINANCING ACTIVITIES</b>				
Issuance of subscription receipts	-	66,000	-	66,000
Cost of securities issuance	-	(2,950)	-	(2,950)
Issuance of common shares	43,755	-	44,757	-
Deferred financing fees	(831)	-	(831)	-
	42,924	63,050	43,926	63,050
Foreign currency translation	442	866	1,880	917
<b>Net decrease in cash and cash equivalents</b>	<b>45,192</b>	<b>19,353</b>	<b>39,775</b>	<b>18,062</b>
Cash and cash equivalents, beginning of period	17,167	2,518	22,584	3,809
<b>Cash and cash equivalents, end of period</b>	<b>\$ 62,359</b>	<b>\$ 21,871</b>	<b>\$ 62,359</b>	<b>\$ 21,871</b>
<b>Cash and cash equivalents are comprised of:</b>				
Cash	\$ 2,001	\$ 21,871	\$ 2,001	\$ 21,871
Short-term investments	60,358	-	60,358	-
	\$ 62,359	\$ 21,871	\$ 62,359	\$ 21,871
Interest paid during the period	\$ 329	\$ 58	\$ 639	\$ 58
Income taxes paid during the period	\$ 18	\$ 27	\$ 763	\$ 27

The accompanying notes to the unaudited interim consolidated financial statements are an integral part of these statements.

**1. Basis of Presentation**

The accompanying unaudited interim consolidated financial statements include the accounts of Candax Energy Inc. ("Candax" or the "Company") and its subsidiaries, and have been prepared in accordance with Canadian generally accepted accounting principles applicable for interim reporting periods. These unaudited notes to the interim consolidated financial statements do not include all disclosures required in the annual financial statements and should be read in conjunction with the audited consolidated financial statements and notes for the year ended December 31, 2005.

These unaudited interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the annual audited consolidated financial statements for the year ended December 31, 2005. In the opinion of management, all adjustments required for a fair presentation are included in these unaudited interim consolidated financial statements in accordance with the accounting policies of the Company.

**2. Accounts Receivable**

Included in accounts receivable is \$4.1 million relating to amounts paid by the Company for its drilling program at Chaal which will be reimbursed by Mitsubishi Corporation ("Mitsubishi") in accordance with the Farmout Agreement entered into in November 2005. The terms of the farm-out are that Mitsubishi will pay 100% of Candax's net costs for the Chaal-1 well, up to a maximum of US \$8 million, in return for earning a 20% interest in the Chaal Permit.

**3. Long-term Receivable**

Effective March 31, 2006, the Company entered into an agreement with Caterpillar Power Ventures International Ltd. ("Caterpillar") to purchase, over time, 50% of Caterpillar's US \$5 million loan to Societe d'Electricite d'El Bibane ("SEEB"), a Tunisian power generation company in which the Company and Caterpillar each have a 50% interest. Under the terms of the agreement, the Company will increase its participation in Caterpillar's loan to SEEB from zero to US \$2.5 million through payments made to Caterpillar. The Company is required to pay Caterpillar US \$0.2 million annually on or before March 31 of each year. In addition, any amount collected by the Company from SEEB on account of the gas receivables which were outstanding on March 31, 2006, in the amount of US \$0.7 million will be used to offset the loan to Caterpillar.

**4. Limited Recourse Long-Term Debt**

	<u>Rate</u>		
Limited recourse SEEB debt			
Project financing (US\$ based)	LIBOR +1.65%	\$	3,956
Project financing (Euro based)	ADB* + 2%		6,347
Due to Caterpillar Power Ventures Inc.	13%		2,939
			13,242
Amount due within one year			(2,068)
		\$	11,174

\* African Development Bank Base Rate

On March 18, 2002, SEEB and its joint venture partner closed a US \$22.2 million limited-recourse project financing, 50% of which was subsequently converted into Euros. Security for the financing is limited to the project assets and a corporate non-performance guarantee of US \$0.8 million. Candax's share of the

**Candax Energy Inc.**  
**Notes to the Consolidated Financial Statements**  
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project financing at June 30, 2006 is \$10.3 million. All required interest and principal payments are expected to be repaid through operating cash flows of the SEEB power plant. The proceeds of this project financing were used to fund construction costs of the SEEB plant which commenced operations May 9, 2003. Also included in the limited recourse SEEB debt is an amount of \$2.9 million in respect of Candax's share of additional project financing provided by Caterpillar Power Ventures Inc. to complete the SEEB project. There are no fixed repayment terms nor will the lender demand repayment in 2006. The venture plans to repay this debt with SEEB operating cash flows, yet does not anticipate this to occur within 2006. Accordingly, this additional financing has been classified as a long-term obligation. During the quarter, interest expense in the amount of \$0.3 million has been recorded in the consolidated statements of operations and deficit.

**5. Capital Stock**

**Common shares**

Candax is authorized to issue an unlimited number of common shares without par value. The Company's issued and outstanding common shares consist of the following:

	Number	Amount
Balance at December 31, 2005	130,677,000	64,699,068
Conversion of broker warrants	2,700,000	2,160,000
Conversion of share purchase warrants	35,497,106	42,596,528
Transfer from warrants		1,978,250
<b>Balance at June 30, 2006</b>	<b>168,874,106</b>	<b>111,433,846</b>

During the six months ended June 30, 2006 2,700,000 broker warrants were exercised at \$0.80 and on April 18, 2006 35,497,106 share purchase warrants were exercised at \$1.20. During the period 5,752,894 share purchase warrants expired and an amount of \$0.3 million was transferred from warrants to contributed surplus.

**Stock Options**

The following table summarizes the options outstanding in accordance with the Company's share incentive plan:

	Weighted Average Exercise Price	Number of Options
<b>Outstanding - beginning of period</b>	<b>\$ 0.80</b>	<b>11,250,000</b>
<b>Transactions during the period:</b>		
Granted	1.01	260,000
Exercised	-	-
Expired	-	-
<b>Outstanding - end of period</b>	<b>\$ 0.80</b>	<b>11,510,000</b>
<b>Options exercisable - end of period</b>	<b>\$ 0.80</b>	<b>7,578,333</b>

During the six months ended June 30, 2006 stock options to acquire 260,000 common shares were granted. The fair value of these options was \$0.2 million based on the Black Scholes option pricing model assuming a risk-free rate of 4.23%, an expected remaining life of five years, and an expected volatility of 60% on the measurement date. The stock option expense for the three months ended June 30, 2006 was \$0.1 million and for the six months ended June 30, 2006 was \$0.4 million. As at June 30, 2006 the unamortized fair value of unvested stock options granted amounted to \$0.3 million.

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**Notes to the Consolidated Financial Statements**  
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**6. Segmented Information**

By generation source

	Oil and gas operations		Electricity generation operations		Total	
	2006	2005	2006	2005	2006	2005
<b>For the three months ended June 30</b>						
Sales (net of royalties)	\$ 1,139	\$ 1,731	\$ -	\$ 502	\$ 1,139	\$ 2,233
Depletion, depreciation and amortization	329	907	460	438	789	1,345
Interest expense	-	-	261	163	261	163
Net income (loss)	(22)	(85)	(439)	(101)	(461)	(186)
<b>Fixed assets as at</b>						
June 30, 2006 and December 31, 2005	45,069	42,891	15,426	16,353	60,496	59,244
<b>For the six months ended June 30</b>						
Sales (net of royalties)	\$ 10,332	\$ 1,731	\$ -	\$ 502	\$ 10,332	\$ 2,233
Depletion, depreciation and amortization	2,325	907	927	438	3,252	1,345
Interest expense	-	-	599	163	599	163
Net income (loss)	2,571	(605)	(1,393)	(101)	1,178	(706)

**7. Asset Retirement Obligation**

**For the three months ended June 30, 2006**

Balance at March 31, 2006	\$	2,338
Accretion expense		51
Foreign exchange		(104)
Balance at June 30, 2006	\$	2,285

**For the six months ended June 30, 2006**

Balance at December 31, 2005	\$	2,282
Accretion expense		102
Foreign exchange		(99)
Balance at June 30, 2006	\$	2,285

The total undiscounted amount of estimated cash flows required to settle the obligation is \$5.0 million at December 31, 2005, which has been discounted using a credit-adjusted risk-free rate of 9%. Most of these obligations are not expected to be paid until 2011.

**8. Income taxes**

The future tax liability of \$5.5 million at June 30, 2006 relates to the difference in the unclaimed tax deductible costs of capital assets in Tunisia and the related carrying value. The liability is based on consolidated accounting values and any cash liability for income tax purposes is not triggered unless the underlying assets are sold.

**9. Commitments**

(a) In March 2006, the Company issued a letter of credit in the amount of US \$2.2 million in favour of Aburrah Ltd. in connection with the redevelopment program of the El Bibane field. As at June 30, 2006, this amount is a short-term restricted investment and is in the form of a US dollar bond held as security with a Canadian financial institution.

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**Notes to the Consolidated Financial Statements**  
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(b) Under the terms of an agreement with the Tunisian government, 20% of the Company's oil production must be dedicated to the domestic market. The production sold under this domestic market obligation receives a price equal to 90% of the U.S. dollar price for the Brent-based export sales. Oil production is accumulated in a storage facility until a marketable cargo is achieved. Under this agreement, the state-owned company, ETAP, with respect to its 55% rights on the Ezzaouia field production and on behalf of the Government with respect to the domestic market obligation and the Company's Tunisian entities have agreed to optimize tanker lifting volumes. As a result of this reciprocal practice, a short-term volumetric imbalance may arise through an "under/over" lift position. This short-term situation is corrected from future production allocations.

(c) On April 13, 2006, the Company signed a credit facility with the Bank of Scotland. The initial facility size was for US \$10 million although the assets in Tunisia could support a significantly higher facility if required. The primary purpose of the facility will be the Company's new venture activities although it also provides operational flexibility for the redevelopment of the El Bibane field and potentially the fast-track of new project development activities. The facility bears interest at LIBOR plus 2% and there are no fixed repayment terms. No funds have been drawn on this facility to date.

**10. Subsequent Events**

(a) Limited recourse long-term debt default

As described in Note 4, the Company has a 50% joint venture interest in the SEEB power plant and as a result, has limited recourse long-term debt in the amount of \$10.3 million. Under the terms of the credit facility, SEEB was required to make regularly scheduled principal and interest payments on or before May 1, 2006 in the amount of \$0.7 million, and to make deferred principal repayments on or before May 2, 2006 in the amount of \$0.8 million, the Company's proportionate share of each was \$0.4 million and \$0.4 million respectively. Due to the lack of production from the El Bibane field, the SEEB power plant has not generated revenues and as a result was unable to meet its current obligations under the credit facility. Negotiations with the lenders are on-going.

The next required debt service payment was scheduled for August 1, 2006 and SEEB had insufficient cash resources to meet this obligations. In order to ensure the on-going operation of SEEB, the Company is prepared to fund its share of SEEB's renegotiated debt repayments, if required, for the period up to March 2007. It is expected that any repayments made by the Company will be repayable by SEEB once normal operations have resumed once the El Bibane Field is redeveloped and gas production resumes which is currently expected in the third quarter of 2006. The Company has on deposit with the lender \$1.7 million which can be used to fund these required payments. This deposit is classified as a long-term restricted investment on the Company's balance sheet.

The maximum amount of potential future payments which the Company may be required to fund is based on SEEB's debt repayments which are scheduled as follows:

Date	Description	Amount
	Deferred principal payments	\$ 561
August 1, 2006	Regularly scheduled principal and interest payments	615
November 1, 2006	Regularly scheduled principal and interest payments	218
February 1, 2007	Regularly scheduled principal and interest payments	742
Total maximum amount of potential future payments		\$ 2,136

(b) Letter of Credit

As described in Note 9(a) above, the Company had a letter of credit outstanding in the amount of US \$2.2 million in favour of Aburrah Ltd. On July 20, 2006, in accordance with the terms of the contract, this letter of credit was drawn in full as payment for goods shipped for the El Bibane redevelopment program.