



Candax Energy Inc.

**Audited Consolidated Financial Statements
for the years ended December 31, 2005 and 2004**

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements and other financial information included in the Annual Report are the responsibility of, and have been prepared by, the management of Candax Energy Inc. within reasonable limits of materiality. To fulfill this responsibility, the Company maintains appropriate systems of internal control, policies and procedures. These systems of internal control, policies and procedures help ensure that the Company's reporting practices and accounting and administrative procedures provide reasonable assurance that the financial information is relevant, reliable, and accurate, and that assets are safeguarded and transactions are executed in accordance with proper authorization. These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. When alternative methods exist, the Company has chosen those that it deems most appropriate in the circumstances, in order to ensure that the consolidated financial statements are presented fairly in all respects. Where appropriate, these consolidated financial statements reflect estimates based on judgments of the management. Financial information presented elsewhere in this Annual Report is consistent, where applicable, with that shown in the accompanying consolidated financial statements.

PricewaterhouseCoopers LLP, the independent auditors, have examined the consolidated financial statements of the Company. The independent auditors' responsibility is to express a professional opinion on the fairness of the consolidated financial statements. The auditors' report outlines the auditors' opinion and the scope of their examination and their report follows.

The consolidated financial statements have also been reviewed by the Directors of Candax Energy Inc. and by its Audit Committee. The Audit Committee is comprised of a majority of independent directors, and meets periodically during the year with the independent auditors and the management. The independent auditors have full and unrestricted access to the Audit Committee.

(signed)

Michael I.T. Wood
President and
Chief Executive Officer,

(signed)

Christopher J. Hopkins
Chief Financial Officer

March 31, 2006

AUDITORS' REPORT

To the Shareholders of Candax Energy Inc.

We have audited the consolidated balance sheet of Candax Energy Inc. as at December 31, 2005 and the consolidated statement of operations and deficit and cash flow for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and the results of its operations and its cash flows for the year then ended, in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at December 31, 2004 and for the period from June 4, 2004 to December 31, 2004 were audited by other auditors who expressed an opinion without reservation on those consolidated financial statements in their report dated August 19, 2005.

(signed)

PricewaterhouseCoopers, LLP
Chartered Accountants
Toronto, Ontario

March 24, 2006 (except as to Note 14 which is as at March 27, 2006)

Candax Energy Inc.
Consolidated Balance Sheets

As at December 31 (in thousands of Canadian dollars)	2005	2004
ASSETS		
Current		
Cash and cash equivalents	\$ 22,584	\$ 3,809
Restricted investments (Note 13(b))	2,326	-
Accounts receivable	1,736	37
Inventory (Note 4)	2,452	-
Deposits and prepaids	1,587	-
	30,685	3,846
Restricted investments (Note 5)	1,808	-
Petroleum and natural gas properties (Note 6)	42,891	128
Property, plant and equipment (Note 6)	16,353	-
	\$ 91,737	\$ 3,974
LIABILITIES		
Current		
Accounts payable and accrued liabilities	\$ 5,933	\$ 150
Current portion of long-term debt (Note 7)	1,157	-
	7,090	150
Limited recourse long-term debt (Note 7)	12,225	-
Asset retirement obligation (Note 11)	2,282	-
Future income tax liability (Note 12)	5,645	-
	27,242	150
SHAREHOLDERS' EQUITY		
Capital stock (Note 8)	64,699	-
Warrants	2,299	-
Special warrants	-	4,273
Contributed surplus	1,136	-
Cumulative translation adjustment	(1,688)	-
Deficit	(1,951)	(449)
	64,495	3,824
	\$ 91,737	\$ 3,974
Commitments (Note 13)		

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

Candax Energy Inc.
Consolidated Statements of Operations and Deficit

For the periods noted (in thousands of Canadian dollars except for per share amounts)	Year ended December 31, 2005	Period from June 4th, 2004 (date of incorporation) to December 31, 2004
Revenues		
Sales, net of royalties	\$ 12,882	-
Interest and other income	1,048	-
	<u>13,930</u>	<u>-</u>
Expenses		
Operating costs	2,681	-
Depletion, depreciation and amortization	3,995	-
General and administrative	3,726	449
Interest	926	-
Foreign exchange	595	-
Stock-based compensation	1,136	-
Accretion on asset retirement obligation	156	-
	<u>13,215</u>	<u>449</u>
Income (loss) for the period before current and future income taxes	<u>715</u>	<u>(449)</u>
Current income tax expense	786	-
Future income tax expense (Note 12)	1,431	-
	<u>2,217</u>	<u>-</u>
Loss for the period	<u>\$ (1,502)</u>	<u>\$ (449)</u>
Deficit, beginning of period	(449)	-
Deficit, end of period	<u>\$ (1,951)</u>	<u>\$ (449)</u>
Loss per share - basic and diluted	(0.02)	(4,490)
Weighted average number of shares outstanding - basic and diluted	83,220,077	100

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

Candax Energy Inc.
Consolidated Statements of Cash Flow

For the periods noted (in thousands of Canadian dollars)	Year ended December 31, 2005	Period from June 4th, 2004 (date of incorporation) to December 31, 2004
OPERATING ACTIVITIES		
Loss	\$ (1,502)	\$ (449)
Items not affecting cash		
Settlement costs	100	-
Stock-based compensation	1,136	-
Depletion, depreciation and amortization	3,995	-
Future income tax liability	1,431	-
Accretion on asset retirement obligation	156	-
	<u>5,316</u>	<u>(449)</u>
Net change in non-cash working capital	1,173	138
	<u>6,489</u>	<u>(311)</u>
INVESTING ACTIVITIES		
Acquisition of subsidiaries (Note 3)	(44,068)	-
Restricted investments	(1,808)	-
Petroleum and natural gas properties	(2,235)	(128)
	<u>(48,111)</u>	<u>(128)</u>
FINANCING ACTIVITIES		
Repayment of long-term debt	(895)	-
Issuance of common shares and warrants	68,250	-
Conversion of warrants	(4,273)	-
Issuance of warrants	2,299	4,355
Costs of share issuance	(3,551)	(107)
	<u>61,830</u>	<u>4,248</u>
Foreign currency translation	(1,433)	-
Net increase in cash and cash equivalents	<u>18,775</u>	<u>3,809</u>
Cash and cash equivalents, beginning of period	3,809	-
Cash and cash equivalents, end of period	<u>\$ 22,584</u>	<u>\$ 3,809</u>
Cash and cash equivalents are comprised of:		
Cash	\$ 1,712	\$ 3,809
Short-term investments	20,872	-
	<u>\$ 22,584</u>	<u>\$ 3,809</u>
Interest paid during the year	\$ 634	-
Income taxes paid during the year	\$ 137	-

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

1. Description of the Business

Candax Energy Inc. ("Candax" or the "Company") was incorporated as Addax Energy Inc. on June 4, 2004 under the laws of the Province of Ontario. On June 25, 2004, the Company filed articles of incorporation changing its name to Candax Energy Inc.

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 has a 50% interest in Société d'Electricité d'El Bibane ("SEEB"), a Tunisian power generation company. At present, all of the operating assets of the Company are located in Tunisia.

Candax is in the process of acquiring various petroleum and natural gas properties. The recovery of both the costs of acquiring the petroleum and natural gas properties and the related deferred exploration and development expenses depends on the existence of economically recoverable reserves, the ability of the Company to obtain the financing necessary to complete exploration and the development of the properties, and the future profitable production, or alternatively, on the sufficiency of proceeds from disposition.

2. Summary of Significant Accounting Policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The significant accounting policies are summarized below:

Consolidation

The consolidated financial statements include the accounts of Candax together with its wholly owned subsidiaries, Ecumed Petroleum Grombalia Ltd., Ecumed Petroleum Tunisia Ltd., Ecumed Petroleum Zarzis Ltd., (known collectively as the "Tunisian properties"), Candax Energy Limited ("CEL"), Candax Energy Services Limited ("CESL") and the proportionate share of its 50% investment in SEEB. All significant intercompany balances and transactions have been eliminated.

Joint ventures

Substantially all of the Company's exploration and operating activities, including electricity generation, are conducted jointly with others. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

Measurement uncertainty

Management has made estimates and assumptions regarding certain assets, liabilities, revenues and expenses in the preparation of the consolidated financial statements. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. Accordingly, actual results may differ from estimated amounts.

Depletion and amortization, and amounts used for ceiling test calculations are based on estimates of oil and natural gas reserves and commodity prices, production expenses and capital costs required to develop and produce those reserves. The majority of the Company's reserve estimates are evaluated annually by independent engineering firms. By their nature, estimates of reserves and the related future cash flows are subject to measurement uncertainty, and the impact of differences between actual and estimated amounts on the consolidated financial statements of future periods could be material.

The calculation of the asset retirement obligation includes estimates of the future costs to settle the asset retirement obligation, the timing of the cash flows to settle the obligation, and the future inflation rates. The impact of differences between actual and estimated costs, timing and inflation on the consolidated financial statements of future periods could be material.

Cash and cash equivalents

Cash and cash equivalents comprise cash and short-term market investments with maturities of three months or less at the date of acquisition.

Restricted investments

Restricted investments represent amounts which have been pledged as security for transactions entered into by the Company. The investments are held by third parties and as such are not available for the Company's own use. (See Notes 5 and 13(b)).

Petroleum and natural gas properties and related depletion and amortization

Candax follows the full cost method of accounting, whereby all costs incurred in exploring for and developing oil and gas reserves are capitalized. Such expenditures include land acquisition costs, geological and geophysical expenses, carrying charges for unproved properties, costs of drilling both productive and non-productive wells, gathering and production facilities and general and administrative costs directly related to exploration and development activities. Capitalized costs are accumulated on a country-by-country basis and are amortized and depleted using the unit-of-production method based upon estimated proved reserves. For those properties that are still in the development stage, related costs are capitalized until either commercial production commences or it is determined that the invested amounts will never be recovered.

Natural gas reserves are converted to equivalent barrels of oil on the basis of their relative energy content (6 mcf equals 1 barrel). Costs directly associated with the acquisition and evaluation of unproved properties are initially excluded from the computation of depletion. These unproved properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered impaired, the cost of the property or the amount of the impairment is added to all other capitalized costs subject to amortization and depletion.

The Company calculates a ceiling test whereby the net capitalized costs of properties cannot exceed the sum of the undiscounted cash flows expected to result from the properties using proved reserves. Cash flows are calculated based on third-party quoted forward prices and adjusted for the Company's contracted prices and quality differentials. If there is impairment, the magnitude of it would be calculated by comparing the carrying amount of property, plant and equipment to the estimated net present value of future cash flows from proved plus risked probable reserves. A risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying value above the net present value of future cash flows would be recorded as a permanent impairment and charged as additional depletion expense in the consolidated statements of operations and deficit.

Sales of oil and gas properties are accounted for as adjustments to capitalized costs, with no gain or loss recognized unless such adjustments would alter the rate of depletion and amortization by more than 20%.

Foreign currency translation

The Tunisian subsidiaries are considered self-sustaining operations and exist in a business environment where the US dollar is their functional currency. The financial statements of self-sustaining operations are translated into Canadian dollars from their functional currency using the current rate method. Under this method, assets and liabilities are translated into Canadian dollars using the exchange rate in effect at the consolidated balance sheet date. Revenues and expenses are translated into Canadian dollars at the average exchange rate for the period. All resulting exchange gains and losses are recorded in shareholders' equity in the cumulative translation adjustment account.

CEL and CESL are considered integrated foreign operations and as such, their financial statements are translated using the temporal method. Under this method, monetary assets and liabilities denominated in foreign currency are translated into Canadian dollars at the exchange rate in effect at the consolidated balance sheet date and non-monetary assets and liabilities are translated into Canadian dollars at the exchange rate in effect on the transaction date. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the average exchange rate for the period. All resulting exchange gains and losses are recorded in the consolidated statements of operations and deficit.

Inventory valuation

The crude oil inventory value is calculated using the related production and depletion costs per barrel and the spare parts are carried at the lower of cost and market.

Asset retirement obligation

The Company recognizes the fair value of an asset retirement obligation ("ARO") in the period in which it is incurred when a reasonable estimate of fair value can be made. The fair value of the estimated ARO is recorded as a long-term liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is amortized to expense through depletion over the life of the asset. The liability amount is increased each reporting period due to the passage of time and the amount of this accretion is charged to earnings in the period. Revisions, if any, to the estimated timing of cash flows or to the original estimated undiscounted cost, if any, also result in an increase or decrease to the ARO and the related asset. Actual costs incurred upon settlement of the ARO are charged against the ARO to the extent of the liability recorded. Any difference between the actual costs incurred upon settlement of the ARO and the recorded liability is recognized as a gain or loss in the Company's earnings in the period in which the settlement occurs.

Asset retirement assets for natural gas and crude oil are amortized using the unit-of-production method.

Stock-based compensation plan

The Company has an incentive stock option plan which is described in Note 8. The Company accounts for its stock-based compensation plan using the fair value method. The fair value of stock options is determined on their grant date and recorded as compensation expense over the period that the stock options vest, with a corresponding increase in contributed surplus. When stock options are exercised, the proceeds, together with the amount recorded in contributed surplus, are recorded in capital stock. The calculation of this expense is described in Note 8.

Financial instruments

Canadian accounting standards require the disclosure of the fair value of financial assets and liabilities. The fair value of the Company's current financial assets and liabilities is considered to approximate book value due to their current nature, as does the long-term debt, which is at floating rates.

Revenue recognition

Revenues from the sale of oil, gas and electricity are recorded when title passes to the customer.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method future tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Future tax liabilities and assets are measured using enacted tax rates. The effect on future tax liabilities and assets of a change in tax rates is recognized in the period that the change occurs.

Net income (loss) per common share

Net income (loss) per common share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period. For the purposes of the weighted average number of common shares calculation, common shares are determined to be outstanding from the date they are issued. Diluted income (loss) per common share is calculated using the treasury stock method, which assumes that all outstanding stock option grants are exercised, if dilutive, and the assumed proceeds are used to purchase the Company's common shares at the average market price during the year.

3. Acquisition

On April 26, 2005, Candax completed the purchase of the Tunisian operations of Centurion Energy International Inc. ("Centurion") for a purchase price of \$44.1 million satisfied with cash, inclusive of a \$2.9 million working capital adjustment. The results from these operations have been included from that date

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however the effective date of the purchase is January 1, 2005. The economic benefits from the properties have been recorded as an adjustment to the purchase price.

Specifically, Candax has purchased Centurion's wholly-owned subsidiaries: Ecumed Petroleum Grombalia, Ltd., Ecumed Petroleum Zarzis, Ltd., Ecumed Petroleum Tunisia, Ltd. and the 50% interest of Centurion's in the Societe d'Electricite d'El Bibane ("SEEB") power plant, which represented all of Centurion's production from the Ezzaouia (31.3846% working interest), El Bibane (73.7729% working interest), Robbana (80% working interest) and Al Manzah (75% working interest) Centurion has retained the right to participate for up to 50% of Candax's resultant working interest in any Deep Triassic exploration well at either or both of Ezzaouia and El Bibane.

The acquisition was accounted for using the purchase method and accordingly the purchase price was allocated to the assets acquired and liabilities assumed based on their fair values on April 26, 2005 as follows:

Current assets, including cash of \$584	\$	4,468
Restricted investments		1,946
Petroleum and natural gas properties		45,153
Property, plant and equipment		17,659
Current liabilities		(3,707)
Long-term debt		(14,924)
Asset retirement obligation		(2,317)
Future income tax liability		(4,210)
Purchase price	\$	44,068

4. Inventory

Crude oil	\$	1,693
Spare production equipment and parts		759
	\$	2,452

5. Restricted Investments

Restricted investments represent a US\$ 1.6 million debt service reserve held by the Arab Banking Corporation as security for principal and interest payments to be made by SEEB under its limited recourse long-term debt. (See Note 7).

6. Capital Assets

2005	Cost	Accumulated Amortization	Net book Value
Petroleum and natural gas properties	45,381	(2,490)	42,891
Property, plant and equipment	17,659	(1,306)	16,353
	63,040	(3,796)	59,244
2004			
Petroleum and natural gas properties	128	-	128

Candax Energy Inc.
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(in thousands of Canadian dollars unless otherwise stated)

As at December 31, 2005

- included in the cost of properties is \$0.4 million of capitalized head office general and administrative costs
- petroleum and natural gas properties include \$13.4 million in respect of unproved properties in Tunisia which have been excluded from depletion calculations.
- the prices used in the ceiling test evaluation of the Company's crude oil and natural gas reserves were;

	Natural Gas Price	Crude oil and Natural Gas Liquids
	US\$/Mcf	\$US/Bbl
2006	0.36	53.06
2007	0.37	52.12
2008	0.38	49.29
2009	0.38	44.59
2010	0.39	42.71
Average thereafter	0.41	41.86

Chaal Permit

On September 30, 2004, Candax signed a memorandum of understanding with a Tunisian company to apply as joint venture partners ("JVP") for the Chaal Permit in Tunisia. The Company will be the operator with an 80% working interest in the property. Candax reimbursed its partner for past costs incurred by the partner on the permit to a gross amount of US\$0.2 million. Candax has also agreed to assign a 2% net profits interest to its partner after all costs have been recovered.

On November 30, 2005, Candax signed an agreement with Mitsubishi Corporation ("Mitsubishi") for the farm-out of a 20% working interest in the Chaal Permit. Candax retains a 60% working interest in the Chaal Permit and is the Licence operator. 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. 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. Mitsubishi has agreed to pay Candax certain other cash bonuses dependent upon receiving government consent to undertake the development of the Chaal project and achieving certain other gas sales-based thresholds.

7. Limited Recourse Long-Term Debt

	Rate		
Limited recourse SEEB debt			
Project financing (US\$ based)	LIBOR +1.65%	\$	4,139
Project financing (Euro based)	ADB* + 2%		6,168
Due to Caterpillar Power Ventures Inc.	13%		3,075
			<u>13,382</u>
Amount due within one year			<u>(1,157)</u>
		\$	<u><u>12,225</u></u>

* 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 project financing at December 31, 2005 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 \$3.1 million in respect of

Candax Energy Inc.
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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. Interest in the amount of \$1.0 million has been recorded in the consolidated statements of operations and deficit in interest expense.

8. 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
Upon incorporation on June 4, 2004	1	\$ 1
Private placement	4,679,999	99
Balance at December 31, 2004	4,680,000	100
Conversion of special warrants	43,372,000	4,448,900
Settlement costs	125,000	100,000
Conversion of subscription receipts	82,500,000	66,000,000
Value attributed to warrants		(2,298,955)
Share issuance costs		(3,550,977)
Balance at December 31, 2005	130,677,000	64,699,068

On April 14, 2005, Candax completed a private placement of 82,500,000 subscription receipts at a price of \$0.80 per subscription receipt for total proceeds of \$66 million. Each subscription receipt entitled the holder to acquire, for no additional consideration, one common share and one-half of one common share purchase warrant, each whole warrant being exercisable to acquire one common share at \$1.20 for one year. On August 23, 2005 Candax received a receipt from the applicable securities regulatory authorities in Canada for a prospectus dated August 22, 2005 which, qualified the distribution of the common shares and warrants of Candax issued upon the exchange of these subscription receipts.

The value attributed to the warrants was \$2.3 million using the following assumptions under the Black-Scholes model:

Expected volatility	60%
Risk-free interest rate	3.043%
Term	0.65 year
Exercise price	\$1.20

The agents in respect of the sale of 45,000,000 of the subscription receipts received a cash commission of \$2.2 million, being equal to 6% of the gross proceeds from the sale of the subscription receipts, as well as broker warrants entitling them to acquire 2,700,000 common shares, being equal to 6% of the subscription receipts sold through the agents. Each broker warrant entitles the holder to acquire one common share at a price of \$0.80 for a period of one year from the closing date.

Stock options

In April 2005, the Board of Directors established a share incentive plan to provide additional incentive to its directors, officers, employees and consultants in their efforts on behalf of the Company in the conduct of its affairs. The maximum number of common shares reserved for issuance under the share option plan comprising part of the share incentive plan may not exceed 10 % of the number of common shares

Candax Energy Inc.
Notes to the Consolidated Financial Statements
(in thousands of Canadian dollars unless otherwise stated)

outstanding. Under the terms of the plan, all options vest immediately, unless otherwise specified. All options granted under the plan expire no later than the tenth anniversary of the grant date.

On April 7, 2005 and May 24, 2005, the Board approved the grant, pursuant to the stock option plan, of a total of 11,150,000 stock options to various directors, officers, employees, and consultants. Each stock option entitles the holder to purchase one Common Share of the Company at a price of \$0.80 per share. One-third of the granted options vest immediately, one-third vest on the first anniversary of the grant date, and the remaining one-third vest on the second anniversary of the grant date. The stock options expire on April 1, 2010 or May 24, 2010, at which time they will be of no further force or effect. No options were exercised or forfeited during the year. At December 31, 2005, 3,716,667 options at \$0.80 per share were exercisable.

The fair value was estimated on the date of the grant using the Black-Scholes fair value option-pricing model and the following assumptions:

Expected volatility	0% (i)
Risk-free interest rate	3.96%
Term	5 years
Dividend yield	nil

(i) since the Company's shares were not publicly traded at the time of the granting, the Company is eligible to use the "minimum value" under Section 3870 of the Canadian Institute of Chartered Accountant's Handbook, which assumes a volatility of 0%.

Using the fair value method, the compensation expense is amortized over the three-year vesting period of the options. For the year ended December 31, 2005, the Company recorded a stock-based compensation expense of \$1.1 million in relation to options granted during the year. The portion of the fair value charge to be recognized in future periods is \$0.5 million.

9. Related Party Transactions

As described in Note 1, the Company has a 50% interest in SEEB. During the year the Company had gas sales to SEEB in the amount of \$0.7 million and as at December 31, 2005 the Company had a receivable from SEEB in the amount of \$0.4 million.

10. Segmented Information

(a) By generation source

	Oil and gas operations	Electricity generation operations	Total
For the year ended December 31, 2005			
Sales (net of royalties)	\$ 11,286	\$ 1,596	\$ 12,882
Depletion, depreciation and amortization	2,690	1,305	3,995
Interest expense	-	926	926
Loss for the period	(473)	(1,029)	(1,502)
As at December 31, 2005			
Capital assets	42,891	16,353	59,244

(b) All capital assets and revenues are located in Tunisia with the exception of interest earned on the US dollar-denominated term deposit located in the Guernsey and interest earned on a Canadian dollar-denominated money market fund and a US dollar-denominated bond located in Canada.

11. Asset Retirement Obligation

Balance at December 31, 2004		-
Increase resulting from acquisition		2,317
Accretion expense		156
Foreign exchange		(82)
Revision in estimate		(109)
Balance at December 31, 2005	\$	2,282

The total undiscounted amount of estimated cash flows required to settle the obligation is \$5,037 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.

12. Income taxes

The future tax liability of \$5.6 million at December 31, 2005 relates to the difference in the unclaimed tax deductible costs of capital assets in Tunisia and the related carrying value. The carrying value is based on the fair value of net assets acquired in the Acquisition (See Note 3). When the assets are amortized there will be an associated tax benefit for accounting purposes. 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. The approximate value of tax pools available in Tunisia are \$47,870.

Profit before income taxes		715
Canadian corporate tax rate		39.10%
Calculated income tax provisions		280
Effect on taxes from foreign tax rate differential		78
Expenses incurred with no recognized tax benefit		1,859
		<u>2,217</u>

At December 31, 2005, the Company had non-capital tax losses available to offset future income for tax purposes of in Canada and Tunisia. The losses expire in the years as noted:

	<u>Canada</u>	<u>Tunisia</u>
2008	-	470
2011	400	-
2012	2,000	-
	<u>2,400</u>	<u>470</u>

The Company has not recognized a future tax asset for Canadian non-capital losses carried forward, since it is not, more likely than not, that such an asset will be utilized in the foreseeable future.

13. Commitments

(a) The Company leases one of its office premises under a non-cancellable operating lease, which expires in 2015, with an option to terminate the lease without penalty in 2008 and 2012. The future minimum annual lease payments are approximately \$0.2 million per year.

(b) As of December 31, 2005, the Company has guaranteed a standby letter of credit for Falcon Chaal Petroleum Limited in the amount of US\$ 2 million in favour of MCX Northafrica Co., Ltd. under the

Farmout Agreement dated November 30, 2005 between the Company and Mitsubishi as described in Note 5. The letter of credit will be released upon the approval by the Tunisian government for the assignment of the Chaal license to a company formed under a joint operating agreement. This amount is a restricted investment and is in the form of a US\$ bond held as security with a Canadian financial institution.

14. Subsequent Events

Limited recourse long-term debt default

As described in Note 7, 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 principal and interest payments on February 1, 2006 in the amount of \$1.4 million, the Company's proportionate share of which was \$0.7 million. Due to the lack of production from the El Bibane oil field, the SEEB power plant has not generated revenues and as a result was unable to meet its obligations under the credit facility. The lenders agreed to defer the principal payments until May 2, 2006, and provided the interest was paid they waived the event of default that would otherwise have arisen. SEEB paid the interest in the first quarter of 2006 from the proceeds of business interruption insurance and hence no default has occurred.

The next required debt service payment is scheduled for May 1, 2006 and SEEB will have insufficient cash resources to meet its obligations. Discussions with the lenders have begun regarding this payment but no agreement has been made. 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 middle part of 2006. The Company has on deposit with the lender \$1.8 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
May 1, 2006	Regularly scheduled principal and interest payments	\$ 357
May 2, 2006	Deferred principal repayments	426
August 1, 2006	Regularly scheduled principal and interest payments	1,365
Total maximum amount of potential future payments		\$ 2,148



MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a discussion of the consolidated financial condition and results from operations of Candax Energy Inc. ("Candax" or the "Company") for the periods indicated. All references to "year" refer to the year ended December 31, 2005. The following should be read in conjunction with the audited consolidated financial statements and notes. Additional information relevant to the Company's activities, including the Company's Annual Information Form, can be found on SEDAR at www.sedar.com. This information is presented as of March 31, 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

The world energy sector has seen record prices set in 2005 and this situation in the short-term seems unlikely to change. A combination of supply factors, transportation limitations and production uncertainty have combined with continued strong demand contributing to increases in Brent oil prices to levels in excess of \$US 65 per barrel in mid-2005 while averaging approximately \$US 56 per barrel in the fourth quarter.

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 consolidated statements of income (loss) and deficit and cash flows are converted to Canadian funds for reporting purposes based on the average Canadian to US dollar exchange rates 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 December 31, 2005 was \$1.1630 and averaged \$1.2114 during the year.

Capital Structure and Dilution

Since incorporation in later part of the second quarter of 2004, Candax has participated in multiple share and securities offerings. The funds raised through these capital offerings financed initial development activities and Candax's April 2005 acquisition of Centurion's operations in Tunisia and additional working capital requirements. These funds will also be used to fund development drilling and exploration programs in Tunisia in the coming months and development activities elsewhere. As at December 31, 2004, there were 4,680,000 common shares outstanding. In the second quarter, in connection with the conversion of special warrants and settlement costs, 43,497,000 common shares were issued, bringing the number of common shares outstanding on June 30, 2005 to 48,177,000. On August 23, 2005 Candax received a receipt from the applicable securities regulatory authorities in Canada for a prospectus dated August 22, 2005 which, among other things, qualified the distribution of the common shares and warrants of Candax issuable upon the exchange of certain subscription receipts of Candax. The common shares and warrants of Candax commenced trading on the TSX at the opening on Monday, August 29, 2005, under the symbols CAX and CAX.W respectively. This increased the number of shares outstanding as at December 31, 2005 to 130,677,000 which remains the current balance outstanding. Each of the 41,250,000 warrants entitled the holder thereof to acquire one common share of Candax at a price of \$1.20 until 5:00 p.m. EST on April 14, 2006, subject to adjustment.

In addition on April 7, 2005 and May 24, 2005, the Board approved the grant, pursuant to the stock option plan, of a total of 11,150,000 stock options to various directors, officers, employees, and consultants. Each stock option entitles the holder to purchase one Common Share of the Company at a price of \$0.80



per share. One-third of the granted options vest immediately, one-third vest on the first anniversary of the grant date, and the remaining one-third vest on the second anniversary of the grant date. The stock options expire on April 1, 2010 or May 24, 2010, at which time they will be of no further force or effect.

On November 1, 2005, Candax signed an agreement with Pro-Edge Consultants Inc. (Pro-Edge) to act as its Investor Relations firm. Pursuant to the commencement of the engagement of Pro-Edge by Candax, Candax has issued 50,000 options at \$0.49 to Pro-Edge in accordance with Candax's share incentive plan. The options, each of which is exercisable to acquire one common share of Candax, expire on October 27, 2007. Assuming the ongoing engagement of Pro-Edge by Candax, an additional 30,000 options will be issued to Pro-Edge at the end of every full 4 month period for which Pro-Edge has been engaged. Such options are subject to approval by the Toronto Stock Exchange, will have an expiry date of two years and will vest over a 12 month period, with one-quarter of the options vesting at the end of each 4 month period.

Acquisition of Tunisian Producing Assets from Centurion Energy International

On April 26, 2005, Candax completed the purchase from Centurion Energy International Inc. of its Tunisian operations for a total cost of \$44.1 million including working capital adjustments and costs related to the acquisition. Specifically, Candax has purchased Centurion's wholly-owned subsidiaries: Ecumed Petroleum Grombalia, Ltd., Ecumed Petroleum Zarzis, Ltd., Ecumed Petroleum Tunisia, Ltd. and the 50% interest of Centurion's in the SEEB power plant, which represented all of Centurion's production from the Ezzaouia (31.4% working interest), El Bibane (73.8% working interest), Robbana (80% working interest) and Al Manzah (75% working interest) fields approximating 1,200 barrels of oil per day of oil and 4.8 MMscf per day of natural gas. Centurion has retained the right to participate for up to 50% of Candax's resultant working interest in any Deep Triassic exploration well at either or both of Ezzaouia and El Bibane. Centurion's interest in the Mellita permit and the accompanying PetroCanada farm-out agreement were not included in this purchase and sale transaction.

The initial purchase price of \$41.2 million was adjusted upward by \$2.9 million for working capital adjustments for the period from January 1, 2005 to the April 26, 2005 closing date. The effective date of the transaction is January 1, 2005 and all economic benefits accrue to Candax from that date forward. However as title to the assets did not pass until April 26, 2005, all revenues and costs are treated as an adjustment to the purchase price and reflected in the allocation of the purchase price to the acquired assets. Consequently, Candax began consolidating the Tunisian operations on May 1, 2005.

Chaal Licence Award

The area comprising the Chaal Permit is located in central Tunisia approximately 50 kilometres west of the City of Sfax. Candax has an 80% working interest in the Chaal Permit 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 order to comply with the terms of the Chaal Permit and to render the permit capable of being converted into an exploration permit, the Company and its 20% partner in the Chaal permit, Societe de Maintenance d'Installation Pétrolières ("SMIP") must carry out a work program prior to June 14, 2007. The program requires the acquisition of 90 kilometres of 2D seismic data at an estimated cost of US\$1,000,000 (the Company's share of which would be US\$800,000), provided that in the event that the work program is completed at a lesser cost, the obligations of the Company and SMIP will be deemed to have been fulfilled.

On December 16, 2005, Candax received approval to convert the prospecting permit into an exploration permit by agreeing with its joint venture partners to drill the Chaal 1 well, and thus is not required to complete the seismic acquisition. The new exploration permit has a period of two years and a financial obligation to expend a minimum of US\$3.0 million in the drilling of an exploration well.

On November 30, 2005, Candax signed an agreement with Mitsubishi Corporation ("Mitsubishi") for the farm-out of a 20% working interest in the Chaal Permit. Candax retains a 60% working interest in the

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Chaal Permit and is the Licence operator. 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. Mitsubishi has an option to acquire a further 5% interest from Candax in the Chaal Permit prior to the drilling of a second well subject to certain conditions. In addition, Mitsubishi has agreed to pay Candax certain other cash bonuses dependent upon receiving government consent to undertake the development of the Chaal project and achieving certain other gas sales-based thresholds.

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 previous quarters has no analytical value for the majority of the reported results. Discussion will be limited to the quarters in the current year with comparative analysis provided only when meaningful.

Revenue

Sales, net of royalties for the year and the three months ended December 31, 2005, were \$12.9 million and \$1.4 million respectively. The Company sold approximately 316,000 barrels of oil at an average price of US\$49.53 per barrel for sales of \$18.4 million for the year however only \$12.9 million is recognized since the results prior to the acquisition were not included. The balance relates to gas sales and the Company's share of electricity sales (for which the Company provides the gas for its generation) for the year. Only the portion of the sales subsequent to the acquisition closing date has been included in revenue. Revenue for the fourth quarter of \$1.4 million was substantially lower than the third quarter revenue of \$9.2 million due to timing of sales and the shut-in of the El Bibane well and the resultant suspension of electricity generating activities as described below.

Production

The following table summarizes the production since the January 1, 2005 effective date of the acquisition of the Tunisian operations.

	Q1	Q2	Q3	Q4	Total
Oil (BBLs/day)	1,194	1,062	809	470	881
Gas (mmcf/day)	4.4	4.4	2.6	-	2.8
BOEs/day	1,933	1,792	1,237	470	1,354

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.

As described above, the economic benefit of this production belongs to Candax although under Canadian generally accepted accounting principles is not included in the results of operations until after the acquisition closing date.

Company Share of Proved Plus Probable Reserves for the period ended December 31, 2005
(Escalated Prices and Costs)

Reserves Category	Boe		Oil		Natural Gas	
	Gross (Mboe)	Net (Mboe)	Gross (Mbbbl)	Net (Mbbbl)	Gross (MMcf)	Net (MMcf)
Total Proved – All Categories	7,744	3,988	5,064	2,361	16,083	9,765
Probable – All Categories	17,234	11,670	5,890	3,062	68,063	51,645
Total Proved Plus Probable	24,978	15,658	10,954	5,423	84,146	61,410

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. Prior to shut-in, the El Bibane well was producing approximately 530

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barrels of oil per day and 3.7 mmcf/d of gas sales net to Candax. 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. Total restart costs of approximately \$0.6 million are included in operating costs for the year.

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 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 the second quarter 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 the costs detailed above, is the deferral of production to later periods. No production from El Bibane was reported in the fourth quarter. With the expected successful redevelopment of the El Bibane field, this shut-in will not affect reserves.

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 have been released reducing the carrying costs to an absolute minimum. The Company's share of the ongoing costs is expected to be \$0.1 million per month which was funded by the plant until December 2005. The plant will restart as soon as gas is produced from El Bibane which is expected to occur at the end of the second quarter of 2006. Under the terms of its credit facility, SEEB was required to make principal and interest payments on February 1, 2006 in the amount of \$1.4 million, the Company's proportionate share of which was \$0.7 million. Due to the lack of a source of gas, the SEEB power plant has not generated revenues and as a result was unable to meet its obligations under the credit facility. The lenders agreed to defer the principal payments until May 2, 2006, and provided the interest was paid on February 1, 2006 they waived the event of default that would otherwise have arisen. SEEB paid the interest in the first quarter of 2006 from the proceeds of business interruption insurance and hence no default has occurred.

The next required debt service payment is scheduled for May 1, 2006 and SEEB will have insufficient cash resources to meet its obligations. Discussions with the lenders have begun regarding this payment but no agreement has been made. 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 middle part of 2006. The Company has on deposit with the lender \$1.8 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:

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Total maximum amount of potential future payments		\$ 2,148

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Operating Costs

Operating costs for the year and the three months ended December 31, 2005 were \$2.7 million and \$0.2 million respectively. The operating costs for the fourth quarter were significantly lower than the third quarter operating costs due to the fact the El Bibane and SEEB operations were not producing. Prior to the shut-in of El Bibane 3, the operating costs for both oil and gas production and electricity generation were operating at expected levels.

General and Administrative Costs

General and administrative costs for the year and the three months ended December 31, 2005 were \$3.6 million and \$0.9 million respectively. General and administrative costs include costs of the acquired assets as well as head office and start-up costs for the year including the fees associated with the prospectus and final receipt enabling the listing of the Company's common shares.

General and administrative expenses for the fourth quarter were significantly lower than the third quarter costs of \$1.4 million, as the share issuance costs were paid in August.

Candax is an early stage company that is incurring proportionately higher general and administrative expenses as it incurs start-up costs and develops its portfolio.

Interest expense

Interest expense for the year and the three months ended December 31, 2005 were \$0.9 million and \$0.4 million, 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 year and the three months ended December 31, 2005 was \$4.0 million and \$0.5 million respectively. This amount is calculated using the purchase price of the acquired assets and the proved reserves information as at December 31, 2005. The expense booked for the fourth quarter is significantly less than the amount of \$2.2 million booked in the third quarter as this expense is based on units-of-production and as described earlier, the majority of the Company's assets were not producing.

Selected Quarterly Financial Data

<i>in thousands of Canadian dollars except per share amounts</i>	Q1	Q2	Q3	Q4	Year
2005					
Sales, net of royalties	-	2,233	9,202	1,447	12,882
Net income (loss)	(520)	(186)	2,966	(3,762)	(1,502)
Net income (loss) per share - basic	(0.11)	-	0.04		(0.02)
Net income (loss) per share - diluted	-	-	0.02		(0.02)
Total assets	3,716	89,305	91,051	91,737	91,737
Long-term financial liabilities	-	13,524	11,807	12,225	12,225
2004					
Sales, net of royalties	-	-	-	-	-
Loss	-	(9)	(181)	(259)	(449)
Loss per share	-	(0.09)	(1,806)	(2,590)	(4,490)
Total assets	-	-	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

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fourth quarter was significantly less than the third quarter because of timing of shipments and the suspension of the operations of El Bibane and SEEB as discussed earlier.

Liquidity, Capital Resources and Capital Expenditures

Candax, through the subscription receipts described above, raised net proceeds of \$63.1 million earlier in the year. The acquisition of the Tunisian assets described above required \$43.7 million and the remaining cash is held to fund working capital requirements and petroleum development activities and/or acquisitions. The balance of cash and cash equivalents as at December 31, 2005 was \$22.3 million. Of this amount, \$20.9 million has been invested in highly liquid investments with high-quality institutions.

Contractual obligations

<i>(in thousands of Canadian dollars)</i>	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Limited recourse long-term debt	\$13,382	\$1,157	\$4,869	\$3,246	\$4,110
Purchase obligation (1)	2,682	2,682			

(1) The Company has purchase obligations with respect to the El Bibane operations.

Critical Accounting Estimates

A discussion of the Company's significant accounting policies is contained in Note 2 to the 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.

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Company's President and Chief Executive Officer and Chief Financial Officer, on a timely basis so that appropriate decisions can be made regarding public disclosure. As at the end of the period covered by this management's discussion and analysis, management of the Company, with the participation of the President and Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures as required by Canadian securities laws. Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer have concluded that, as of the end of the year covered by this management's discussion and analysis, the disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the Company's annual filings and interim filings (as such terms are defined under Multilateral Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings*) and other reports filed or submitted under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified by those laws and that material information is accumulated and communicated to management of the Company, including the President and Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

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 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

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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.