

Candax Energy Inc

CAX : TSX : C\$1.09

SPECULATIVE BUY

Target: C\$1.33 ↑

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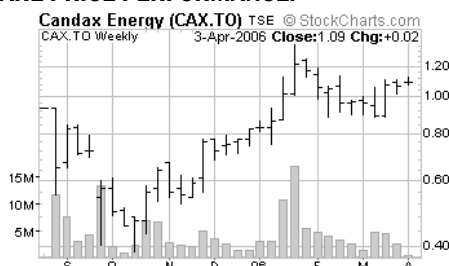
COMPANY STATISTICS:

52-week Range: \$0.39-1.38
 Avg. Daily Vol. (000): 651000
 Market Capitalization (M): \$140.0
 Shares Out. (M) basic: 130.7
 Shares Out. (M) fd: 174.2
 Net Long-term Debt/CF: (11.2x)

EARNINGS SUMMARY:

FYE Dec	2005A	2006E
Equivalent Production (boe/d):	1,357	2,195
EPS:	(0.02)	0.05
Operating EPS:	(0.01)	0.05
P/Operating EPS:	(nm)	21.8x
CFPS:	0.05	0.20
P/CF:	21.8x	5.5x

SHARE PRICE PERFORMANCE:



COMPANY SUMMARY:

Candax Energy Inc. is an international energy company involved in oil and gas exploration and production and power generation. Candax has operations in Tunisia and looks to expand into the Middle East and other parts of North Africa. With an experienced, international oil and gas knowledgeable management team inclusive of Michael Wood, President and CEO, John Clarke, Executive Vice President and Chris Hopkins, CFO; Candax is primed for growth.

All amounts in C\$ unless otherwise noted.

Energy -- Oil and Gas, Exploration and Production

RAISING TARGET ON VALUATION UPDATE

Event

Candax released its year-end financial results and Annual Information Form last Friday after market close. We have updated our valuation of Candax based on the details of their year-end reserve report. We now have calculated a 10% pre-tax NAV of \$1.10 basic, \$1.16 fully diluted. The valuation assumes only the original probable reserves of the Chaal permit as determined by their independent engineering report of Glendower International Limited. The acquired reserves from Centurion were evaluated by Ryder Scott Company.

Impact

Positive. In spite of the operational difficulties and shutdown experienced at El Bibane, Candax's reserves increased by 7% overall (34% for proven). Reserve values increased substantially, due to higher pricing. At year-end 2005, Candax reserve value rose to \$135.6 million (10% pre-tax), up 150% from the \$54.6 million the prior year. While we anticipated an upgrade due to price, the reported results were higher than our previous estimate.

Action

Continue to rate Candax a SPECULATIVE BUY.

Valuation

Candax shares are trading near the NAV of their current assets, including approximately \$0.20 to \$0.25 per share for Chaal, under a low reserve case scenario. We are increasing our target price to \$1.33 per share (from \$0.83) to reflect the mid-case potential on a risked basis for Chaal. On an unrisked (success) basis, the upside case is higher.

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Next Catalyst

The Chaal prospect (60%), currently drilling at approximately 4000 metres, should be in the reservoir within the week and at total depth early next week. Assuming positive indications, Candax will then conduct a series of production tests over the following three weeks.

VALUATION UPDATE

Candax released its detailed engineering report in its Annual Information Form (AIF) filing on Friday, March 31, 2006. A summary of the valuation, based on forecast prices is presented in figure 1. We have also indicated the % changes from the prior year report.

Figure 1: Candax Year-end reserves, NPV and comparison to 2004

	Oil & NGLs		Natural Gas		Equivalent		Pre Tax 10% NPV m\$	2005 v 2004 % Change	
	Gross mstb	Net	Gross mmcf	Net	Gross mboe	Net		Equivalent Net reserves	Pre Tax NPV
Tunisia - Acquired									
Proved Developed Producing	2,734	820	3,102	864	3,251	964	20,450	-21%	15%
Proved Developed Non-producing	85	23	51	15	94	26	0	-21%	-100%
Proved Undeveloped	2,205	1,519	12,930	8,886	4,360	3,000	27,450	76%	292%
Total Proved	5,024	2,362	16,083	9,765	7,705	3,990	47,900	35%	91%
Probable Additional	4,072	1,608	8,063	3,645	5,416	2,216	44,700	3%	210%
Proved and Probable	9,096	3,970	24,146	13,410	13,120	6,205	92,600	21%	134%
Tunisia - Chaal Permit									
Proved Developed Producing	0	0	0	0	0	0	0	0%	0%
Proved Developed Non-producing	0	0	0	0	0	0	0	0%	0%
Proved Undeveloped	0	0	0	0	0	0	0	0%	0%
Total Proved	0	0	0	0	0	0	0	0%	0%
Probable Additional	1,454	1,454	48,000	48,000	9,454	9,454	43,000	0%	186%
Proved and Probable	1,454	1,454	48,000	48,000	9,454	9,454	43,000	0%	186%
Company Total									
Proved Developed Producing	2,734	820	3,102	864	3,251	964	20,450	-21%	15%
Proved Developed Non-producing	85	23	51	15	94	26	0	-21%	-100%
Proved Undeveloped	2,205	1,519	12,930	8,886	4,360	3,000	27,450	76%	292%
Total Proved	5,024	2,362	16,083	9,765	7,705	3,990	47,900	35%	91%
Probable Additional	5,526	3,062	56,063	51,645	14,870	11,670	87,700	0%	198%
Proved and Probable	10,550	5,424	72,146	61,410	22,574	15,659	135,600	7%	148%

Source: Company reports, AIF, Canaccord Adams estimates

As highlighted in Figure 1, Candax increased its net reserves on its acquired Tunisian assets by 21%, reflecting the combination of the planned redevelopment programme at El Bibane and the effect of higher oil prices on the economic life of the fields. The probable reserve estimate for Chaal permit was unchanged, resulting in a total increase in 2P reserves of 7%. The valuation comparison to last year, however, showed a significant increase of 148% to \$135.6 million, as last years reserve report was based on a US\$30/b oil price scenario. While we were anticipating a change due to higher prices, the reserve volumes and values were higher than we had been estimating.

We have used Candax's year-end reserve reports as a basis for updating our net asset value. While proved developed producing reserves declined at El Bibane, total proved reserves increased due primarily to the planned redevelopment which now includes the

drilling EBB-4, the re-drilling of EBB-3, and the installation of a gas lift and injection system. Candax anticipates delivery of the barge mounted drilling rig in mid-April and commencement of the drilling of EBB-4 by the end of the month. Figure 2 summarizes our new base NAV.

Figure 2: Candax Updated NAV, 10% pre-tax

	2005	Per Share	
		Basic	Diluted
Net asset value calculation			
Proven Reserves, 10% pre-tax	47,900	0.37	0.28
Probable Reserves, 10% pre-tax	44,700	0.34	0.26
Value of reserves excluding Chaal	92,600	0.71	0.53
Cash	11,370	0.09	0.07
Warrant proceeds	49,500	0.00	0.28
Option proceeds	8,920	0.00	0.05
Net Asset Value excluding Chaal (fd)	162,390	0.80	0.93
Chaal, Probable Reserves.10% pre-tax	32,250	0.25	0.19
Carry on Chaal well	7,356	0.06	0.04
Net Asset Value, year-end including Chaal (fd)	201,996	1.10	1.16
Shares Outstanding (basic and fully diluted)		130,677	174,157

Source: Company reports, Canaccord Adams estimates

What is the potential upside from success at Chaal?

Candax is currently drilling, at approximately 4000 metres, a Jurassic test on a potential large structure on their Chaal permit (60%). With the farm-out of 20% to Mitsubishi, the well is being drilled at essentially no cost to Candax. The Glendower report has assigned probable reserves of 60 Bcf (gross) to the immediate area surrounding the original ABK-1 well. In a previous report, the upside potential for the whole permit ranged from 250 Bcf to as much as 844 Bcf. We have assigned a nominal value, equivalent to US\$3.25/boe for additional upside at Chaal and risked the potential success of a larger reserves by 50% and 20% respectively. Figure 3, summarizes both the risked and unrisked potential to Candax.

Figure 3: Incremental Upside Potential at Chaal

Incremental Potential from Chaal Permit	Unrisked (mm\$)		Risked (mm\$)		Basic Per Share		Diluted Per Share	
	Pre-tax Value	COS (%)	Pre-tax Value	Unrisked	Risked	Unrisked	Risked	
Chaal incremental to 190 Bcf	30	50.0%	15	0.23	0.11	0.17	0.09	
Chaal incremental 190 to 844 Bcf	164	20.0%	33	1.26	0.25	0.94	0.19	
	194		48	1.48	0.37	1.11	0.27	

Source: Canaccord Adams estimates

On a risked basis, the range in upside potential at Chaal is in the order of \$0.09-0.27 per share on a fully diluted basis. Exploration is sometimes binary (success or failure), so the 100% success (unrisked) value based on the reserve scenario above ranges from \$0.17 to \$1.11 per fully diluted share. Clearly, Chaal has the potential to add significant value to Candax.

Valuation Matrix – suggest market is giving little upside to Chaal even on a risked basis

We have summarized our current NAV and the range of upside potential upon various success scenarios at Chaal in Figure 4.

Figure 4: Valuation Matrix – Range of potential NAVUpside from Chaal

Valuation Matrix	Basic	Diluted
Year-end NAV, including Chaal	\$1.10	\$1.16
Risked Upside		
Chaal to 190 Bcf	\$1.21	\$1.25
Chaal to 844 Bcf	\$1.46	\$1.43
Unrisked Upside		
Chaal to 190 Bcf	\$1.33	\$1.33
Chaal to 844 Bcf	\$2.58	\$2.27

Source: Company reports, Canaccord Adams estimates

Warrants – Are they in or out?

In conjunction with its acquisition of assets from Centurion in 2005, Candax issued 82.5 million subscription receipts at a unit price of \$0.80. Each subscription receipt was converted into one common share and one-half of a common share purchase warrant, exercisable until April 14, 2006 at a strike price of \$1.20. With this exercise date closing in, the question becomes will the warrants be exercised? For small shareholders, they will be challenged to exercise warrants if they remain trading at a premium to the stock price (taking into account transaction fees on purchasing shares in the market versus none for exercising the warrant). For large shareholders, the question is less clear, as it may depend on the amount of warrants they own and the ability to purchase the same shares in the open market. For both shareholders, however, the real question is whether an additional investment in Candax has potential merit on its own. We believe the Candax story today is not that dissimilar from when it first went public last year. The company is trading at approximately its NAV, has a solid management team that is actively investigating new growth opportunities in North Africa and the Middle East, and existing assets such as Chaal which have significant upside, that in the best case scenario could double the value of the company. Even in the case that none of the warrants are exercised, Candax can fund its capital programme with cash and cash flow. We believe that while the downside on disappointment at Chaal might be in the order of \$0.25 per share, the upside on success could be over \$1.00 per share. A reasonable businessperson's risk/reward, but perhaps not for all.

Conclusion

We anticipate the market will shortly begin to speculate on the results from Chaal. While it is clear the unrisked potential is significant, we are risking the chance of success in our valuation, waiting for the final results. Our target price increase to \$1.33 (from \$0.83) reflects the updated reserves valuation at year-end plus an average of the risked upside potential from Chaal. We continue to rate Candax shares as a SPECULATIVE BUY.

Investment Risks

In addition to operating risks inherent in oil and gas exploration and production activities, oil and natural gas price realization and production may be lower or higher than our forecast. Collectively these risks could impact the company's valuation and our forecasts.

Other risks include:

- Candax acquired producing assets that are mature with a relatively short reserve life and a high water cut. There is no guarantee that all future volumes of production will occur in sufficient quantities to make existing fields commercial.
- Two major fields (El Bibane and Ezzaouia) currently represent greater than 95% of the proved value of Candax. Should either of these fields experience a production related problem for a prolonged period of time, then there could be a material impact on our financial and valuation estimates.
- Unless new discoveries or assets are acquired, future cash flows from existing assets will decline substantially, which may impact the future valuation of Candax.
- All producing and potential properties are presently located in Tunisia. Although currently seen as a relatively stable government, the company's operations, financial results and valuation could be adversely affected by events beyond its control taken by the current or future governments with respect to policy changes regarding taxation, regulation, and other business environment changes.

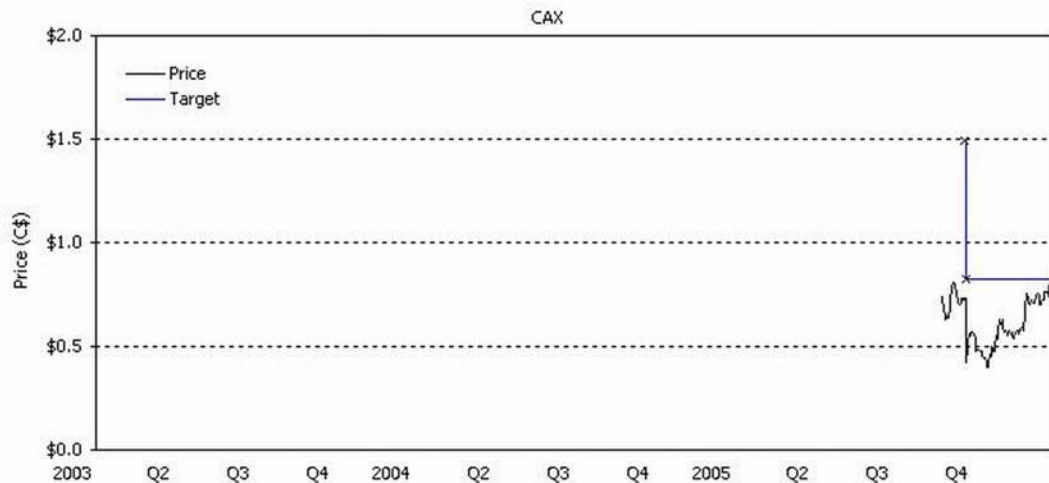
An analyst has visited the issuer's head office in Toronto. No payment or reimbursement was received from the issuer for the related travel costs.

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Price Chart:*



Date	Analyst	Rating	Target Price
1) 09/22/05	TP	Speculative Buy	1.50
2) 09/26/05	TP	Speculative Buy	0.83

* Price charts assume event 1 indicates initiation of coverage or the beginning of the measurement period.

Distribution of Ratings:

Global Stock Ratings
(as of 1 March 2006)

Rating	Coverage Universe		IB Clients	
	#	%	#	%
Buy	275	53.8%	37	37.1%
Speculative Buy	56	11.0%	43	42.9%
Hold	157	30.7%	24	24.2%
Sell	23	4.5%	17	17.4%
	511	100.0%		

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Candax Energy Inc	1A, 2, 3, 7, 11 (John Zaozirny)

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