

Candax Energy Inc.¹ (CAX-T, \$1.05)

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Investment Brief – Candax Energy Inc. is a public junior international oil and gas company that is less than one year old. Run by an internationally experienced management team, Candax is executing a strategy that utilizes all its business and technical expertise to develop and produce oil and gas assets in North Africa and the Middle East.

Rating **SECTOR OUTPERFORM**
(SPECULATIVE)

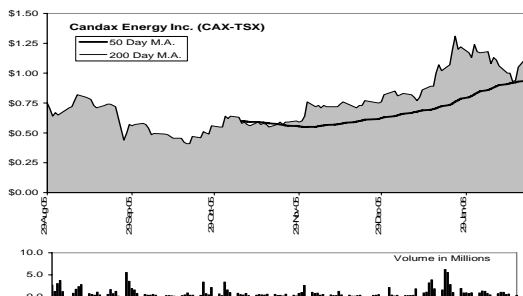
Target Price **\$1.25**

Current Price	\$1.05
Return (incl. dividend)	19%
52-Week High / Low	\$1.38 / \$0.39
Shares O/S	130.7M (basic) / 183.1M (F/D)
Market Capitalization	\$137.2 million
Enterprise Value	\$121.7 million
Daily Volume	934,000
Currency	C\$ unless noted
Company CEO	Michael Wood
Company Web Site	www.candax.com

Financial Forecast	2005E	2006E	'06/'05
Liquids (bbl/d)	583	1,350	132%
Natural Gas (mmcf/d)	1.8	2.3	28%
Total (boe/d)	875	1,725	97%
% Liquids	67%	78%	18%
Cash Flow (\$M)	6.9	23.2	237%
F/D CFPS	\$0.06	\$0.13	127%
F/D EPS	(\$0.01)	\$0.06	(798%)
Capital Expenditures (\$M)	50.7	25.0	
Net Debt (\$M)	(10.4)	(8.6)	(17%)
WTI (US\$/bbl)	\$56.54	\$60.00	6%
AECO (\$/GJ)	\$8.37	\$8.30	(1%)
Valuation Parameters			
Price/CFPS (multiple)	18.8	8.3	(56%)
Price/EPS (multiple)	(126.9)	18.2	(114%)
EV/boe/d	\$139,106	\$70,559	(49%)

Source: Candax Energy and Haywood Securities

Price Performance



Source: Bloomberg

El Bibane Drilling Still Delayed – Revising Production Estimates Down, But Not Target Price

■ Candax has announced a further delay for drilling of El Bibane

The rig for the El Bibane offshore oilfield redevelopment was to be mobilized on January 23, 2006. The drilling rig and barge is still undergoing fabrication and safety certification.

■ El Bibane production not expected until summer

The offshore rig on El Bibane should be mobilized in early Q2/06, allowing production from El Bibane to return by the start of Q3/06. However, this does not impact our valuation of the company. We have adjusted our production estimates to reflect this.

■ Chaal drilling ahead

The exploration well on the Chaal permit was spudded on February 5, 2006. With approximately 50 days of drilling time, there will not likely be news out on the prospect until late March 2006.

Expectations – We expect that the redrilling of the El Bibane field could result in production that exceeds our forecasted numbers. We note that when the field first came onstream in 1998, it produced at rates of almost 5,000 bbl/d from one well. A successful well will likely also be a market catalyst for a higher share price.

Valuation – Our target price of \$1.25 represents our estimate of the Company's risked current net asset value as well as the \$0.25-per-share impact of one successful exploration prospect on its Chaal Permit in Tunisia. An unsuccessful well at Chaal would see a \$0.50 per share reduction in valuation and target price.

Catalysts – Our 2006 forecast is based on the successful work at El Bibane, with an expected oil production rate limited by gas consumption at the Company's Société d'Electricité El Bibane (SEEB) electrical power-generation facility. Better than expected production results or exploration success would have a positive effect on our view of Candax.

Industry & Company Profile	Revisions, Date of Record	Risk Profile	Moderate
Oil and Gas – Candax is a junior oil and gas exploration company focused on oil and natural gas in North Africa and the Middle East.	Rating – New, November 2, 2005 Target – New, November 2, 2005 Forecast – Revised production forecast, February 20, 2006	Forecast Risk Financial Risk Valuation Risk Political Risk	Moderate Moderate Moderate Low

Please see rating structure, risk profile parameters, disclaimers, and notes at the end of this report.

Candax Energy Ltd. (CAX-T)

Rating:	S. OUTPERFORM (SPECULATIVE)		One-Year Target Price:	\$1.25
Current Price	\$1.05		Market Capitalization (\$M)	137.2
Current Shares Outstanding (millions)	130.7	<u>Dilution</u>	Current Net Debt (est) (\$M)	<u>(15.5)</u>
Fully Diluted Shares Outstanding (millions)	183.1	40.1%	Enterprise Value (\$M)	<u>121.7</u>
Book Value (\$M)	66.4		EV / BV (multiple)	1.8

Production	03	04	05E	06E	'05 / '04	'06 / '05
Liquids (bbl/d)			583	1,350		132%
Natural Gas (mmcf/d)			1.8	2.3		28%
Total (boe/d)			875	1,725		97%
Percent Liquids			67%	78%		18%
Percent Natural Gas			33%	22%		(35%)

Revenue (\$M)			13.0	33.6		158%
Cash Flow (\$M)			6.9	23.2		237%
CFPS Basic			\$0.10	\$0.18		73%
CFPS Fully Diluted			\$0.06	\$0.13		127%

		<u>\$/FD Share</u>	<u>% of CF</u>
CFPS Sensitivity	Oil (US\$1.00/bbl)	\$0.003	1%
	Gas (\$0.25/mcf)	\$0.001	0%
	100 bbl/d	\$0.004	2%
	1.0 mmcf/d	\$0.006	3%

Earnings (\$M)			(0.6)	10.6		(1842%)
EPS Basic			\$0.01	\$0.08		1000%
EPS Fully Diluted			(\$0.01)	\$0.06		(798%)
Capital Expenditures (\$M)			50.7	25.0		(51%)
Reinvestment Ratio			736%	108%		(85%)
Net Debt (\$M)			(10.4)	(8.6)		(17%)
Debt / Cash Flow - Trailing (years)			(1.5)	(0.4)		(75%)

Per BOE Analysis (\$/boe)						
Revenue			\$40.79	\$53.36		31%
Operating Expense			\$8.88	\$5.00		(44%)
Net Operating Revenue			\$31.42	\$43.02		37%
G&A			\$9.39	\$6.35		(32%)
Cash Flow			\$20.89	\$36.86		76%
DD&A			\$13.07	\$13.70		5%
Earnings			(\$2.67)	\$16.81		(730%)

Valuation Parameters						
Current Price / F/D CFPS (multiple)			18.8	8.3		(56%)
Debt-Adjusted CF Multiple			16.5	5.2		(68%)
Target Price / F/D CFPS (multiple)			22.4	9.9		(56%)
Current Price / F/D EPS (multiple)			(126.9)	18.2		(114%)
EV / boe/d			\$139,106	\$70,559		(49%)
Target EV / boe/d			\$174,761	\$89,685		(49%)

Price Assumptions						
Crude Oil WTI (US\$/bbl)	\$31.06	\$41.46	\$56.54	\$60.00	36%	6%
Company Average (C\$/bbl)			\$54.31	\$67.50		24%
AECO (C\$/GJ)	\$6.33	\$6.26	\$8.37	\$8.30	34%	(1%)
Company Average (C\$/GJ)			\$0.41	\$0.39		(6%)

Source: Haywood Securities

Investment Thesis

Candax Energy's management is a well-experienced, hands-on team that has founded, run, and sold private and public oil and gas companies. Combining the international expertise of senior management and its advisers with the technical skills of the remainder of the team, Candax should be able to deliver meaningful exploration-driven production growth with risked production potential that could more than double the Company's cash flow. We recommend the Company to investors for this exposure, and rank the overall risk profile as moderate. We are maintaining our rating of Candax Energy Inc. (CAX-T) at SECTOR OUTPERFORM (SPECULATIVE), and our 12-month target price of \$1.25 per share remains unchanged.

Revisions to Estimates

The continuing delays associated with the preparation of the drilling barge for the El Bibane field has necessitated an update to our 2006 production forecast. It was previously assumed that production of 2,000 bbl/d and 6.0 mmcf/d (1,500 bbl/d and 4.5 mmcf/d net) would come on in the first part of Q2, 2006. However, since the barge remains in the final stages of fabrication and safety certification, it is unlikely that we will see the full impact of production from El Bibane until late Q2/06 or early Q3/06.

Summary of Revisions

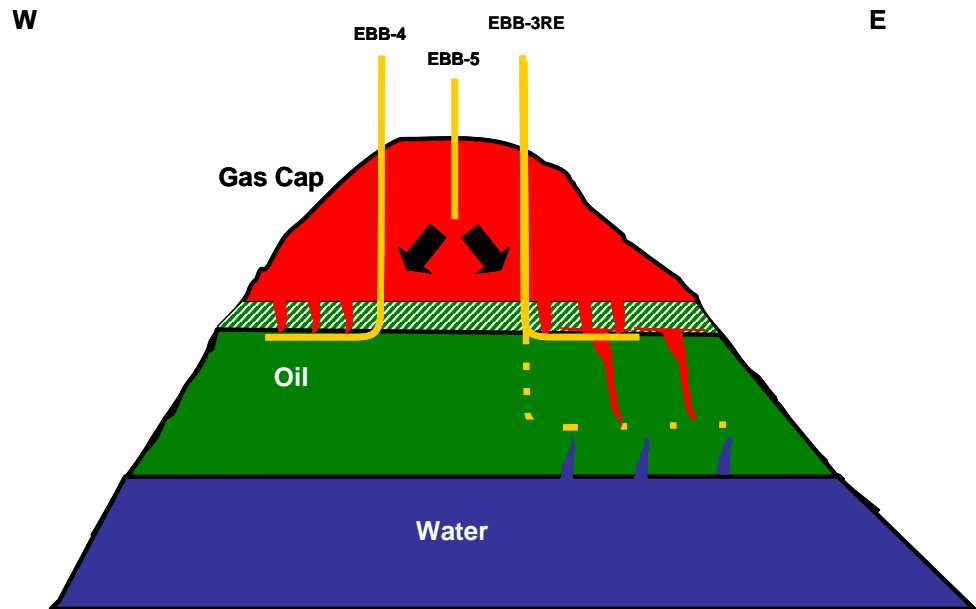
	2005E				2006E			
	Revised	Previous	Change	%	Revised	Previous	Change	%
Production								
Liquids (bbl/d)	583	583	(0)	(0%)	1,350	1,900	(550)	(29%)
Gas (mmcf/d)	1.8	1.8	0.0	0%	2.3	4.4	(2.1)	(49%)
Total (boe/d)	875	875	(0)	(0%)	1,725	2,629	(904)	(34%)
Sales Price								
Liquids Price (\$/bbl)	\$54.31	\$54.88	(\$0.57)	(1%)	\$67.50	\$67.50	(\$0.00)	(0%)
Gas (\$/GJ)	\$0.43	\$0.43	\$0.00	0%	\$0.39	\$0.39	(\$0.00)	(0%)
Equivalent (\$/boe)	\$40.79	\$29.11	\$11.68	40%	\$53.36	\$49.50	\$3.86	8%
Financials								
Cash Flow (\$M)	\$6.9	\$6.9	(\$0.0)	(0%)	\$23.2	\$33.8	(\$10.6)	(31%)
F/D CFPS	\$0.06	\$0.06	(\$0.00)	(7%)	\$0.13	\$0.18	(\$0.06)	(31%)
Earnings (\$M)	(\$0.6)	(\$0.6)	(\$0.0)	1%	\$10.6	\$17.0	(\$6.4)	(38%)
F/D EPS	(\$0.01)	(\$0.01)	(\$0.00)	(26%)	\$0.06	\$0.11	(\$0.05)	(38%)
Net Debt (\$M)	(\$10.4)	(\$17.4)	\$7.0	(40%)	(\$8.6)	(\$24.7)	\$16.1	(65%)
Trailing D/CF (multiple)	(1.5)	(2.5)	1.0	(40%)	(0.4)	(0.7)	0.4	(49%)
Capital Expenditures (\$M)	\$50.7	\$50.7	\$0.0	0%	\$25.0	\$25.0	\$0.0	0%

Source: Candax Energy and Haywood Securities

Corporate Update

Candax has announced further delay to the El Bibane field redevelopment. Further to the press release of February 7, 2006, Candax announced on February 20, 2006 that they are still experiencing contractor delays regarding the mobilization of their jack-up drilling rig for the El Bibane offshore oil field. According to the company, these delays are due to some issues in the final stages of fabrication and safety certification. The time slippage is not costing Candax additional money and they are actively working with the drilling contractor to have the matter resolved.

El Bibane Field Schematic Cross Section



Source: Candax Energy

Now that the schedule is better known, we have revised our 2006 production estimates to reflect this timing. Full production from the field should be back sometime in late Q2/06 or early Q3/06, but we expect that a successful well at EBB-4 could be brought onstream once it has been completed. The result would be partial production from the field prior to the redrilling of the EBB-3 well.

As we highlighted in our previous report, owing to the close proximity of the new horizontal wells to the gas cap of El Bibane, much more gas will be produced at El Bibane than from the previous well. Therefore, full field production is contingent on the drilling of the gas injection well at EBB-5, as well as on the completion of the required surface facilities, as gas consumption at the SEEB power plant is limited to approximately 6.5 mmcf./d. The full field redevelopment is expected to cost Candax approximately US\$20 million for its 74% interest. The Company is fully funded for this expenditure.

Drilling continues on the Chaal Permit. As announced on February 7, 2006, the exploration well on the Chaal Permit was spud on February 4, 2006. The well is expected to take approximately 50 days to reach total depth of 4,500 metres. Testing could require up to an additional 30 days. However, it is likely

that with a successful well, further news from the company would come out around the end of March. This could propel the company's share price above the exercise price of the warrants of \$1.20. Full exercise of these warrants would bring in just under \$50 million.

As previously reported, the exploration well at Chaal is a joint venture between Candax and Mitsubishi. They are drilling a twin of a well, ABK1, that in 1963 tested gas and condensate from a 150-metre hydrocarbon section on the Permit. The ABK1 well tested natural gas and varying amounts of natural gas liquids at rates up to 3.0 mmcf/d, and condensate volumes that ranged from 25 bbl/mmcf to 80 bbl/mmcf over an extended test period. This was followed by a second well which found a similar hydrocarbon column but was left untested. It is believed that the company that drilled the wells was looking for oil and gave up the block after the two wells proved unsuccessful.

Candax is drilling the twin of the ABK1 discovery well to confirm the old production-test results, including flow rates and condensate ratios. Gross reserves have been assigned of approximately 60 bcf to the structure identified by the ABK1 and ABK2 wells. However, the full structure could be 200 bcf to 500 bcf in size. A successful well at Chaal-1 would result in a second well drilled immediately on the prospect. Candax has the rig for one well plus an option to drill a second well.

Valuation

In the following table, we summarize a series of calculations that reflect the estimated net asset value for the Company. We note that the last reserves report was done on December 31, 2004, but do not expect new reserves or values from Candax until late in Q1/06. We also note that the table does not attribute any value to the Al Manzah field, which came onstream in late 2005. However, we have included the original reserves report data, which have been adjusted for Candax's revised Chaal Permit interest of 60%, and two price scenarios using our current price outlook (2005 US\$57/bbl, 2006 US\$ 60/bbl, and 2007 US\$ 55/bbl), plus a long-term price as noted. As well, we have included Candax's comparative calculation of NAV using its price outlook, also adjusted for the revised working interest in the Chaal Permit.

Net Asset Value

Estimated Net Asset Value (Summary)	Net Reserves Dec 31, 2004 (Mboe)	Commodity-Price Scenarios			
		Dec 31/04	US\$50/bbl	US\$45/bbl	Candax
		NPV10% Value (C\$M)	NPV10% Value (C\$M)	NPV10% Value (C\$M)	NPV10% Value (C\$M)
Tunisian Assets (Centurion acquisition - Ryder Scott Report)*	5.1	38.3	84.9	78.3	55.0
Chaal Permit (Glendower International Limited Report)	6.0	11.3	33.0	30.4	29.6
Cash in Bank	0.0	25.0	25.0	25.0	25.0
	11.1	\$74.6	\$142.9	\$133.7	\$109.6
Shares Outstanding					
Basic	130.7				
Fully Diluted	183.2				
Net Asset Value per Share					
Basic		\$0.57	\$1.09	\$1.02	\$0.84
Fully Diluted		\$0.73	\$1.10	\$1.05	\$0.92
41.3 Million Warrants @ \$1.20/Share = \$49.6M					
11.2 Million Options @ \$0.80/Share = \$9.0M					

* Note that the Centurion assets were evaluated in US\$ and converted at our current exchange rate of \$0.83.

Source: Candax Energy and Haywood Securities

Based on the above summary, estimates of net asset value range from \$0.84 to \$1.09 per basic share. We note that under the current commodity-price scenario, the assumptions used generate little difference in NAV, owing to the impact of high prices used over the next three years.

However, we note the potential for upside to this evaluation based on the size of the Chaal Permit and future exploration potential. In our view, unexplored risked upside potential on the Chaal Permit should have a value equivalent to the reserves value assigned to the known discovery on the block (the ABK wells). This value represents approximately \$30 million or \$0.25 per basic share. Should the possible reserves, up to 844 bcf, associated with the ABK wells be found to be real, the impact on Candax could result in a doubling of the Company's asset value—significantly higher than our risked reserves assumption.

Our target price represents our estimation of the net asset value of the current assets in the Company. Using \$1.00 per basic share from existing reserves and an incremental \$0.25 per share for undetermined exploration upside potential on the Chaal Permit, we establish a 12- to 18-month target price of \$1.25. We note, however, that exploration drilling on the Chaal Permit, as well as other potential opportunities, will result in share-price volatility—of which investors should be mindful along with the likely short-term buying or selling opportunities presented.

Should the Chaal well come up dry, this would likely eliminate the short-term potential of this prospect and would see a \$0.50/share decrease in our value and target price for Candax

For comparative purposes, we are including a table of international oil and gas producers. While not based on cash flow, we note that our target price for Candax derived from a multiple of cash flow is in line with companies of a similar type in the current market.

Valuation Comparison Table

	<u>Candax</u> ¹ CAX-T (Based on 2007 estimates)	<u>Oilexco</u> ^{1,2,4} OIL-T	<u>PanOcean</u> ^{1,2,4,6} POC.SV.B-T (US\$ except Share & Target Price)	<u>TransGlobe</u> ¹ TGL-T (US\$ except Share & Target Price)
Production (2006 estimate)				
Oil and NGL (bbl/d)	1,350	26,997	15,001	4,500
Natural Gas (mmcf/d)	2.3	0.0	0.0	7.6
Total (boe/d)	1,725	26,998	15,001	5,767
Share Price (Feb 17/06)	\$1.05	\$3.70	\$32.00	\$6.62
2006 F/D CFPS	\$0.13	\$2.30	\$5.97	\$0.79
Current P/CF Multiple (times)	8.3	1.6	4.4	6.9
Target Price	\$1.25	\$8.00	\$50.00	\$8.50
Target P/CF Multiple (times)	9.9	3.5	7.0	8.9
Current Shares Outstanding (millions)	130.7	193.4	24.7	58.5
F/D Shares Outstanding (millions)	183.1	212.8	26.8	61.4
2006 Cash Flow (\$M)	23	490	152	48
2006 Capital Expenditures (\$M)	25	200	112	45
2006 Net Debt (\$M)	(9)	(277)	(7)	4
Enterprise Value (\$M)	122	582	636	329
Current EV / boe/d	\$70,559	\$21,562	\$42,399	\$57,071
Target EV / boe/d	\$89,685	\$52,002	\$80,995	\$84,838

Source: Company data and Haywood Securities

Rating Structure

SECTOR OUTPERFORM – Haywood’s top rating category. The analyst believes that the security will outperform its sector. Furthermore, the shares are forecast to provide attractive returns measured against alternative investments when considering risk profiles. The rating carries a minimum total return threshold of 15% for equities and 12% for trusts. The rating applies to companies that have tangible underlying assets that give a measure of support to the market valuation. The rating category considers both the absolute and relative values in assigning the highest rating on the security. **SECTOR OUTPERFORM (SPECULATIVE)** – Investment for risk accounts only. The security has strong upside although its risk profile leaves the potential for significant downside. Return expectations should generally exceed those of **SECTOR OUTPERFORM** to allow for the additional risk. Companies in this rating category carry greater financial and/or execution risk without tangible assets for underlying support. **SECTOR PERFORM** – The analyst believes that the security will trade with tight correlation to its underlying sector. Furthermore, the target price (together with any anticipated distributions) is at or above the market price, and forecast risk-adjusted returns are attractive relative to alternative investments. **SECTOR UNDERPERFORM** – Investors are advised to sell the security or hold alternative securities within the sector. Stocks in this category are expected to underperform relative to their sector. The category also represents stocks with unattractive forecast returns relative to alternative investments. **RESEARCH COMMENT** – An analyst comment about an issuer event that does not include a rating. **COVERAGE DROPPED** – Haywood Securities will no longer cover the issuer. Haywood will provide notice to clients whenever coverage of an issuer is discontinued. The termination of coverage will not occur unless clients have been provided with advice relating to positions they may still hold, such as a recommendation to sell their securities.

Risk Profile Parameters – Oil and Gas Sector

Forecast Risk: High – Haywood forecasts are below guidance. The Company has a history of missing targets and/or Haywood expects guidance to be lowered. Limited hedging increases commodity risk beyond peers. To raise expectations requires higher commodity prices or production that is ahead of guidance. **Moderate** – Haywood forecasts are generally in line with guidance. The Company has a history of meeting or exceeding guidance. Forecasts are consistent with current commodity pricing and production guidance. Hedging practices are in line with peers. **Low** – Haywood forecasts exceed guidance. The Company has a history of meeting or exceeding guidance. Forecasts allow for modestly lower commodity pricing or production levels. Commodity hedging lowers volatility relative to peers.

Financial Risk: High – The capital expenditure program in the current year or the next year of the forecast is not fully funded but requires additional debt and/or equity financing. This categorization does not necessarily predict whether the additional funds will be raised. **Moderate** – The capital expenditure program in the current year or the next year is fully funded with cash flow and limited debt. **Low** – The capital expenditure program in the current year or the next year is fully funded with cash flow and no new debt.

Political Risk: High – Properties are located in an area with limited petroleum industry activity or infrastructure. An environment unfriendly to the industry makes obtaining permits to drill or produce hydrocarbons challenging. Significant government or local opposition exists. **Moderate** – Properties are located in an area with minimal petroleum industry activity or infrastructure. An environment friendly to the industry makes obtaining permits relatively straightforward. All levels of government are considered indifferent to hydrocarbon activity. **Low** – Properties are located in an area with established petroleum exploration and development activity. Oil and gas Production Sharing Agreements or Exploration Permits are in hand. Government at all levels supports the sector.

Valuation Risk: High – The current valuation is at the high end of historic levels and/or at a premium to peers. The valuation reflects continued production growth and/or continuing strong commodity prices or further appreciation. Where applicable, the market capitalization exceeds the NAV by more than 30%. **Moderate** – The current valuation is within historic ranges and generally consistent with peers. The valuation reflects reasonable production growth and/or commodity price appreciation. Where applicable, the market capitalization exceeds the NAV by 15% to 30%. **Low** – The current valuation is at the low end of historic ranges and/or at a discount to peer valuations. The valuation reflects limited production growth and/or no commodity price appreciation. Where applicable, the market capitalization exceeds the NAV by less than 15% or falls below the capitalization.

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This report has been approved by HSUK for the purposes of section 21 of the UK’s Financial Services and Markets Act 2000. If you wish to contact HSUK please email Bonnie Chang at bchang@haywood.com.

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