

Candax Energy Inc. (CAX-T, \$0.63)

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Investment Brief – Candax Energy Inc. is a public junior international oil and gas company that is approximately 1 year old. Run by an internationally experienced management team, Candax is carrying out a strategy that uses all its business and technical expertise to develop and produce oil and gas assets in North Africa and the Middle East.

Rating **SECTOR OUTPERFORM**
Target Price **\$1.15**
Risk **SPECULATIVE**

Risk Forecast	Moderate
Financial Risk	High
Valuation Risk	Moderate
Political Risk	Low

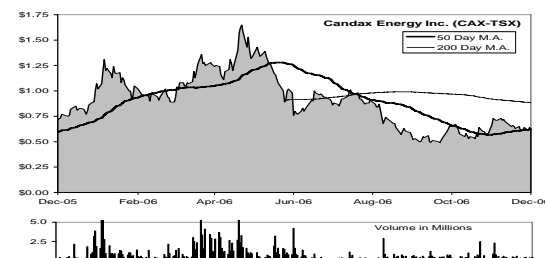
Current Price	\$0.63
Return (incl. dividend)	83%
52-Week High / Low	\$1.73 / \$0.46
Shares O/S	168.9M (basic) / 180.4M (F/D)
Market Capitalization	\$106.4 million
Enterprise Value	\$67.2 million
Daily Volume (3-mo. avg.)	477,000
Currency	C\$ unless noted

Financial Forecast	2005	2006E	2007E	2007E/2006E
Liquids (bbl/d)	587	600	1,400	133%
Natural Gas (mmcf/d)	1.8	0.0	2.8	
Total (boe/d)	879	600	1,874	212%
% Liquids	67%	100%	75%	(25%)
Cash Flow (\$M)	5.3	8.2	28.7	252%
F/D CFPS	\$0.04	\$0.04	\$0.16	263%
F/D EPS	(\$0.03)	(\$0.00)	\$0.10	(8752%)
Capital Expenditures (\$M)	45.5	25.0	29.0	16%
Net Debt (\$M)	(11.4)	(29.7)	(29.5)	(1%)
WTI (US\$/bbl)	\$56.54	\$66.50	\$65.00	(2%)
AECO (\$/GJ)	\$8.37	\$6.20	\$6.30	2%

Valuation Parameters	2005	2006E	2007E	2007E/2006E
Price/CFPS (multiple)	16.4	14.3	4.0	(72%)
Price/EPS (multiple)	(18.9)	(552.1)	6.4	(101%)
EV/boe/d		\$111,978	\$35,861	(68%)

Source: Candax Energy and Haywood Securities

Price Performance



Source: Bloomberg

2007 Budget and Corporate Update – El Bibane Still Delayed. No Change to Target or Rating

■ Candax Board approves US\$25.4 million budget for 2007

The budget includes firm expenditures on the El Bibane redevelopment project, as well as workovers and a waterflood pilot for the Ezzaouia shallow oil project. Also included are contingent expenditures for a deep test of the multi-Tcf gas prospect at Ezzaouia, as well as continued work on the Chaal gas prospect. Candax also announced a new Production Sharing Contract for an oil prospect on the island of Madagascar.

■ More delays at El Bibane – yet again

While drilling was expected to start at El Bibane before the end of 2006, it is yet again delayed by the continuing saga of equipment availability and the use of inappropriate equipment on location. While the bulk of the drilling equipment is now located in Zarzis, Tunisia, a further review of the drilling assembly has determined that a floating mud barge is not suitable for drilling in the Mediterranean. As a result, Candax is currently looking to source a jack-up mud barge. The management of Candax is hopeful of beginning drilling before the end of Q1/07, but we must ask the question “What else?” is going to be found wanting before the drilling at El Bibane actually starts.

■ Target and recommendation remain unchanged

Redevelopment of the El Bibane prospect provides Candax with increased cash flow in 2007. However, the upside in this story remains the deep potential from the Company’s Tunisian exploration prospects.

Expectations – We expect that the share price of Candax will continue to languish, absent any near-term catalysts. However, start of the drilling at El Bibane could provide a small lift to the Company’s share price early in 2007. We would also expect that at some point in the next 12 months, Candax will be able to close on one of the international production/development projects, but we have not factored this possibility into our valuation or production estimates.

Valuation – Our target price of \$1.15 includes the engineering value of 36 bcf proven plus probable net to Candax from Chaal, plus the Company’s current assets. In the event that Chaal ultimately proves to be uneconomic, we still believe that our current valuation of Candax is supported by the Company’s remaining assets and cash-flow prospects.

Catalysts – Our 2007 forecast is based on successful redevelopment at El Bibane, with an expected oil production rate limited by the reservoir characteristics. Better than expected production results or exploration success would have a positive effect on our view of Candax.

Industry & Company Profile

Oil and Gas – Candax is a junior oil and gas exploration company focused on oil and natural gas exploration and production in North Africa and the Middle East.

Revisions, Date of Record

Rating – SECTOR OUTPERFORM from Under Review, June 21, 2006
 Target – \$1.15 from Under Review, June 21, 2006
 Forecast – Revised 2006 and 2007 estimates, December 20, 2006

Company CEO Michael Wood

Company Web Site www.candax.com

Please see rating structure, important disclosures, risk profile parameters, disclaimers, and notes on pages 7 - 10 of this report.

Candax Energy Inc. (CAX-T)

Rating:	SECTOR OUTPERFORM		One-Year Target Price:		\$1.15	
Current Price	\$0.63		Market Capitalization (\$M)		106.4	
Current Shares Outstanding (million)	168.9	<u>Dilution</u>	Current Net Debt (est.) (\$M)		(39.2)	
Fully Diluted Shares Outstanding (million)	180.4	6.8%	Enterprise Value (\$M)		67.2	
Book Value (\$M)	104.0		EV / BV (times)		0.6	
Production						
	2004	2005	2006E	2007E	2006E / 2005	2007E / 2006E
Liquids (bbl/d)		587	600	1,400	2%	133%
Natural Gas (mmcf/d)		1.8	0.0	2.8	(100%)	
Total (boe/d)		879	600	1,874	(32%)	212%
Percent Liquids		67%	100%	75%	50%	(25%)
Percent Natural Gas		33%	0%	25%	(100%)	
Revenue (\$M)						
		12.9	15.3	37.9	19%	148%
Cash Flow (\$M)						
		5.3	8.2	28.7	54%	252%
CFPS Basic		\$0.06	\$0.06	\$0.17	(9%)	193%
CFPS Fully Diluted		\$0.04	\$0.04	\$0.16	14%	263%
CFPS Sensitivity						
	Oil (US\$1.00/bbl)			\$/FD Share	% of CF	
	Gas (\$0.25/mcf)			\$0.003	1%	
	100 bbl/d			\$0.001	1%	
	1.0 mmcf/d			\$0.004	2%	
				\$0.006	3%	
Earnings (\$M)						
		(1.5)	0.1	17.8	(104%)	32700%
EPS Basic		(\$0.02)	\$0.00	\$0.11	(117%)	3439%
EPS Fully Diluted		(\$0.03)	(\$0.00)	\$0.10	(97%)	(8752%)
Capital Expenditures (\$M)						
		45.5	25.0	29.0	(45%)	16%
Reinvestment Ratio		856%	306%	101%	(64%)	(67%)
Net Debt (\$M)						
		(11.4)	(29.7)	(29.5)	161%	(1%)
Debt / Cash Flow - Trailing (years)		(2.1)	(3.6)	(1.0)	70%	(72%)
Per BOE Analysis (\$/boe)						
		\$40.15	\$69.81	\$55.46	74%	(21%)
Operating/Transportation Expense		\$8.36	\$16.94	\$7.00	103%	(59%)
Net Operating Revenue		\$31.79	\$52.87	\$44.30	66%	(16%)
G&A		\$15.15	\$18.26	\$6.43	21%	(65%)
Cash Flow		\$11.30	\$30.63	\$42.04	171%	37%
DD&A		\$12.94	\$22.10	\$15.00	71%	(32%)
Earnings		(\$7.95)	(\$8.07)	\$26.05	2%	(423%)
Valuation Parameters						
Current Price / F/D CFPS (multiple)		16.4	14.3	4.0	(13%)	(72%)
Debt-Adjusted CF Multiple			7.9	3.0		(63%)
Target Price / F/D CFPS (multiple)		29.9	26.2	7.2	(13%)	(72%)
Current Price / F/D EPS (multiple)		(18.9)	(552.1)	6.4	2827%	(101%)
EV / boe/d			\$111,978	\$35,861		(68%)
Target EV / boe/d			\$274,132	\$87,927		(68%)
Price Assumptions						
Crude Oil WTI (US\$/bbl)	\$41.46	\$56.54	\$66.50	\$65.00	18%	(2%)
Company Average (C\$/bbl)		\$56.93	\$69.65	\$73.34	22%	5%
AECO (C\$/GJ)	\$6.26	\$8.37	\$6.20	\$6.30	(26%)	2%
Company Average (C\$/GJ)		\$0.41	\$0.41	\$0.41	(1%)	1%

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 speculative. We are maintaining our SECTOR OUTPERFORM rating of Candax Energy Inc. (CAX-T) and our 12-month target price of \$1.15 per share.

Revisions to Estimates

Further to Candax's corporate update on December 20, 2006, we have revised our estimates as shown below. We had previously assumed that 2007 capital expenditures would equal 2007 cash flow, but with the Company's official program now approved, we have adjusted our estimates as noted below. Major changes include a further delay to full production from El Bibane extending into mid-2007, as drilling should begin before the end of Q1/07. Also, the Company is implementing a workover program at the shallow Ezzaouia oil field, which will include a pilot waterflood project. Candax expects that the workover program will increase field production by approximately 500 bbl/d (approximately 150 bbl/d net to Candax) starting around the end of Q1/07.

Revision of 2006 and 2007 Estimates

	2006E				2007E			
	Revised	Previous	Change	%	Revised	Previous	Change	%
Production								
Liquids (bbl/d)	600	680	(80)	(12%)	1,400	1,685	(285)	(17%)
Gas (mmcf/d)	0.0	0.0	0.0	0%	2.8	3.6	(0.8)	(22%)
Total (boe/d)	600	680	(80)	(12%)	1,874	2,292	(418)	(18%)
Sales Price								
Liquids Price (\$/bbl)	\$69.65	\$70.99	(\$1.34)	(2%)	\$73.34	\$73.89	(\$0.54)	(1%)
Gas (\$/GJ)	\$0.41	\$0.41	(\$0.00)	(0%)	\$0.41	\$0.40	\$0.01	3%
Equivalent (\$/boe)	\$69.81	\$71.46	(\$1.66)	(2%)	\$55.46	\$55.00	\$0.47	1%
Financials								
Cash Flow (\$M)	\$8.2	\$10.8	(\$2.6)	(24%)	\$28.7	\$35.7	(\$6.9)	(19%)
F/D CFPS	\$0.04	\$0.06	(\$0.01)	(25%)	\$0.16	\$0.20	(\$0.04)	(19%)
Earnings (\$M)	\$0.1	\$2.7	(\$2.6)	(98%)	\$17.8	\$22.3	(\$4.5)	(20%)
F/D EPS	(\$0.00)	\$0.01	(\$0.02)	(108%)	\$0.10	\$0.12	(\$0.02)	(20%)
Net Debt (\$M)	(\$29.7)	(\$39.6)	\$9.9	(25%)	(\$29.5)	(\$40.3)	\$10.8	(27%)
Trailing D/CF (multiple)	(3.6)	(3.7)	0.0	(1%)	(1.0)	(1.1)	0.1	(9%)
Capital Expenditures (\$M)	\$25.0	\$25.0	\$0.0	0%	\$29.0	\$35.0	(\$6.0)	(17%)

Source: Haywood Securities

Corporate Update

And the delays continue with the redevelopment of the El Bibane oil field. While the drilling barge is in Zarzis, Tunisia, and is awaiting final certification before being deployed at the El Bibane location, yet another equipment-related delay has been revealed. An ancillary barge that was going to be used for the drilling mud system at El Bibane has now been determined to be inappropriate for use in the Mediterranean. The result has been a further delay in mobilizing the drilling system to El Bibane. Management is now working to locate a jack-up barge for the drilling mud system and is hopeful that the drilling will begin before the end of Q1/07. We can't help but wonder why it took until now to decide that a barge was not suitable for a drilling mud system, and what other surprises may be in store before drilling at El Bibane actually starts.

Candax intends to drill a total of three wells at El Bibane. The first well at El Bibane (EBB-4) is a new horizontal drilling location on the northwest flank of the El Bibane structure. This well is intended to be brought onstream as soon as possible after drilling and completion, before drilling the remaining two wells. The second well at EBB-3RE is a redrill of the original production well. Recall that this well's horizontal section is being redrilled closer to the estimated location of the current gas-oil contact within the reservoir. The final well at EBB-5 is a vertical well to be drilled as a natural gas injection well.

Included in the field redevelopment is the installation of onshore gas compression and separation facilities. We understand that this work has proceeded approximately on schedule and will be ready when the El Bibane wells are finally drilled and brought onstream. The El Bibane field natural gas production is primarily processed in an onshore gas-fired electrical generation facility. However the facility is capable of burning only approximately 6.0 mmcf/d. With the field redevelopment, the two new horizontal wells are expected to produce 20 mmcf/d or more. As a result, Candax will reinject gas into the El Bibane reservoir. The gas reinjection will allow Candax to produce the El Bibane oil at optimal production rates without being constrained by gas consumption.

Candax has announced a new Production Sharing Contract (PSC) on the island of Madagascar. Candax has a 60% interest and is the operator of Block 1101. The PSC is awaiting ratification by the Madagascar president, which is expected shortly. Block 1101 is an onshore block on the northwestern tip of Madagascar and encompasses approximately 15,000 square kilometres of land. Candax and its 40% Dubai-based partner have a 2-year Phase I program commitment that includes geological and geochemical studies, some 2D seismic, and one well, to total approximately US\$1.5 million. This is not a high-impact block, but is close to known hydrocarbon seeps in the area and could provide some relatively lower risk oil production if Candax is successful in discovering any oil accumulations on this block.

As part of the 2007 budget, Candax has a number of high-impact projects that may be drilled. Included is the deep, multi-Tcf gas prospect at Ezzaouia and the continued redevelopment at Chaal.

There was no additional news on the Chaal natural gas prospect. Candax and its partners are continuing a technical review of the appraisal and development drilling options available for the Chaal prospect.

Given the time required to investigate and assess the options, then book a drilling date with a rig contractor, we believe it will be late 2007 before Candax returns to the Chaal prospect. While management has given no further indication of the timing of Chaal, previous corporate presentations by Candax had indicated that a new rig may be brought into the country to drill at both Chaal and the Company's potentially high-impact deep-gas prospect at Ezzaouia. Drilling the deep Triassic prospect at Ezzaouia requires reaching an agreement with the Tunisian government about a change in the cost sharing of the well. Should reaching an agreement drive the timing of a new rig for Chaal, we estimate that a further Chaal evaluation well could be delayed until the middle or possibly second half of 2007.

Valuation

Should the Chaal well ultimately prove to be uneconomic, the potential of the prospect would be eliminated, and our value and target price for Candax would decrease marginally. However, until such a possibility is definitely established, now pushed to late 2007, we are maintaining our target price and recommendation. Also, should a prospect size of more than 120 bcf be proven at Chaal, it would cause us to review our target price with a positive view. We also note that while the market was looking to the Chaal prospect as a catalyst to value Candax, our assumption of cash flow in 2007 from the Company's current assets supports our target price.

The redevelopment of El Bibane should be underway before the end of Q1/07. Our current production estimates for 2007 include only 1,000 bbl/d from each of the two redeveloped El Bibane wells, with full field production anticipated by July. Should the production prove to be more in line with management's estimates of as much as 2,000 bbl/d per well, our annualized cash flow per share could increase to as much as \$0.35 per fully diluted share.

Valuation Comparison Table

	<u>Candax</u>	<u>Oilexco</u>	<u>TransGlobe</u>
	CAX-T	OIL-T	TGL-T
		(US\$ except Share & Target Price)	(US\$ except Share & Target Price)
Production (2007 estimate)			
Oil and NGL (bbl/d)	1,400	30,487	4,450
Natural Gas (mmcf/d)	2.8	0.0	9.0
Total (boe/d)	1,874	30,492	5,950
Share Price (December 20, 2006)	\$0.63	\$6.94	\$5.80
2007 F/D CFPS	\$0.16	\$2.74	\$0.92
Current P/CF Multiple (times)	4.0	2.3	5.7
Current P/DACF Multiple (times)	3.0	1.7	4.1
Target Price	\$1.15	\$12.00	\$8.50
Target P/CF Multiple (times)	7.2	3.9	8.3
Current Shares Outstanding (millions)	168.9	197.0	58.7
F/D Shares Outstanding (millions)	180.4	217.0	62.0
2007 Cash Flow (\$M)	28.7	593.4	56.5
2007 Capital Expenditures (\$M)	29.0	410.0	55.0
2007 Net Debt (\$M)	(29.5)	24.9	(3.3)
Enterprise Value (\$M)	67.2	1378.0	283.8
Current EV / boe/d	\$35,861	\$45,192	\$47,702
Target EV / boe/d	\$87,927	\$69,739	\$74,112
EV / EBITDA	2.6	2.2	4.0
Target EV / EBITDA	6.0	4.1	7.0

Source: Company data and Haywood Securities

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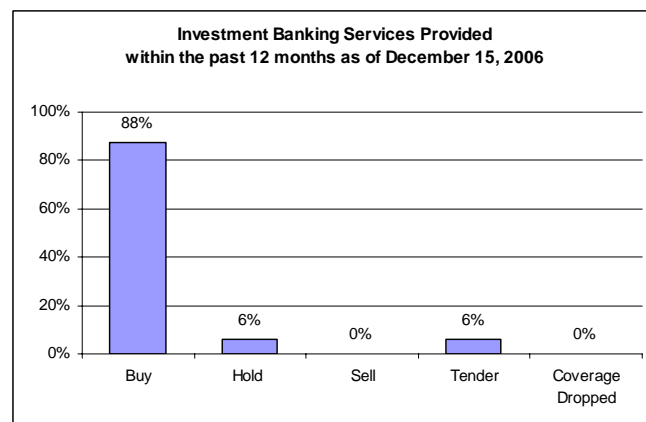
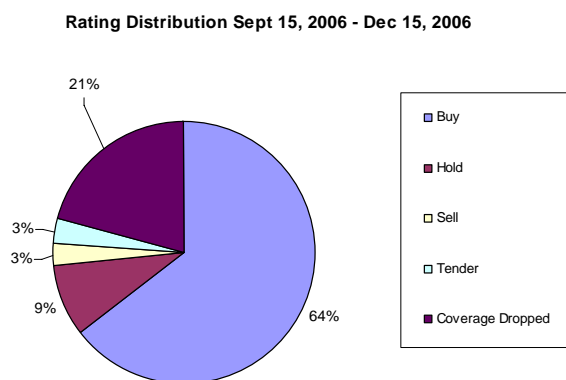
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Changes in the rates of exchange between currencies may cause the value of your investment to fluctuate.

If you are a UK resident private customer and you propose to do business with Haywood Securities Inc, please take note of the following:

Any investment services undertaken on your behalf by Haywood Securities Inc are not covered by the rules and regulations made for the protection of private investors in the UK. This means that you will not have the benefit of rights designed to protect investors under the Financial Services and Markets Act 2000 and under the rules of the Financial Services Authority (“FSA”). In particular, you will not benefit from the following UK protections:

- (a) the right to claim through the UK’s Financial Services Compensation Scheme for losses resulting in the unlikely event of our default;
- (b) in the event of a dispute, access to the UK’s Financial Ombudsman Service;
- (c) protection of money held on your behalf under the FSA’s Client Money Rules.