International Energy

Candax Energy Inc. (CAX-T; $1.40)

Recommendation: Market Perform

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WELLINGTON WEST Capital Markets Inc.

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All values in C$ unless otherwise noted.

Current Price	$1.40
Target Price (12-Month)	$1.20
Implied Capital Gain	-10 %

Changes

	Old	New
EPS 2006E	$0.09	unchanged
DACF/sh FD 2006E	$0.14	$0.17
EPS 2007E	$0.18	$0.17
DACF/sh FD 2007E	$0.29	unchanged
Recommendation	Market Perform	unchanged
Target Price	$1.20	unchanged

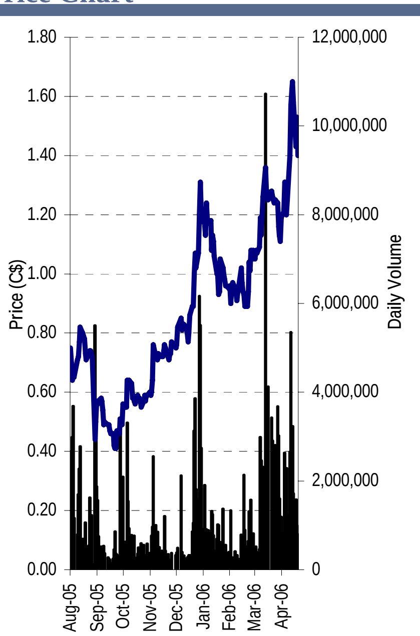
Company Profile

Candax Energy Inc. is a Canadian junior E&P with both producing and exploration assets in Tunisia. Candax began trading on the TSX on August 29th 2005 under the symbol CAX. The company is expected to be producing more than 2,000 boepd by August 2006 and is drilling the Chaal exploration well with partner Mitsubishi.

Chaal test results kick off a summer of catalysts – watch for material acquisition

- **Q1 production averaged 650 bopd; expect Q3 exit at 2,650 bopd**
  Production optimization of acquired properties generated $0.01 EPS. El Bibane operations expected to commence in June and add 2000 bopd.
- **Chaal-1 test results expected at end-May; must exceed 5 mmcf/d**
  Significant increase in net pay and the presence of overpressures provide confidence in ability of Chaal-1 to flow at commercial rates from 3 zones.
- **Potential for rapid growth through accretive acquisition in mid-'06**
  Candax currently has $70 mm in cash against an expected CAPEX of $42 mm. We estimate organic growth to produce $51 mm in cash flow in '07.
- **Maintain $1.20 target and Market Perform recommendation.**
  We estimate a risked portfolio NPV of $1.16/share including 151 Bcf of net risked reserves at Chaal. Currently trading at just 4x 2007 EV/DACF.

Price Chart



Source: PCQuote

Financial Summary

Shares O/S (M FD)	181.2	52-Week Trading Range	$0.39-$1.73
Market Capitalization (M)	$254	Average Weekly Volume	5,315,702
Net Debt - 2005E (M)	-$58	Market Float (M)	$169
Enterprise Value (M)	$196	Risked Portfolio NPV/share (FD)	$1.16

Forecasts	2005	2006E	2007E
Production (boe/d)	815	1,986	4,209
% gas	57%	28%	32%
Wtd Ave Realized Price ($/boe)	$65.6	$58.1	$51.6
CapEx (M)	$48.1	$41.9	$50.2
Oil and Gas Revenue (M)	$12.9	$42.1	$79.3
Total Revenue (M)	$13.9	$47.0	$85.6
Debt Adjusted Cash Flow (M)	$7.4	$28.8	$51.0
Shares Outstanding (M)	77.1	170.0	173.8
DACFPS (FD)	$0.04	$0.17	$0.29
EPS (FD)	($0.01)	$0.09	$0.17
Valuation	**2005**	**2006E**	**2007E**
EV/DACF	36.9x	7.1x	3.9x
EV/BOE/d (per unit production)	$240,643	$98,720	$46,577
P/E	(121.8x)	15.2x	8.0x

Source: Company reports, Wellington West Capital Markets Inc.

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Investment Summary and Outlook

Since late 2004 Candax has shown the ability to leverage relationships and gain access to high quality assets under favourable terms while minimizing their capital at risk. World-class technical competence has allowed short-term production issues in mature fields to be dealt with swiftly, strengthening the long-term asset value. A stable production base in Tunisia can be enhanced with success in high-impact exploration prospects. We expect that Candax will seize opportunities for low-risk growth throughout the region with further acquisitions and farm-in agreements.

All eyes on Chaal ahead of El Bibane operations

Q1 highlights: production growth, delays at El Bibane, and $65 million in cash

Due to uneven lifting schedules Candax sold 134,900 bbls in Q1 despite production of just 58,850 bbls. We estimate true production averaged 647 boepd in Q1 up from 2005 exit rate of 575 boepd. Sales volumes are expected to remain lumpy on a quarterly basis, becoming more regular at higher rates of production. Production growth has come through optimization of existing fields and restarting modest production at Al Manzah. We anticipate Candax will be able to add up to 2,000 bopd of production from El Bibane in July to generate $0.10/share of fully diluted cash flow in the second half of 2006.

The shut-in at El Bibane has forced the SEEB partnership to default on a limited recourse long-term debt payment. The group was required to make a principal and interest payment of $0.7 million on or before May 1, 2006 and an additional payment of $0.8 million the following day. Candax reported that negotiations with lenders are currently on-going but that the company is prepared to fund their 50% share of the debt repayments if required to March 2007 out of a $1.8 million deposit with the lender.

Construction delays at El Bibane have forced us to revise our estimated start-up date to July. We continue to believe the redevelopment will strengthen the asset and add significant value, but have pushed back 1 month of cash flow in our forecasts. Current plans are expected to boost net production from the field to 2,000 bopd and add up to 1 mm bbls of reserves. Additional reserves can be captured through a proposed gas recycling program to strip any associated liquids and provide an additional element of pressure maintenance.

The expiry of 35.5 million warrants at $1.20 in April increased Candax cash balances by $42.6 million. We have increased our CAPEX budget to $41.9 million to account for $35 million in estimated expenditures at El Bibane and an appraisal well at Chaal. Furthermore, Candax reported a new bank credit facility with the Bank of Scotland for US$10 million specifically for new venture activity. We anticipate the company will generate $26 million in cash flow through 2006 which can be used for development fast-track initiatives or the acquisition of additional opportunities.

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Chaal well results expected to demonstrate commerciality with rate >5 mmcf/d

The Chaal-1 exploration well has completed drilling and is in the midst of an 18 day testing program. To date Candax has announced the well has found 450 meters of gross Middle to Lower Nara with approximately 90 m of net pay. This compares very favourably with 24 m in the pre-existing ABK-1 well that was used in the historic estimate of 60 Bcf of 2P reserves. Importantly, this offset, just 450 m away, tested at a cumulative rate of 3 mmcf/d almost 40 years ago.

Candax plans to test three individual zones plus a composite multi-zone test to obtain an estimate of productive capacity. We estimate a minimum commercial rate of approximately 5 mmcf/d at existing gas prices. Due to increased net pay thickness and substantial overpressures reported we anticipate a very high probability of commercial test rates. Remaining questions will include; gas chemistry (CO_2, H_2S, N_2, or liquids content), geographic extent, reservoir heterogeneity, and commercialization. Commercialization is of some import as Candax plans to sell gas under a long-term test contradicts ETAP objectives.

The Mitsubishi farm-out reported in April allows Candax to participate at 60% equity with no well costs up to $8 million (gross). This 4:1 promote demonstrates substantial confidence in the play on the part of Mitsubishi, and a striking reduction in capital-at-risk for Candax. Of note, the Chaal-1 well lies within the envelope of existing probable reserves. Therefore, this well has the ability to move reserves from probable to proven, but also add incremental volumes through increased pay thickness. However, we suggest that additional wells will be required to gain confidence in upside volumetrics beyond 200 Bcf.

We estimate a net risked value of $0.55/share associated with Chaal. This is based on an estimated 840 Bcf of gross upside potential and a 30% probability of commercializing it. We have recently increased our probability of success to 30% from 20% based on initial well results. Risked reserves of 252 Bcf are then reduced to account for the 60% equity held by Candax for a total net risked resources of 151 Bcf or 25.2 million boe. We estimate an NPV/boe of $3.70 for onshore gas in Tunisia which provides a net risked value of $93.2 million, or $0.55 per fully diluted share.

Exhibit 1: EMV Calculations – Chaal

Prospect	EMV-success	EMV-risked	EMV/sh success	EMV/sh risked
Chaal	$310.8 million	$93.2 million	$1.84	$0.55

Source: Wellington West Capital Markets Inc.

Potential acquisition could vault Candax into mid-tier producer by year-end

We continue to draw attention to the potential for a game-changing acquisition of up to $1 billion. Candax have stated publicly intent to acquire assets through the Middle East and North Africa to build on core competencies of key staff. We had previously expressed fears of significant dilution associated with an acquisition at this scale. However, the company has demonstrated their ability to add substantial value to acquired assets, boosting the NPV_{10} of the Centurion assets from $41 to $82 million in 12 months. We anticipate Candax will attempt to emulate this form of value creation in a larger acquisition this summer.

Valuation and Summary Recommendation

We have maintained our $1.20 target and our Market Perform recommendation in the absence of any new data. We anticipate additional drilling at Chaal is required to substantially increase our risked value of this play. Production growth is forecast to generate $0.29 in fully diluted cash flow per share in 2007 suggesting a notably low EV/DACF multiple at current market prices. This is offset by our estimated risked portfolio NPV of $1.16/share.

We recommend investors begin to take a hard look at Candax in preparation for a potential evolution to a mid-tier player. Even modest success at Chaal and production re-start at El Bibane could generate more than 4,000 boepd of production in 2007. Favourable fiscal terms and high quality production allow for the realization of outstanding netbacks. The accretive nature of an acquisition may take some time to realize but is expected to be many times larger than the current market capitalization of the company.

We believe that a robust discounted future cash flow calculation is the most accurate representation of the future value of this company and therefore receives the highest weight. The risked NPV calculation captures exploration risk and upside potential and we consider it of greater importance than an acquisition at this time. Acquisition values are based on 2004 averages in North Africa, including the related Centurion disposition in early 2005.

Exhibit 2: Net Asset Valuation Table

Valuation Matrix		Forecast	Target Multiple		Value	Weighting		Weighted Value
Risked NPV/share	$	1.16	1.0	$	1.16	60%	$	0.69
2007 DACF Multiple	$	0.29	5.0	$	1.47	10%	$	0.15
Asset EMV/share	$	1.32	1.0	$	1.32	20%	$	0.26
EV/BOE - 2004 Acquisition Value	$	1.14	1.0	$	1.14	10%	$	0.11
						12 month target price	**$**	**1.22**

Source: Company reports, Wellington West Capital Markets Inc.

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Candax Energy Inc.	CAX-T	-

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