

Candax Energy Inc. (CAX-T, \$1.18)

Recommendation: Market Perform

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All values in C\$ unless otherwise noted.

Current Price	\$1.18
Target Price (12-Month)	\$1.05
Implied Capital Gain	-11%

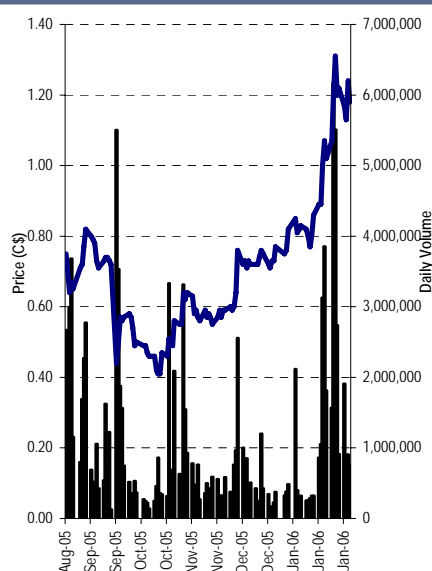
Changes

	Old	New
NAV/Share	\$0.87	\$0.94
EPS 2006E	\$0.14	unchanged
DACF/sh FD 2006E	\$0.22	unchanged
EPS 2007E	\$0.23	unchanged
DACF/sh FD 2007E	\$0.37	unchanged
Recommendation	Market Perform	Market Perform
Target Price	\$0.95	\$1.05

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 May 2006 and is drilling the Chaal exploration well in February with partner Mitsubishi.

Price Chart



Source: PCQuote

What if we're wrong? Scenarios describe upside potential and near-term risks.

- El Bibane; a balance of cash flow and depletion risk**
 Restarting production at El Bibane faces risks of high decline in the absence of additional reserves in both upside and downside cases.
- Acquisition should capitalize on competitive advantages, \$50M cash**
 An acquisition of ~\$50 to 60 million could provide up to 4000 boepd of production paid out of mid-year cash balances if share price rises >\$1.30.
- Chaal; CAX can mitigate development risks with multi-well expl**
 Candax has no capital exposure to the initial exploration well at Chaal but could gain \$0.11/share in 2007 cash flow even in a down-side case.
- Increasing target to \$1.05, maintain Mkt Perform recommendation.**
 We now calculate a fully risked NPV of \$0.94 per share enhanced by a forecast 2007 cash flow of \$0.37 per share based on success at Chaal.

Financial Summary

Shares O/S (M)	130.7	52-Week Trading Range	\$0.39-\$1.38
Market Capitalization (M)	\$131	Average Weekly Volume	5,284,618
Net Debt - 2005E (M)	-\$17	Market Float (M)	\$121
Enterprise Value (M)	\$114	NAV/Share - 2005E	\$0.94
Forecasts	2005E	2006E	2007E
Production (boe/d)	834	2,141	4,209
% gas	55%	28%	32%
Wtd Ave Realized Price (\$/boe)	\$62.2	\$56.5	\$51.6
CapEx (M)	\$45.2	\$23.4	\$49.4
Oil and Gas Revenue (M)	\$12.5	\$44.1	\$79.3
Total Revenue (M)	\$14.8	\$49.6	\$85.6
Debt Adjusted Cash Flow (M)	\$8.3	\$29.6	\$51.6
Shares Outstanding (M)	77.1	134.5	138.3
DACFPS	\$0.06	\$0.22	\$0.37
EPS	\$0.02	\$0.14	\$0.23
Valuation	2005E	2006E	2007E
EV/DACF	15.1x	4.0x	2.3x
EV/BOE/d (per unit production)	\$136,494	\$53,149	\$27,031
P/E	41.5x	7.2x	4.4x

Source: Company reports, Wellington West Capital Markets Inc.

Please see disclaimers at the end of this report.

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.

Introduction to Scenarios

Scenarios demonstrate most likely way forward – reveal speculative upside

Recent share price appreciation above our estimated NAV led us to explore a range of potential scenarios for key catalysts for Candax in 2006. Our baseline outcomes are those we consider most likely given the current conditions. This report explores the impact on the valuation of Candax of significantly different results. We suggest that events most likely to change the course of this stock in the coming year include: production resumption at El Bibane, an acquisition, exploration drilling at Chaal, and negotiations regarding deep Triassic targets. What emerges is useful insight into the forward path of this company.

El Bibane production; balance of strong cash flow and rapid reserve depletion

Our base-case model assumes Candax is able to restore and increase production from El Bibane to as much as 2000 bopd. Analysis of this scenario suggests that Candax will have to add reserves with a new well to prevent rapid declines. Despite the capability of these wells to produce as much as 7000 barrels of fluid per day, we found that deliverability on this scale would require reserve additions beyond our estimates of possible values. Higher rates would produce tremendous near-term cash flow but at a cost to ultimate reserve recovery. The worst case scenario sees no incremental reserve additions and rapid increases in water-cut. While we associate this case with a low probability it does introduce some risk to 2007 cash flow estimates.

Modest acquisition would be immediately accretive and suffer less complications

This scenario demonstrates, counter-intuitively, why Candax is a more attractive stock at \$1.35 than it is at \$0.95. The non-dilutive April 14th warrant exercise, which appears likely, could add up to \$49 million to company coffers. This cash can be employed in the acquisition of a producing asset of approximately 3500 to 4000 boepd and immediately increase cash flow. We feel significantly larger acquisitions will be hindered by intense competition causing Candax to either overpay or obtain lower quality assets. Expected production from El Bibane should generate strong cash flow and allow Candax to remain selective in a value-add acquisition.

Multiple wells at Chaal will offset risks associated with contracting gas delivery

The Chaal permit presents significant near-term upside for Candax with very little capital exposure. In the consideration of three different cases (60 Bcf discovery, 840 Bcf discovery, and a dry-hole) we found that in almost every case a second well would be required to maximize the value of the property. The scenarios demonstrated the value of an appraisal program to delineate the resource and allow for negotiation of a long-term gas sales contract. The downside case is disappointing but offers some protection through the promoted farm-out to Mitsubishi.

Triassic exploration is likely to remain a lesser priority; negotiations the key

Exploration potential in Triassic structures underlying the El Bibane and Ezzaouia fields is world-class. The opportunity to pursue these plays must be discussed as our estimates of a success case add almost \$3 per share. In our opinion Candax activity in this play is highly dependent upon early participation by ETAP. On-going negotiations are expected to continue through 2006 in our most likely scenario. In the event that ETAP agrees to participate we see only upside but expect access to a rig to delay drilling to 2007. Our worst case scenario has Candax simply waiting for external factors to force ETAP's hand to increase domestic supply.

Summary – Scenarios in Brief: Impacts and Lessons***Scenario Family 1: Production at El Bibane*****Scenario A: Inability to sustain economic production rates**

Probability: Low

Impact: Negative - Could reduce NAV by \$0.24/share

Lessons: Risk in 2007 cash flow forecasts due to potential for rapidly rising water-cut.

Scenario B: Production re-starts at 2,000 bopd

Probability: High

Impact: Positive - Could generate \$0.22/share in 2006 cash flow

Lessons: Modest risk associated with depletion if no new reserves

Scenario C: Production re-starts at 10,000 bopd

Probability: Low

Impact: Moderate - Gains offset by rapid declines.

Lessons: Significant reserve additions are required to reach capacity

Conclusions: Production capacity should be restrained to enhance recovery. Our base case delivers \$0.22/share in cash flow in 2006 and increases NAV/sh by \$0.12

Scenario Family 2: Asset Acquisition**Scenario A: Successful \$50 million acquisition**

Probability: High

Impact: Positive - Immediately accretive.

Lessons: Tremendous opportunity to enhance shareholder value if warrants vest.

Scenario B: Successful \$500 million acquisition

Probability: Moderate

Impact: Moderate - Risk of growth at the expense of shareholder value.

Lessons: Competition may force a dilutive acquisition. Candax can mitigate risks by seeking out of favour (heavy oil, gas in Middle East) assets that are underexploited.

Scenario C: No acquisition in 2006

Probability: Moderate

Impact: Moderate - Downside protection from El Bibane cash flow.

Lessons: In the absence of an acquisition Candax is dependent upon success at El Bibane. Exploration acreage with low entry costs could provide a growth portfolio.

Conclusions: Candax should capitalize on regional competitive advantages with an immediately accretive acquisition of an out of favour asset.

Scenario Family 3: Exploration at Chaal

Scenario A: Discovery of 60 Bcf

Probability: Low (however probability of finding *at least* 60 Bcf is high)

Impact: Positive - Could add \$0.11/share in 2007 cash flow.

Lessons: A second well closely following the first well can mitigate a number of risks.

Scenario B: Discovery of 840 Bcf

Probability: Moderate

Impact: Very Positive - Could add \$200+ million to corporate NAV.

Lessons: Significant appraisal drilling required combined with long-term tests.

Scenario C: Exploration Failure

Probability: Low

Impact: Negative - Loss of up to \$0.30/share NAV and \$0.11/share in 2007 cash flow

Lessons: Risk mitigation through farm-out was a good move.

Conclusions: Multiple appraisal wells can reduce risks before gas sales contract. We anticipate a staggered increase in NAV through the appraisal program.

Scenario Family 4: Triassic Exploration

Scenario A: Government participation at Ezzaouia

Probability: Low

Impact: Positive - Success case NAV could exceed \$400 million net to Candax.

Lessons: Negotiations on participation and rig contracts will likely delay drilling to 2007

Scenario B: No government participation at Ezzaouia

Probability: High

Impact: Mildly Negative - Likely result of this scenario is a delay.
Lessons: Candax have a series of priority projects which will hold their attention while negotiations continue. Candax is unlikely to drill without ETAP participation.

Conclusions: Negotiations are expected to continue with earliest drilling in mid-2007. However, there is little downside in a delay.

Scenarios in Detail: Four catalysts for 2006

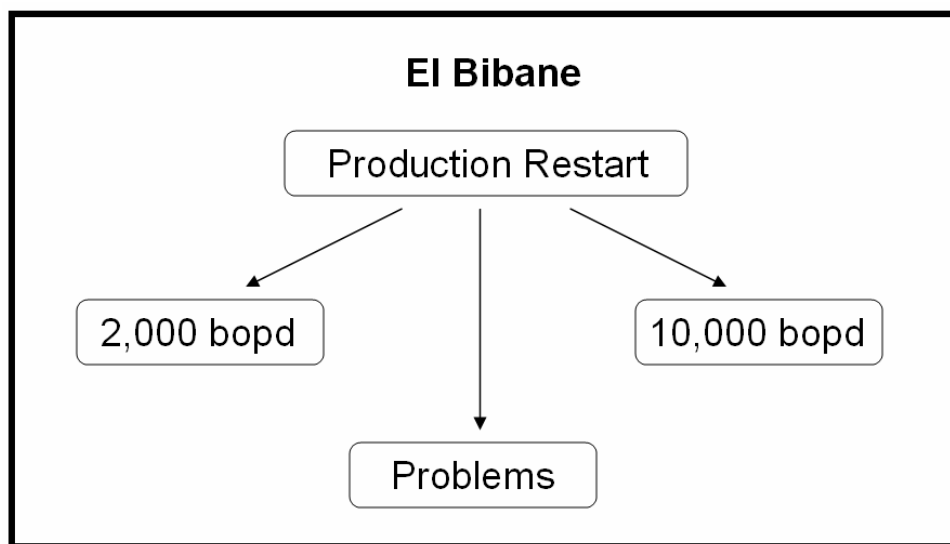
Scenario Family 1: Production at El Bibane

The most significant near-term catalyst for Candax is the re-instatement of production at El Bibane. Prior to a September shut-in this field was producing 750 bbls/d of oil and 5 mmcf/d of gas from a single horizontal well, El Bibane 3. The company has begun operations on the field to re-instate production from the field and increase recoverable reserves.

The single producer will be replaced by a re-drilled horizontal leg, a second horizontal producer in the western flank of the field, and a gas injection well. Operations should begin in early February and are expected to be completed by early April. Productive capacity of the new wells is uncertain. Candax hope to place the new horizontal producers in an optimal depth window between a down-dip water leg and an overlying gas-cap. An active water drive precludes the need for artificial pressure maintenance.

We expect production to begin at slightly more than 2000 bopd declining to approximately 1600 bopd by year-end. However, initial production rates are uncertain. Total fluid production from El Bibane 3 was as high as 7000 bbls/d, demonstrating the tremendous productive capacity from these horizontal wells. Therefore an upside case should consider the potential to add as much as 10,000 bopd of new production from two wells.

Our most likely scenario is dependent upon a number of factors beyond the control of Candax. Therefore, we present three differing scenarios in brief below to investigate alternative outcomes within the range of possibility.

Exhibit 1: Scenarios for El Bibane production - 2006


Source: Wellington West Capital Markets

Scenario A – Inability to obtain economic production rates

Both new wells find reservoir with a thinner than expected oil leg between a structurally higher water column and slightly depleted gas cap. Production begins at reasonable rates but water-cut quickly rises to more than 95%, maximizing fluid handling capabilities. After only 9 months the wells have produced 400,000 bbls of oil but are producing essentially gas and water with less than 100 bopd. Production continues to delay abandonment costs while condensate stripping becomes the primary vehicle for revenue from the field.

Impact: Negative. Could reduce value of Candax by \$0.24/share.

We should begin by noting that we consider this scenario unlikely and would suggest it has a less than 10% chance of occurrence. However, it is not impossible. What is important is that even in this downside case Candax is able to realize approximately \$20 million in operating cash flow in 2006. This suggests that projections of 2007 cash flow should incorporate some risk and raises caution towards the vertical placement of new horizontal legs and over-producing a thin oil-leg.

Scenario B – Production re-starts at 2000 bopd

El Bibane 3RE and 4 find a 40 m oil column and are each able to obtain 400 m of horizontal length in the top third of this column. El Bibane 4 begins production at 1200 bopd and 7 mmcf/d of gas. Three weeks later El Bibane 3 ramps up to 800 bopd after 1 week of production and 5 mmcf/d of gas. Production hits a peak of 2200 bopd from the field in May 2006 then declines at approximately 20% by year-end to 1750 bopd. By year-end 2008 the field has produced 1 million barrels of additional oil and water cut has increased to 90%.

Impact: Positive. Expected to generate \$0.22/sh in cash flow in 2006.

This is our base case scenario with a probability of 80%. Although we feel the wells may be capable of higher rates, we suggest that a first year average of less than 2000 bopd is prudent reservoir management. Candax report that remaining reserves are expected at 2 million bbls. A rate of 2000 bopd would produce 730,000 bbls per year or 36.5% of total remaining reserves. In our opinion this is too high and would lead to rapid depletion and reduce the overall recoverable volume from the field.

This scenario would allow Candax to meet our forecast \$29.6 million or \$0.22 per share of cash flow in 2006. Production should continue with only modest decline in 2007 generating a solid base for exploration efforts in that year. Longer reserve life would allow for the ability to recover significant volumes of condensate through gas recycling operations – adding value. We have not attributed any value to the recovery of gas-condensate but under this scenario expect this operation to recover up to 600,000 bbls by 2009.

Scenario C – Production re-starts at 10,000 bopd

El Bibane 3RE and 4 find a 50 m oil column and are each able to obtain 400 m of horizontal length in the top third of this column. Reserves are greater than expected due to near virgin conditions on the western flank of the field. El Bibane 4 begins production at 6000 bopd and 20 mmcf/d of gas. Three weeks later El Bibane 3 ramps up to 4000 bopd after 1 week of production and 18 mmcf/d of gas. Production hits a peak of 10,000 bopd from the field in May 2006 maximizing fluid handling capacity then declines at approximately 30% by year-end to 7000 bopd.

By year-end 2007 the field has produced 4.0 million barrels of additional oil and water cut has increased to 70%. Pressures have been depleted significantly with fluid withdrawal outpacing the natural water drive while gas production has begun to overwhelm oil. In 2008 Candax begins blow-down of the gas-cap to capture the remaining gas-condensate.

Impact: Moderate. Near-term gains offset by rapid declines. Significant reserve additions would make this a very positive scenario with increases in both NAV and cash flow.

We feel that the likelihood of this scenario is limited by the technical prudence of the Candax operating team and assign a probability of 10%. While the addition of new reserves is probable the magnitude required to sustain these rates seems unreasonable. The forecast of initial production of 10,000 bopd would result in 3.0 million barrels produced by May 2007. Our own optimistic resource estimates based on maps provided by Candax would allow for no more than 4.5 mm bbls of recoverable oil resources under primary recovery. Thus a technically strong team like that at Candax would not induce exploitation of an oil field towards a reserve life of less than 2 years.

We introduce the scenario to raise our opinions of limitations on potential upside in production and reserves. Candax has recently upgraded onshore facilities at El Bibane to handle 10,000 bbls per day of oil. Further, before El Bibane 3 was shut-in it was producing as much as 7,000 bbls per day of fluid (mostly water). Therefore, the wells are capable of these high rates and the

infrastructure is present to accommodate. Unfortunately, in our opinion, the geology is not. We feel production at this rate would decrease the total recoverable volume of oil and reduce the total value of the field. If reserves are increased substantially we would expect them to be produced at a more reasonable rate.

Conclusion – Rates should accommodate reserves to add sustainable cash flow

We continue to believe that an average production rate of less than 2000 bopd is reasonable and allows for sustainable reservoir management. The potential for higher rates are mitigated by the risk of rapid declines and reduced ultimate recovery. This risk could be offset by the discovery of additional reserves exceeding an expected 2 million bbls of future recovery. Importantly, risks associated with lesser than expected recovery may not manifest in initial production rates, but rather through rapid increases in water production and depletion.

Scenario Family 2: Asset Acquisition

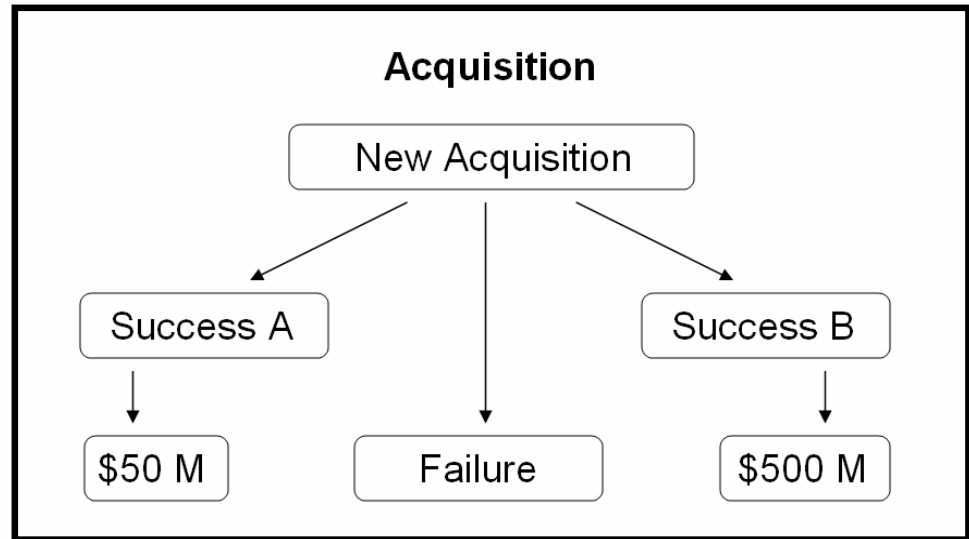
Candax has stated that it is currently pursuing 6 new business opportunities throughout North Africa and the Middle East. In 2005 the company evaluated more than 20 deals leading to 4 bids with a combined value of more than \$570 million. Of note the 6 current opportunities are noted to range from \$10 million to \$1 billion in value.

We had previously noted our concern with potential for dilution in deals of significant magnitude. Recent share price appreciation has allowed for \$1.20 April 2006 warrants to suddenly be in-play. In the event of exercise 41.3 million warrants could add up to \$49.6 million to Candax coffers. This changes the dynamic of a potential acquisition.

We now feel that the most reasonable forward course is an acquisition of approximately \$50-60 million: in particular, the acquisition of an appraised or underexploited field currently producing between 3,000 and 4,000 boepd. Such an acquisition would be immediately accretive in terms of value as well as adding significant cash flow. We note that three acquisitions have been completed in North Africa since 2004 with average metrics of \$4.11 per boe of 2P reserves and \$13,625 per producing boepd.

However, Candax has the ability and will to acquire projects of more than 10 times this size. We have therefore pursued scenarios covering acquisitions of \$500 million and \$50 million. Further we have investigated a scenario in which Candax are unable to grow through acquisitions in 2006.

Exhibit 2: Scenarios for a potential near-term acquisition



Source: Wellington West Capital Markets

Scenario A – Successful acquisition of approximately \$50 million

Candax is able to acquire a structurally complex medium-gravity oil field currently producing 3700 boepd for \$50 million. Production has declined slowly as the field has seen little recent activity. Primary recovery and limited appraisal has lead to as little as 5% of the 250 mm bbls of total oil-in-place to be booked as reserves. The company has been able to negotiate a favourable production contract with incentives for growth in reserves and production.

Impact: Positive. Immediately accretive. Very low risk growth strategy.

We see such an acquisition as immediately accretive in both valuation of Candax and in additional cash flow. We have not assigned probabilities to these occurrences as we feel they are purely business decisions. However, we feel this option is the clearest path to increasing shareholder value and meeting management goals for growth.

Importantly we feel an acquisition of this scale could allow Candax to employ their regional competitive advantages. Candax have demonstrated the ability to maximize value from mature assets through optimization. Further they have shown the ability to partner to reduce risk, enhance fiscal terms, and gain access to deals. Regional relationships can enhance access and smooth negotiations but are less valuable in the face of competition. We feel that opportunities significantly greater than this are likely to obtain multiple bids including national companies with lesser dependence on return-based economics.

We estimate an acquisition of the character noted above could generate as much as \$40 million in annual cash flow. Through optimization this could increase both recoverable reserves and production. Assuming such an acquisition would occur at NAV, it would add approximately \$50 million to our calculated NAV of \$113 million.

Scenario B – Successful acquisition of approximately \$500 million

Candax successfully acquires the local subsidiary of a senior global producer for \$500 million in partnership with a large Asian downstream firm. The acquired company produces 30,000 boepd net from 12 fields on a series of adjacent onshore blocks. In gaining access to resources of this size Candax must agree to relinquish operatorship to a minority stake European-based major partner. Intense competition for the assets has led to more than 9 months of negotiation and a winning bid price 25% greater than NAV. Potential resources on the licence exceed 1 billion barrels and 6 Tcf of gas.

Impact: Moderate. Risk of growth at the expense of shareholder value.

Despite a desire to complete a deal of this size we see a number of obstacles. Candax clearly has the ability to negotiate deals of this kind through advisor Alexander Kulpecz. Further, a recent farm-in deal with Mitsubishi has demonstrated the ability to leverage partnerships and reduce capital at risk. Candax has also communicated that it is willing to accept financing arrangements through partners in a creatively managed leverage. Partners gain access to the upstream experience and relationships of Candax in return for risked capital.

In this scenario the key risk is intense global competition for quality assets of this scale. This is manifested as accepting either too high of a price or lower quality assets. In some cases lower quality assets can be an ideal fit with a technically competent team willing to add reserves through enhanced recovery mechanisms or solid fundamental engineering. However, in this scenario Candax relinquishes operational control and therefore has little sway over technical details. Massive partners demonstrate reluctance to focus capital on this low-priority asset and production declines.

Beyond the risks associated with asset quality and price is the spectre of significant dilution on a non-accretive acquisition. In this scenario the company is forced to pay above NAV to acquire the asset. Operational limitations hinder the ability to add value to this acquisition beyond invested capital. “Growth for the sake of growth” dilutes shareholder value and share price lags.

This scenario is useful in describing the necessary ingredients for a successful acquisition of this scale. Candax can mitigate many of the risks identified here by pursuing assets currently out of favour. These would include gas assets in the Middle East or heavy oil. Further the ability to retain some technical and operational input will allow objectives to match those of the operating committee. Partnership with a strong and influential partner can provide access and financial weight to an offer, with a financing deal structured specifically to this upstream investment. In every case we see a time lag for an acquisition of this nature unless the company is willing to enter the fray of competitive bidding and risk dilution.

Scenario C – Inability to close an acquisition in 2006

After submitting 8 bids in 2006 Candax finishes the year without a significant acquisition. The company has remained consistent in refusing to overpay for assets experiencing intense competitive bids. The first two wells on the Chaal

permit have found significant quantities of gas and sales contracts are currently under negotiation. El Bibane production met expectations averaging 1750 bopd through the last 9 months of 2006. After warrant expiry and operating cash flow, cash balances exceed \$70 million. Candax has acquired exploration licences in two neighboring countries and begun seismic acquisition in preparation for wells in mid-2007. The company continues to negotiate the acquisition of 4 opportunities with the backing of two major partners.

Impact: Moderate. El Bibane should provide substantial cash flow – will likely require exploration acreage for growth.

This scenario is surprisingly positive but relies on exploration success for growth. Candax would see significant pressure from shareholders to deploy cash and would have to resist an imprudent deal simply for the sake of expenditure. We have confidence that this team would exhibit patience while focusing efforts on success elsewhere. However, in the event of exploration failure at Chaal the pressure would mount as an acquisition would be the only recourse left for growth.

We anticipate that in the absence of a deal in the near-term Candax will acquire exploration acreage with minimal entry costs to provide future growth. Low entry costs are somewhat challenging as promoted acreage is common throughout North Africa and the Middle East. A focus on out-of-favour assets again may allow Candax to employ their core strengths and not sacrifice value.

Clearly the greatest risk in this scenario is pressure to acquire assets with a strong cash balance outside of defined investment criteria. Existing acreage does not have a large portfolio of exploration opportunities and we expect the Triassic targets to be mired in negotiation through 2006. The ability of Candax to maintain rigorous standards through such a difficult year would be a credit to their management abilities but no doubt a strain on shareholder relations.

Conclusion – Maintain competitive advantages through accretive acquisitions

A modest acquisition of approximately \$50 million would be immediately accretive and allow Candax to capitalize on their regional competitive advantages. We feel that in the current investment climate a large-scale acquisition could force the company to; relinquish technical and operating control, pay a significant premium to net asset value, and dilute shareholder value. Recent acquisition metrics suggest Candax could obtain almost 4000 boepd and more than 12 mm bbls of 2P reserves from expected Q2 cash balances. The absence of an acquisition in 2006 may put some pressure on Candax to deploy cash against their strict investment criteria.

Scenario Family 3: Exploration at Chaal

The primary avenue for organic growth at Candax is through exploration at Chaal. The company holds a 60% interest in this large onshore permit which contains an existing gas discovery. A Glendower resource assessment of the

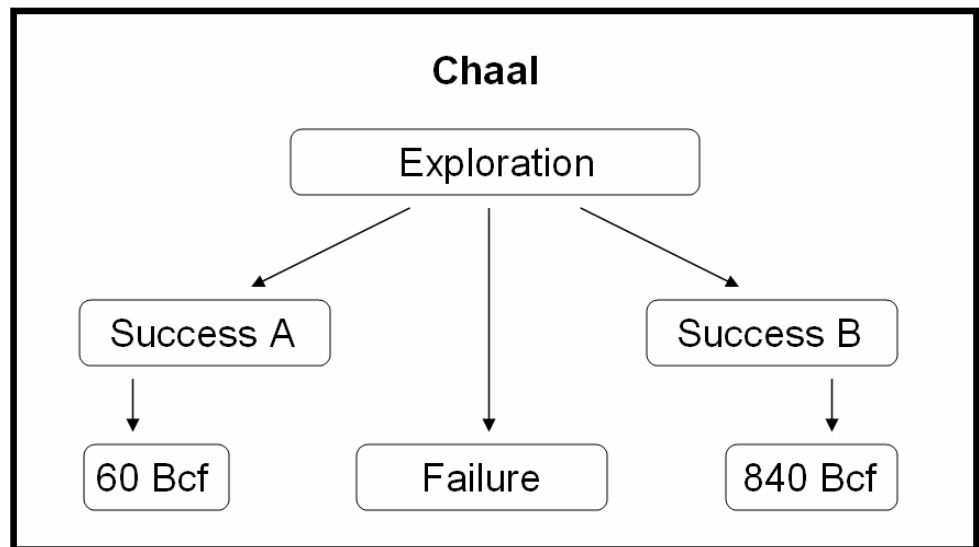
licence attributed 60 Bcf of 2P and 844 Bcf of 3P resources to a large Lower Nara structural accumulation tested by two wells.

Candax has proposed a new exploration test of this structure through the offset of ABK-1 which tested gas and condensate from a number of intervals at rates up to 3 mmcf/d. In October 2005 Mitsubishi farmed into the property under a 4:1 promote for a 20% equity. The partnership has currently contracted a rig which should begin drilling in early February.

We have attributed a 20% chance of exploration success to the 844 Bcf of potential resources. Some uncertainty exists in the extent of the originally tested accumulation. The 60 Bcf of probable reserves cover less than 10% of the total area and with two existing wells represents a high probability outcome. The vertical extent of the hydrocarbon column combined with lateral extent defined by appraisal wells will be the only short-term method of determining resource extent.

The primary uncertainty at Chaal is the total recoverable volume. Existing tested wells demonstrate an accumulation that is capable of producing at economic rates (for at least the short-term). The sustainability of these rates and the extent of the reservoir must be tested through a future appraisal program. We see three clear scenarios emerge from this forthcoming drilling campaign.

Exhibit 3: Scenarios for Exploration at Chaal



Source: Wellington West Capital Markets

Scenario A – Discovery of 60 Bcf

An initial exploration well discovers a 120 m gas column in an interbedded carbonate with modest porosity development adjacent to ABK-1. A 21 day test program is able to obtain flow rates between 500 mcf/d and 2 mmcf/d from 6 zones. A second well, 6 km to the south, finds very poor porosity development in the primary zone and low gas saturation. The southern lobe is determined to be an uneconomic accumulation. Development focuses on the northern lobe

thought to contain 60 Bcf of recoverable reserves. Four wells with initial rates of 5 mmcf/d produce the field with relatively low decline. Gas is sold into the existing infrastructure for the domestic market at approximately US\$5/mcf.

Impact: Positive. Could add at least \$0.11/sh in cash flow in 2007.

This scenario is based on the ability of the future exploration program simply to move probable reserves to proven, yet capture no additional upside. We estimate the likelihood of this event as relatively low, but the probability of finding *at least* 60 Bcf at 80%. ABK-1 found a 150 m gas column with a productive capacity of 3 mmcf/d. The existence of a large mappable closure and the thick gas column suggest further gas resources should exist within the structure.

The key uncertainty in regards to the resource potential is the heterogeneity of reservoir quality. Candax have described the target as a limestone reservoir with primary porosity enhanced through leaching in areas adjacent to faults. A large north-south fault has been mapped across the structure and is thought to have created an area of enhanced reservoir quality. However, the distribution of productive reservoir found at ABK-1 could vary dramatically within a small area limiting the extent of recoverable resources.

Under this scenario it is critical to maximize gas sales revenue associated with initial production as ~10% of the resource could be produced in the first year. Candax have proposed producing gas immediately under long-term test while appraising the accumulation. Negotiation of a long-term gas sales contract will require some estimate of the total recoverable volume to establish the rate and duration of the contract. Assuming US\$5/mcf pricing this project could generate as much as \$20 mm in net cash flow for Candax in the first year.

We feel that drilling a second appraisal well as soon as possible after the initial success would help mitigate some of the risks present in this case. Mitsubishi have an option to earn an additional 5% equity in the permit through a 20% carry on a second well. Therefore, reducing the uncertainty and capital-at-risk through an immediate second well can help add value to this down-side scenario.

Scenario B – Discovery of 840 Bcf

An initial exploration well discovers a 150 m gas column in an interbedded carbonate with modest porosity development adjacent to ABK-1. A 21 day test program is able to obtain flow rates between 500 mcf/d and 2 mmcf/d from 6 zones. A second well, 6 km to the south, finds excellent reservoir development and a 300m gas column. Test rates in the second well exceed 3 mmcf/d from individual zones. Six appraisal wells delineate a large accumulation bound by an inactive water leg at 4000 m subsea. An additional 45 development wells increase peak production to 250 mmcf/d in 2009. Gas is sold into the existing infrastructure for the export to Europe at approximately US\$6/mcf.

Impact: Very Positive. Could add \$200 million to corporate NAV.

Existing well results and mapping suggest a discovery of this size is a reasonable expectation. The question that remains is the ability of this accumulation to flow hydrocarbons at economic rates. Carbonate reservoirs can be very heterogeneous and the appraisal program would be critical in reducing this uncertainty. We feel that approximately 6 wells with long-term production tests would be the minimum required to properly appraise a discovery of this size.

Candax estimate the existing domestic market capacity at 120 mmcf/d, which would be insufficient to maximize revenue from this property. Our calculations show that an accumulation of this size could easily manage peak production of 250 mmcf/d. We would expect an 840 Bcf discovery to allow for Candax to export gas to Italy through the TransMed system and sales to a Tunisian intermediary.

Additional potential on the licence could contain as much as 1 Tcf of further resources. The involvement of Mitsubishi raises the specter of an LNG project, but this would require exploration success well beyond the original 840 Bcf. Appraisal drilling would have to preclude a gas sales contract and facility design. In almost every case under this scenario sales associated with long-term production tests are likely to be the only revenue through 2007/2008. However, beyond 2009 annual cash flow from this project could exceed \$200 million net to Candax; exceeding initial capital outlays in 2010.

This case emphasizes the importance of two elements of the exploration program: a long-term production test and immediate appraisal drilling. Gas sales contracts are difficult as they require some certainty over the magnitude and rate of recoverable gas resources. Therefore, revenue is likely to be delayed in order to ensure maximum value for this onshore field. Facility design will be important to capture produced condensate liquids which could exceed 25 million barrels and add tremendous value to the production stream.

Scenario C – Exploration failure

An initial exploration well discovers a 150 m gas column in an interbedded carbonate with modest porosity development adjacent to ABK-1. Initial flow rates on drill stem tests are encouraging but decline after 8 hours demonstrating limited reservoir extent. Multiple zones demonstrate permeability and gas saturation but heterogeneity of the reservoir makes predictability a challenge. A second well finds virgin reservoir conditions but lesser reservoir quality. Test rates in the second well remain below 300 mcf/d. The partnership decides to abandon the well and hope the interpretation of 3D seismic data may reveal additional exploration upside.

Impact: Negative. Loss of up to \$0.30/sh in risked NAV and \$0.11/sh cash flow in 2007. This scenario would build pressure for a potential acquisition.

Candax have mitigated this scenario through reducing their capital exposure in the first exploration well to nil. Furthermore they acquired the permit through direct negotiation with the government rather than part of an acquisition; eliminating entry costs. The lack of substantial data from the original wells allows for the possibility of depletion on an extended test. As we

have discussed above the potential for heterogeneous reservoir must be considered as a risk against un-appraised lateral extent.

Given the existing data we feel an uneconomic accumulation is an unlikely, but possible, outcome. These data show short-term commercial deliverability and the presence of a thick hydrocarbon column. However, at least two wells would be required to demonstrate viability of an exploration success in a down-side case. We do not anticipate fiscal or commercial terms associated with gas production to be burdensome as Candax have negotiated a very favourable PSC.

Conclusion – Multiple wells can reduce risk in sales contracts and extent

This simple study suggests that at least two exploration wells with long-term tests would be required to verify the commercial viability of a gas accumulation at Chaal. The limited existing data combined with the uncertainty in reservoir extent argue for a second well to address these risks. Gas sales contracts negotiated without a full understanding of the total recoverable volume have tremendous risk. The design of facilities specific to this field and sales contracts should follow an adequate appraisal program. Candax has mitigated financial risk associated with this prospect through a healthy 4:1 promote and no anticipated expenditures on the first well.

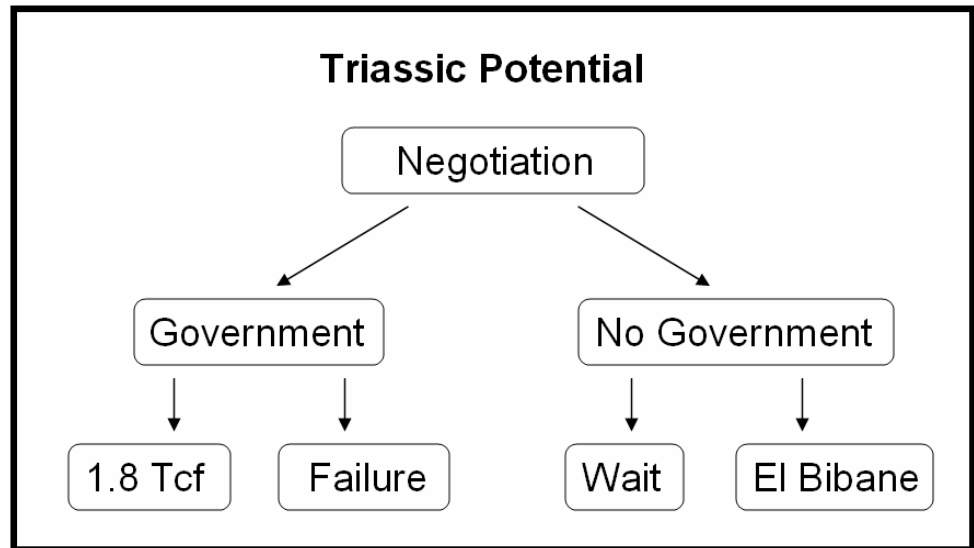
Scenario Family 4: Triassic Exploration

Candax has obtained rights to two significant Triassic targets below the El Bibane and Ezzaouia Fields. These prospects would target potential within the TAGI sandstone and are reported to have the potential to contain up to 3 Tcf of gas and 300 mm bbls of condensate. Our analysis of these prospects suggest they carry a very low chance of commercial success (~5%) at this time.

This set of scenarios has tremendous material impact for Candax but lesser near-term relevance. We feel Candax is unlikely to proceed until a resolution has been reached with the Tunisian government regarding participation in the exploration phase. At the onshore prospect Ezzaouai the government has the right to wait until a declaration of commerciality to elect to participate in a development. Candax have expressed that they are unwilling to carry a disproportionate share of the risked capital in the exploration phase.

We expect negotiations to be the primary activity on this front through 2007 with the primary objective being government participation at Ezzaouia. Priorities at El Bibane, Chaal and new business opportunities will likely overwhelm the Triassic exploration program for the next year. A further delay associated with obtaining a rig capable of drilling these depths only after negotiations have been completed will likely delay a Triassic well into mid to late 2007.

Exhibit 4: Scenarios for Exploration in the Deep Triassic



Source: Wellington West Capital Markets

Scenario A – Government participation at Ezzaouia

Increasing global prices for natural gas force Tunisia to increase domestic supply through upstream activity. Favourable production sharing contracts increase foreign investment and ETAP start to participate in exploration of large gas prospects to encourage drilling. Both ETAP and Centurion agree to participate in an exploration well at Ezzaouia targeting the deep Triassic. Candax are able to obtain a rig capable of drilling to 5000 m in November 2007.

Impact: Positive. Incremental value is substantial with success case NAV of \$430 million net to Candax.

Using USGS data for the largest undiscovered field in this play we attribute 1.8 Tcf of potential to an exploration target. Our analysis also suggests that probability of success is low due to a lack of Paleozoic source rocks in this region. However, in the event of success Candax could vault to another level. In the least case, potential at El Bibane would be greatly enhanced. An LNG project is feasible for an onshore field of this size, and may benefit from existing relationships with Mitsubishi.

North African acquisition metrics suggest an accumulation of this size could be worth approximately \$430 million net to Candax. This discovery would have a long development cycle and require significant up-front capital. Candax would have the option of a divestiture to focus on their competitive niche; growth through short-term production optimization projects.

In a failure case Candax would have risked approximately \$5 to 8 million on a world-class exploration prospect. The company has reduced capital-at-risk through involvement of both ETAP and Centurion and exposed shareholders to significant upside. We have currently attributed only \$0.08/sh of risked value within our current NAV barely offsetting exploration costs.

Scenario B – No government participation at Ezzaouia

The Tunisian government is unwilling to expend tax revenue on risky upstream exploration and has no contractual obligation to do so. Relatively inexpensive imports from neighbors Libya and Algeria offset rising demand at costs below world prices. Candax is unable to convince ETAP to participate in a well despite the risk of no activity on the permit. Candax consider an offshore test at El Bibane but focus on development of Chaal and consolidation of a new acquisition.

Impact: Mildly negative. Likely result of this scenario is a delay.

Unfortunately, we consider this to be the most likely scenario. Despite excellent in-country relationships it is difficult to convince anyone to spend money when they have no obligation and the most likely outcome is failure. Also conversations with Centurion have revealed they had attempted to negotiate a similar agreement with ETAP for 2 years without success on these same permits.

A lack of government participation provides a number of options to Candax to maximize the value of these assets. They could farm-out equity in the Triassic however such a deal would be complicated by equity in the overlying producing fields. They could move to drill a Triassic test at El Bibane, but this would be more expensive as it is both deeper and offshore. The most likely outcome in our opinion is continued negotiation.

We suggest that Candax will likely have a number of active projects which will demand their attention away from the Triassic. A potential acquisition, production at El Bibane and exploration activity at Chaal should take priority over a Triassic test. Prospectivity may be enhanced in the interim by exploration tests in adjacent regions of this basin. Tunisia is likely to entice further foreign investment through the introduction of production sharing contracts and improving fiscal terms. This could see the risk associated with this prospect decline independent of any Candax activity – increasing value.

Conclusion – Negotiations are likely to continue but little downside in a delay

We feel Candax are unlikely to test the deep Triassic potential at Ezzaouia or El Bibane before mid-year 2007. Even in the event of successful negotiations the company would still have to acquire a slot in a heavy duty rig. Due to the high risk we associate with these prospects they garner only \$0.08/sh in risked present value. Therefore a delay in pursuing these opportunities has only negligible impact on valuation while retaining them adds considerable upside exposure.

Negotiations with the government remain the key to pursuit of this play. We anticipate it will require an external stimulus (i.e. increased domestic demand) to encourage ETAP to assume exploration risk and see little chance that Candax will drill these targets without them.

Conclusion – Upside catalysts through 2006

Candax has a number of potential catalysts to add significant shareholder value through 2006. Simple scenarios highlight upside potential in an immediately accretive modest acquisition and expected production at El Bibane. Risk mitigation at Chaal allows Candax to pursue significant growth with little capital at risk. Failure at Chaal puts some pressure on the ability of Candax to grow organically and increases the likelihood of a near-term acquisition. We expect upside potential in the deep Triassic to remain at the negotiating table through 2006 as Candax pursues higher priority activity.

Valuation and Summary Recommendation

We are increasing our target price to \$1.05 backed by a fully risked portfolio NPV of \$0.94 per share. Strong expected cash flow in 2007 leads to target prices above NAV. Our target incorporates an asset EMV of \$1.02/share representing the risked exploration potential and reduced by a conservative acquisition value of \$0.82/sh.

NPV and EMV estimates have increased due to more accurate information regarding gas prices in Tunisia. Previously we had been using US\$2.75/mcf as a domestic gas price which appears to have been low. Guidance from Candax confirmed by ETAP documents suggest current gas prices are closer to \$5/mcf. This increased gas price has added to our value of the Chaal project and is manifest by a \$0.07/share increase in risked NPV.

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 5: Net Asset Valuation Table

Valuation Matrix	Forecast	Target Multiple	Value	Weighting	Weighted Value
Risked NPV/share	\$ 0.94	1.0	\$ 0.94	60%	\$ 0.56
2007 DACF Multiple	\$ 0.36	5.0	\$ 1.82	10%	\$ 0.18
Asset EMV/share	\$ 1.02	1.0	\$ 1.02	20%	\$ 0.20
EV/BOE - 2004 Acquisition Value	\$ 0.82	1.0	\$ 0.82	10%	\$ 0.08
12 month target price					\$ 1.03

Source: Company reports, Wellington West Capital Markets Inc.

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