

Candax Energy Inc. (CAX-T, \$0.87)

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Investment Brief – Candax Energy Inc. is a public junior international oil and gas company that is approximately one 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.

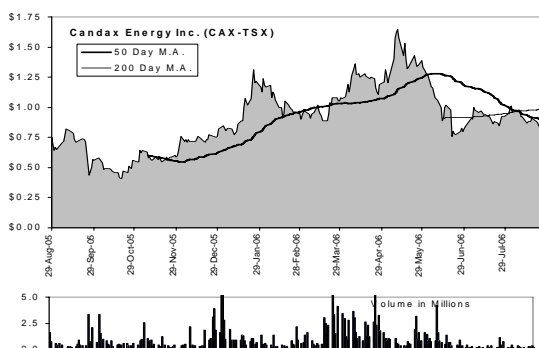
Rating **SECTOR OUTPERFORM**
Target Price **\$1.15**
Risk **SPECULATIVE**

Current Price \$0.87
 Return (incl. dividend) 32%
 52-Week High / Low \$1.73 / \$0.39
 Shares O/S 168.9M (basic) / 180.4M (F/D)
 Market Capitalization \$147 million
 Enterprise Value \$97 million
 Daily Volume (3-mo. avg.) 939,000
 Currency C\$ unless noted
 Company CEO Michael Wood
 Company Web Site www.candax.com

Financial Forecast	2005	2006E	2007E	2007E/2006E
Liquids (bbl/d)	587	1,000	2,200	120%
Natural Gas (mmcf/d)	1.8	0.5	4.5	800%
Total (boe/d)	879	1,083	2,950	172%
% Liquids	67%	92%	75%	(19%)
Cash Flow (\$M)	5.3	18.3	45.6	148%
F/D CFPS	\$0.04	\$0.10	\$0.25	152%
F/D EPS	(\$0.03)	\$0.04	\$0.16	269%
Capital Expenditures (\$M)	45.5	25.0	35.0	40%
Net Debt (\$M)	(11.4)	(47.2)	(57.8)	22%
WTI (US\$/bbl)	\$56.54	\$67.50	\$65.00	(4%)
AECO (\$/GJ)	\$8.37	\$6.67	\$7.51	13%
Valuation Parameters				
Price/CFPS (multiple)	22.7	8.7	3.4	(60%)
Price/EPS (multiple)	(26.0)	20.2	5.5	(73%)
EV/boe/d		\$89,336	\$32,807	(63%)

Source: Candax Energy and Haywood Securities

Price Performance



Source: Bloomberg

Chaal testing suspended – a bad string of luck

■ If it wasn't for bad luck, Candax would have no luck at all

Candax announced that the testing program at the Chaal-1 well in Tunisia had been suspended. While flowing the well back after an acid injectivity test, some kind of equipment failure resulted in a leak between the casing/tubing and the testing program was halted. In order to determine the nature of the equipment failure, the tubing will have to be pulled from the wellbore. The coiled tubing unit is incapable of conducting this operation and until a rig can be deployed, the well is being suspended.

■ No timeline for resumption of testing at Chaal

This is the second round of difficulties to beset testing of the Chaal prospect. Candax and its partners remain convinced of the multi-bcf production potential of Chaal, but are now unable to determine what that potential is without a full-size drilling or completion rig. Candax and partners are conducting a technical review of all future appraisal and development options and will announce the plans at such time as the work program has been agreed upon.

■ Target and recommendation remain unchanged, but...

The delay in testing of the Chaal-1 well leaves the upside potential of this prospect in limbo. While we are not changing our target or recommendation, we note that there will be no definitive determination of the potential of Chaal for at least six months.

Expectations – We expect that the share price of Candax will languish, absent any near-term catalysts. The company has provided no update on the El Bibane recompletion work, but had previously indicated an update should be forthcoming in September. We would also expect that at some point in next 6 to 12 months, Candax will be able to close on one of the international production/development projects, but have not factored this 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 still 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 production forecast, June 21, 2006

Risk Profile

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

Moderate - High

Please see rating structure, important disclosure, risk profile parameters, disclaimers, and notes on pages 6-9 of this report.

Candax Energy Inc. (CAX-T)

Rating:	SECTOR OUTPERFORM			One-Year Target Price:	\$1.15	
Current Price	\$0.87			Market Capitalization (\$M)	146.9	
Current Shares Outstanding (millions)	168.9	<u>Dilution</u>		Current Net Debt (est.) (\$M)	<u>(50.1)</u>	
Fully Diluted Shares Outstanding (millions)	180.4	6.8%		Enterprise Value (\$M)	<u>96.8</u>	
Book Value (\$M)	105.5			EV / BV (times)	<u>0.9</u>	
<hr/>						
Production	2004	2005	2006E	2007E	'06E / '05	'07E / '06E
Liquids (bbl/d)		587	1,000	2,200	70%	120%
Natural Gas (mmcf/d)		1.8	0.5	4.5	(71%)	800%
Total (boe/d)		879	1,083	2,950	23%	172%
Percent Liquids		67%	92%	75%	38%	(19%)
Percent Natural Gas		33%	8%	25%	(77%)	231%
Revenue (\$M)		12.9	27.0	58.6	109%	117%
Cash Flow (\$M)		5.3	18.3	45.6	245%	148%
CFPS Basic		\$0.06	\$0.12	\$0.27	85%	128%
CFPS Fully Diluted		\$0.04	\$0.10	\$0.25	161%	152%
				<u>\$/FD Share</u>	<u>% of CF</u>	
CFPS Sensitivity	Oil (US\$1.00/bbl)			\$0.004	1%	
	Gas (\$0.25/mcf)			\$0.002	1%	
	100 bbl/d			\$0.004	2%	
	1.0 mmcf/d			\$0.006	2%	
Earnings (\$M)		(1.5)	7.9	28.6	(623%)	263%
EPS Basic		(\$0.02)	\$0.05	\$0.17	(373%)	244%
EPS Fully Diluted		(\$0.03)	\$0.04	\$0.16	(229%)	269%
Capital Expenditures (\$M)		45.5	25.0	35.0	(45%)	40%
Reinvestment Ratio		856%	136%	77%	(84%)	(44%)
Net Debt (\$M)		(11.4)	(47.2)	(57.8)	315%	22%
Debt / Cash Flow - Trailing (years)		(2.1)	(2.6)	(1.3)	20%	(51%)
Per BOE Analysis (\$/boe)						
Revenue		\$40.15	\$68.21	\$54.42	70%	(20%)
Operating/Transportation Expense		\$8.36	\$9.22	\$5.00	10%	(46%)
Net Operating Revenue		\$31.79	\$54.79	\$43.98	72%	(20%)
G&A		\$15.15	\$10.12	\$4.09	(33%)	(60%)
Cash Flow		\$11.30	\$44.54	\$42.34	294%	(5%)
DD&A		\$12.94	\$17.46	\$15.00	35%	(14%)
Earnings		(\$7.95)	\$17.15	\$26.54	(316%)	55%
Valuation Parameters						
Current Price / F/D CFPS (multiple)		22.7	8.7	3.4	(62%)	(60%)
Debt-Adjusted CF Multiple			5.3	2.1		(60%)
Target Price / F/D CFPS (multiple)		29.9	11.5	4.6	(62%)	(60%)
Current Price / F/D EPS (multiple)		(26.0)	20.2	5.5	(178%)	(73%)
EV / boe/d			\$89,336	\$32,807		(63%)
Target EV / boe/d			\$135,719	\$46,250		(66%)
Price Assumptions						
Crude Oil WTI (US\$/bbl)	\$41.46	\$56.54	\$67.50	\$65.00	19%	(4%)
Company Average (C\$/bbl)		\$56.93	\$73.62	\$73.19	29%	(1%)
AECO (C\$/GJ)	\$6.26	\$8.37	\$6.67	\$7.51	(20%)	13%
Company Average (C\$/GJ)		\$0.41	(\$0.10)	(\$0.10)	(124%)	4%

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

Corporate Update

Candax announced that current operations on the Chaal-1 exploration well have been suspended. While conducting the initial stages of the workover on the well, a leak developed within the closed system of casing and tubing. This is likely the result of some kind of mechanical failure downhole and requires the tubing string to be pulled from the wellbore. The coiled-tubing unit on site is incapable of this operation and until a full-size drilling or completion rig can be deployed to Chaal, the well is being suspended.

We note that within Tunisia, rig access is very tight. Candax and its partners are currently conducting a full technical review of the appraisal and development drilling options available for the Chaal prospect. According to Candax management,

"The joint venture partners are aligned in their views that Chaal has huge potential and the next phase will be to develop the program for further appraisal and potential future development. We will be investigating both multilateral completions and under-balanced drilling as ways of optimizing both well productivity and maximizing the reservoir potential, as well as acidization and fracturing. A technical review of the options available is underway and we will confirm the program and timing as soon as the forward program is finalized and agreed to. Due to the current tight rig market, Candax does not expect any potential future drilling at Chaal to occur in 2006".

Given the time required to investigate and assess the options and then book a drilling time with a rig contractor, we believe that it will be at least six months before Candax can return to the Chaal prospect. While management has given no further indication of the timing of Chaal except as noted above, previous presentations by Candax had indicated that a new rig may be brought into the country to drill at both Chaal and the company's potential high-impact deep gas prospect at Ezzaouia. Drilling the deep Triassic prospect at Ezzaouia requires reaching an agreement with the Tunisian government with respect to a change in cost-sharing of the well. Should this 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 the second half of 2007.

Net Asset Value and Near-Term Upside

Candax has approximately \$62 million in cash on the balance sheet. The following table previously published has been updated to reflect the company's current capital position with the December 31, 2005 estimated value of the company's reserves. We note that Chaal only represents 23% of Candax's Net Asset Value, while the company's cash on hand is 33% of NAV. Given that commodity prices have increased since the engineering value of Candax was determined, we would expect a minor increase in value today, based on the current outlook for world oil prices.

Candax Updated Net Asset Value

Estimated Net Asset Value (summary)	Proven + Probable Reserves		
	31-Dec-05 (Mboe)	NPV10% Value (C\$M)	Per Basic Share
Proven + Probable Reserves			
Chaal Permit (60% interest)	6.0	43.0	0.25
El Bibane, Al Manzah, Ezzouia etc.	9.7	82.2	0.49
	15.7	125.2	0.74
Estimated cash on hand (June 30, 2006)		62.4	0.37
Net Asset Value - Basic		187.6	1.11
Net Asset Value - Fully Diluted		196.5	1.09
Shares Outstanding (millions)			
Basic		168.9	
Fully Diluted (11.5 Million Options @ \$0.80/Sh)		180.4	

Source: Candax Energy and Haywood Securities

Based on the cash on hand, Candax has a Net Asset Value of \$1.09. This NAV includes \$0.25 per share for the 2005 year-end value placed on the proven plus probable reserves assigned to Chaal of 60 bcf gross (36 bcf net to Candax). We should note that the reserves report was prepared using a Brent oil price of only US\$56 per barrel in 2006 and declining thereafter. Using prices which reflect the current oil-price environment would see a higher net asset value to Candax. The natural gas pricing in Tunisia is directly tied to world oil prices.

As the Chaal prospect must still be definitively tested, there is potential for a positive impact on the value of Candax, however this is now a 2007 activity. There is no hydrocarbon risk, as indicated by the incomplete drill-stem testing of the well and the failed acidization attempt just suspended, as well as by other positive indicators characterized by the influx of hydrocarbons during drilling and the bottom hole pressure of more than 11,000 psi. Candax has determined that the minimum required flow rate to move ahead with the Chaal gas development project is 5.0 mmcf/d.

The El Bibane field redevelopment project is still expected to begin in September. The Company issued an update on the El Bibane redevelopment

work on June 23, 2006, stating that it expected work to begin in September 2006. The Company reiterated this expectation in its Q2/06 report. Delays have plagued the redevelopment of the El Bibane offshore field as a result of delays in the reconstruction of the offshore drilling barge. Despite Candax having its own engineering staff in the shipyard where the drilling barge work is being conducted, the process has been slowed by numerous construction and procurement issues. Our estimates as revised in June and Company expectations, call for production from El Bibane to begin in late Q4/06.

We also note that while the news flow out of Candax has not been good of late, the company is still operating and producing oil in Tunisia. Recall that Candax has three small oil fields – Robanna, Al Manzah and Ezzaouia. These three fields are currently producing around 500 bbl/d of oil net to Candax.

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 definitively established, now pushed out to 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 is looking for 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 soon be underway. Our current production estimates for 2007 include only 1,000 bbl/d from each of the two redeveloped El Bibane wells. Should the production prove to be more in line with management's estimates of as much as 2,000 bbl/d per well, our cash flow per share for 2007 would increase to as much as \$0.35 per fully diluted share. Once El Bibane is placed onstream later this year, a conservative cash-flow multiple could see us with a higher target price.

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- n/a
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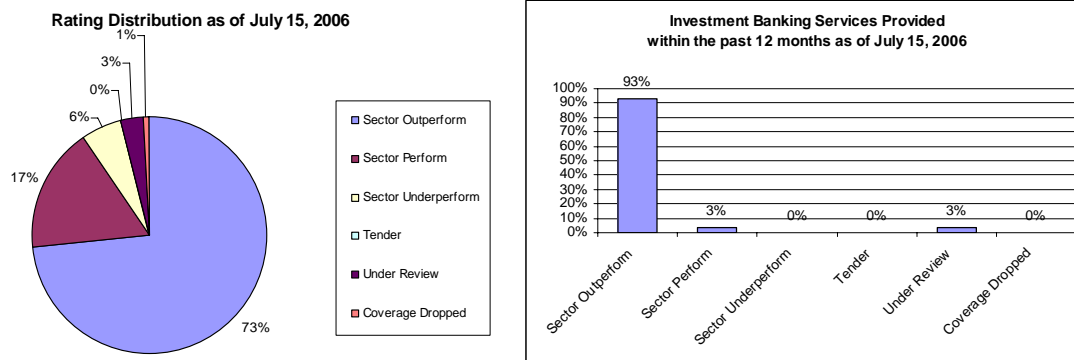
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