

Candax Energy Inc. (CAX-T, \$1.19)

Recommendation: Market Perform

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All values in C\$ unless otherwise noted.

Current Price	\$1.19
Target Price (12-Month)	\$1.20
Implied Capital Gain	1%

Changes

	Old	New
NAV/Share	\$0.94	unchanged
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	\$1.05	\$1.20

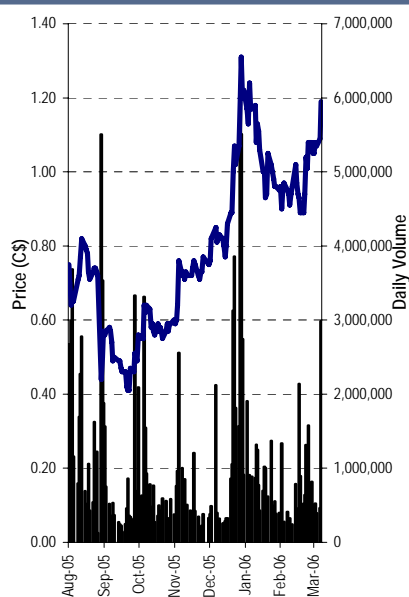
Company Profile

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

Time to take a hard look at Candax; expect Q2 growth through drilling and acquisitions.

- 2005 recycle ratio of 3.5x demonstrates quality of acquired assets**
 The addition of 13.2 mm boe of 2P reserves, against full-cycle capital expenditures estimated at \$79 mm, generate F&D costs of just \$6.00/bbl.
- Investors trip to Tunisia highlighted by ETAP deep gas initiative**
 New ETAP officials stated near-term priorities on increasing gas reserves and deep exploration – a Triassic test at Ezzaouia appears likely for 2007.
- Initial Chaal results expected this week; could add \$1.48/sh in success**
 Upside case provides 840 Bcf of gross recoverable gas at Chaal. We suggest a positive result in the first well is likely with test rates in May.
- Increasing target price to \$1.20 while maintaining Market Perform.**
 Increase in target on increased reserves and likelihood of Triassic test. Exploration success, acquisitions, and warrant cash offer further upside.

Price Chart



Source: PCQuote

Financial Summary

Shares O/S (M)	130.7	52-Week Trading Range	\$0.39-\$1.38
Market Capitalization (M)	\$156	Average Weekly Volume	4,823,719
Net Debt - 2005E (M)	-\$11	Market Float (M)	\$144
Enterprise Value (M)	\$144	NAV/Share - 2005E	\$1.02
Forecasts	2005	2006E	2007E
Production (boe/d)	815	1,746	4,209
% gas	57%	28%	32%
Wtd Ave Realized Price (\$/boe)	\$65.6	\$56.1	\$51.6
CapEx (M)	\$48.1	\$24.7	\$50.2
Oil and Gas Revenue (M)	\$12.9	\$35.8	\$79.3
Total Revenue (M)	\$13.9	\$41.3	\$85.6
Debt Adjusted Cash Flow (M)	\$7.4	\$24.7	\$51.0
Shares Outstanding (M)	77.1	134.5	138.3
DACFPS	\$0.06	\$0.18	\$0.37
EPS	(\$0.01)	\$0.12	\$0.23
Valuation	2005	2006E	2007E
EV/DACF	27.1x	6.1x	2.9x
EV/BOE/d (per unit production)	\$176,915	\$82,550	\$34,242
P/E	(103.5x)	9.9x	5.1x

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.

Accretive acquisition set stage for 2006 catalysts

2005 Results demonstrate strong netbacks and low F&D costs for RR >3.5

A 2006 Ryder Scott report has attributed 13.1 mm boe of 2P reserves to the properties acquired from Centurion in February 2005. Acquisition costs of \$44 million plus approximately \$2 million in CAPEX in 2005 provide costs-to-date of \$46 million. Ryder Scott estimated future development costs of \$32.5 million for a full cycle F&D cost of \$78.5 million.

Candax was able to achieve a volume weighted netback of \$21.14/boe on average production of 1,356 boepd. Per unit operating and G&A costs were notably high for the year. High G&A costs per boe of production were elevated at shut-in of El Bibane production to as much as \$22.73/boe in Q4. Operating costs however peaked in Q3 at \$17.27/boe due to expenditures associated with maintenance and work-over. We expect both these costs to improve at the restart of El Bibane production mid-year 2006.

A recycle ratio of 3.5x in 2005 demonstrates the ability of the Candax team to acquire accretive assets in a competitive international forum. Production problems at El Bibane have been partially offset through innovative additions at Ezzaouia, Al Manzah and Robbana. As a modest example, Al Manzah was acquired at no cost and through a simple work-over Candax has been able to capture an additional 81,000 bbls of net 49° API reserves.

Importantly, Candax reported a notable 35% increase in proven reserves through operational activity. Redevelopment of the acquired assets has led to an increase in proven plus probable reserves of 1.4 mm boe. This increase is reflected by a \$10.4 million increase in our estimated corporate NAV to \$1.02/share.

Tunisian investor's tour; top quality technical team and Triassic breakthrough

We have recently had the opportunity to visit the operations of Candax Tunisian subsidiary, Ecumed. Site visits included the Chaal wellsite, the offshore El Bibane Field, and the onshore processing facility/SEEB gas plant. The quality of the technical and local management team is impressive and made-up largely of Tunisian nationals.

El Bibane production restart is a complex and unique operation which is testing the limit of existing technology. Tremendous engineering, project management and procurement issues must be resolved to restart production from the field. A large jack-up rig must be mounted on a barge to navigate the shallow water (4 to 6 m) setting of the field 18 km offshore. Fabrication of this unit is expected to be completed in mid April with arrival in Tunisia by the end of the month.

The Chaal exploration well is expected to be drilling through the reservoir zone, at approximately 4400 m, this week. Wellsite operations include a fully contained mud-pit to prevent contamination of oil-based drilling fluids into the local environment. We expect initial results from the well to be released as early as this week with test results reported in early May. The well is located less than 500 m from ABK-1, which tested at more than 2 mmcf/d with up to 10% condensate.

Exhibit 1: Chaal exploration drilling and El Bibane 3 production well



Source: Wellington West Capital Markets Inc.

Meetings with senior Tunisian energy officials and the Chairman of ETAP highlighted a new priority on deep gas exploration. Candax has consistently expressed intent to drill the Triassic at Ezzaouia only with full participation of state player ETAP. Until recently ETAP had not participated in either exploration or offshore developments. In contrast however, ETAP has recently agreed to take a stake in a \$650 million offshore development, and acquired two exploration permits in western Tunisia.

ETAP emphasized it would now evaluate opportunities on a case by case basis and encouraged discussions regarding Triassic exploration. We expect that a change in the risk profile of the state to increase reserves is likely to be

matched with incentives to encourage exploration. Officials went as far as stating a task force exists to review existing fiscal policies with a mandate to reduce specific terms to encourage deep gas exploration. This bodes very well for Candax in Tunisia in the coming years.

We now feel ETAP participation in a Triassic test is likely. As a consequence we have increased our probability of commercial success in the Triassic from 5% to 10% at both Ezzaouia and El Bibane. Although the state has elected not to participate at El Bibane, and therefore has relinquished a right to back-in, we have increased the likelihood based on our understanding that El Bibane would only be tested after the Triassic at Ezzaouia.

This increase in confidence raises the current risked EMV to \$0.40/share, assuming 300 million boe of gross potential per prospect. We have assumed Centurion would exercise their right to 50% of Candax equity in the prospects and that ETAP would participate in Ezzaouia but not El Bibane. As a consequence we estimate a success case value of \$4.46/share net to Candax.

Exhibit 2: EMV Conceptual Decision Tree and Calculations – Deep Triassic Play

Prospect	EMV-success	EMV-risked	EMV/sh success	EMV/sh risked	Minimum Commercial Field Size (MCFS)
El Bibane	\$409.4 million	\$36.0 million	\$3.13	\$0.28	125 million boe
Ezzaouia	\$174.2 million	\$15.3 million	\$1.33	\$0.12	125 million boe

Source: Wellington West Capital Markets Inc.

Near term catalysts have the potential to catapult Candax to the next level

In the event of success at Chaal Candax could prove-up as much as 840 Bcf of gross recoverable gas resources. Our success case value for this asset is \$1.48/share based on a 60% interest and domestic gas price of US\$5/mcf. The company is currently discussing options to realize immediate cash flow from any discovery through sales from a long-term production test. Officials in Tunisia did express some uncertainty over the ability of Candax to do so without a specified gas sales contract in-place. Such a contract would require some estimate of total volume, appraisal of which could delay production by as much as 2 years.

We expect results from the Chaal well as early as this week, with test results to follow in early May. Candax are likely to report any material gas shows and net-pay values ahead of drill-stem testing. We anticipate the market will react favourably to positive news from the well. Conversely, in the event of failure a second well should be planned to adequately appraise the potential of this very large structure. In the worst-case scenario, of no commercial hydrocarbons, we anticipate as much as \$0.30/share of reduction in our NAV.

The most material near-term catalyst is the potential for a significant accretive acquisition. Candax has well publicized their intent to acquire additional assets throughout the Middle East and North Africa for as much as \$1

billion. Our previous fears of significant dilution associated with overpaying due to intense competition for these assets have been belayed.

We expect Candax to announce a significant acquisition in Q2 financed through the participation of a much larger partner. We have returned from Tunisia with greater confidence in the ability of the Candax team to make high quality acquisitions incorporating value-added assets beyond tangible NAV. Further we have a high regard for; the technical abilities of Mr. Munn and Wilson who continue to scour data rooms throughout the region, and the ambitions of corporate executives for growth.

Valuation and Summary Recommendation

We are increasing our target price to \$1.20 backed by a fully risked portfolio NPV of \$1.02 per share. Strong expected cash flow in 2007 of \$0.37/share leads to target prices above NAV. Our target incorporates an asset EMV of \$1.47/share, a significant increase, based upon increased likelihood of ETAP participation in Triassic exploration at Ezzaouia and reduced by a conservative acquisition value of \$0.92/sh.

A number of near-term catalysts have the potential to add significant value beyond existing assets. We estimate exploration success at Chaal could add \$1.18/share to our current NAV. An accretive acquisition, although likely, is impossible to quantify at this time as we have little indication of scale or funding.

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. 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 3: Net Asset Valuation Table

Valuation Matrix	Forecast	Target Multiple	Value	Weighting	Weighted Value
Risked NPV/share	\$ 1.02	1.0	\$ 1.02	60%	\$ 0.61
2007 DACF Multiple	\$ 0.37	5.0	\$ 1.84	10%	\$ 0.18
Asset EMV/share	\$ 1.47	1.0	\$ 1.47	20%	\$ 0.29
EV/BOE - 2004 Acquisition Value	\$ 0.92	1.0	\$ 0.92	10%	\$ 0.09
12 month target price					\$ 1.18

Source: Company reports, Wellington West Capital Markets Inc.

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Candax Energy Inc.	CAX-T	11, 12

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*Tunisia properties and facilities visited March 2006