# CASPIAN ENERGY INC.

## ANNOUNCES SECOND QUARTER 2007 FINANCIAL RESULTS

Caspian Energy Inc. (the "Company" or "CEK") (TSX and AIM: CEK) announced today its financial results for the three and six month periods ended June 30, 2007. Its interim unaudited financial statements for the period and related management's discussion and analysis have been filed with Canadian securities regulatory authorities and are available for viewing at www.sedar.com.

For the three and six month periods ended June 30, 2007, CEK's net loss was $6,059,772 and $7,436,907, respectively. For the three and six month periods ended June 30, 2006, CEK's net loss was $$974,273 and $1,371,582, respectively. Large non-cash items equal to $1,877,803 (2Q 2006 - $305,689) relating to stock-based compensation charges and $3,346,492 (2Q 2006 - $(702,564)) pertaining to foreign exchange losses contributed to the loss in 2Q 2007. During 2Q 2007, the Company recorded a charge of $448,569 (2006 - $1,408,619) pertaining to future income taxes in the Republic of Kazakhstan .

Caspian recorded charges of $468,409 pertaining to interest and $78,590 pertaining to accretion of the discount on its convertible debentures during the 2007 fiscal period. During 2Q 2006, accretion of the debentures discount amounted to $83,101.

CEK's operations used $849,893 in cash during the three month period and provided $1,316,961 for the comparative quarter of 2006. At the close of 2Q 2007, Caspian had working capital of $9.1 million.

Oil revenues before transportation costs during 2Q 2007 were $1,889,400 and for 2Q 2006 were $1,358,550. During the 2007 fiscal quarter, both of the Company's wells (EZ#213 and EZ#301) contributed to sales volumes. EZ#301 was put back on-stream subsequent to the close of the first quarter 2007 and its productive capacity was reflected in 2Q 2007 results.

For the three months ended June 30, 2007 operating costs were $560,577 and for the 2006 comparative period, operating costs were $331,185 and transportation expenses were $156,504 and $12,796, respectively. Administrative expenses for the same periods were $984,878 and $731,052, respectively.

A recovery in Capital expenditures of $4,496,504 was recorded for 2Q 07 (for 2Q 06, an expenditure of $8,155,440 was recorded). During 2Q 07, drilling supplies of approximately $5 million were reclassed from capital to inventory, reflecting the true nature of this category of assets. Since capital expenditures are composed of advances to Aral and the expenditure of funds by Aral, whose carrying value is denominated in US dollars, the CAD:USD exchange rate has also served to reduce the application of funds to this category of assets.

CEK today filed on SEDAR interim unaudited financial statements and MD&A with respect to its June 30, 2007 first fiscal quarter.

William Ramsay, Chairman and Chief Executive Officer, Caspian Energy, Inc. commented:

“I am pleased to report that wells 213 and 301 continue to perform very satisfactorily at choked-back rates of 384 and 926 BOPD, respectively. In addition, preparations are well advanced to begin the drilling of several shallow well targets in the north western section of the North Block, identified from the 3D seismic programme that was shot over the Baktygaryn area. These individual targets may not be as large as those in the middle Carboniferous; however, they still offer potential for meaningful recoverable amounts of oil and furthermore, will be much quicker and more economic to drill.”

The Company is an oil exploration and development corporation operating in the Republic of Kazakhstan.

For further information contact:

**Caspian Energy Inc.**
William Ramsay
President and Chief Executive Officer
020 7861 3232

**Bell Pottinger Corporate and Financial**
Algy Rowe
020 7861 3232

**Jefferies International Limited**
Toby Hayward / Jack Pryde
+44 (0)20 7618 3500

CAUTIONARY NOTE

Some of the statements and information contained in this news release may include certain estimates, assumptions and other forward-looking information. The actual performance, developments and/or results of the Company may differ materially from any or all of the forward-looking statements, which include current expectations, estimates and projections, in all or in part attributable to general economic conditions, and other risks, uncertainties and circumstances partly or totally outside the control of the Company, including oil prices, imprecision of reserve estimates, drilling risks, future production of gas and oil, rates of inflation, changes in future costs and expenses related to the activities involving the exploration, development, production and transportation of oil, hedging, financing availability and other risks related to financial activities, and environmental and geopolitical risks. Further information which may cause results to differ materially from those projected in the forward-looking statements is contained in the Company’s filings with Canadian securities regulatory authorities. The Company disclaims any intention or obligation to update or revise forward-looking information, whether as a result of new information, future events or otherwise, except in accordance with applicable securities laws.

## BUSINESS PROSPECTS AND OUTLOOK

The Company has been successful in establishing itself as an operating entity in the ROK and expects to continue with future growth through continued work there.

Prior to the end of the fourth quarter 2005, EZ#301 was drilled to a total depth of 4,846 metres and logged. The well was completed with the drilling rig before the rig was moved to the EZ#302 location. EZ#301 was matrix acidized and the two potentially productive hydrocarbon bearing zones were flow-tested. The lower zone (KT-2) was tested at 2,532 Bopd. The upper zone (KT-1) had difficulty maintaining an independent flow, so it was commingled with the lower zone and the well was tied-in to the Zhagabulak production facility. Subsequently, productions logs were ran and it was determined that the KT-1 was producing 100 Bopd. Well 301 was undergoing a government mandated pressure survey in November 2006, when a production logging tool and cable were lost in the hole. During the second quarter, the tool and wire were recovered and the well has resumed production. Well 301 is currently producing 926 BOPD, 8 BWPD, 1,274 MCFD with a FTP (flowing tubing pressure) of 588 psig and a shut in casing pressure of 1,896 psig on a 12 mm choke.

The second exploration effort, EZ#302, was spud on December 25, 2005. Acidizing and testing of the well were performed following removal of the drilling rig. The well showed indications of hydrocarbons while drilling and logging; however, the stimulation efforts failed to cause the well to flow naturally. In well 302, a workover is being evaluated to isolate the KT-1 and the lower portions of the KT-2 that exhibit higher water saturations on the logs.

The third location, EZ#303 is about 5.2 km southwest of EZ#302. EZ#303 spud on May 28, 2006. The well was permitted to a depth of 5,700 metres. EZ#303 reached a total depth of 4,630 metres in a sidetrack wellbore after the initial wellbore reached a depth of 5,430 metres, but was lost due to a drill string parting, while pulling out of the hole for logging. A total of 70 meters were perforated and acidized in both the KT-1 and KT-2 intervals. A combined test of both intervals yielded water with small amounts of oil, while the separate test on the KT-1 yielded water. The well is suspended pending a workover strategy.

The original producing well, EZ#213, drilled and completed during the Soviet period, was re-entered in November 2006 and perforations were added in the KT-1 reservoir. Due to different casing weights, problems were encountered with packer setting for the acid operation and consequently, only one-half of the productive zones were acidized. Despite the limits on the acidization, a significant improvement of daily production over the pre-workover rates was achieved. Well 213 is currently producing 384 BOPD, 54 BWPD, 528 MCFD with a flowing tubing pressure of 544 psig and a shut-in casing pressure of 1,970 psig on an 8.7 mm choke. A survey to determine the production contribution from the KT-1 and KT-2 intervals is planned for Q3, the results of which will be integrated into the final analysis and ranking of potential workover strategies for wells 302 and 303.

Further drilling in the remainder of the Zhagabulak area will be delayed while the Company focuses on shallower targets in the western side of the North Block.

The Company has initiated the development process for East Zhagabulak. While East Zhagabulak is small, a development contract will ultimately lead to commercialization. Expansion is planned as drilling in the surrounding Zhagabulak area unfolds.

Ongoing petrophysical analyses of all wells penetrating the below salt reservoirs is being completed and correlations of these wells will aid in the identification of future drilling locations in the North Block. Identification and acquisition of well data within the extended territory is also be evaluated for inclusion into this process.

The Baktygaryn 3-D seismic program was completed in early November 2005. PGS-GIS, in Almaty, ROK was awarded the processing contract. Due to the presence of large salt bodies in the Baktygaryn Area, the 3-D data set was processed through PSDM (Pre-Stack Depth Migration) and interpretation of this data has been completed. PSTM (Pre-Stack Time Migration) analysis, for the above salt section has also been conducted. The acquisition of the 367 kilometre regional 2-D seismic survey covering the west and north areas of the North Block and tying into the Zhagabulak and Baktygaryn 3-D seismic surveys that was completed in March 2007 has also been processed and interpreted. The Baktygaryn 3-D program and the regional 2-D program were fully interpreted at the end of October 2006. The interpreted data from all new seismic data acquired and from the earlier reprocessed Soviet-era 2-D seismic is being combined to create a geological model and identify additional leads and prospects across the North Block territory. This work is expected to be completed during 3Q 2007.

The Baktygaryn Area presents drilling targets in both the below salt Lower Permian and Carboniferous sections and the above salt Upper Permian and Mesozoic sections with depths ranging from approximately 400 to 2,300 metres and provides a second tier of exploration to the Company's drilling portfolio. Three locations are being permitted with target depths of 600 to 800 metres. These targets are recognized in the forms of channel sands, traps against the Kungurian salt ridges and underneath salt overhangs. The Company expects to spud its first well in this area during October 2007.

Soviet-era seismic data interpretation, mapping and the associated shallow well drilling in the Itisay, Kozdesay and West Kozdesay areas, located in the southwestern portion of the North Block, yielded minor positive tests and shows of oil associated with the post-salt sediments of Jurassic, Triassic and Upper Permian ages. A review of this data has resulted in the identification of several prospects and leads ranging from 600 to 1,800 metres in trapping positions against Permian salt ridges and under-salt overhangs. Several lines from the Company's 2006 2-D seismic program were shot across certain of these leads and prospects to verify this premise. The entire vintage and modern data sets are being fully interpreted and well-to-seismic ties performed for aiding in the creation of a geological model for these Areas. The Company expects to have identified several drillable prospects by the close of 3Q 2007.

Future, potential seismic activity, pending the results of the ongoing 2-D seismic interpretation, includes a third 3-D seismic acquisition late in the fourth quarter.

**Interim Consolidated Balance Sheet**
**(Unaudited)**

| | June 30, 2007 $ | December 31, 2006 $ (Audited) |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | 5,625,618 | 17,022,285 |
| Accounts receivable | 1,009,530 | 672,879 |
| Prepaids and other deposits | 2,690,168 | 2,713,994 |
| Inventory (note 3) | 5,683,164 | 177,055 |
| | 15,008,480 | 20,586,213 |
| **Restricted cash** (note 2) | 178,719 | 194,412 |
| **Property, plant and equipment** (note 4) | 119,175,091 | 118,323,038 |
| | 134,362,290 | 139,103,663 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities | 5,837,117 | 5,305,085 |
| **Asset retirement obligation** (note 5) | 155,726 | 156,255 |
| **Future income taxes** | 720,859 | 358,848 |
| **Convertible debentures** (note 6) | 18,011,307 | 18,683,004 |
| | 24,725,009 | 24,503,192 |
| **Shareholders' Equity** | | |
| **Share capital** (note 7) | 121,470,892 | 121,470,892 |
| **Warrants to purchase common shares** (note 7) | 946,508 | 946,508 |
| **Contributed surplus** (note 9) | 14,503,989 | 12,030,272 |
| **Deficit** | (27,284,108) | (19,847,201) |
| | 109,637,281 | 114,600,471 |
| | 134,362,290 | 139,103,663 |

See accompanying notes to consolidated financial statements.

**Interim Consolidated Statement of Loss and Deficit**
**(Unaudited)**

| | Three months e June 30, 2007 $ | Three months e June 30, 2006 $ | Six months end June 30, 2007 $ | Six months end June 30, 2006 $ |
|---|---|---|---|---|
| **Revenue** | | | | |
| Oil and gas revenue, net | 1,889,400 | 1,358,550 | 2,247,397 | 2,110,461 |
| Interest | 1,520,836 | 496,203 | 1,648,185 | 594,283 |
| Other | (66,251) | (6,663) | 2,492 | 565 |
| | 3,343,985 | 1,848,090 | 3,898,074 | 2,705,309 |
| **Expenses** | | | | |
| General and administrative | 984,878 | 731,052 | 1,589,198 | 1,418,423 |
| Accretion of convertible debentures (note 6) | 78,590 | 83,101 | 164,602 | 111,975 |
| Interest | 1,190,266 | 606,526 | 1,651,059 | 609,112 |
| Operating | 560,577 | 331,185 | 927,206 | 605,842 |
| Transportation | 156,504 | 12,796 | 184,713 | 18,355 |
| Stock-based compensation (note 8) | 1,877,803 | 305,689 | 2,473,717 | 611,378 |
| Foreign exchange loss (gain) | 3,346,492 | (702,564) | 3,084,189 | (804,200) |
| Depletion, depreciation and accretion | 760,078 | 45,959 | 811,728 | 97,387 |
| | 8,955,188 | 1,413,744 | 10,886,412 | 2,668,272 |
| **(Loss) income before income taxes** | (5,611,203) | 434,346 | (6,988,338) | 37,037 |
| **Future income taxes** | 448,569 | 1,408,619 | 448,569 | 1,408,619 |
| **Net loss for the period** | (6,059,772) | (974,273) | (7,436,907) | (1,371,582) |
| **Deficit – Beginning of period** | (21,224,336) | (13,806,698) | (19,847,201) | (13,409,389) |
| **Deficit – End of period** | (27,284,108) | (14,780,971) | (27,284,108) | (14,780,971) |
| **Basic loss per share** (note 7) | (0.06) | (0.01) | (0.07) | (0.01) |
| **Diluted loss per share** (note 7) | (0.06) | (0.01) | (0.07) | (0.01) |

See accompanying notes to consolidated financial statements.

**Interim Consolidated Statement of Cash Flows**
(Unaudited)

| | Three months ended June 30, 2007 $ | Three months ended June 30, 2006 $ | Six months ended June 30, 2007 $ | Six months ended June 30, 2006 $ |
|---|---|---|---|---|
| **Cash provided by (used in)** | | | | |
| **Operating activities** | | | | |
| Net loss for the period | (6,059,771) | (974,273) | (7,436,907) | (1,371,582) |
| Items not affecting cash | | | | |
| Stock-based compensation | 1,877,803 | 305,689 | 2,473,717 | 611,378 |
| Unrealized foreign exchange loss | 2,324,801 | 447,866 | 2,737,540 | 826,000 |
| Depletion, depreciation and accretion | 760,078 | 45,959 | 811,728 | 97,387 |
| Accretion of convertible debentures | 78,590 | 83,101 | 164,602 | 111,975 |
| Future income taxes | 448,569 | 1,408,619 | 448,569 | 1,408,619 |
| Interest on convertible debentures | 468,409 | - | 925,792 | - |
| Interest on inter-company advance | (748,372) | - | (748,372) | - |
| | (849,893) | 1,316,961 | (623,331) | 1,683,777 |
| Changes in non-cash working capital balances | (418,509) | (1,991,034) | (336,650) | (1,875,517) |
| | (1,268,402) | (674,073) | (959,981) | (191,740) |
| **Financing activities** | | | | |
| Convertible debentures | - | (87,289) | - | 18,345,190 |
| Loan payable | - | (263,268) | - | (235,697) |
| Foreign exchange | - | (447,866) | - | (826,000) |
| Restricted cash | 18,526 | (2,194) | 15,693 | (2,743) |
| Issuance of common shares and warrants | - | 50,090,450 | - | 50,804,650 |
| Share issue expenses | - | (3,123,706) | - | (3,782,317) |
| | 18,526 | 46,166,127 | 15,693 | 64,303,083 |
| **Investing activities** | | | | |
| Acquisition of property, plant and equipment | 4,496,504 | (8,155,440) | (5,502,127) | (21,331,979) |
| Changes in non-cash working capital balances | (5,558,027) | (2,513,220) | (4,950,252) | (3,830,447) |
| | (1,061,523) | (10,668,660) | (10,452,379) | (25,162,426) |
| **Increase (decrease) in cash and cash equivalents** | (2,311,399) | 34,823,394 | (11,396,667) | 38,948,917 |
| **Cash and cash equivalents – Beginning of period** | 7,937,017 | 14,219,609 | 17,022,285 | 10,094,086 |
| **Cash and cash equivalents – End of period** | 5,625,618 | 49,043,003 | 5,625,618 | 49,043,003 |
| **Interest paid and received** | | | | |
| Interest received | 54,691 | 496,203 | 183,840 | 580,490 |

See accompanying notes to consolidated financial statements.

## 1 Nature of operations

Caspian Energy Inc. ("Caspian" or the "Company") is engaged in the exploration for and development and production of oil and gas in the Republic of Kazakhstan. Its primary operating activities are carried out through its wholly-owned subsidiary, Caspian Energy Ltd. ("Caspian Ltd.").

Caspian's principal assets are a 50% interest in Aral Petroleum Capital LLP ("Aral"), held by Caspian Ltd. Through its interest in Aral, Caspian has the right to explore and develop certain oil and gas properties in Kazakhstan, known as the North Block, a 3,458 square kilometre area located in the vicinity of the Kazakh pre-Caspian basin. The Company also has minor resource interests in Canada.

Aral's exploration and development rights to the North Block were granted pursuant to the terms of an exploration contract between the government of Kazakhstan and Aral (the "Exploration Contract"). The initial three-year term of the Exploration Contract has been extended for a two-year period (expiring in December 2007) and is subject to a further extension of two years thereafter, in accordance with the terms of the contract.

Under the terms of the Exploration Contract, Aral was obligated to spend at least US$20.8 million under a minimum work program in respect of the North Block during the initial three-year term of the contract. The expenditures include processing and reinterpretation of geological and geophysical data of prior years, two dimensional and three dimensional seismic shoots and surveys, drilling exploration wells, well reactivations and well surveys and testing. As of December 31, 2005, Aral's financial obligation under the minimum work program had been discharged.

Under terms of a shareholders' agreement dated June 25, 2004, among Caspian Ltd., Azden Management Limited ("Azden") and Aral, Caspian was committed to fund Aral's US$20.8 million obligation under the initial work program. This financial commitment was satisfied, in full, by the Company. In addition, Caspian Ltd. has undertaken, on a best efforts basis, to raise financing of US$84.0 million to fund Aral's operations pursuant to the Exploration Contract. At March 31, 2007, Caspian Ltd. had discharged this undertaking.

## 2 Significant accounting policies

The consolidated financial statements of Caspian are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles.

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

**Cash and cash equivalents**

Cash and cash equivalents are comprised of cash and short-term investments with an initial maturity date of three months or less.

**Inventory**

Inventory is recorded at the lower of cost calculated using the weighted average method, and net realizable value. Cost comprises direct materials and where applicable direct labour costs and those overheads which have been incurred in bringing the inventories to their present location and condition. Net realizable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

**Joint ventures**

The Company's oil and gas exploration and development activities are conducted mainly in Kazakhstan through its 50% interest in Aral and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

**Property, plant and equipment**

**a) Capitalized costs**

The Company follows the full cost method of accounting for oil and natural gas operations, whereby all costs related to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical costs, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells, the cost of petroleum and natural gas production equipment and overhead charges directly related to exploration and development activities. Proceeds from the sale of oil and gas properties are applied against capital costs, with no gain or loss recognized, unless such a sale would change the rate of depletion and depreciation by 20% or more, in which case, a gain or loss would be recorded.

**b) Depletion, depreciation and amortization**

The capitalized costs are depleted and depreciated using the unit-of-production method based on proven petroleum and natural gas reserves, as determined by independent consulting engineers. Oil and natural gas liquids reserves and production are converted into equivalent units of natural gas based on relative energy content on a ratio of six thousand cubic feet of gas to one barrel of oil. Significant development projects and expenditures on exploration properties are excluded from calculation of depletion prior to assessment of the existence of proved reserves.

Other property, machinery and equipment are recorded at historical cost. Depreciation is calculated on a straight-line basis at the following annual rates:

| | |
|---|---|
| Buildings | 8% |
| Machinery and equipment | 8% |
| Vehicles | 7% |
| Other fixed assets | 10% |

**c) Ceiling test**

The Company follows the Canadian accounting guideline on full cost accounting. In applying the full cost guideline, Caspian calculates its ceiling test for each cost centre by comparing the carrying value of oil and natural gas properties and production equipment to the sum of undiscounted cash flows expected to result from Caspian's proved reserves. If the carrying value is not fully recoverable, the amount of impairment is measured by comparing the carrying value of oil and gas properties and production and equipment to the estimated net present value of future cash flows from proved plus probable reserves using a risk-free interest rate and expected future prices. Any excess carrying value above the net present value of the future cash flows is recorded as a permanent impairment.

**d) Unproved property**

Costs of acquiring and evaluating unproven properties are initially excluded from costs subject to depletion, until it is determined whether or not proved reserves are attributable to the properties or, in the case of major development projects, commercial production has commenced, or impairment has occurred. Impairment occurs whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When proven reserves are determined or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion for that country's cost centre.

**e) Asset retirement obligation**

Caspian records the fair value of asset retirement obligations ("ARO") as a liability in the period in which it incurs a legal obligation to restore an oil and gas property, typically when a well is drilled or other equipment is put in place. The associated asset retirement costs are capitalized as part of the carrying amount of the related asset and depleted using a unit-of-production method over the life of the proved reserves. Subsequent to initial measurement of the obligations, the obligations are adjusted at the end of each reporting period to reflect the passage of time and changes in estimated future cash flows underlying the obligation. Actual costs incurred on settlement of the ARO are charged against the ARO.

**Income taxes**

Income taxes are calculated using the liability method of tax accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying value amount on the balance sheet are used to calculate future income tax assets and liabilities. Future income tax assets and liabilities are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse.

**Stock-based compensation**

The Company grants options to purchase common shares to employees and directors under its stock option plan. Under this standard, future awards are accounted for using the fair value of accounting for stock-based compensation. Under the fair value method, an estimate of the value of the option is determined at the time of grant using a Black-Scholes option-pricing model. The fair value of the option is recognized as an expense and contributed surplus over the vesting period of the option. Proceeds received on exercise of stock options, along with amounts previously included in contributed surplus, are credited to share capital.

**Revenue recognition**

Revenue from the sale of oil and natural gas is recognized based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating and maintenance costs, transportation, and production-based royalty expenses will be recognized in the same period in which the related revenue is earned and recorded.

**Measurement uncertainty**

The amounts recorded for depletion and depreciation of property, plant and equipment, the provision for asset retirement obligations and the amounts used for ceiling test calculations are based on estimates of reserves and future costs. The Company's reserve estimates are reviewed annually by an independent engineering firm. The amounts disclosed relating to fair values of stock options issued are based on estimates of future volatility of the Company's share price, expected lives of options, and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty.

**Earnings (loss) per share**

Basic per share amounts are calculated using the weighted average number of shares outstanding during the period. Diluted per share amounts are calculated based on the treasury stock method whereby the weighted average number of shares is adjusted for the dilutive effect of options. The Company applies the treasury stock method for the calculation of diluted net income (loss) per share whereby the effect of the "in the money" instruments such as stock options and warrants affect the calculation. The treasury stock method assumes that the proceeds from the exercise are used to repurchase common shares of the Company at the weighted average market price during the year.

**Financial instruments**

*Fair values*

The fair values of accounts receivable, accounts payable and accrued liabilities, and loan payable approximate their carrying values due to their short-term maturity.

*Credit risk*

Substantially all of the Company's accounts receivable are due from companies in the oil and gas industry and are subject to the normal industry credit risks. The carrying value of accounts receivable reflects management's assessment of the associated credit risks.

**Foreign currency**

All operations are considered financially and operationally integrated. Results of operations are translated to Canadian dollars, using average rates for revenues and expenses, except depreciation which is translated at the rate of exchange applicable to the related assets. Monetary items denominated in foreign currency are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Foreign exchange gains and losses are recorded in the statement of loss.

**Restricted cash**

Under the terms of the Exploration Contract, Aral has accrued 1% of the capital costs of exploration (the "Liquidation Fund") in an amount of US $329,000 as of June 30 and December 31, 2006, (Caspian – Cdn. $178,719 and Cdn. $194,412, respectively) and deposited the cash in a restricted bank account. It is anticipated that the Liquidation Fund will be used to finance the restoration of the License Area upon expiration of the Exploration Contract, unless a production contract is awarded.

## 3 Inventory

| | June 30, 2007 $ | December 31, 2006 $ |
|---|---|---|
| Drilling supplies | 5,122,069 | - |
| Oil inventory | 35,184 | 24,742 |
| Fuel | 7,774 | 3,522 |
| Construction materials | 4,120 | 4,342 |
| Spare parts | 7,468 | 3,425 |
| Other materials | 506,549 | 141,024 |
| | 5,683,164 | 177,055 |

## 4 Property, plant and equipment

| | June 30, 2007 $ | December 31, 2006 $ |
|---|---|---|
| Petroleum and natural gas assets | 119,587,861 | 118,334,595 |
| Other assets | 2,792,816 | 2,508,707 |
| | 122,380,677 | 120,843,302 |
| Accumulated depletion and depreciation | (3,205,586) | (2,520,264) |
| | 119,175,091 | 118,323,038 |

Excluded from the depletable base of oil and gas assets at June 30, 2007 are unproved properties of $72,687,701 (December 31, 2006 – $65,707,839).

Aral applied the ceiling test to its capitalized assets at June 30, 2007 and December 31, 2006 and determined that there was no impairment of such carrying costs.

During the period ended June 30, 2007, the Company capitalized $101,011 (December 31, 2006 – $387,660) of general and administrative expenses related directly to exploration and development activities.

## 5 Asset retirement obligation

The Company records the fair value of asset retirement obligations as a liability in the period in which it incurs the legal obligation.

The asset retirement obligation results from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations at June 30, 2007 is $167,542, which will be incurred between 2014 and 2019. A credit-adjusted risk-free rate of 12.9% was used to calculate the fair value of the asset retirement obligations, and an inflation factor of 8.4%.

A reconciliation of the asset retirement obligation is provided below:

| | **June 30, 2007 $** | **December 31, 2006 $** |
|---|---|---|
| Opening balance | 156,255 | 88,900 |
| Liabilities incurred | - | 38,382 |
| Accretion | 4,450 | 4,760 |
| Change in estimate | (4,979) | 24,213 |
| Closing balance | 155,726 | 156,255 |

Under the terms of the Exploration Contract (note 1), the Company is required to create a fund to finance actual future restoration costs, equal to 1% of the capital costs of exploration. At June 30, 2007 and December 31, 2006, $178,719 and $194,412, respectively have been placed in a restricted bank account related to the funding requirement.

## 6 Convertible debentures

On March 1, 2006, the Company received US $16 million and issued 10% per annum, convertible debentures in a like amount. The debentures mature on March 2, 2011 and are convertible at any time and from time to time into common shares of the Company at a conversion price of $2.45 per share. The Company may repay the principal amount of the debentures, in whole or in part, or require conversion into common shares of the Company if the volume-weighted average trading price of the common shares, for 40 consecutive trading days, is at least $4.08.

| | Face amount $ | Fair value of conversion option $ | Accretion $ | Interest $ | Carrying value $ |
|---|---|---|---|---|---|
| Debentures issued, opening balance | 18,320,884 | (1,483,805) | 281,168 | 1,564,757 | 18,683,004 |
| Accretion of discount | - | - | 164,602 | - | 164,602 |
| Translation adjustment | (1,605,193) | - | - | (156,898) | (1,762,091) |
| Interest accrual | - | - | - | 925,792 | 925,792 |
| Balance – June 30, 2007 | 16,715,691 | (1,483,805) | 445,770 | 2,333,651 | 18,011,307 |

## 7 Share capital

**Authorized**

Unlimited number of voting common shares, without stated par value

**Issued**

| | Number of shares | Amount $ |
|---|---|---|
| Issued and outstanding as at January 31, 2005 | 84,122,163 | 75,376,278 |
| Exercise of warrants (i) | 205,000 | 135,300 |
| Share issue costs (v) | - | (290,816) |
| Issued and outstanding as at December 31, 2005 | 84,327,163 | 75,220,762 |
| Exercise of warrants (ii) | 357,100 | 888,505 |
| Private placement (iii) | 19,609,000 | 49,056,442 |
| Exercise of options (iv) | 50,000 | 87,500 |
| Share issue costs (v) | - | (3,782,317) |
| Issued and outstanding as at December 31, 2006 and June 30, 2007 | 104,343,263 | 121,470,892 |

i) During the period, 205,000 warrants were exercised. The warrants had an exercise price of $0.66 per common share.

ii) During the period, 357,100 broker warrants were exercised. The warrants had an exercise price of $2.00 per common share.

iii) On April 5, 2006 a private placement of 19,609,000 common shares were issued at $2.55 per share.

iv) On April 10, 2006, 50,000 common shares at $1.75 per were issued pursuant to the Company's stock option plan.

v) Share issue costs have not been tax-effected.

**Stock options**

The Company has a stock option plan (the "Plan") under which it may grant options to directors, officers and employees for the purchase of up to 15% of the number of common shares from time to time. Options are granted at the discretion of the board of directors. The exercise price, vesting period and expiration period are also fixed at the time of grant at the discretion of the Board of Directors in accordance with terms of the Plan.

Changes to the Company's stock options are summarized as follows:

| | **Number of options** | **Weighted average option price $** |
|---|---|---|
| Balance – January 31, 2005 | 7,173,228 | 1.72 |
| Granted | 1,993,271 | 1.69 |
| Balance – December 31, 2005 | 9,166,499 | 1.72 |
| Granted | 1,943,433 | 1.29 |
| Exercised | (50,000) | 1.75 |
| Balance – December 31, 2006 | 11,059,932 | 1.64 |
| Granted | 2,668,845 | 0.88 |
| Expired | (400,000) | 2.15 |
| Balance – June 30, 2007 | 13,328,777 | 1.47 |
| Exercisable – June 30, 2007 | 12,332,944 | 1.48 |

The following is a summary of stock options outstanding and exercisable as at June 30, 2007:

| | Options outstanding | | Options exercisable | |
|---|---|---|---|---|
| **Range of exercise price** | **Options outstanding** | **Weighted average remaining contractual life in years** | **Weighted average exercise price** | **Options exercisable** |
| $0.75 | 2,079,090 | 2.2 | $0.75 | 2,079,090 |
| $0.86 | 800,000 | 4.6 | $0.86 | 666,667 |
| $0.89 | 1,868,845 | 4.8 | $0.89 | 1,868,845 |
| $1.25 | 1,043,433 | 4.0 | $1.25 | 1,043,433 |
| $1.34 | 900,000 | 4.4 | $1.34 | 300,000 |
| $1.61 | 843,271 | 3.2 | $1.61 | 843,271 |
| $1.75 | 1,100,000 | 3.2 | $1.75 | 1,100,000 |
| $2.00 | 1,050,000 | 2.4 | $2.00 | 787,500 |
| $2.15 | 3,644,138 | 2.2 | $2.15 | 3,644,138 |
| | 13,328,777 | | $1.48 | 12,332,944 |

**Per share amounts**

The weighted average number of common shares outstanding during the period ended June 30, 2007 of 104,343,263 (June 30, 2006 – 103,907,429 shares) was used to calculate loss per share amounts.

In computing diluted loss per share, no shares were added to the weighted average number of common shares outstanding during the period ended June 30, 2007 (June 30, 2006 – nil) as they are anti-dilutive. The fully-diluted number as at June 30, 2007 was 130,754,673 shares (June 30, 2006 – 127,553,295).

**Warrants**

588,270 broker warrants are outstanding at June 30, 2007 and all have vested. These warrants entitle the holder to purchase one common share at a price of $2.77 until April 5, 2008. The fair value of the outstanding warrants using the Black-Scholes method was $946,508 (December 31, 2006 – $946,508).

## 8 Stock-based compensation

Options granted to both employees and non-employees are accounted for using the fair value method. The fair value of common share options granted in the period ended June 30, 2007 was estimated to be $1,493,527 as at the grant date using a Black-Scholes option-pricing model and the following assumptions:

| | |
|---|---|
| Risk free interest rate | 4% |
| Expected life | 5 year average |
| Expected volatility | 73 – 75% |
| Expected dividend yield | 0% |

The estimated fair value of the options is amortized to expense and credited to contributed surplus over the option vesting period on a straight-line basis.

## 9 Contributed surplus

| | **June 30, 2007 $** | **December 31, 2006 $** |
|---|---|---|
| Balance – Beginning of period | 12,030,272 | 7,668,133 |
| Stock options issued to employees, officers and directors | 2,473,717 | 2,384,901 |
| Fair value of debentures conversion option | - | 1,483,805 |
| Fair value of warrants expired | - | 493,433 |
| Balance – End of period | 14,503,989 | 12,030,272 |

The term and vesting conditions of each option may be fixed by the board when the option is granted, but the term cannot exceed 5 years from the date upon which the option is granted.

The options granted to directors, officers and employees may be exercised over five years from the date of granting and expire from time to time to April 2012.

The debentures are convertible into common shares of the Company at a price of $2.45 per share and mature on March 31, 2011.

## 10 Commitments

In accordance with the shareholders' agreement in respect of Aral, Caspian was obligated to fund the initial work program of Aral pursuant to the Exploration Contract. The minimum work program was US $20.8 million and matured at the end of calendar 2005. As at December 31, 2005, this obligation was fully discharged. The work program extension to December 2007 includes drilling three wells to a combined total of 8,500 metres with a monetary obligation of US $20.6 million. No additional seismic is required. The Company's calendar 2006 minimum work program with the Republic of Kazakhstan was approved for US $12.2 million and was discharged during 2006. US $8.4 million is the minimum commitment for calendar 2007.

## 11 Financial instruments

Caspian's financial instruments included in the consolidated balance sheet are comprised of cash and cash equivalents, accounts receivable, other deposits and, accounts payable. The fair values of these financial instruments approximate their carrying amounts due to the short-term nature of the instruments. A substantial portion of Caspian's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

A substantial portion of Caspian's activities are settled in foreign currencies and consequently, the Company is subject to fluctuations in currency translation rates.

The liability and equity components of the convertible debentures are presented separately in accordance with their substance. The liability component is accreted to the amount payable at maturity by way of a charge to earnings using the effective interest method.

## 12 Segmented information

The Company's activities are conducted in two geographic segments: Canada and Kazakhstan. All activities relate to exploration for and development of petroleum and natural gas.

| | Canada<br>$ | Kazakhstan<br>$ | Total<br>$ |
|---|---|---|---|
| **Revenue** | | | |
| Oil and gas revenue, net | 23,196 | 2,224,201 | 2,247,397 |
| Interest | 1,648,185 | - | 1,648,185 |
| Other | - | 2,492 | 2,492 |
| | 1,671,381 | 2,226,693 | 3,898,074 |
| **Expenses** | | | |
| General and administrative | 1,366,914 | 222,284 | 1,589,198 |
| Accretion of convertible debentures | 164,602 | - | 164,602 |
| Interest | 935,088 | 715,971 | 1,651,059 |
| Operating | 5,663 | 921,543 | 927,206 |
| Transportation | 204 | 184,509 | 184,713 |
| Stock-based compensation | 2,473,717 | - | 2,473,717 |
| Foreign exchange loss (gain) | 8,179,790 | (5,095,601) | 3,084,189 |
| Depletion, depreciation and accretion | 2,500 | 809,228 | 811,728 |
| Future income taxes | - | 448,569 | 448,569 |
| | 13,128,478 | (1,793,497) | 11,334,981 |
| **Net loss for the period** | (11,457,097) | 4,020,190 | (7,436,907) |
| **Assets** | | | |
| Current assets | 5,036,959 | 9,971,521 | 15,008,480 |
| Restricted cash | - | 178,719 | 178,719 |
| Property, plant and equipment, net | 31,673 | 119,143,418 | 119,175,091 |
| | 5,068,632 | 129,293,658 | 134,362,290 |
| **Liabilities** | 18,651,779 | 6,073,229 | 24,725,008 |

## 13 Reconciliation of International Financial Reporting Standards

Accounting practices under Canadian GAAP and International Financial Reporting Standards ("IFRS") are, as they affect these financial statements, substantially the same except for the following:

**Property and equipment**

Under Canadian GAAP, an impairment loss should be recognized when the carrying amount of a cost centre is not recoverable and exceeds its fair value. The carrying amount is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. Unproved properties and major development projects are included in this recoverability test. A cost centre impairment loss should be measured as the amount by which the carrying amount of assets capitalized in a cost centre exceeds the sum of:

- the fair value of proved and probable reserves; and
- the costs (less any impairment) of unproved properties that have been subject to a separate test for impairment and contain no probable reserves

For costs beyond the exploration and evaluation stage, IFRS requires (i) an impairment to be recognized when the recoverable amount of an asset (cash generating unit) is less than the carrying amount; (ii) the impairment loss to be determined as the excess of the carrying amount above the recoverable amount (the higher of fair value less costs to sell and value in use, calculated as the present value of future cash flows from the asset), rather than the excess of the carrying amount above the undiscounted future cash flows of the asset; and (iii) the reversal of an impairment loss when the recoverable amount changes. A ceiling test based on cash generating units did not reveal the need for an impairment charge.

For exploration and evaluation costs, IFRS 6 has been adopted effective January 1, 2005. IFRS 6 allows for continued application of an entity's existing policy with respect to accounting for exploration and evaluation costs.

**Impairment of long-lived assets**

Under Canadian GAAP, a long-lived asset should be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. An impairment loss should be recognized when the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. Under IFRS, the carrying amounts of the Company's assets, other than oil and gas properties, inventories and deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amounts are estimated. An impairment loss is recognized when the carrying amount of an asset exceeds its recoverable amount. Impairment losses, if any, are recognized in the income statement. This difference in accounting policy has no impact on these financial statements.

Under Canadian GAAP, the carrying amount of a long-lived asset is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. This assessment is based on the carrying amount of the asset at the date it is tested for recoverability, whether it is in use or under development. Under IFRS, the recoverable amount of the

Company's assets other than oil and gas properties is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflect current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. This difference in accounting policy has no impact on these financial statements.

In respect of impairment of assets other than oil and gas properties, under Canadian GAAP, an impairment loss is not reversed if the fair value subsequently increases. For IFRS, an impairment loss may be reversed if there has been a change in the estimates used to determine the recoverable value.

An impairment loss, on assets other than oil and gas properties, is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized. This difference in accounting policy has no impact on these financial statements.

**Asset retirement obligation**

In re-measuring an asset retirement obligation for the passage of time, Canadian GAAP requires re-measurement based on the risk-free rate that existed when the liability was initially measured. IFRS requires the use of current market assessed interest rates in each estimate. This difference did not result in a material reconciling item.

**Inventory**

Under Canadian GAAP, the Company measures its supplies inventory at the lower of historical cost or net replacement cost. Under IFRS, the lower of cost or net realizable value principle would apply. This difference did not result in a material reconciling item.