

Caspian Energy Inc.

Consolidated Financial Statements
December 31, 2017 and 2016

Independent Auditors' Report

To the Shareholders of Caspian Energy Inc.

We have audited the accompanying consolidated financial statements of Caspian Energy Inc., which comprise the consolidated statements of financial position as at December 31, 2017 and December 31, 2016, the consolidated statements of income (loss) and comprehensive income (loss) and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Caspian Energy Inc. as at December 31, 2017, December 31, 2016 and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to note 1 in the consolidated financial statements which describes matters and conditions that indicate the existence of a material uncertainty that may cast significant doubt about Caspian Energy Inc.'s ability to continue as a going concern.

Calgary, Alberta
April 30, 2018

MNP LLP
Chartered Professional Accountants

Caspian Energy Inc.

Consolidated Statements of Financial Position As at December 31

(in thousands of Canadian dollars)

	2017	2016
	\$	\$
Assets		
Current assets		
Cash and cash equivalents (Note 7)	126	85
Trade receivables and other current assets (Note 8)	1,972	1,970
Inventory	93	86
	<u>2,191</u>	<u>2,141</u>
Non-current assets		
Restricted cash (Note 9)	23	–
VAT receivable (Note 10)	3,335	3,883
Property and equipment (Note 11)	5,805	12,425
Exploration and evaluation assets (Note 12)	29,147	30,936
	<u>29,175</u>	<u>34,844</u>
Total assets	<u>40,501</u>	<u>49,385</u>
Liabilities		
Current liabilities		
Trade and other payables	27,977	29,481
Loans payable (Note 13)	327	–
	<u>28,304</u>	<u>29,481</u>
Non-current liabilities		
Loans payable (Note 13)	27,469	26,320
Decommissioning liability (Note 14)	1,116	1,081
Deferred tax liability (Note 15)	14,843	12,233
	<u>43,428</u>	<u>39,634</u>
Total liabilities	<u>71,732</u>	<u>69,115</u>
Shareholders' deficit		
Share capital (Note 16)	183,035	183,035
Contributed surplus	18,507	18,507
Deficit	(235,200)	(224,176)
Accumulated other comprehensive income	2,427	2,904
	<u>(31,231)</u>	<u>(19,730)</u>
Total shareholders' deficit	<u>(31,231)</u>	<u>(19,730)</u>
Total liabilities and shareholders' deficit	<u>40,501</u>	<u>49,385</u>

Reporting entity and going concern (Note 1)
Commitments and contingencies (Note 26)

Approved by the Board of Directors

(signed) “*Frank Ingriselli*” Director

(signed) “*Wei Zhao*” Director

Caspian Energy Inc.

Consolidated Statements of Income (Loss) and Comprehensive Income (Loss) For the years ended December 31

(in thousands of Canadian dollars)

	2017	2016
	\$	\$
Revenue		
Oil and natural gas revenue, net	2,750	3,937
Expenses		
General and administrative	1,123	1,413
Operating expenses	2,391	2,085
Depletion and depreciation (Note 11)	1,291	75
	4,805	3,573
Operating (loss) income before other items	(2,055)	364
Gain on disposition of property and equipment (Note 11)	28	–
Impairment (expense) reversal (Note 11)	(4,752)	11,785
Finance expense, net (Note 20)	(2,901)	(2,618)
Foreign exchange gain	1,240	756
(Loss) income before taxes	(8,440)	10,287
Tax expense (Note 15)	(2,584)	(7,371)
Net (loss) income	(11,024)	2,916
Other comprehensive (loss) income		
Foreign currency translation adjustments	(477)	51
Comprehensive (loss) income	(11,501)	2,967
(Loss) income per share (Note 19)	(0.02)	0.01

See accompanying notes to the consolidated financial statements.

Caspian Energy Inc.

Consolidated Statements of Changes in Shareholders' Deficit For the years ended December 31

(in thousands of Canadian dollars)

	2017	2016
	\$	\$
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Share capital		
Balance, January 1 and December 31	183,035	183,035
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Contributed surplus		
Balance, January 1 and December 31	18,507	18,507
<hr/>		
Deficit		
Balance, January 1	(224,176)	(227,092)
Net (loss) income	(11,024)	2,916
<hr/>		
Balance, December 31	(235,200)	(224,176)
<hr/>		
Accumulated other comprehensive income		
Balance, January 1	2,904	2,853
Exchange differences on translation of foreign operations	(477)	51
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Balance, December 31	2,427	2,904
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Total shareholders' deficit	(31,231)	(19,730)

Caspian Energy Inc.

Consolidated Statements of Cash Flows For the years ended December 31

(in thousands of Canadian dollars)

	2017	2016
	\$	\$
Cash flow provided by (used in)		
Operating activities		
Net (loss) income	(11,024)	2,916
Adjustments for:		
Depletion and depreciation (Note 11)	1,291	75
Gain on disposition of property and equipment (Note 11)	(28)	–
Impairment expense (reversal) (Note 11)	4,752	(11,785)
Finance expense (Note 20)	2,901	2,618
Foreign exchange	389	(289)
Deferred tax expense	2,610	7,371
Changes non-cash working capital (Note 23)	(1,491)	(3,320)
Net cash used in operating activities	(600)	(2,414)
Financing activities		
Proceeds from loans payable (Note 13)	482	2,970
Repayment of loans payable (Note 13)	–	(1,432)
Net cash provided by financing activities	482	1,538
Investing activities		
(Increase) decrease in restricted cash	(23)	36
Decrease in VAT receivable	327	845
Property and equipment expenditures (Note 11)	(67)	(15)
Proceeds from disposition of property and equipment (Note 11)	36	–
Exploration and evaluation asset expenditures (Note 12)	(106)	(120)
Net cash provided by investing activities	167	746
Change in cash and cash equivalents	49	(130)
Foreign exchange on cash held in foreign currencies	(8)	(7)
Cash and cash equivalents – January 1	85	222
Cash and cash equivalents – December 31	126	85

See accompanying notes to the consolidated financial statements.

Caspian Energy Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2017 and 2016

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1. Reporting entity and going concern

Caspian Energy Inc. (“Caspian” or the “Company”) is a publicly traded company on the NEX, a separate board of TSX Venture Exchange under the stock symbol CKZ.H. Caspian’s registered office is located at 2200, 885 West Georgia Street, Vancouver, British Columbia, Canada.

Caspian is engaged in the exploration for and development and production of oil and natural gas in the Republic of Kazakhstan (“ROK”) through its subsidiary, Aral Petroleum Capital LLP (“Aral”). Aral is owned 10% by the Company and 90% by the Company’s wholly-owned subsidiaries, Caspian Energy Canada Ltd. (“CECL”) and Groenzee B.V. (“Groenzee”).

Through its interest in Aral, the Company has the right to explore and develop certain oil and natural gas properties in Kazakhstan, known as the North Block (the “Exploration Contract”), a 1,466.41 square kilometre area located in the Aktyubinsk region in Kazakhstan (the “License Area”). The term of the Exploration Contract is until December 29, 2018 during which time Aral is committed to a minimum work program in the amount of USD 58.3 million. Aral also has a production contract (the “Production Contract”) with the Ministry of Energy (“ME”) of ROK for carrying out oil extraction activities in the East Zhagabulak field within the License Area. The term of the Production Contract is until July 28, 2035. See Note 26.

As at December 31, 2017, Sixth Energy Limited (“Sixth Energy”), the sole shareholder of ASER, owned and controlled approximately 59.9% of the Company’s issued and outstanding shares. The majority shareholder of Sixth Energy is Mr. Wei Zhao.

Going concern

These consolidated financial statements have been presented on a going concern basis. For the year ended December 31, 2017, the Company reported a net loss of \$11 million and had negative cash flows from operating activities of \$0.6 million. As at December 31, 2017, the Company had a net working capital deficiency of \$26.1 million and a cumulative shareholders’ deficit of \$31.2 million.

The Company has an agreement with Sixth Energy whereby Sixth Energy will provide a secured loan facility of up to USD 61.5 million to Aral (the “Loan Facility”) (Note 13 (b)). The Loan Facility will be secured by share pledges over the entirety of the Company’s Aral interests in favour of the Lenders on a pro-rata basis and repayable on May 20, 2018 or some other later date agreed to by the parties.

The Company’s ability to continue as a going concern is in significant doubt and is dependent upon obtaining financing to fund exploration and development activities and general and administrative expenses and on Aral achieving profitable operating results from its Kazakhstan operations.

The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets and classification of liabilities that might be necessary should the Company be unable to continue its operations. Such adjustments could be material.

2. Basis of presentation

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and Interpretations issued by the International Financial Reporting Interpretations Committee in effect at January 1, 2017. The consolidated financial statements were authorized for issue by the Board of Directors on April 30, 2018.

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For the years ended December 31, 2017 and 2016

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(b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for held-for-trading financial assets which are measured at fair value with changes in fair value recorded in the consolidated statement of income (loss) and comprehensive income (loss). The methods used to measure fair values are discussed in Note 6.

(c) Functional and presentation currency

Functional currency is the currency of the primary economic environment in which a company operates. The functional currency of the Company is Canadian dollars (“CAD”). The functional currency of the Company’s subsidiaries are CAD for CECL, the United States dollar (“USD”) for Groenzee and the Kazakhstani Tenge (“KZT”) for Aral.

These consolidated financial statements are presented in CAD.

3. Significant accounting policies

(a) Basis of consolidation

(i) Subsidiaries:

The following entities have been consolidated within the Company’s financial statements:

<u>Entity</u>	<u>Registered</u>	<u>Holding</u>
Caspian Energy Inc.	Canada	Parent
CECL	Canada	100%
Groenzee	Netherlands	100%
Aral	Kazakhstan	10% by CEI, 40% by CECL and 50% owned by Groenzee

Subsidiaries are entities controlled by the Company. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

Transactions eliminated on consolidation:

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign currency translation

Foreign currency transactions are translated into the respective functional currencies of the Company and its subsidiaries using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated statement of income (loss) and comprehensive income (loss).

The financial results and position of the Canadian parent whose functional currency is different from the presentation currency are translated as follows:

- Assets and liabilities are translated at period-end exchange rates prevailing at that reporting date; and
- Income and expenses are translated at average exchange rates for the period.

Exchange differences arising on translation of the Canadian parent are transferred directly to the Company’s exchange difference on translating foreign operations on the Statement of Comprehensive Loss and are reported as a separate component of shareholders’ equity titled “Accumulated Other Comprehensive Income”.

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(c) Financial instruments

All financial instruments are initially recognized at fair value on the consolidated statements of financial position. The Company has classified each financial instrument into one of the following categories: fair value through profit or loss (assets and liabilities), loans and receivables, financial assets available-for-sale, financial assets held-to-maturity, and other financial liabilities. Subsequent measurement of financial instruments is based on their classification.

(i) Non-derivative financial instruments:

Non-derivative financial instruments comprise cash and cash equivalents, trade receivables and other current assets, trade and other payables and loans payable. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below:

Financial assets at fair value through profit or loss

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Company manages such instruments and makes purchase and sale decisions based on their fair value in accordance with the Company's risk management or investment strategy. Upon initial recognition, attributable transaction costs are recognized in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognized in the consolidated statements of income (loss) and comprehensive income (loss). The Company has designated cash and cash equivalents at fair value through profit or loss.

Other

Other non-derivative financial instruments, such as trade receivables and other current assets, trade and other payables and loans payable are measured at amortized cost using the effective interest method, less any impairment losses.

(ii) Derivative financial instruments:

The Company evaluates all financial instruments for freestanding and embedded derivatives. The Company has not entered into any financial derivative contracts.

(iii) Share capital:

Common shares, stock options and consideration warrants are classified as equity. Incremental costs directly attributable to the issue of common shares, stock options and consideration warrants are recognized as a deduction from equity, net of any tax effects.

The Company uses the Black-Scholes pricing model to estimate the fair value of stock options and consideration warrants on the date of issuance. Inputs into the Black-Scholes pricing model require estimates, including such items as estimated volatility of the Company's stock and the estimated life of the financial instruments being fair valued.

(d) Cash and cash equivalents

Cash and cash equivalents include cash on hand, cash in bank accounts and highly liquid bank deposits with original maturities of less than three months.

(e) Trade receivables and other current assets

Trade receivables and other current assets are initially recognized at fair value and subsequently accounted at amortized cost using the effective interest method less provision for impairment of such receivables. A provision for impairment of trade receivables and other current assets is established when there is objective evidence that the Company will not

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be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The amount of the provision is recognised in the consolidated statements of income (loss) and comprehensive income (loss). The primary factor that the Company considers whether a receivable is impaired is its overdue status.

(f) Inventory

Inventory is recorded at the lower of cost or net realisable value. The cost of inventory and supplies represents purchase cost. The cost of crude oil inventory comprises raw material, direct labour, other direct costs and related production overheads (based on normal operating capacity). The cost of inventory is assigned on a weighted-average basis. Net realisable value is determined by reference to the sales proceeds of items sold in the ordinary course of business less selling expenses or to management's estimates based on prevailing market conditions. Supplies are capitalised to property and equipment when used for renewals and betterments of oil and natural gas properties or recognised as expenses when used for daily operations. Slow-moving or obsolete inventory items are written-off to the consolidated statement of income (loss) and comprehensive income (loss).

(g) Restricted cash

Restricted cash represents funds accumulated on a special account in JSC Kazkommertsbank in Kazakhstan to meet future liabilities on site restoration.

(h) Value added tax

Kazakhstani tax authorities permit the settlement of sales and purchases value added tax ("VAT") on a net basis. VAT recoverable represents VAT on purchases net of VAT on sales.

VAT is payable to the tax authorities upon collection of accounts receivable from customers. VAT on purchases, which have been settled at the reporting date, is deducted from the amount payable. In addition, VAT related to sales which have not been collected at the reporting date is also included in the balance of VAT payable. Where provision has been made for impairment of receivables, an impairment loss is recorded for the gross amount of the debtor, including VAT. The related deferred VAT liability is maintained until the debtor is written off for tax purposes.

VAT recoverable is recorded in accounts related to purchased goods, work and services, which were purchased with VAT and if the purchases were made in order to generate revenue.

At each reporting date, the VAT recoverable amount is subject to offsetting against the VAT payable.

(i) Exploration and evaluation assets

Recognition and subsequent measurement

Costs directly associated with an exploration drilling and geological and geophysical works related to the licensed area, historical costs and bonuses paid to the Government of Kazakhstan are capitalised until the determination of reserves is evaluated. If it is determined that commercial discovery has not been achieved, these costs are recognised in profit or loss at the point at which this determination is made. No depletion is recognised during the exploration and evaluation phase as the assets are not yet in use.

Impairment of exploration and evaluation assets

Exploration and evaluation assets are tested for impairment whenever facts and circumstances suggest that the carrying amount exceeds the recoverable amount. An analysis is performed on a well-by-well basis, and once the well is considered dry, its cost is fully written-off.

One or more of the following facts and circumstances indicate that the Company should test exploration and evaluation assets for impairment (the list is not exhaustive):

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- the period for which the Company has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed;
- substantive expenditure on further exploration for and evaluation of oil and natural gas resources in the specific area is neither budgeted nor planned;
- exploration for and evaluation of oil and natural gas resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources and the Company has decided to discontinue such activities in the specific area;
- sufficient data exist to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

Once commercial reserves are found, and development is sanctioned by management, exploration and evaluation assets are tested for impairment and transferred to development assets. Expenditure on the construction, installation or completion of infrastructure facilities such as pipelines and the drilling of commercially proven development wells, is capitalised within property, plant and equipment and intangible assets according to their nature. When development is completed on a specific field, it is transferred to production assets. Extraction assets are aggregated with exploration and evaluation tangible assets, and development expenditures associated with the production of proved reserves.

(j) **Property and equipment**

Recognition and subsequent measurement

Property and equipment are stated at cost, less accumulated depletion and depreciation and impairment provisions, where required. The cost of property and equipment comprises construction cost or purchase price, including import duties and non-refundable taxes, and any directly attributable costs of bringing the asset to working condition for its intended use, and development costs of oil and natural gas properties.

Development costs include the cost of drilling wells to produce proved reserves, the cost of production facilities (such as flow lines, separators, treaters, heaters, storage tanks, improved recovery systems and gas processing facilities) and other overhead costs related to development of oil and natural gas resources.

The individual significant parts of an item of property, plant and equipment (components), whose useful lives are different from the useful life of the given asset as a whole are depreciated individually, applying depreciation rates reflecting their anticipated useful lives. Cost of replacing major parts or components of property and equipment items are capitalised and the replaced part is retired.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the consolidated statement of income (loss) and comprehensive income (loss) during the financial period in which they are incurred.

Recognised as an item of property and equipment are specialised spare parts and servicing equipment with a significant initial value and a useful life of more than one year. Other spare parts and servicing-related equipment are recognised as inventories and accounted for in the consolidated statement of income (loss) and comprehensive income (loss) at the moment they are used.

Gains and losses on disposals of property, plant and equipment (or component of an item of property and equipment) determined by comparing proceeds with carrying amount are recognised in the consolidated statement of income (loss) and comprehensive income (loss).

Depletion and depreciation

The cost of each item of property and equipment is depreciated using the straight-line method to their residual values over their estimated useful lives, except for production wells which are depreciated using the unit of production method

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applied to the net book value of assets at end of period, net of estimated salvage values and based on total proved developed reserves as determined by independent consulting engineers.

The expected useful lives are as follows:

	<u>Useful lives in years</u> unit of production method
Oil and natural gas property	
Other tangible assets	
Machinery and equipment	5 – 10
Vehicles and other	3 – 14
Building and premises	7 – 14

The residual value of an asset is the estimated amount that the Company would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Company expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Impairment

At the end of each reporting period, the Company reviews property and equipment for circumstances that indicate the assets may be impaired. Assets are grouped together into cash-generating units (“CGU”) for the purpose of impairment testing. For the purposes of assessing impairment, management of the Company considers the East Zhagabulak field a CGU.

If any such indication of impairment exists, the Company makes an estimate of the CGU’s recoverable amount. A CGU’s recoverable amount is the higher of its fair value less costs to sell and its 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 reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of future cash flows expected to be derived from the production of proved and probable reserves.

Fair value less costs of disposal is determined as the amount that would be obtained from the sale of a CGU in an arm’s length transaction between knowledgeable and willing parties. The fair value less costs of disposal of oil and gas assets is generally determined as the net present value of the estimated future cash flows expected to arise from the continued use of the CGU, including any expansion prospects, and its eventual disposal, using assumptions that an independent market participant may take into account. These cash flows are discounted by an appropriate discount rate which would be applied by such a market participant to arrive at a net present value of the CGU. When the recoverable amount is less than the carrying amount, the asset or CGU is impaired. For impairment losses identified on a CGU, the loss is allocated on a pro rata basis to the assets within the CGU. The impairment loss is recognized as an expense in the consolidated statement of income (loss) and comprehensive income (loss).

At the end of each subsequent reporting period these impairments are assessed for indicators of reversal. Where an impairment loss subsequently reverses, the carrying amount of the asset or CGU is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss have been recognized for the asset or CGU in prior periods. A reversal of an impairment loss is recognized in the consolidated statement of income (loss) and comprehensive income (loss).

(k) Impairment of financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset. The present value of the estimated future cash flows is discounted at the financial assets original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate.

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(All tabular amounts are in thousands of Canadian dollars except as otherwise indicated)

The carrying amount of an impaired financial asset is reduced through the use of an allowance account and the amount of the loss is recognised in the consolidated statement of income (loss) and comprehensive income (loss). Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of finance income in the consolidated statement of income (loss) and comprehensive income (loss). Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Company.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in the consolidated statements of income (loss) and comprehensive income (loss). An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in the consolidated statement of income (loss) and comprehensive income (loss).

(l) Provisions

Provisions are recognized when the Company has a present or constructive obligation as a result of a past event that can be estimated with reasonable certainty and are measured at the amount that the Company would rationally pay to be relieved of the present obligation. To the extent that provisions are estimated using a present value technique, such amounts are determined by discounting the expected future cash flows at a risk-free pre-tax rate and adjusting the liability for the risks specific to the liability.

Decommissioning obligation

The Company recognizes a decommissioning obligation in the period in which a well is drilled or acquired and a reasonable estimate of the future costs associated with removal, site restoration and asset retirement can be made. The estimated decommissioning obligation is recorded with a corresponding increase in the carrying amount of the related cost centre.

Decommissioning obligations are measured at the present value of management's best estimate of the expenditures required to settle the present obligation at the statement of financial position date. Subsequent to the initial measurement, the provision is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

(m) Trade and other payables

Trade and other payables are accrued when the counterparty has performed its obligations under the contract. Trade and other payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

(n) Loans payable

Loans payable are initially recorded at fair value including transaction costs and subsequently measured at amortized cost using the effective interest method. The Company capitalizes borrowing costs to finance construction of qualifying assets during the period of the time that is required to complete the asset for its intended use. All other borrowings costs are expensed. Interest costs on borrowings are recognized in the period in which they are incurred regardless of how the borrowings are applied. Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

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(o) Revenue recognition

Revenue is recognised to the extent it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable, excluding discounts, sales taxes, excise duties and similar levies.

Revenue from the sale of oil and petroleum products is recognised when the significant risks and rewards of ownership have been transferred, which is considered to occur when title passes to the customer. This generally occurs when the product is physically transferred into a pipe or other delivery mechanism.

(p) Finance income and expenses

Finance income and expenses comprise interest income, interest expense on borrowings, the unwinding of discount on other financial assets and liabilities and foreign exchange gains and losses. Interest income and interest expense are recognized as amounts accrue in the consolidated statements of income (loss) and comprehensive income (loss) using the effective interest rate method.

(q) Operating leases

Where the Company is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor, the total lease payments are charged to the consolidated statement of income (loss) and comprehensive income (loss) on a straight-line basis over the term of the lease.

(r) Tax expense

Tax expense is comprised of current and deferred tax. Tax expense is recognized in the consolidated statement of income (loss) and comprehensive income (loss) except to the extent that it relates to items recognized directly in the shareholders' deficit, in which case it is recognized in shareholders' deficit.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at period end, adjusted for amendments to tax payable with regards to previous years.

Deferred tax is recorded, using the asset and liability method, on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. However, deferred tax is not recorded on taxable temporary differences arising on the initial recognition of goodwill or on the initial recognition of assets and liabilities in a transaction other than a business combination that affect neither accounting nor taxable profit or loss. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the statement of financial position date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient future taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

(s) Share-based payments

The Company may grant stock options to purchase common shares to employees and directors under its stock option plan. Share-based payments to these individuals is measured at the fair value of the options issued and recognized as expense over the vesting periods with a corresponding increase to contributed surplus. A forfeiture rate is estimated

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on the grant date and is adjusted to reflect the actual number of options that vest. Proceeds received on exercise of stock options, along with amounts previously included in contributed surplus, are credited to share capital.

(t) Per share amounts

Basic earnings (loss) per share is calculated by dividing the income (loss) attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the weighted average number of common shares outstanding for the effects of dilutive instruments such as stock options granted to employees and directors and consideration warrants. The calculation assumes the proceeds on exercise of stock options and consideration warrants are used to repurchase shares at the current market price. The effects of in-the-money consideration warrants and stock options granted to employees and non-employees are anti-dilutive in loss periods.

4. New and amended standards

(a) Standards and amendments effective in the current year

On January 1, 2017, the Company adopted amendments to IAS 7 Statement of Cash Flows and IAS 12 Income Taxes. The adoption of these amendments had no impact on the amounts recorded in the consolidated financial statements for the year ended December 31, 2017.

(b) New and amended standards not yet adopted

The Company has reviewed new and amended accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on the Company:

IFRS 2 Share-based Payment

In June 2016, the International Accounting Standards Board (“IASB”) issued amendments to IFRS 2 Share-based Payment to clarify the accounting requirements related to classification and measurement of share-based payment transactions. The amendments are effective for annual periods beginning on or after January 1, 2018. The Company does not expect the amendments to impact its consolidated financial statements.

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments which replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 introduces a single approach to determine whether a financial asset is measured at amortized cost or fair value based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets and introduces a new expected credit loss model for calculating impairment of financial assets. For financial liabilities where the fair value option is applied, any change in fair value resulting from an entity’s own credit risk is recorded in other comprehensive income rather than the statement of income, unless this creates an accounting mismatch. The Company anticipates that adoption of IFRS 9 will result in changes to the classification of the Company’s financial assets but will not change the classification of the Company’s financial liabilities or result in material changes in the carrying values of the Company’s financial instruments. IFRS 9 also contains a new model to be used for hedge accounting for risk management contracts, however, the Company does not currently have any risk management contracts. IFRS 9 is effective for annual periods beginning on or after January 1, 2018.

IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers which replaces IAS 18 Revenue. The standard provides a single, principles based five-step model to be applied to all contracts with customers. The standard requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive, when control is transferred to the purchaser. Disclosure requirements have also been expanded. The Company has chosen to use the modified retrospective approach for adoption for annual periods beginning on or after

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January 1, 2018. The Company has completed a preliminary analysis of all revenue streams and underlying contracts with customers. Based on the Company's preliminary analysis there is not expected to be a material impact to the timing or amounts recorded as revenue under the new standard. Disclosures may be enhanced based on new requirements.

IFRS 16 Leases

In January 2016, the IASB issued IFRS 16 Leases which replaces the previous leases standard, IAS 17 Leases. IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Certain short-term leases (less than 12 months) and leases of low-value assets are exempt from the requirements, and may continue to be treated as operating leases. IFRS 16 is effective for periods beginning on or after January 1, 2019. The Company is assessing the impact of IFRS 16 on its financial statements and it is anticipated that IFRS 16 will have an impact on the statement of financial position, however the magnitude of the impact is yet to be determined.

5. Critical accounting judgments and estimates in applying accounting policies

(a) Judgments

Judgment is used in situations when there is a choice and/or assessment requirement by management. The following are critical judgments apart from those involving estimations (disclosed below), that management has made in the process of applying the Company's accounting policies and that have a significant effect on the amounts recognized in the consolidated financial statements.

(i) Going concern

As discussed in Note 1, these consolidated financial statements have been prepared in accordance with IFRS on a going concern basis, which assumes the realization of assets and discharge of liabilities in the normal course of business within the foreseeable future. Management uses judgment to assess the Company's ability to continue as a going concern and the existence of conditions that cast doubt upon the going concern assumption.

It is management's assessment that the going concern assumption is appropriate as the Company has an agreement with Sixth Energy for a secured loan facility of up to USD 61.5 million to Aral (Notes 1 and 13(b)).

(ii) Functional currency

The determination of the functional currency for the Company and each of its subsidiaries was based on management's judgment of the underlying transactions, events, and conditions relevant to each entity.

(iii) Cash-generating units

The Company's assets are aggregated into CGUs based on an assessment of the unit's ability to generate independent cash in-flows. The determination of the Company's CGUs was based on management's judgment in regards to shared infrastructure, geographical proximity, petroleum type and similar exposure to market risk and materiality. The allocation of assets into CGU's requires significant judgment and interpretations with respect to the way in which management monitors operations.

(iv) Exploration and evaluation assets

The application of the Company's accounting policy for exploration and evaluation assets requires management to make certain judgments as to future events and circumstances as to whether economic quantities of reserves have been found.

(v) Impairment

Judgments are required to assess when impairment or reversal of impairment indicators are evident and when

Caspian Energy Inc.

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impairment or reversal of impairment testing is required.

(vi) Current and deferred taxes

Judgments are made by management to determine the likelihood of whether deferred tax assets at the end of the reporting period will be realized from future taxable earnings.

Tax interpretations, regulations and legislation in the various jurisdictions in which the Company operates are subject to change. As such, current and deferred taxes are subject to measurement uncertainty. Management uses judgment to assess deferred tax assets at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings.

(vii) Contingencies

Management uses judgment to assess the existence of contingencies. By their nature, contingencies will only be resolved when one or more future events occur or fail to occur. Management also uses judgment to assess the likelihood of the occurrence of one or more future events.

(b) Estimates

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected. The significant areas of estimation uncertainty are as follows:

(i) Reserves

The estimate of petroleum and natural gas reserves is integral to the calculation of the amount of depletion charged to the consolidated statement of loss and comprehensive loss and is also a key determinant in assessing whether the carrying value of any of the Company's development and production assets has been impaired. Changes in reported reserves can impact asset carrying values and the decommissioning provision due to changes in expected future cash flows.

The Company's reserves are evaluated and reported on by independent reserve engineers at least annually in accordance with Canadian Securities Administrators' National Instrument 51-101. Reserve estimation is based on a variety of factors including engineering data, geological and geophysical data, projected future rates of production, commodity pricing and timing of future expenditures, all of which are subject to significant judgment and interpretation.

(ii) Carrying value of development and production and exploration and evaluation assets

If any indication exists that an asset or CGU may be impaired, the Company estimates the recoverable amount. The recoverable amounts of individual assets and CGUs have been determined based on the higher of value-in-use and fair value less costs to sell.

These calculations require the use of estimates and assumptions, such as estimates of proved plus probable reserves, future production rates, oil and natural gas prices, future costs and other relevant assumptions, all of which are subject to change. A material adjustment to the carrying value of the Company's development and production and exploration and evaluation assets may be required as a result of changes to these estimates and assumptions.

The Company's concessions may be subject to renewal extensions which require approval from local government authorities. The Company has been successful in obtaining approvals for certain of its concessions and is currently awaiting renewal on others. As there is no indication that pending extensions will not be approved, management has used judgment to conclude that all extensions will be approved. If the Company fails to obtain extension renewals, estimates of proved plus probable reserves may be negatively impacted.

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(iii) Depletion and depreciation

Amounts recorded for depletion and depreciation and amounts used for impairment calculations are based on estimates of total proved and probable petroleum and natural gas reserves and future development capital. By their nature, the estimates of reserves, including the estimates of future prices, costs and future cash flows, are subject to measurement uncertainty. Accordingly, the impact to the consolidated financial statements in future periods could be material.

(iv) Decommissioning provision

Amounts recorded for the Company's decommissioning provision require the use of management's best estimates of future decommissioning expenditures, expected timing of expenditures and future inflation rates. The estimates are based on internal and third party information and calculations and are subject to change over time and may have a material impact on profit and loss or financial position.

(v) Share-based payments

The estimated fair value of stock options and consideration warrants, by their very nature, are subject to measurement uncertainty. The Company uses the Black-Scholes pricing model to estimate the fair value of stock options and consideration warrants, which is based on significant assumptions such as volatility, forfeiture rate, interest rate, dividend yield and expected term.

(vi) Deferred taxes

Deferred taxes are based on estimates as to the timing of the reversal of temporary and taxable differences, substantively enacted tax rates and the likelihood of assets being realized.

(vii) Contingencies

When contingencies exist, management estimates the related financial impact to the Company of the possible outcomes of one or more future events.

6. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

The Company is required to classify fair value measurements using a hierarchy that reflects the significance of the inputs used in making the measurements.

The fair value hierarchy is as follows:

- Level 1 – quoted prices in active markets for identical assets or liabilities;
- Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 – inputs for the asset or liability that are not based on observable market data.

Cash and cash equivalents have been measured using level 1 inputs.

(a) Cash and cash equivalents, trade receivables and other current assets and trade and other payables

The fair value of cash and cash equivalents, trade receivables and other current assets and trade and other payables are estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2017 and 2016, the fair value of these balances approximated their carrying value due to their short term to maturity.

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(b) Loans payable

The fair value of loans payable is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. At December 31, 2017, the fair value of loans payable was estimated at \$26.5 million (2016 – \$23.9 million) using a discounted cash flow analysis based on the Company's expected borrowing rate for similar borrowing arrangements.

(c) Share-based payments

The fair values of stock options and consideration warrants are measured using a Black-Scholes pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected forfeiture rate (based on historic forfeitures), expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds). The Company did not issue any stock options or consideration warrants in 2016 or 2017.

7. Cash and cash equivalents

	2017	2016
Cash in CAD	\$ 7	\$ 6
Cash in USD	106	43
Cash in Pounds Sterling	1	1
Cash in KZT	12	35
	\$ 126	\$ 85

8. Trade receivables and other current assets

	2017	2016
Compensation receivable from participants	\$ 1,251	\$ 1,331
Current portion of VAT receivable (Note 10)	604	543
Goods and services tax receivable	9	5
Prepaid taxes, insurance and other items	108	91
	\$ 1,972	\$ 1,970

The compensation receivable from participants relates to the Company's losses related to the indemnification of litigation settled in a prior year. The Company's former partners had a liability to reimburse the losses as a result of the indemnification. During 2013, the compensation was repaid by participants by transferring to the account of the current participant, ASER, and the funds will be transferred to the account of the Company by the end of 2018.

The Company considers its receivables to be aged as follows:

	2017	2016
Current	\$ 65	\$ 20
31 to 120 days past due, not considered impaired	25	75
Over 120 days past due, not considered impaired	1,882	1,875
	\$ 1,972	\$ 1,970

In determining the recoverability of trade receivables and other current assets, the Company considers any change in the credit quality of the balances from the date credit was initially granted up to the reporting date. Accordingly, the Company believes no allowance is required.

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9. Restricted cash

Under the terms of the Exploration Contract, Aral has an obligation to create a liquidation fund of 1% of the capital cost of exploration (“the Liquidation Fund”) and deposit cash in a restricted bank account. The account balance at December 31, 2017 was \$23,000 (KZT 5,982,000) (2016 – \$nil). It is anticipated that the Liquidation Fund will be used to finance the cost of restoring the License Area upon expiration of the Exploration Contract and the Production Contract.

10. VAT receivable

As at December 31, 2017, the Company has non-current VAT receivable of \$3,335,000 (KZT 882,220,000) (2016 – \$3,883,000 (KZT 964,540,000)). The Company expects that the full amount of VAT receivable will be recovered against VAT accrued on future local sales.

11. Property and equipment

	Oil and natural gas property	Other tangible assets	Total
Cost			
Balance at December 31, 2015	\$ 70	\$ 589	\$ 659
Additions	–	15	15
Impairment reversal	11,785	–	11,785
Decommissioning revisions (Note 14)	50	–	50
Foreign exchange	132	(6)	126
Balance at December 31, 2016	12,037	598	12,635
Additions (recoveries)	(5)	72	67
Disposition	–	(81)	(81)
Decommissioning revisions (Note 14)	22	–	22
Foreign exchange	(737)	(36)	(773)
Balance at December 31, 2017	\$ 11,317	\$ 553	\$ 11,870
Accumulated depletion and depreciation			
Balance at December 31, 2015	\$ (70)	\$ (49)	\$ (119)
Depletion and depreciation included in expense	(69)	(6)	(75)
Depletion and depreciation included in inventory	(13)	–	(13)
Foreign exchange	(4)	1	(3)
Balance at December 31, 2016	\$ (156)	\$ (54)	\$ (210)
Depletion and depreciation included in expense	(1,259)	(32)	(1,291)
Depletion and depreciation included in inventory	(1)	–	(1)
Impairment	(4,752)	–	(4,752)
Disposition	–	73	73
Foreign exchange	116	–	116
Balance at December 31, 2017	\$ (6,052)	\$ (13)	\$ (6,065)
Carrying amount			
December 31, 2016	\$ 11,881	\$ 544	\$ 12,425
December 31, 2017	\$ 5,265	\$ 540	\$ 5,805

As at December 31, 2017, the Company identified indicators of impairment on its oil and natural gas property such as the shut-in of two-thirds of the Company’s wells and significant capital expenditures required to bring such wells back on production. The recoverable amount was based on the fair value less costs of disposal in the amount of \$5,265,000 (USD

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4,185,000; KZT 1,392,822,000) which represents expected future net cash flows (before income tax) anticipated to be produced from proved reserves at a 10% discount rate as compared to the carrying amount of \$10,017,000 (USD 7,944,000; KZT 2,643,646,000). As a result, the Company recognized \$4,752,000 of impairment.

The following forward commodity price estimates were used in the determination of future net cash flows:

Year	WTI	Brent	Domestic	Brent to	Export	Inflation
	Crude Oil Price	Crude Oil Price	Field Price	Field Export Differential	Field Price	Forecast
	\$/US/bbl	\$/US/bbl	\$/US/bbl	\$/US/bbl	\$/US/bbl	%
2018	58.50	63.50	28.58	24.88	38.64	2.0
2019	58.70	61.30	27.59	25.20	36.10	2.0
2020	62.40	63.40	28.53	25.54	37.86	2.0
2021	69.00	70.10	31.55	27.21	42.89	2.0
2022	73.10	74.20	33.39	27.57	46.63	2.0
2023	74.50	75.60	34.02	28.59	47.01	2.0
2024	76.00	77.10	34.70	28.97	48.13	2.0
2025	77.50	78.60	35.37	29.35	49.25	2.0
2026	79.10	80.30	36.14	30.39	49.91	2.0
2027	80.70	81.90	36.86	30.79	51.11	2.0

A 5% increase (decrease) in the forward commodity price estimates or a 1% decrease (increase) in the applied discount rate would have resulted in a (decrease) increase in the reversal of previously recognized impairment of approximately \$1,418,000 and \$355,000, respectively.

As at December 31, 2016, the Company identified indicators of impairment reversal on its oil and natural gas property such as an increase in forecast domestic commodity prices and a decrease in export custom duties which resulted in inclusion of economic quantities of proved reserves in the Company's December 31, 2016 independently prepared reserve report. The Company performed an impairment test to determine the amount of previously recognized impairment to reverse. The recoverable amount was based on the fair value less costs of disposal in the amount of \$11,785,000 (USD 8,882,000; KZT 2,960,282,000) which represents expected future net cash flows (before income tax) anticipated to be produced from proved reserves at a 10% discount rate as compared to the carrying amount of \$nil. As a result, the Company reversed \$11,785,000 of previously recognized impairment.

The following forward commodity price estimates were used in the determination of future net cash flows:

Year	WTI	Brent	Domestic	Brent to	Export	Inflation
	Crude Oil Price	Crude Oil Price	Field Price	Field Export Differential	Field Price	Forecast
	\$/US/bbl	\$/US/bbl	\$/US/bbl	\$/US/bbl	\$/US/bbl	%
2017	55.00	56.00	25.20	24.20	31.80	2.0
2018	58.70	59.70	26.87	24.54	35.16	2.0
2019	62.40	63.40	28.53	25.54	37.86	2.0
2020	69.00	70.10	31.55	27.21	42.89	2.0
2021	75.80	76.90	34.61	28.22	48.68	2.0
2022	77.30	78.40	35.28	28.59	49.81	2.0
2023	78.80	79.90	35.96	28.97	50.93	2.0
2024	80.40	81.50	36.68	30.00	51.50	2.0
2025	82.00	83.20	37.44	30.39	52.81	2.0
2026	83.70	84.90	38.21	30.79	54.11	2.0

A 5% increase (decrease) in the forward commodity price estimates or a 1% decrease (increase) in the applied discount rate would have resulted in an increase (decrease) in the reversal of previously recognized impairment of approximately

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\$1,096,000 and \$283,000, respectively.

12. Exploration and evaluation assets

Balance at December 31, 2015	\$	31,106
Additions		120
Decommissioning revisions (Note 14)		15
Foreign exchange		(305)
<hr/>		
Balance at December 31, 2016	\$	30,936
Additions		106
Decommissioning revisions (Note 14)		–
Foreign exchange		(1,895)
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Balance at December 31, 2017		29,147

13. Loans payable

	2017	2016
Asia Dynamic (a)	\$ 11,366	\$ 10,605
Sixth Energy (b)	14,873	14,671
ASER (c)	1,167	1,044
Mr. Wei Zhao (d)	390	–
<hr/>		
	27,796	26,320
Current portion of loans payable	(327)	–
<hr/>		
	\$ 27,469	\$ 26,320

(a) Asia Dynamic loan

The Company has an unsecured USD 6 million loan facility with Asia Dynamic Energy Corporation (“Asia Dynamic”) pursuant to which USD 6 million in loans was advanced to Caspian. The amounts drawn under the facility bear interest at a rate of 10% per annum and are repayable on or before May 20, 2019.

As at December 31, 2017 and 2016, the reported amount of the loan payable is comprised of the following:

	2017	2016
Principal	\$ 8,304 (USD 6,000)	\$ 8,304 (USD 6,000)
Effect of 2015 modification	(1,500) (USD 1,230)	(1,500) (USD 1,230)
Accretion	790 (USD 606)	485 (USD 371)
Accrued interest	4,931 (USD 3,660)	3,791 (USD 2,781)
Foreign exchange	(1,159)	(475)
<hr/>		
	\$ 11,366 (USD 9,036)	\$ 10,605 (USD 7,922)

(b) Sixth Energy loan

Aral has a USD 10 million facility with Sixth Energy dated May 21, 2014 and amended August 20, 2014 (the “Interim Loan”), of which USD 9.1 million was drawn as at December 31, 2017 (2016 – USD 9.1 million). The Interim Loan bears interest at an annual rate of 10%. On the first draw-down under the USD 61.5 million Loan Facility (Note 1), the balance owing under the Interim Loan will be consolidated with the Loan Facility, resulting in Aral having access to up to USD 51.5 million, assuming the full draw-down of the Interim Loan. The Loan Facility will be secured by share pledges over the entirety of the Company’s Aral interests in favour of the Lenders on a pro-rata basis and repayable on May 20, 2018 or some other later date agreed to by the parties. As the Interim Loan will be consolidated

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with the Loan Facility, it has been classified as long-term.

As at December 31, 2017, the \$14,873,000 (2016 – \$14,671,000) balance owing under the Interim Loan is comprised of \$11,444,000 (USD 9.1 million) of principal plus \$3,429,000 of accrued interest (2016 – \$12,224,000 (USD 9.1 million) of principal plus \$2,447,000 of accrued interest).

(c) ASER loan

On May 25, 2015, the Company signed a USD 1 million facility agreement with ASER. The facility is unsecured, bears interest at 10% per annum and due on May 25, 2025 or such later date as agreed by the Company and ASER. During 2017, the Company drew USD 0.1 million under the facility (2016 – USD 0.6 million).

As at December 31, 2017, the \$1,167,000 (2016 – \$1,044,000) balance owing under the facility is comprised of \$1,014,000 (USD 0.8 million) of principal plus \$153,000 of accrued interest (2016 – \$988,000 (USD 0.7 million) of principal plus \$56,000 of accrued interest).

(d) Mr. Wei Zhao loan

During 2017, the Company received a total of \$390,000 in loans from Mr. Wei Zhao. \$63,000 of the loan is a draw on a USD 1 million unsecured loan facility obtained in September 2017. Amounts drawn under the loan facility bear interest at 10% per annum and are due on September 1, 2027. \$327,000 of the loan is unsecured and non-interest bearing with no fixed terms of repayment and was received for working capital purposes and was therefore classified as current.

(e) HKBDC loan

In July 2016, the Company obtained a USD 500,000 loan facility from Hong Kong Business Development Co. Limited (“HKBDC”). The facility bears interest at 10% per annum and is repayable in three months from the date of each draw. On July 13, 2016, the Company drew USD 320,000.

The Company repaid the \$420,000 (USD 320,000) loan principal and \$11,000 of accrued interest in full on October 21, 2016.

14. Decommissioning obligation

The following table presents the reconciliation of the carrying amount of the obligation associated with the reclamation and abandonment of the Company’s oil and natural gas properties:

Balance at December 31, 2015	\$	949
Revisions		65
Accretion		74
Foreign exchange		(7)
<hr/>		
Balance at December 31, 2016		1,081
Revisions		22
Accretion		82
Foreign exchange		(69)
<hr/>		
Balance at December 31, 2017	\$	1,116

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The following significant weighted average assumptions were used to estimate the December 31, 2017 and 2016 decommissioning obligation:

	2017	2016
Undiscounted cash flows - uninflated	\$1.1 million (KZT 295.4 million)	\$1.1 million (KZT 268.5 million)
Inflation rate	8%	8%
Risk-free rate	8%	8%
Expected timing of cash flows	18 years	19 years

15. Taxes

Tax expense for the years ended December 31, 2017 and 2016 is as follows:

	2017	2016
Current tax recovery	\$ (26)	\$ –
Deferred tax expense	2,610	7,371
	\$ 2,584	\$ 7,371

The following is a reconciliation of income taxes calculated at the combined Federal and Provincial rates with the income tax expense in the consolidated statement of loss and comprehensive loss:

	2017	2016
(Loss) income before income taxes	\$ (8,440)	\$ 10,287
Expected tax expense (recovery) at statutory tax rate of 27% (2016 – 27%)	(2,279)	2,777
Change in deferred tax asset not recognized	(4,817)	(11,447)
Change in tax pool estimates and other non-deductible items	8,821	18,017
Impairment reversal	–	(3,182)
Effect of tax rate differences	859	1,206
Tax expense	\$ 2,584	\$ 7,371

Deferred tax assets are recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. A deferred tax asset related to deductible temporary difference has been recorded as the Company expects that future taxable profits will be sufficient to utilize the deferred tax asset.

As at December 31, 2017, the Company had estimated \$51.5 million of Canadian tax losses available for deduction against future Canadian taxable income which expire between 2025 and 2037 and \$100.9 million (KZT 26,702 million) of Kazakhstani tax losses available for deduction against future Kazakhstani taxable income which expire between 2018 and 2027.

The components of the net deferred tax asset (liability) at December 31 are:

	2017	2016
Tax reserves	\$ (28,597)	\$ (25,757)
Loans payable	(212)	(311)
Tax losses available for carry forward	13,895	13,750
Share issue costs	15	29
Property and equipment	56	56
	\$ (14,843)	\$ (12,233)

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The unrecognized deductible temporary (taxable) differences at December 31 are as follows:

	2017		2016	
Tax losses available for carry forward	\$	100,927	\$	86,125
Property and equipment		75,902		114,784
	\$	176,829	\$	200,909

16. Share capital

(a) Authorized

Unlimited number of voting common shares, without stated par value

(b) Issued

	Number of shares		Amount	
Balance, December 31, 2015, 2016 and 2017	463,657,593	\$	183,035	

17. Stock options

The Company has a stock option plan (“the Plan”) for which up to 15% of the issued and outstanding common shares can be reserved for issuance to directors, officers and employees. Options are granted at the discretion of the Board of Directors. The exercise price, vesting period and expiration period are fixed at the time of grant at the discretion of the Board of Directors in accordance with terms of the Plan.

A continuity of options outstanding and exercisable as at December 31 is summarized as follows:

	2017		2016	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Opening	150,000	\$ 1.18	717,000	\$ 1.28
Expired	(150,000)	(1.18)	(567,000)	(1.30)
Closing	–	\$ –	150,000	\$ 1.18

18. Consideration warrants

Each consideration warrant is exercisable only following the issuance of a Caspian common share upon the exercise of an outstanding stock option in accordance to which the terms of the particular consideration warrant corresponds.

A continuity of consideration warrants outstanding as at December 31 is summarized as follows:

	2017		2016	
	Number of consideration warrants	Weighted average exercise price	Number of consideration warrants	Weighted average exercise price
Opening	225,000	\$ 1.18	1,075,500	\$ 1.28
Expired	(225,000)	(1.18)	(850,500)	(1.30)
Closing	–	\$ –	225,000	\$ 1.18
Exercisable	–	–	–	–

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19. Per share amounts

	2017	2016
Net (loss) income for the year	\$ (11,024)	\$ 2,916
Weighted average number of shares (in thousands) – basic: Issued common shares at January 1	463,658	463,658
Net (loss) income per share – basic and diluted	\$ (0.02)	\$ 0.01

The effect of stock options and consideration warrants is not dilutive.

20. Finance expense

	2017	2016
Interest and accretion on loans payable (Note 13)	\$ 2,819	\$ 2,544
Accretion of decommissioning obligation (Note 14)	82	74
Net finance expense	\$ 2,901	\$ 2,618

21. Compensation

(a) Employee compensation cost

The consolidated statement of loss and comprehensive loss is prepared primarily by nature of expense. During 2017, the Company incurred \$468,000 (2016 – \$447,000) of employee compensation cost included in general and administrative expenses and \$452,000 (2016 – \$441,000) of employee compensation cost included in operating costs.

(b) Directors and key management compensation

The Company considers its Board of Directors and executives to be key management personnel. Compensation attributed to key management personnel comprises the following:

	2017	2016
Salaries	\$ 193	\$ 185
Director fees	7	46
	\$ 200	\$ 231

22. Related party transactions

The Company conducts business with the following related parties:

Company	Relationship as at December 31, 2017
Sixth Energy	Owned and controls approximately 59.9% of the Company's issued and outstanding shares
ASER	Wholly-owned subsidiary of Sixth Energy
Asia Dynamic	Controlled by the majority shareholder of Sixth Energy
Mr. Wei Zhao	Majority shareholder of Sixth Energy

Amounts due to related parties are disclosed in Notes 13.

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The following related party amounts have been recognized in the consolidated statements of income (loss) and comprehensive income (loss) for the years ended December 31, 2017 and 2016:

	2017	2016
Interest and accretion on loans payable		
Sixth Energy	\$ 1,271	\$ 1,123
ASER	103	52
Asia Dynamic	1,445	1,358
	<u>\$ 2,819</u>	<u>\$ 2,533</u>

23. Supplemental cash flow disclosure

(a) Change in non-cash working capital

	2017	2016
Trade accounts receivable and other current assets	\$ 25	\$ (527)
Inventory	(6)	(14)
Trade and other payables	(1,510)	(2,779)
	<u>\$ (1,491)</u>	<u>\$ (3,320)</u>

(b) Income taxes

The Company paid \$26,000 of income taxes in 2017 (2016 – \$nil).

24. Financial risk management

The Company's activities expose it to a variety of financial risks that arise as a result of its operating and financing activities such as credit risk, liquidity risk and market risk. This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board of Directors oversees management's establishment and execution of the Company's risk management framework. Management has implemented and monitors compliance with risk management policies. The Company's risk management policies are established to identify and analyse the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

(a) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company's trade receivables and other current assets are with customers in the petroleum and natural gas business and are subject to normal credit risks. The Company's cash and cash equivalents and restricted cash consist of cash in bank accounts and highly liquid bank deposits with original maturities of less than three months. Accordingly, the Company views credit risk as minimal.

The maximum exposure to credit risk is as follows:

	2017	2016
Cash and cash equivalents (Note 8)	126	85
Trade receivables and other current assets (Note 9)	1,972	1,970
Restricted cash (Note 10)	23	–
	<u>2,121</u>	<u>2,055</u>

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(b) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. There is presently significant liquidity risk in that the Company will not be able to meet its financial obligations as they come due. The Company aims to maintain sufficient capital in order to meet short-term business requirements, after taking into account cash flows from operations and the Company's holdings of cash and cash equivalents. The Company's cash and cash equivalents are invested in business accounts, which are available upon demand for the Company's requirements. Cash and cash equivalents are not invested in any asset-backed deposits or investments.

The following are contractual maturities of financial liabilities, including estimated interest payments as at December 31, 2017:

	Carrying amount	Estimated contractual cash flows	Due in			
			2018	2019	2025	2027
Trade and other payables	27,977	27,977	27,977	–	–	–
Loans payable	27,796	30,878	15,641	13,195	1,918	124

(c) Market risk

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates, will affect the Company's net earnings or the value of the financial instruments. The objective of market risk management is to manage and control exposures within acceptable limits, while maximizing returns. Caspian may utilize derivative instruments to manage market risk. The Company had no financial derivative contracts at December 31, 2017 or 2016.

(i) Currency risk

Currency risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. Foreign exchange rates to Canadian dollars for the noted dates and periods are as follows:

	Closing rate		Average rate	
	As at December 31		Year ended December 31	
	2017	2016	2017	2016
KZT	0.0038	0.0040	0.0040	0.0039
USD	1.2579	1.3427	1.2981	1.3245

The following tables provide information on the foreign currency denominated financial instruments held by the Company:

As at December 31, 2017	Balance denominated in		Total CAD equivalents
	KZT	USD	
Cash and cash equivalents	3,211	83	117
Trade receivables and other current assets	498,115	–	1,883
Trade and other payables	(7,331,013)	(127)	(27,869)
Loans payable	–	(21,787)	(27,406)

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As at December 31, 2016	Balance denominated in		Total CAD equivalents
	KZT	USD	
Cash and cash equivalents	8,689	32	78
Trade receivables and other current assets	485,397	–	1,954
Trade and other payables	(7,275,456)	(77)	(29,391)
Loans payable	–	(19,602)	(26,320)

The following represents the estimated impact on net loss of a 25% change in the closing rate of the KZT and a 10% change in the closing rate of the USD as at December 31, 2017 and 2016 on foreign denominated financial instruments held by the Company, with other variables such as interest rates and commodity prices held constant:

	2017	2016
KZT	5,163	5,460
USD	2,746	2,638
	7,909	8,098

On August 20, 2015, the National Bank of Kazakhstan switched from a policy of bank-controlled foreign exchange rates to a policy of market-driven foreign exchange rates. As a result, the KZT devalued by more than a total of 58% as of December 31, 2017 (48% as of December 31, 2016). Aral's revenues and trade receivables and other current assets as well as the majority of Aral's expenses and trade and other payables are denominated in KZT, all of which devalued accordingly.

(ii) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Interest earned on cash and short-term investments is at nominal rates and therefore, the Company does not consider interest rate risk to be significant. The Company has no variable interest-bearing financial liabilities. The Company had no interest rate swaps or financial contracts in place at December 31, 2017 or 2016.

(iii) Commodity price risk

Commodity price risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in commodity prices. Lower commodity prices reduce the Company's ability to raise capital. Commodity prices for crude oil are impacted by world economic events that dictate the levels of supply and demand. The Company had no commodity price risk derivative contracts at December 31, 2017 or 2016. At December 31, 2017, with other variables unchanged, a 10% movement in commodity prices would have a \$275,000 (2016 – \$388,000) effect on the Company's consolidated net loss.

25. Capital management

The Company's general policy is to maintain a sufficient capital base in order to manage its business effectively with the goal of increasing the value of its assets and thus its underlying share value. The Company's objectives when managing capital are to maintain financial flexibility to meet financial obligations, to facilitate growth, and to optimize the use of capital resources to provide an appropriate investment return to its shareholders. The Company monitors its capital structure and makes adjustments in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may:

- Issue new shares through a public offering or private placement;
- Utilize its working capital; or
- Access other forms of debt.

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The Company considers its capital structure to include shareholders' equity, working capital and loans payable:

	2017	2016
Total shareholders' deficit	\$ (31,231)	\$ (19,730)
Working capital deficiency	(26,113)	(27,340)
Loans payable, long term portion	(27,469)	(26,320)

26. Commitments and contingencies

(a) Tax contingent liabilities in the Republic of Kazakhstan

Kazakhstan's tax legislation and regulations are subject to ongoing changes and varying interpretations. Instances of inconsistent opinions between local, regional and national tax authorities are not unusual. The current regime of penalties and interest related to reported and discovered violations of Kazakhstan's tax laws are severe. Penalties are generally 50% of the taxes additionally assessed and interest is assessed at the refinancing rate established by the National Bank of Kazakhstan multiplied by 2.5. As a result, penalties and interest can amount to multiples of any assessed taxes. Fiscal periods remain open to review by tax authorities for five calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. Because of the uncertainties associated with Kazakhstan's tax system, the ultimate amount of taxes, penalties and interest, if any, may be in excess of the amount expensed to date and accrued at December 31, 2017.

The Company believes that tax liabilities have been accounted for sufficiently. Nevertheless, the interpretation of the relevant authorities may differ, which could have a serious effect on these consolidated financial statements.

(b) Transfer pricing

The Kazakhstani law on transfer pricing prescribes Kazakhstani companies to maintain and, if required, to provide economic rationale and method of the determination of prices used in international transactions, such as export sales, including existence of the documentation supporting the prices and differentials. Additionally, differentials could not be applied to the international transactions with companies registered in off-shore countries. In case of deviation of transaction price from market price the tax authorities have the right to adjust taxable items and to impose additional taxes, fines and interest penalties.

Aral has had no export sales in recent years. The Company's transfer pricing policy is considered to be in accordance with transfer pricing legislation and the Company believes that its transfer pricing policy will be sustained and all documentation supporting determination of export prices will be provided to the government authorities, if required.

Regardless of the inherent risks that the tax authorities may question transfer pricing policy of the Company, related to the law on transfer pricing, the management of the Company believes that it will be able to sustain its position in case the transfer pricing policy of the Company will be challenged by the tax authorities.

(c) Export sales

According to the Exploration Contract, Aral is required to sell 100% of oil extracted during the term of the Exploration Contract for refining in Kazakhstan. Commencing from September 2005, Aral applied on a monthly basis to the ME of ROK for its production for the succeeding month to be included in the Ministry's Export Quota for transportation by rail. Should Kazakhstani government authorities determine that Export Quotas received by the Company were in violation of the Exploration Contract, Aral may be subject to fines and penalties which cannot be reliably estimated and/or to the termination of the Exploration Contract.

According to the Production Contract, Aral is obliged to sell 20% of produced crude oil to the domestic market. During 2017 the Company had no export sales and all produced crude oil was sold to the local market. During 2016 the Company sold 5% of its crude oil to the export and the residual crude oil was sold to local market.

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(d) Minimum work program

On December 29, 2016, the Company signed Addendum No. 11 to its Subsurface Use Contract No.1081 that decreased minimal work program for 2016 and moved drilling of two wells to work program of 2017 and 2018. As a result the Company fulfilled its minimal commitments for 2016 in all material respects.

On May 30, 2017, the Company signed Addendum No. 12 to its Subsurface Use Contract No.1081 that decreased the rate of fines for non-fulfilment of financial obligations to 1% from the total amount of unfulfilled obligations for the period. During 2017, the Company did not fulfil the work program and recognized a provision in the amount of \$404,000 (KZT 106,276,000) (2016 – \$nil) in operating expenses and trade and other payables.

The Company has the following minimum work program commitments:

	Exploration Activity		Production Activity	
	\$	KZT	\$	KZT
2018	17,920	4,741,178	5,346	1,414,349
2019	–	–	124,906	33,046,610
2020 to 2034	–	–	767,552	203,072,814

Non-fulfilment of commitments under the minimum work program may result in punitive actions by the Government of the ROK, including suspending or revoking the Exploration Contract. Aral believes that non-compliance with these Exploration Contract terms would not lead to any significant adjustments to the consolidated financial statements.

(e) Social and training commitments

In accordance with the Exploration Contract, the Aral is obliged to finance certain training of Kazakhstani staff engaged in the works to be executed under the Exploration Contract in amount of not less than 1% of Aral's annual investment cost.

In accordance with the Exploration Contract and the Production Contract, Aral is obliged to finance certain social infrastructure annually. The annual amount of social obligation is equal to USD 160,000. For the years 2017 and 2016, the Company fulfilled its social obligations under Production and Exploration Contracts in full.

(f) Restoration

Under the terms of the Exploration Contract, Aral should create a liquidation fund (Note 9).The full extent of the Aral's obligation to restore the License Area will not be known until it submits and agrees a proposed program for restoration of the License Area which is required to be submitted within two years after the Production Contract signing.

(g) Gas utilisation

The Company made assessment on realization of approved gas utilization plan by construction of special plant that will pump back gas to land. For the period of construction the Company requested state authorities for an approval on associated gas burning. During this period state authorities' plans to construct gas processing plant in Aktobe region, and in its turn after completion and commissioning of the gas processing plant the Company along with other oil producers in this region should supply the processing plant with associated gas on free of charge basis. On February 12, 2018, the Company obtained a permission for gas utilization until December 31, 2018.

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27. Segmented information

The Company's operations are conducted in one business sector, the oil and natural gas industry. Geographical areas are used to identify Company's reportable segments. A geographic segment is considered a reportable segment once its activities are regularly reviewed by the Company's management. The Company has two reportable segments which are as follows:

- Kazakhstan, which includes the oil and natural gas industry; and
- Other, which includes corporate assets and the operations in the Canadian and Netherlands entities. None of these individual segments meet the quantitative thresholds for determining reportable segments.

	December 31, 2017			December 31, 2016		
	Kazakhstan	Other	Total	Kazakhstan	Other	Total
Property and equipment	\$ 5,805	-	5,805	\$ 12,425	-	12,425
Exploration and evaluation assets	\$ 29,147	-	29,147	\$ 30,936	-	30,936
Other assets	\$ 5,440	109	5,549	\$ 5,983	41	6,024
Total liabilities	\$ 46,635	25,097	71,732	\$ 52,411	16,704	69,115
Capital expenditures	\$ 173	-	173	\$ 135	-	135

	Year ended December 31, 2017			Year ended December 31, 2016		
	Kazakhstan	Other	Total	Kazakhstan	Other	Total
Revenue	\$ 2,746	4	2,750	\$ 3,934	3	3,937
General and administrative	734	389	1,123	994	419	1,413
Operating expenses	2,391	-	2,391	2,084	1	2,085
Depletion and depreciation	1,291	-	1,291	75	-	75
Impairment expense (reversal)	4,752	-	4,752	(11,785)	-	(11,785)
Finance expense	1,353	1,548	2,901	1,197	1,421	2,618
Other items	(519)	(749)	(1,268)	(542)	(214)	(756)
Tax expense	2,610	(26)	2,584	7,371	-	7,371
Segment (loss) income	\$ (9,866)	(1,158)	(11,024)	\$ 4,540	(1,624)	2,916