

## **CASPIAN ENERGY INC.**

### **Management's Discussion and Analysis**

May 14, 2012 – The following Management's Discussion and Analysis ("MD&A") of financial results as provided by the management of Caspian Energy Inc. ("Caspian" or the "Company") should be read in conjunction with the unaudited interim consolidated condensed financial statements and selected notes for the three months ended March 31, 2012 and the audited consolidated financial statements and notes for the years ended December 31, 2011 and 2010. This commentary is based upon information available to May 14, 2012.

The intention of this Management's Discussion and Analysis (MD&A) is for Caspian to explain to its shareholders and the investment community three analyses from management's perspective:

1. Caspian's performance in fiscal 2012;
2. Caspian's current financial condition; and
3. Caspian's future prospects.

This MD&A complements and supplements the disclosures in our audited consolidated financial statements which have been prepared according to International Financial Reporting Standards ("IFRS").

References to "we", "us" and "our" in this MD&A are to the Company and all references to dollars are in Canadian dollars, unless otherwise indicated. Additional information relating to the Company, including its annual information form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

#### **Basis of Preparation**

The financial statements, MD&A and comparative information have been prepared in Canadian dollars unless otherwise indicated and in accordance with International Financial Reporting Standards ("IFRS").

#### **FORWARD-LOOKING STATEMENTS AND OTHER INFORMATION**

This MD&A contains non-IFRS financial measures and forward-looking statements and readers are cautioned that the MD&A should be read in conjunction with the Company's disclosure under "Non-IFRS Financial Measures" and "Forward-Looking Statements". Certain statements contained in this MD&A constitute forward-looking statements. Forward-looking statements are included under "Business Prospects and Outlook" and elsewhere in this MD&A. These statements relate to future events or the Company's future performance. All statements other than statements of historical fact may be

forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as “seek”, “anticipate”, “budget”, “plan”, “continue”, “estimate”, “expect”, “forecast”, “may”, “will”, “project”, “predict”, “potential”, “targeting”, “intend”, “could”, “might”, “should”, “believe” and similar words suggesting future outcomes or statements regarding an outlook. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to: the performance characteristics of the Company’s oil and natural gas properties; drilling plans and the timing and location thereof; plans for the exploration and development of the North Block; plans for seismic acquisition and surveys; production capacity and levels, and the timing of achieving such capacity and levels; the level of expenditures for compliance with environmental regulations; the size of oil and natural gas reserves; projections of market prices and costs; supply and demand for oil and natural gas; expectations regarding the ability to raise capital and to continually add to reserves through acquisitions and development; and capital expenditure programs.

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Company believes the expectations reflected in those forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct and readers are cautioned not to place undue reliance on forward-looking statements contained in this MD&A. Some of the risks and other factors which could cause results to differ materially from those expressed in the forward-looking statements contained in this MD&A include, but are not limited to: volatility of oil and natural gas prices; liabilities inherent in oil and natural gas operations; uncertainties associated with estimating oil and natural gas reserves; competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel; geological, technical, drilling and processing problems; fluctuations in currency and interest rates; product supply and demand; risks inherent in the Company’s foreign operations; changes in environmental and other regulations or the interpretation of such regulations; political and economic conditions in the Republic of Kazakhstan; and the other factors discussed in this MD&A.

Statements relating to “reserves” are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described can be profitably produced in the future. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward-looking statements contained in this MD&A are made as of the date hereof. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

Finally, in the presentation of the MD&A, Caspian uses terms that are universally applied in analyzing corporate performance within the oil and gas industry, but which regulators require that we provide disclaimers.

**Barrel of Oil Equivalent (BOE)** – The oil and gas industry commonly expresses production volumes and reserves on a “barrel of oil equivalent” basis (“BOE”) whereby natural gas volumes are converted at the ratio of six thousand cubic feet to one barrel of oil. The intention is to sum oil and natural gas measurement units into one basis for

improved analysis of results and comparisons with other industry participants. Throughout this MD&A Caspian has used the 6:1 BOE measure which is the approximate energy equivalency of the two commodities at the burner tip. BOE does not represent a value equivalency at the plant gate, which is where Caspian sells its production volumes, and therefore may be a misleading measure if used in isolation.

**Non-IFRS Measures** – Certain measures in this document do not have any standardized meaning as prescribed by IFRS such as operating netback, funds flow, funds flow from operations, funds flow per share, net debt and capitalization and, therefore, are considered non-IFRS measures. The Company presents funds flow from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of earnings per share. These measures may not be comparable to similar measures presented by other issuers. These measures have been described and presented in this document in order to provide shareholders and potential investors with additional information regarding the Company's liquidity and its ability to generate funds to finance its operations. Management's use of these measures has been disclosed further in this document as these measures are discussed and presented.

## **A PRECIS OF CURRENT ACTIVITY**

Currently, well EZ #301 is producing an average 252 barrels per day by natural pressure, after being permitted by regulators to return to production May 3, 2012 on the premise that both East Zhagabulak wells will begin capturing solution gas by year-end. EZ #213 is pumping at a daily rate of 152 barrels.

Completion of construction and commissioning of the gas pipeline to transfer gas to the Alibekmola Gas Processing Plant is expected to occur during December 2012. Concurrently, the pilot production stage will end and the development stage will begin in East Zhagabulak.

Well EZ #308 spud on July 16, 2011. Production casing was set to 4,775 metres. Electronic logging operations have identified substantial intervals of possible pay in the KT-I zone and an additional 88 metres of net pay in the KT-II. Presently, production tubing of varying sizes is being run in the well.

Well 306 spud on January 9, 2012. It is intended to delineate the southern extent of the discovery and further confirm the considerable value of the East Zhagabulak field. The geological conditions for Well 306 are the same as for the recently drilled Well 308, targeting the same hydrocarbon bearing horizons; KT-I at a depth of 3,360 to 3,879 metres and KT-II at 4,070 to 4,700 metres. Well 306 is presently drilling ahead at 3,637 metres, while having cored the KT-I at 3,628 – 3,637 metres.

Sakramabas #316 spud on July 22, 2011. This well encountered net pay zones aggregating 184.8 metres and equates to a new discovery well in the West Zhagabulak field of Kazakhstan.

Following successful logging, Well 316 has been cased to a depth of 4,950 metres. Presently, preparations are ongoing for a well-log survey and acoustic cement bond logging.

Success at Well 316 will enable Aral to declare a commercial discovery in the North Block. Successful testing of this well, followed by government confirmation, will qualify us to seek an extension of our exploration contract over the entire Greater Zhagabulak field by a further two or possibly three years. The current three-year exploration contract expires December 29, 2012.

The rig which drilled Well 316 to total depth in the West Zhagabulak field, was immediately mobilized to East Zhagabulak, where it set surface casing on Well 315 on May 9, 2012. If successful, Well 315 will result in the material conversion of P3 (possible) reserves to P2 (probable) reserves.

Aral Petroleum Capital LLP (Aral or APC), the operating entity in Kazakhstan, holds a 25-year production licence for East Zhagabulak and a three-year exploration permit for the larger North Block, an area of some 1,549 square kilometres in West-Central Kazakhstan that contains both East and West Zhagabulak.

On April 16, 2012, 1,672,012 common shares and 836,007 share purchase warrants were issued to satisfy the 4Q 2011 interest obligation on the Company's Convertible Debentures. The deemed price of the stock issued is \$0.139625 per share and the warrant exercise price is \$0.191065.

Pursuant to the pronouncements of IFRS, Caspian's convertible debentures constitute a financial liability with an embedded derivative (which is the conversion feature of this instrument). Revaluation of the derivative component of the Company's Convertible Debentures from the date of the Second Amending Agreement to quarter end has resulted in an unrealized gain equal to \$118,000 as the fair value of the conversion option has decreased due to the deteriorating market value per share of the Company's common shares.

During 2007, Aral had a dispute with its drilling subcontractor, Nabors, in relation to a mechanical failure at the drilling site that resulted in the loss of the well and the re-drilling of an interval of the well. Nabors made a claim for compensation. Aral viewed Nabors as responsible for the failure. The matter was under negotiation and the amount of possible cash outflows was not then determinable. Negotiations to resolve the dispute were unsuccessful.

The negotiations were unsuccessful and on October 25, 2011, the Specialized Inter-District Economical Court of Almaty City found in favour of Nabor and ordered Aral to pay the equivalent of approximately US\$3.2 million to Nabors. Aral appealed this

decision and on December 28, 2011, the Almaty City Court (Appellate Collegium) upheld the lower court's decision.

Aral continues to believe in the merits of its defence against Nabors' claim and is making legal arrangements to file a supervisory appeal to The Supreme Court of the Republic of Kazakhstan, which is Aral's final route of appeal. If Aral is unsuccessful in its appeal, Caspian will be required to fund approximately US\$1.6 million of Aral's obligation to Nabors pursuant to an indemnity in favour of Asia Sixth.

## **BUSINESS OF THE COMPANY**

Caspian has a 40% interest in Aral Petroleum Capital LLP ("Aral"), which is held by Caspian Energy Ltd. ("Caspian Ltd."), the Company's wholly-owned subsidiary, through which it has the right to explore and develop certain oil and gas properties in the Republic of Kazakhstan ("ROK") known as the North Block, a 1,549 square kilometre area located in the vicinity of the Kazakh pre-Caspian basin. The Company's strategy is to focus on the operations of Aral and the significant opportunity it presents in the North Block.

Aral's exploration and development rights in the North Block were granted pursuant to an exploration contract dated December 29, 2002 between Aral and the Ministry of Energy and Mineral Resources of the ROK (the "Exploration Contract"). Under the terms of the Exploration Contract, Aral agreed to spend at least USD20.8 million under a minimum work program in respect of the North Block, during the initial three-year term of the contract. Eligible expenditures include such things as processing and reinterpretation of geological and geophysical data of prior years, two dimensional and three dimensional seismic surveys, drilling exploration wells, well reactivations and well surveys and testing. As discussed below, funds raised by the Company are used to discharge the obligations of Aral relating to the minimum work program. As at December 31, 2005, Aral's financial obligation under the minimum work program had been discharged in full. Further, Aral undertook to expend USD12.2 million by the close of calendar 2006, which undertaking was also discharged. The initial term of the Exploration Contract was extended for a two-year period through to December 2007, and subsequently through December 2009. The work program extension to December 2007 included drilling three wells to a combined total of 8,500 metres with a monetary obligation of USD20.6 million. The 2008 work program committed the Company to undertake USD8.5 million of exploration expenditures prior to the close of the calendar year and the 2009 work program – USD10.6 million. As at December 31, 2007, Aral had incurred USD119.7 million in charges related to the work commitments of the Minimum Working Program agreed with the ROK competent bodies. At that point, shortfalls under the Work Commitments aggregated USD7.1 million. Management of Aral believed the Company was in compliance with its commitments under the Minimum Working Program and received authorization from the Ministry of Energy and Natural Resources and other competent bodies to carry over fulfillment of the above shortfalls to the year ending December 31, 2008. At December 31, 2008, Aral had discharged these obligations having incurred USD138.5 million in charges related to the work commitments of the Minimum Working Program. During the first quarter of 2009, Aral's request for a three year extension (through December 2012) to the exploration period for the North Block

contract was approved by all the required ROK regulatory bodies. Concurrent with the extension, the proposed 2009 minimum work commitment was increased from USD10.5 million to USD38.9 million. On November 25, 2009, during a Zapkaznedra ITD Technical Council (the regulatory body) session, the Council decreed that the Aral Petroleum Capital LLP Updated Work Program has financial obligations of USD 21.4 million. Aral has a 2009 deficiency in qualifying expenditures equal to USD 11.0 million, which the Council has agreed to defer to future periods. Also, the Exploration Period was extended for three years to December 29, 2012. As at December 31, 2010, Aral had expended USD 8.5 million toward discharging these obligations.

Addendum No. 6 to the Exploration Contract was granted State Registration on July 13, 2011. The Competent Body of the ROK agreed to amend the Work Program for the years 2010 – 2012 by carrying forward the drilling of two exploration wells (estimated cost USD 13.95 million) and seismic operations (estimated cost USD 2.04 million) from 2010 to 2011 and 2012, with no decrease in expenditures commitment in the extension period. The approved amended Work Program stipulates expenditures of USD 2.10 million, 25.84 million and 22.46 million for the years 2010, 2011 and 2012, respectively. Aral expended USD 6.42 million during 2010.

The various requirements of the work program agreed to with the Ministry of Oil and Gas for 2011, both in terms of functions and expenses, have been carried out by Aral. During 2011, Aral's total expenditures for the year exceeded the commitment, reaching a total of \$34.3 million. As at March 31, 2012, Aral had incurred USD 11.0 million of qualifying expenditures.

Non-fulfillment of commitments under the Work Program may result in punitive actions by the Government of the Republic of Kazakhstan, including suspending or revoking the Exploration Contract.

In accordance with Kazakhstani tax legislation Aral is required to pay royalties in relation to the volume of oil produced. However, management of Aral believes that in accordance with the Exploration Contract the test production phase is not subject to royalties and that Aral will be liable to pay royalties only at the experimental-industrial phase or when the Production Contract is signed. Management of Aral has based this belief upon its communications to date with Kazakhstani authorities, in connection with which, no indications have been made that such royalties are payable. Should tax authorities consider Aral's position as incorrect, additional taxes and fines may be imposed. Accordingly, at March 31, 2012 no provision for royalties has been recorded by Aral. The previously mentioned additional fines and taxes that could be levied aggregate \$1.2 million.

Caspian accesses western capital markets and utilizes western technology to explore and exploit its Kazakh assets. The proceeds from its financing activities are used to fund the exploration program and support pilot production in the North Block. The operational strategy of the Company is as follows:

- To prove-up the maximum amount of reserves with the minimum number of wells
- To utilize 3-D seismic and international standards and evaluation technology

- To focus initially on the Zhagabulak area in the North Block, where the pilot production exists, then move to the Sakramabas area and subsequently, other areas within the North Block
- To position the Company to maximize value to the investor through development of the North Block
- To be aware of competitive efforts and resultant opportunities that may manifest themselves in the form of reserves/production acquisitions

The aforementioned strategies relate to future events and performance and are subject to uncertainties that may dictate a future change in strategy or cause actual results of the Company's operations to differ. *See "Forward-Looking Statements and Other Information"*.

Kazakhstan's economy continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible outside of the Country, a low level of liquidity of debt and equity securities in the markets and relatively high inflation. Additionally, the oil and gas industry in Kazakhstan is impacted by political, legislative, fiscal and regulatory developments. The prospects for future economic stability are largely dependent upon the effectiveness of economic measures undertaken by the Government, together with legal, regulatory and political developments, which are beyond the Company's control. The financial condition and future operations of the Company may be adversely affected by continued uncertainties in the business environment of Kazakhstan. Management is unable to predict the extent and duration of these uncertainties, nor quantify the impact, if any, on the financial statements. Tax legislation and practice in Kazakhstan are in the developmental stage and therefore are subject to varying interpretations and frequent changes, which may be retroactive.

Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activities of the Company may not coincide with that of Management. As a result, transactions may be challenged by tax authorities and the Company may be charged additional taxes, penalties and interest. Tax periods remain open to review by the tax authorities for three to five years; however, under certain circumstances a tax year may remain open longer. *See "Forward-Looking Statements and Other Information"*.

### **East Zhagabulak (EZ)**

The Zhagabulak Area is located in the southeastern corner of the North Block. The Government of Kazakhstan has estimated that this Area contains 642 million barrels of oil in place with 193 million barrels classified as recoverable. These Kazakh estimates were based upon the results of Soviet era 2-D seismic data and stratigraphic test wells. Caspian neither accepts nor denies these estimates, but is seeking to validate this data through its exploration program.

The initial 3-D seismic program covering 406 square kilometres has been completed, processed and interpreted, indicating significant structures. Processing through Pre-Stack Time Migration (PSTM) of the Zhagabulak 3-D seismic data set was completed at the

end of August 2005. The processing was performed by PGD-Dank (a division of Paradigm Geophysical) in Almaty, ROK. Following processing, the data set was transferred to Halliburton's Landmark Geophysical office in Moscow, Russia for interpretation. Processing through Pre-Stack Depth Migration (PSDM) was completed in December 2005 and transferred to Landmark for interpretation. The presence of a broad, extensive structure separating Zhagabulak from neighboring producing fields has been noted and several potential drilling locations have been identified.

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. On August 31, during a 24 hour test, before field shut-in: 210 Bo, 45 Bw, 286 Mcfd, FTP 250, SICP 1,588, flow line pressure 88 psig at an 8.7 mm choke. On November 3, 2008 a 24 hour test was conducted with the following results: 196 Bo (barrels of oil), 101 Bw (barrels of water), 274 Mcfd (thousand cubic feet of gas per day), FTP (flowing tubing pressure) 250, SICP(shut-in casing pressure) 1,720, flow line pressure 110 psig at an 8.7 mm choke. Well 213 flowed for 22 days after the field was brought back on-line, but ceased flowing on November 14, 2008 due to a high water-cut. Beginning in April 2009, EZ#213 was flowing intermittently averaging 10 Bopd, 3 Bwpd and 13 Mcfd. During December 2009, an electric submersible pump was installed in Well 213 and production resumed. The electrical submersible pump installed in Well 213, during December 2009, failed due to an unknown downhole electrical problem.

The workover on producing well EZ #213 in the East Zhagabulak field was completed. The workover installed a new deep well pump, to increase the daily production rate. Currently,

EZ #213 is currently pumping at a daily rate of 152 barrels.

The location for the first well on the block, EZ#301, 1.1 km southwest of well EZ#213, was chosen from an earlier fast-track interpretation of the 3-D seismic data set. A contract with Nabors Drilling International was concluded in April 2005 and the well spud on July 16, 2005. The well reached a total depth of 4,846 metres on November 7, 2005, logs were run, production casing was set and testing began in mid-December. Acid treatment of the perforated intervals occurred during February 2006. 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 2007, the tool and wire were recovered and the well resumed production. On August 31, during a 24 hour test, before field shut-in, production was 545 Bo, 14 Bw, 743 Mcfd, FTP 309, SICP 1,793, at a flow line pressure of 118 psig on a 12.0 mm choke. On November 3, 2008 a 24 hour test was conducted with the following results: 560 Bo (barrels of oil), 17 Bw (barrels of water), 779 Mcfd (thousand cubic feet of gas per day), FTP (flowing tubing pressure) 338 psig, SICP(shut-in casing pressure) 1,911, flow line pressure 121 psig at a 12.0 mm choke. During March 2009 EZ#301 was flowing 284 Bopd, 7 Bwpd and 382 Mcfd with a flowing tubing pressure of 338 psig on a 12 mm choke. The flow rate had decreased



since the November test due to a suspected asphaltene build-up in the flowline which increased the back-pressure in the flowline from 176 psig, in early February 2009, to 322 psig in March. Remedial actions were undertaken and the flowline was purged with xylene in early April, reducing the back-pressure and restoring the well to 521 Bopd, 13 Bwpd and 640 Mcfd with a flowing tubing pressure of 300 psig on a 12 mm choke. EZ# 301 was shut-in on December 31, 2009, when the pilot production permit expired. During the fourth quarter of 2010, Well 301 averaged 321 Bopd, 16 Bwpd and 459 Mcfd with a flowing tubing pressure of 259 psig on a 10 mm choke. The addition of a downhole pump in this well will significantly increase the production rate and the installation of a pump is planned for the near future. The pump is estimated to cost USD 300k.

Currently, well EZ #301 is producing an average 252 barrels per day by natural pressure, after being permitted by regulators to return to production May 3, 2012 on the premise that both East Zhagabulak wells will begin capturing solution gas by year-end.

A second well location, EZ#302, was drilled approximately 3.6 km southwest of EZ#301 and is structurally updip to that well. EZ#302 spud on December 25, 2005. Acidizing and testing of the well were performed following removal of the drilling rig. The well showed all indications of hydrocarbons while drilling and logging; however, the stimulation efforts failed to cause the well to flow naturally. In well 302 a workover has been prepared to isolate the KT-II and the lower portions of the KT-I that exhibit higher water saturations on the logs.

The third drilling location, EZ#303, located 5.2 km southwest of EZ#302, was permitted to a depth of 5,700 metres and was spud on May 28, 2006. 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. In Well 303 a workover is proposed to isolate and test intervals separately to identify which perforations are producing water.

Completion of construction and commissioning of the gas pipeline to transfer gas to the Alibekmola Gas Processing Plant is expected to occur during December 2012. Concurrently, the pilot production stage will end and the development stage will begin in East Zhagabulak.

Aral Petroleum Capital LLP (Aral or APC), the operating entity in Kazakhstan, holds a 25-year production licence for East Zhagabulak and a three-year exploration permit for the larger North Block, an area of some 1,549 square kilometres in West-Central Kazakhstan that contains both East and West Zhagabulak.

On February 16, 2012, the Associated Petroleum Gas Utilization Program of Aral was reviewed and approved by the Ministry of Oil and Gas. Subsequently, the MOG granted to Aral a permit to flare associated gas until December 29, 2012. The formal permit has not yet been received.

Completion of construction and commissioning of the gas pipeline to transfer gas to the Alibekmola Gas Processing Plant is expected to occur during December 2012. Concurrently, the pilot production stage will end and the development stage will begin in East Zhagabulak.

Well EZ #308 spud on July 16, 2011. Production casing was set to 4,775 metres. Electronic logging operations have identified substantial intervals of possible pay in the KT-I zone and an additional 88 metres of net pay in the KT-II. Presently, production tubing of varying sizes is being run in the well.

The KT-I section, logged over the interval 3,518 to 3,850 metres, identified 31.1 metres of net pay. A pay section, totalling 30 metres exhibited oil saturation of between 50 % and 89 %. By comparison, Well 301 had 36 metres of net pay in this interval.

The KT-II section, logged over the interval 4,505 to 4,780 metres, identified 87.3 metres of net pay. Seventy-seven (77) metres of net pay exhibit oil saturation of between 65 % and 82 %. This compares with Well 301, which had 65 metres of net pay in this interval.

East Zhagabulak Well 301, the company's first exploration well, which spud during July 2005 and was flow-tested during February 2006, reached a total depth of 4,846 metres and encountered approximately 101 metres of net oil pay. Both carboniferous sections were tested. The lower interval (KT-II), the primary target in the well, tested at rates of 2,532 barrels of oil per day (b/d) with 39° API gravity oil. The upper zone (KT-I), a secondary target, was acidized and commingled with the lower zone.

Well 306 spud on January 9, 2012. It is intended to delineate the southern extent of the discovery and further confirm the considerable value of the East Zhagabulak field. The geological conditions for Well 306 are the same as for the recently drilled Well 308, targeting the same hydrocarbon bearing horizons; KT-I at a depth of 3,360 to 3,879 metres and KT-II at 4,070 to 4,700 metres. Well 306 is presently drilling ahead at 3,637 metres, while having cored the KT-I at 3,628 – 3,637 metres.

Sakramabas #316 spud on July 22, 2011. This well encountered net pay zones aggregating 184.8 metres and equates to a new discovery well in the West Zhagabulak field of Kazakhstan.

Following successful logging, Well 316 has been cased to a depth of 4,950 metres and an application has been filed with local authorities to test the commerciality of the find.

Success at Well 316 will enable Aral to declare a commercial discovery in the North Block. Successful testing of this well, followed by government confirmation, will qualify us to seek an extension of our exploration contract over the entire Greater Zhagabulak field by a further two or possibly three years. The current three-year exploration contract expires December 29, 2012.

The rig which drilled Well 316 to total depth in the West Zhagabulak field, was immediately mobilized to East Zhagabulak, where it set surface casing on Well 315 on May 9, 2012. If successful, Well 315 will result in the material conversion of P3 (possible) reserves to P2 (probable) reserves.

Renewed confidence in world oil prices have increased outside interests in the North Block and East Zhagabulak field farm-out and funding efforts.

### **Baktygaryn**

The Baktygaryn Area is located in the northwestern corner of the North Block. The Government of Kazakhstan has estimated that this Area contains 863 million barrels of oil in place with 259 million barrels classified as recoverable. These Kazakh estimates were based upon the results of Soviet era 2-D seismic data and stratigraphic test wells. Caspian neither accepts nor denies these estimates, but seeks to validate this data through its exploration program.

In September 2005, Azimut Energy Services began seismic acquisition work in the Baktygaryn Area. The acquisition program of 235 square kilometres of 3-D seismic data was completed during November 2005 and the data transferred to PGS-GIS in Almaty for processing.

The data was fully processed through Pre-Stack Time Migration for the above salt section and through Pre-Stack Depth Migration for the below salt section and full interpretation of this data was completed by the end of October 2006. The acquisition of the 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 2006 has been processed and interpreted. The interpreted data from all new seismic data acquired and from the earlier reprocessed Soviet-era 2-D seismic has been combined to create a geological model and identify additional leads and prospects across the North Block territory.

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 2,500 metres and provides a second tier of exploration to the Company's drilling portfolio. These targets are recognized in the forms of channel sands, traps against the Kungurian salt ridges and underneath salt overhangs.

In addition to the ongoing interpretation work on the Baktygaryn 3-D and North Block regional 2-D seismic data and the identification of several post-salt drilling targets in the Triassic and Permian formations, further progress on the interpretation has revealed the presence of additional targets which are being added to the Company's prospect and lead portfolio.

The first post-salt well identified from the Baktygaryn 3-D survey, Baktygaryn #703, was spud on March 17, 2008, reached total depth of 2,521 metres on June 15, 2008 and was rig-released on June 19, 2008. Numerous drilling delays were experienced due to deviation problems in the salt and anhydrite section and mechanical failures of the drill

string. The object of the vertical well was to secondarily, test Triassic sandstones downdip on a faulted structure and primarily, Upper Permian sandstones in a trap below a Permian salt diapir overhang. The well encountered excellent reservoir quality sandstones in the Triassic, but due to the downdip location of the well, no hydrocarbons were found. Seismic anomalies that supported the presence of a hydrocarbon trap in the Upper Permian, below a salt overhang, were proven by drilling to be inter-bedded claystones and anhydrite. No reservoirs in the Upper Permian were encountered and the well was plugged and abandoned.

The rig moved to the Aransay #711 location, approximately 20 kilometres east, where it spud on July 11, 2008 and was rig released, plugged and abandoned, on July 26, 2008. On reaching its total depth of 924 metres in the Upper Permian, the well encountered approximately 298 metres of reservoir quality rocks in the Triassic section. The Triassic was interpreted to be sandstone reservoirs trapped against a fault and was supported by a series of flat-based seismic reflectors believed to indicate a potential hydrocarbon/water interface. However, no shows were encountered while drilling and electric logging has confirmed the absence of hydrocarbons. Drilling and petrophysical analysis of electric logs indicated all zones were water saturated. Nevertheless, the presence of reservoir-quality sands of such thickness in the Triassic supports the interpretation that the Triassic is a viable primary target in the area in the presence of a proper trap and seal.

### **Itisay, Kozdesay and West Kozdesay**

These three Areas are located in the southwestern portion of the North Block and collectively, are viewed as one prospect. The Government of Kazakhstan has estimated that these Areas contain 567 million barrels oil in place and 170 million barrels recoverable. These Kazakh estimates were based upon the results of Soviet era 2-D seismic data and stratigraphic test wells. Caspian neither accepts nor denies these estimates, but seeks to validate this data through its exploration program.

Soviet-era seismic data interpretation, mapping and the associated shallow well drilling in these Areas 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. Interpretation of most of the regional 2006 2-D seismic survey covering the west and north areas of the North Block has been completed. The interpreted data from all new seismic data acquired and from the earlier reprocessed Soviet-era 2-D seismic was combined to create a geological model and identify additional leads and prospects across the North Block territory. As a result of this work, some of the earlier leads and prospects in the post-salt sediments identified on vintage maps and seismic in three areas in the south western portion of the North Block, known as Itisay, Kozdesay and West Kozdesay have been confirmed and in addition several new leads and drillable prospects have been identified in trapping positions against Permian salt ridges and under salt overhangs.

### **Other Areas Within The North Block**

Following are some of the other exploration areas within the North Block and their reserve estimates as put forth by the Government of Kazakhstan. Again, Caspian neither accepts nor denies these estimates, but seeks to validate this data through its exploration program: Tashir – 126 million barrels oil in place and 38 million barrels recoverable, Bulash – 116 million and 35 million, respectively, and Shegelshy – 90 million and 31 million, respectively. The grand totals estimated by the Kazakh Government for all prospects in the North Block are 899 million barrels oil in place and 274 million barrels oil recoverable.

Beginning in the fourth quarter of calendar 2004, the Company undertook to reprocess and interpret approximately 3,000 kilometres of Soviet age 2-D seismic data in other areas of the original concession. From this effort the Company identified the Baktygaryn Area for acquiring additional 3-D seismic.

During March 2005, Aral was awarded the exploration rights over an additional 1,110 square kilometre area adjacent to the north and west portions of the North Block. This new territory contains additional seismic and well data and efforts to identify that data for incorporation into the electronic database have begun. Evaluation of the North Block extension, the preliminary identification of potential drilling areas and plans on how to explore are in process.

Digitization and calibration of the existing Soviet age well log data across the entire North Block territory for those wells penetrating into the formations below the Permian salt complex have been completed and petrophysical analysis of these wells commenced during December 2005 and continues to present.

A full North Block prospect evaluation project utilizing all recent and vintage seismic and well log data was completed. Numerous older prospects within the block were confirmed and several new prospects were identified.

A request for an extension of three years (through year 2012) of the exploration period for the North Block contract has been approved by the Ministry of Energy and Mineral Resources with additional work program commitments.

On November 25, 2009, during a Zapkaznedra ITD Technical Council (the regulatory body) session, the Exploration Period was extended for three years to December 29, 2012 with a cumulative expenditures obligation of USD 56.5 million. Protocol No. 188/2010 (issued February 5, 2010), by Zapkaznedra ITD Technical Council, stipulated that 55% of the contractual territory will be and was returned to the ROK in the 4<sup>th</sup> quarter of 2010. The prospective areas - Greater Zhagabulak, Baktygaryn, Uriktau, and West Kozdesay, and others, were retained. No hydrocarbon, highly prospective area, as determined by the Company, was released.

***Summary of Selected Quarterly Results (\$000's - except sales volumes/prices and per share amounts)***

<i>Period</i>	<i>2Q-10</i>	<i>3Q-10</i>	<i>4Q-10</i>	<i>1Q-11</i>	<i>2Q-11</i>	<i>3Q-11</i>	<i>4Q-11</i>	<i>1Q-12</i>
Oil and gas –Boe/d	85	208	168	44	3	167	290	69
Oil and gas sales price – per Boe	63.54	69.40	72.07	77.23	20.30	93.11	94.82	87.84
Oil and gas revenues,net	(537)	(345)	3,819	304	5	1,428	1,869	550
Cash flow from operating activities	(1,104)	(1,917)	1,145	(751)	(298)	7,317	(14,569)	(843)
Comprehensive income (loss)	(5,455)	(2,306)	293	(2,185)	(761)	5,066	(36,626)	(2,225)
Comprehensive income (loss) per share basic and diluted	(0.04)	(0.01)	0.00	(0.01)	(0.00)	0.03	(0.20)	(0.01)

The original producing well, EZ#213 and the second well EZ#301 have both declined as expected, due to loss of energy in the reservoir. On December 31, 2009, both 213 and 301 were shut-in when the pilot production permit expired. On March 11, 2010, concurrent with the approval of the annual ecological permit, the East Zhagabulak field was brought back on-stream.

The East Zhagabulak field was shut-in concurrent with the expiration of the gas flaring permit on December 31, 2010 and production recommenced on June 15, 2011.

Subsequently, the workover on producing well EZ #213 in the East Zhagabulak field was completed. The workover installed a new deep well pump, to increase the daily production rate. On December 31, 2011 well EZ #213 and EZ#301 were shut-in.

Oil and gas revenue fluctuates over the eight quarters, reflecting changes in production volumes combined with great volatility in commodity selling prices.

Net income (loss), over the eight quarters, also varies due to the stock-based compensation charge, which is tied to the date of stock option grants, which generally vest on the date of grant.

Pursuant to the pronouncements of IFRS, Caspian's convertible debentures constitute a financial liability with an embedded derivative (which is the conversion feature of this instrument). Revaluation of the derivative component of the Company's Convertible Debentures from the date of the Second Amending Agreement to quarter end (4Q 2011) resulted in an unrealized gain equal to \$5,754,000 as the fair value of the conversion option has decreased due to the deteriorating market value per share of the Company's common shares. During 1Q 2012, a similar in nature gain of \$118,00 was recorded.

The deal with Asia Sixth was signed November 1, 2010 and closed on December 29, 2011. Caspian Energy Inc. now owns 40 % of Aral Petroleum Capital LLP (Aral), the operating entity in Kazakhstan. Caspian, originally a 50 % owner in Aral, conveyed 10% ownership to Asia Sixth. The accounting loss suffered on this disposition was recognized in 4Q 2011 and equates to \$33,687,000. The loss is mostly comprised of the surrender to Asia Sixth, by Caspian, of 60% of its loan to Aral.

To the close of 1Q 2012, due to the fluctuation in the Canadian dollar versus the United States dollar and the Kazakh Tenge, mostly unrealized foreign exchange losses of \$477,000 were recorded.

*See "Forward-Looking Statements and Other Information".*

## **CONTRACTUAL OBLIGATIONS**

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 USD20.8 million and matured at the end of calendar 2005. As at December 31, 2005, this financial obligation was fully discharged. The work program was extended to December, 2007 and included drilling three wells to a combined total of 8,500 metres. The work program was extended to December 2009 and contains a 2009 exploration commitment which aggregates USD10.5 million. As at December 31, 2007, Aral had incurred USD119.7 million in charges related to the work commitments of the minimum working program agreed with the ROK competent bodies. At this point, shortfalls pursuant to the work commitments aggregated USD7.1 million. Management of Aral believed the Company was in compliance with its commitments under the minimum working program and received authorization from the Ministry of Energy and Natural Resources and other competent bodies to carry over fulfillment of the above shortfalls to the year ending December 31, 2008. At December 31, 2008, Aral had discharged these obligations having incurred USD138.5 million in charges related to the work commitments of the Minimum Working Program. During the first quarter of 2009, Aral's request for a three year extension (through December 2012) to the exploration period for the North Block contract was approved by all the required ROK regulatory bodies. Concurrent with the extension, the proposed 2009 minimum

work commitment was increased from USD10.5 million to USD38.9 million. On November 25, 2009, during a Zapkaznedra ITD Technical Council (the regulatory body) session, the Council decreed that the Aral Petroleum Capital LLP Updated Work Program has financial obligations of USD 21.4 million. Aral has a 2009 deficiency in qualifying expenditures equal to USD 11.0 million, which the Council has agreed to defer to future periods. Also, the Exploration Period was extended for three years to December 29, 2012.

Addendum No. 6 to the Exploration Contract was granted State Registration on July 13, 2011. The Competent Body of the ROK agreed to amend the Work Program for the years 2010 – 2012 by carrying forward the drilling of two exploration wells (estimated cost USD 13.95 million) and seismic operations (estimated cost USD 2.04 million) from 2010 to 2011 and 2012, with no decrease in expenditures commitment in the extension period.

Under the Exploration Agreement with the ROK, the approved work program calls for expenditures of USD25.8 million in 2011 and USD22.5 million in 2012. The various requirements of the work program agreed to with the Ministry of Oil and Gas for 2011, both in terms of functions and expenses, have been carried out by Aral. During 2011, Aral's total expenditures for the year exceeded the commitment, reaching a total of USD34.3 million. As at March 31, 2012, Aral had incurred USD 11.0 million of qualifying expenditures.

Non-fulfillment of commitments under the Work Program may result in punitive actions by the Government of the Republic of Kazakhstan, including suspending or revoking the Exploration Contract.

Set forth below is a summary reconciliation of the minimum work program requirements of Aral under the Exploration Contract as at March 31, 2012:

<b>Fiscal Year</b>	<b>Minimum Work Program (US \$000's)</b>	<b>Amount Paid to Date (US \$000's)</b>	<b>Shortfall (Overpayment) (US \$000's)</b>
<b>2003</b>	5,642.4	550.6	5,091.8
<b>2004</b>	9,707.9	14,333.3	(4,625.4)
<b>2005</b>	20,914.4	23,961.7	(3,047.3)
<b>2006</b>	58,371.2	54,034.6	4,336.6
<b>2007</b>	32,159.1	26,867.9	5,291.2
<b>2008</b>	9,049.4	18,751.9	(9,702.5)



<b>2009</b>	21,400.0	10,362.0	11,038.0
<b>2010</b>	2,097.0	8,512.1	(6,415.1)
<b>2011</b>	25,840.0	34,310.0	(8,470.0)
<b>2012</b>	22,463.0	11,035.0	11,428.0
<b>Total</b>	207,644.4	202,719.1	4,925.3

**CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES AND NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) FOR THE PERIOD**

**Cash Provided by (Used in) Operating Activities**

Caspian's operations used \$843,000 of cash for the three months ended March 31, 2012 and used \$751,000 of cash for the three months ended March 31, 2011.

**Cash Provided by (Used in) Operating Activities**

(000's except per share)	<b>1Q 2012</b>	<b>1Q 2011</b>
<b>Cash provided by (used in) operating activities</b>	\$(843)	\$(751)
<b>Basic</b>	\$(0.00)	\$(0.00)
<b>Diluted</b>	\$(0.00)	\$(0.00)

**Net Income (Loss) and Comprehensive Income (Loss)**

For 1Q 2012, net income (loss) and comprehensive income (loss) was \$(2,225,000) (1Q 2011 – \$(2,185,000)). Finance expense of \$1,397,000 (1Q 11 - \$719,000) contributes to this amount.

(000's except per share)	<b>1Q 2012</b>	<b>1Q 2011</b>
<b>Net and comprehensive income (loss):</b>	\$(2,225)	\$(2,185)
<b>Basic</b>	\$(0.01)	\$(0.01)
<b>Diluted</b>	\$(0.01)	\$(0.01)

## Sales Volumes

Presently, our oil is shipped by rail to Kaliningrad, due to its inability to meet pipeline specifications, a consequence of the lack of facilities that can desalt our feedstock and remove the mercaptans. The Company sold an average 69 Bopd (1Q 11 – 44 Bopd) at a price of \$87.84 (1Q 11 - \$77.23), per barrel, net of ROK takes, during the quarter ended March 31, 2012.

Under the Exploration Contract, Aral is required to pay royalties at a rate of 3% of the volume of hydrocarbons produced and sold based upon the average selling price (less transportation expenses) of the production. Aral is also obligated to allocate 10% of produced hydrocarbons to the ROK. Aral believes that in accordance with the Exploration Contract, the test production phase is excluded from the burden of royalties and that royalties are payable only at the experimental-industrial phase or when a Production Contract is concluded. If Aral's perspective is incorrect and rejected by Kazakh tax authorities, additional taxes and fines approximating \$1.2 million may be levied. Gas sales from Caspian's Canadian non-operated production totaled \$21,764 (2010 - \$24,507).

## Revenues

For 1Q 2012, revenues before transportation costs were \$550,000. For 1Q 2011, revenues before transportation costs were \$304,000. During 2012, the average sales rate increased from 44 Bopd in 2011 to 69 Bopd, while the average price per barrel increased from \$77.23 to \$87.84, due to the volatility of international oil markets.

## Operating Expenses

For 1Q 2012, operating costs were \$317,000 (1Q 11 - \$121,000) and transportation costs were \$24,000 (1Q 11 - \$118,000). Operating costs aggregated \$50.63 (1Q 11 - \$30.44 per barrel).

Transportation costs were \$3.83 (1Q 11 - \$29.68) per barrel.

## Operating Netbacks

Operating netback for the quarter ended March 31, 2012 was \$209,000.

(000's except per boe)	Total (\$)	Per Boe (\$)
<b>Sales, net</b>	550	87.84
<b>Operating costs</b>	317	50.63
<b>Transportation</b>	24	3.83
<b>Netback</b>	209	33.38

Operating netback for the quarter March 31, 2011 was \$(65,000).

(000's except per boe)	Total (\$)	Per Boe (\$)
<b>Sales, net</b>	304	77.23
<b>Operating costs</b>	121	30.44
<b>Transportation</b>	118	29.68
<b>Netback</b>	65	17.11

### General and Administrative Expenses

	1Q 2012	1Q 2011
Office expenses	\$39	\$38
Travel and entertainment	16	65
Salaries/benefits	196	314
Directors	135	-
Legal	52	27
Third parties	73	40
Social tax	5	7
Other taxes	20	-
Other	82	46
<b>Total expense</b>	<b>\$618</b>	<b>\$537</b>

Significant travel expenses are incurred as the operations of the Company are centered in the ROK, a Calgary, Alberta office is maintained for financial reporting and investor relations, the CEO is resident in Portugal, the COO is an American citizen and financing activities span North America, the British Isles, Asia and Europe. Salaries and benefits relate to the remuneration packages of the Chief Executive Officer, Chief Operating Officer and the Chief Financial Officer,

while professional fees are legal, audit, taxation and engineering services. Professional fees escalated in 2011 due to increased legal charges relating to the Asia Sixth transaction.

### **CAPITAL EXPENDITURES**

Capital expenditures of \$2,112,000 for 1Q 2012 (1Q 11 - \$101,000) were incurred.

### **DEPLETION, DEPRECIATION AND ACCRETION**

Depletion, depreciation and accretion expense was \$60,000 (\$9.58 per Boe) for the quarter ended March 31, 2012 and \$55,000 (\$13.84 per Boe) for the quarter ended March 31, 2011.

### **LIQUIDITY AND CAPITAL RESOURCES**

The Company operates within several parameters affecting its liquidity and capital resources:

- Its business is capital intensive, requiring cash infusions on a regular basis as it seeks to grow its business.
- Its inventory of product for sale – its reserves – needs to be constantly replenished and augmented.
- It is a price taker when selling its inventory of oil and natural gas reserves.

Given these constraints, Caspian finances its operations through Canadian equity sources and cash flows.

The Company reported a net loss of \$1,748,000 and negative funds generated from operating activities of \$843,000 for the period ended March 31, 2012. The Company had a net working capital deficiency of \$47,584,000 and a cumulative deficit equal to \$178,368,000 at period end.

On April 7, 2011, the Company concluded an arrangement with its Debentures holders regarding the USD 16 million, 10% per annum, convertible debentures which matured on March 2, 2011. The existing Debentures were restructured as follows:

- 44% of the principal plus accrued interest was converted into common shares of the Company at a price of \$0.19 per common share (this aggregates \$9,790,753 convertible to 49,777,218 common shares)
- the existing Debentures were amended to an amount of \$12,460,958, with a conversion price of \$0.28 per common share, a floor price (minimum conversion price) of \$0.10 per common share and a 24 month maturity date

- Interest remains at 10% per annum, payable in cash quarterly, or at the election of the holders in stock at a 5% discount to 20 day Volume Weighted Average Price (VWAP) plus ½ share purchase warrant (2 year life) at a 30% premium

to VWAP

In accordance with the shareholders' agreement in respect of Aral, Caspian is obligated to jointly fund the minimum work program of Aral pursuant to the Exploration Contract.

On February 23, 2010, the Company announced that it had entered into an agreement to sell a 10% interest in Aral Petroleum Capital LLP to AsiaStar Petroleum Limited. Caspian then held an aggregate 50% interest in Aral, which it operates as a joint venture together with Azden Management Limited. The sale of 10% of Aral equates to a disposition of 20% of Caspian's total interest in Aral.

The deal with Asia Sixth was signed November 1, 2010 and closed on December 29, 2011, with satisfaction of the last of several conditions precedent. Caspian Energy Inc. now owns 40 % of Aral Petroleum Capital LLP (Aral), the operating entity in Kazakhstan, while Asia Sixth Energy Resources Limited owns 60 % of Aral.

Caspian, originally a 50% owner in Aral, conveyed 10% ownership to Asia Sixth in return for Asia Sixth's undertaking to finance capital expenditures to the cumulative threshold of USD \$80 million over the duration of the deal. Caspian also receives a \$2 million loan, secured by production-oriented cash flow, plus access to a further two million on each of the first two anniversaries of the transaction. This arrangement permits Caspian to access a total of \$6 million over two years, if the company so decides. Loans have a maturity of ten years and bear interest at 10 % per year for the first five years and 18 % for the second 5 years. Repayments on this facility are restricted to and sourced from the production proceeds of Aral.

These loans, together with the \$80 million capital facility, ensure that Caspian will have sufficient funds for the initial phase of the project in East Zhagabulak. Management expects the program to become self-funding before the loan facility is fully expended.

Asia Sixth is a special purpose vehicle, representing oil-and-gas-experienced private interests in the Asia Pacific region, 40% indirectly owned by Strong Petrochemical Holdings Ltd, listed on the HKEX and the residual by a Chinese entrepreneur. This company has the technical and administrative capacity to direct the exploration, development and production activities of APC within the North Block.

As part of the transaction, it will be the purchaser's responsibility to make a significant effort to secure USD 80 million in debt financing for Aral for further exploration and development. This transaction will achieve several strategic milestones. It will provide the funding necessary to develop the East Zhagabulak field, phase one of which envisages the immediate drilling of development wells. It will provide the funding required for a sustained exploratory drilling campaign in the Greater Zhagabulak, Baktygaryn, and Urikhtau areas, among others. Finally, it should ensure that Caspian

will not have to provide additional funds for the activity in the North Block in the near term.

***See also “Contractual Obligations”.***

On January 5, 2010, the Company issued 6,553,311 common shares and 655,322 share purchase warrants, at an exercise price of \$0.082191, pursuant to the Convertible Debentures interest obligation pertinent to 4Q 2009.

On April 15, 2010, the Company issued 2,271,117 common shares and 227,116 share purchase warrants at an exercise price of \$0.2183106 pursuant to the 1Q 2010 interest obligation.

On May 27, 2010, the Company closed its non-brokered private placement pursuant to which it issued 9,320,000 common shares at a price of \$0.20 per share to raise gross proceeds of \$1,864,000. The common shares issued in connection with the private placement were subject to a statutory hold period which expired on September 28, 2010.

On July 14, 2010, the Company issued 3,069,293 common shares and 306,929 share purchase warrants at an exercise price of \$0.1758922 pursuant to the 2Q 2010 interest obligation on its Convertible Debentures.

On May 31, 2011, the Company issued 561 common shares upon the exercise of share purchase warrants at an exercise price of \$0.45.

On July 8, 2011, the Company issued 1,438,087 common shares and 719,044 share purchase warrants at an exercise price of \$0.288668 pursuant to the 2Q 2011 interest obligation on its Convertible Debentures.

On October 31, 2011 3,034,470 common shares and 1,517,235 share purchase warrants were issued to satisfy the 3Q 2011 interest obligation on the Company’s Convertible Debentures. The deemed price of the stock issued is \$0.106879 per share and the warrant exercise price is \$0.146256.

On December 22, 2011, 2,406,226 warrants were exercised for proceeds of \$141,078.

On January 5, 2012, 567,999 warrants were exercised for proceeds of \$46,684.

On April 16, 2012, 1,672,012 common shares and 836,007 share purchase warrants were issued to satisfy the 4Q 2011 interest obligation on the Company’s Convertible Debentures. The deemed price of the stock issued is \$0.139625 per share and the warrant exercise price is \$0.191065.

***See “Forward-Looking Statements and Other Information”.***

**OUTSTANDING SHARE DATA**

At May 14, 2012 the number of common shares of the Company outstanding and the number of common shares issuable pursuant to other securities of the Company outstanding are as follows:

<u>Common Shares</u>	<u>Number</u>
Outstanding	225,533,091
Issuable under options	17,791,621
Issuable pursuant to debentures warrants (max)	11,141,941
Issuable pursuant to convertible debentures outstanding (max)	150,042,487

## **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 as further set forth below.

On February 16, 2012, the Associated Petroleum Gas Utilization Program of Aral was reviewed and approved by the Ministry of Oil and Gas. Subsequently, the MOG granted to Aral a permit to flare associated gas until December 29, 2012.

Completion of construction and commissioning of the gas pipeline to transfer gas to the Alibekmola Gas Processing Plant is expected to occur during December 2012. Concurrently, the pilot production stage will end and the development stage will begin in East Zhagabulak.

Currently, well EZ #301 is producing an average 252 barrels per day by natural pressure, after being permitted by regulators to return to production May 3, 2012 on the premise that both East Zhagabulak wells will begin capturing solution gas by year-end. EZ #213 is pumping at a daily rate of 152 barrels.

Well EZ #308 spud on July 16, 2011. Production casing was set to 4,775 metres. Electronic logging operations have identified substantial intervals of possible pay in the KT-I zone and an additional 88 metres of net pay in the KT-II. Presently, production tubing of varying sizes is being run in the well.

The KT-I section, logged over the interval 3,518 to 3,850 metres, identified 31.1 metres of net pay. A pay section, totalling 30 metres exhibited oil saturation of between 50 % and 89 %. By comparison, Well 301 had 36 metres of net pay in this interval.

The KT-II section, logged over the interval 4,505 to 4,780 metres, identified 87.3 metres of net pay. Seventy-seven (77) metres of net pay exhibit oil saturation of between 65 % and 82 %. This compares with Well 301, which had 65 metres of net pay in this interval.

East Zhagabulak Well 301, the company's first exploration well, which spud during July 2005 and was flow-tested during February 2006, reached a total depth of 4,846 metres and encountered approximately 101 metres of net oil pay. Both carboniferous sections were tested. The lower interval (KT-II), the primary target in the well, tested at rates of

2,532 barrels of oil per day (b/d) with 39° API gravity oil. The upper zone (KT-I), a secondary target, was acidized and commingled with the lower zone.

Well 306 spud on January 9, 2012. It is intended to delineate the southern extent of the discovery and further confirm the considerable value of the East Zhagabulak field. The geological conditions for Well 306 are the same as for the recently drilled Well 308, targeting the same hydrocarbon bearing horizons; KT-I at a depth of 3,360 to 3,879 metres and KT-II at 4,070 to 4,700 metres. Well 306 is presently drilling ahead at 3,637 metres, while having cored the KT-I at 3,628 – 3,637 metres.

Sakramabas #316 spud on July 22, 2011. This well encountered net pay zones aggregating 184.8 metres and equates to a new discovery well in the West Zhagabulak field of Kazakhstan.

Following successful logging, Well 316 has been cased to a depth of 4,950 metres. Presently, preparations are ongoing for a well-log survey and acoustic cement bond logging.

If successful, this well will be ranked as a significant new discovery — with the potential to more than double oil reserves in Kazakhstan.

Success at Well 316 will enable Aral to declare a commercial discovery in the North Block. Successful testing of this well, followed by government confirmation, will qualify us to seek an extension of our exploration contract over the entire Greater Zhagabulak field by a further two or possibly three years. The current three-year exploration contract expires December 29, 2012.

The rig which drilled Well 316 to total depth in the West Zhagabulak field, was immediately mobilized to East Zhagabulak, where it set surface casing on Well 315 on May 9, 2012. If successful, Well 315 will result in a material conversion of P3 (possible) reserves to P2 (probable) reserves.

At March 31, 2012, the Company had a working capital deficiency of \$47,584,000.

Under the Exploration Agreement with the ROK, the approved work program calls for expenditures of USD25.8 million in 2011 and USD22.5 million in 2012. The various requirements of the work program agreed to with the Ministry of Oil and Gas for 2011, both in terms of functions and expenses, have been carried out by Aral. During 2011, Aral's total expenditures for the year exceeded the commitment, reaching a total of USD34.3 million.

The deal with Asia Sixth was signed November 1, 2010 and closed on December 29, 2011, with satisfaction of the last of several conditions precedent. Caspian Energy Inc. now owns 40 % of Aral Petroleum Capital LLP (Aral), the operating entity in Kazakhstan, while Asia Sixth Energy Resources Limited owns 60 % of Aral.



Caspian, originally a 50-% owner in Aral, conveyed 10-% ownership to Asia Sixth in return for Asia Sixth's undertaking to finance capital expenditures to the cumulative threshold of USD \$80 million over the duration of the deal. Caspian also receives a \$2 million loan, secured by production-oriented cash flow, plus access to a further two million on each of the first two anniversaries of the transaction. This arrangement permits Caspian to access a total of \$6 million over two years, if the company so decides. Loans have a maturity of ten years and bear interest at 10 % per year for the first five years.

These loans, together with the \$80 million capital facility, ensure that Caspian will have sufficient funds for the initial phase of the project in East Zhagabulak, though the program should become self-funding before the loan facility is fully expended.

Asia Sixth is a special purpose vehicle, representing oil-and-gas-experienced private interests in the Asia Pacific region, 40-% indirectly owned by Strong Petrochemical Holdings Ltd, listed on the HKEX and the residual by a Chinese entrepreneur. This company has the technical and administrative capacity to direct the exploration, development and production activities of APC within the North Block.

The Company's ability to continue as a going concern is in substantial doubt and is dependent upon completion of the aforementioned transaction.

*See "Contractual Obligations".*

## **ADDITIONAL DISCLOSURES**

### **Critical Accounting Estimates**

The preparation of financial statements in accordance with IFRS requires Management to make certain judgments and estimates. Changes in these judgments and estimates could have a material impact on the Company's financial results and financial condition.

Management relies on the estimate of reserves as prepared by the Company's independent qualified reserves evaluator. The process of estimating reserves is critical to several accounting estimates and is complex and requires significant judgments and decisions based on available geological, geophysical, engineering and economic data. These estimates may change substantially as additional data from ongoing development and production activities becomes available and as economic conditions impact crude oil and natural gas prices, operating expense, royalty burden changes, and future development costs. Reserve estimates impact net income through depletion and impairment of petroleum and natural gas properties. The reserve estimates are also used to assess the borrowing base for the Company's credit facilities. Revision or changes in the reserve estimates can have either a positive or a negative impact on net income and the borrowing base of the Company.

Management's process of determining the provision for deferred income taxes, the provision for decommissioning liability costs and related accretion expense, and the fair values assigned to any acquired assets and liabilities in a business combination is based on estimates. These estimates are significant and can include proved and probable

reserves, future production rates, future petroleum and natural gas prices, future costs, future interest rates, future tax rates and other relevant assumptions. Revisions or changes in any of these estimates can have either a positive or a negative impact on asset and liability values and net income.

The fair value of stock options is based on estimates using the Black-Scholes option pricing model and is recorded as share-based payments expense in the financial statements.

## **International Financial Reporting Standards**

### **EVALUATION OF DISCLOSURE CONTROLS**

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), on a timely basis so that appropriate decisions can be made regarding public disclosure.

For the quarter ended March 31, 2012 the CEO and CFO have evaluated the effectiveness of the Company's disclosure controls and procedures as defined in Multilateral Instrument 52-109 of the Canadian Securities Administrators and have concluded that such controls and procedures were not effective because of the material weaknesses described in Management's Report on Internal Control over Financial Reporting.

### **MANAGEMENT REPORT ON INTERNAL CONTROL**

Management is responsible for establishing and maintaining adequate internal control over financial reporting of the Company. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

The Company's internal control over financial reporting includes those policies and procedures that

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

A material weakness in internal controls is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements would not be prevented or detected on a timely basis by the Company.

We note, however, that a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues including instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, our control systems may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected and could be material and require a restatement of our financial statements.

Caspian proportionately consolidates the results of its 40% shareholdings in the Kazakh joint-venture, Aral Petroleum Capital LLP (Aral), with its own financial data. Management of Caspian has limited the scope of design of its DC&P and ICFR to exclude controls, policies and procedures of Aral. To help mitigate the impact of this weakness and to ensure quality financial reporting, Caspian relies upon supervisory controls exercised by Aral management and their undertaking to maintain appropriate policies, procedures and systems of internal control to ensure Aral's reporting practices and accounting and administrative procedures are appropriate, consistent and cost-effective.

**ARAL PETROLEUM CAPITAL LLP**  
**Balance Sheet - At March 31, 2012**  
**(in 000's Canadian dollars)**

	<b>March 31, 2012</b>	<b>December 31, 2011</b>
<b>ASSETS</b>		
Total current assets	4,444	3,546
Total non-current assets	105,153	102,505
<b>TOTAL ASSETS</b>	<b>109,597</b>	<b>106,051</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)</b>		
Total current liabilities	175,083	170,041
Total non-current liabilities	1,054	1,078
Total shareholders' equity (deficit)	(66,540)	(65,068)
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)</b>	<b>109,597</b>	<b>106,051</b>

**ARAL PETROLEUM CAPITAL LLP**

**Statement of Operations – For the quarter ended March 31, 2012**

**(in 000's Canadian dollars)**

	<b>2012</b>	<b>2011</b>
Revenue	1,364	600
Operating costs	1,410	816
Finance expense	2,886	3,912
<b>Operating Income/(Loss)</b>	<b>(2,932)</b>	<b>(4,128)</b>

Due to the Company's size, and its inability to segregate incompatible functions among its employees, there are inherent weaknesses in the Company's internal controls to provide reasonable assurance regarding the reliability of financial reporting. As the Company has a limited number of personnel, management has concluded that a weakness exists in the design of internal controls over financial reporting caused by a lack of adequate segregation of duties. This weakness has the potential to result in material misstatements in the Company's financial statements and should also be considered a weakness in its disclosure controls and procedures. Management has concluded that taking into account the present stage of the Company's development and the best interests of its shareholders, the Company does not have sufficient size and scale to warrant the hiring of additional personnel to correct this weakness at this time. To help mitigate the impact of this weakness and to ensure quality financial reporting, there are supervisory controls exercised by management and audit committee oversight.

There has been no change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal period that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.