# CASPIAN ENERGY INC.

## Management's Discussion and Analysis

November 4, 2011 – 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 financial statements and selected notes for the three and nine months ended September 30, 2011 and with the audited consolidated financial statements and notes for the years ended December 31, 2010 and 2009. This commentary is based upon information available to November 4, 2011.

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 2011;
2. Caspian's current financial condition; and
3. Caspian's future prospects.

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

The reader is cautioned that the aforementioned audited financial statements and MD&A for the year ended December 31, 2010 are presented using Canadian generally accepted accounting principles ("Canadian GAAP") accounting standards whereas the financial statements for the three and nine months ended September 30, 2011 and the 2010 comparatives have been prepared in accordance with IFRS. All references to "Previous GAAP" refer to Canadian GAAP before the adoption of 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.

### Transition to International Financial Reporting Standards

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") representing generally accepted accounting principles ("GAAP") for publicly accountable enterprises in Canada. The transition date to IFRS was January 1, 2010 and comparative figures for 2010 and Caspian's financial position as at January 1, 2010 have been restated to IFRS from the previous Canadian

generally accepted accounting principles ("Previous GAAP"). Reconciliations to IFRS from Previous GAAP financial statements including the impact of the transition on the Company's reported financial position and financial performance, including the nature and effect of significant changes in accounting policies from those used in the Company's financial statements for the year ended December 31, 2010, are summarized in note 17 to the unaudited financial statements.

## 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

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, well EZ #213 is producing an average 284 barrels per day

Currently, well EZ #301 is producing an average 226 barrels per day by natural pressure, after being permitted by regulators to return to production June 15, 2011 on the premise that both wells will begin capturing solution gas by year-end. The EZ field produced 13,990 barrels of oil during September, 2011.

Well EZ #308 spud on July 16, 2011 and is estimated take about 120 days to reach approximately 4,700 metres target depth, The objective is the same carboniferous

structure of Bashkirian layer from which the two earlier successful wells are currently producing. The EZ #308 site lies roughly midway between the Company's two producing wells in the East Zhagabulak field, some 15 kilometres northeast of the Sakramabas location. EZ #308 is currently drilling ahead at approximately 4,376 metres after coring the interval 4,280 – 4,284 metres.

Sakramabas #316 spud on July 22, 2011 and is estimated take about 120 days to reach approximately 4,500 metres target depth, The objective, again, is the same carboniferous structure of Bashkirian layer. The area around the well is locally known as Sakramabas, but officially designated Greater Zhagabulak II and III. S #316 is currently drilling ahead at 3,285 metres.

In the event of a good result at Sakramabas #316, the partners will complete the EZ #308 well and move that rig to a location northeast of Sakramabas, where it would test for oil between Sakramabas and East Zhagabulak. An additional drilling rig would then be contracted in October 2011 to pursue identified targets within East Zhagabulak.

As a precursor to the finalization of the Share Purchase Agreement and Escrow Agreement, the Facility Agreement entered into with Asia Sixth Energy Resources Limited regarding the sale of a 10% stake in Aral was executed on October 22, 2010. The Facility Agreement provides accelerated access to US$ funds to Aral to permit the accomplishment of the aforementioned remedial action at East Zhagabulak and drilling activity. Aral has drawn USD 6.7 million pursuant to this Facility. AsiaStar Petroleum Limited has agreed to be replaced by Asia Sixth Energy Resources Limited as the party to all agreements and contracts regarding this transaction.

Asia Sixth filed necessary documents with the Anti-Monopoly Committee of the ROK during the first quarter of 2011. The partners in Aral have completed their filings for approval of the transaction with the Ministry of Oil and Gas of the ROK, during the second quarter.

On October 3, 2011, Caspian received formal notification from the Ministry of Oil and Gas that it was waiving its pre-emptive right to purchase any of the shares in Aral alienated by the prosposed sales transactions of both Azden and Caspian to Asia Sixth. The Ministry elected to refer to the Anti-Monopoly Commission the details of the proposed sales transactions for their review of concentrated rights. Verbally, we have been informed that a favourable decision was issued from the Anti-Monopoly Commission. Our application is to be included on the agenda at the next session of the Commission of Experts, the date of which has not yet been established, but is expected prior to November month-end. The Commission will issue a minute of decisions reached. All participants must ratify this minute prior to notarization and presentation to accomplish the re-registration of APC and completion of our transaction.

Subsequently, the Commission will issue a protocol and on the basis of the protocol, the MOG (Ministry of Oil and Gas) will review the application at the Work Group session. The session will make a resolution that the MOG permits the implementation of the transaction and issues a protocol to complete the process.

As part of the transaction, it will be the Purchaser's responsibility to secure US$ 80mm in debt financing for Aral for further exploration and development. This transaction will achieve several strategic imperatives. 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 Sakramabas, 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.
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 $4,826,000 as the fair value of the conversion option has decreased due to the deteriorating market value per share of the Company's common shares.

**BUSINESS OF THE COMPANY**

Caspian has a 50% 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 3,458 square kilometre area located in the vicinity of the Kazakh pre-Caspian basin. During the fourth quarter of 2010, 55% (1,909.1 square kms) of this territory was surrendered pursuant to Amendment No. 5 of the Exploration Contract. The North Block now constitutes 1,549 square kilometres. 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 US$20.8 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 US$12.2 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 US$20.6 million. The 2008 work program committed the Company to undertake US$8.5 million of

exploration expenditures prior to the close of the calendar year and the 2009 work program – US$10.6 million. As at December 31, 2007, Aral had incurred US$119.7 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 US$7.1 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 US$138.5 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 US$10.5 million to US$38.9 million. On November 25, 2009, during a Zapkaznedra ITD Technical Council (the regulatory body) session, the Council decreed that the Aral Petroleum Capital LLP Updated Work Program has financial obligations of US$ 21.4 million. Aral has a 2009 deficiency in qualifying expenditures equal to US$ 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 US$ 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 and as at September 30, 2011 has expended USD 4.51 million for the 2011 calendar year. The present cumulative shortfall for 2011 is USD 14.91 million.

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.

Under the terms of a shareholders' agreement dated June 25, 2004 among Caspian Ltd., Azden Management Limited ("Azden") and Aral, Caspian is obligated to fund Aral's initial work program. Further, under the terms of the shareholders' agreement, Caspian was committed to use all reasonable commercial efforts to raise financing of US$84.0 million (to be loaned to Aral) to fund the first stage of Aral's exploration program under the Exploration Contract. Funds were transferred to Aral via monthly instalments. Caspian discharged this undertaking and has advanced further funds to Aral to prosecute the exploration program. These additional capital advances are being matched by Azden, the other shareholder in the Aral joint venture. Terms of the Exploration Contract include a 3% royalty during the pilot phase, a 10% fee, based upon sales, after VAT (value-added

tax), a 30% corporate income tax and the liability for an excess profits tax based upon a sliding scale.

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 September 30, 2011 no provision for royalties has been recorded by Aral. The previously mentioned additional fines and taxes that could be levied aggregate $1.17 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 and/or sale - farmout 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 died 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. During

the fourth quarter of 2010, Well 213 averaged 10 Bopd, 1 Bwpd and 14 Mcfpd with a flowing tubing pressure of 301 psig on an open choke.

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, well EZ #213 is producing an average 284 barrels per day

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: 545 Bo, 14 Bw, 743 Mcfd, FTP 309, SICP 1,793, flow line pressure 118 psig at 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 Mcfpd 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 US$ 300m.

Currently, well EZ #301 is producing an average 226 barrels per day by natural pressure, after being permitted by regulators to return to production June 15, 2011 on the premise that both wells will begin capturing solution gas by year-end. The EZ field produced 13,990 barrels of oil during September, 2011.

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.

The East Zhagabulak field was temporarily shut-in on August 31, 2008 upon expiration of the term of the gas flaring permit. The field resumed production on October 24, 2008, after receipt of the new flare permit, but was shut in again for three days at the beginning of December, due to the expiration of the pilot production approval. The Author's Control Report (ACR) was approved on December 5, 2008 and the field was brought back on line on that date. In conjunction with the ACR, the pilot production period was approved and extended through December 2009.

The Geology Committee of the ROK has extended the Pilot Production period for the East Zhagabulak field for an additional two years, to December 30, 2012. The Ministry of Oil and Gas has approved the gas utilization program. The Project Report of Maximum Permissible Norms of Emissions of Contaminants is currently in the process of review and approval. The Amendment to the Pilot Production Project and Environmental Project Report are in the process of completion.

In connection with the extension of the Pilot Production period for the East Zhagabulak field for an additional two years, the operations at the East Zhagabulak field will be executed pursuant to this project report. Together with the approved Production Contract, at the East Zhagabulak field dated July 22, 2010, the Production Program is under development, soon to be approved and ratified by the necessary government bodies. Upon expiration of the Pilot Production period, operations at the East Zhagabulak field will be conducted under the Production Contract and developed pursuant to the Production Program.

On December 31, 2009, both 213 and 301 were shut-in when the pilot production permit expired and remain shut-in. The renewal permit has been granted; however, an additional environmental emissions permit is necessary before we can resume production. This permit is expected imminently.

The twenty-five year Production Contract for East Zhagabulak was executed and received by the Company on July 28, 2010. The Company tendered two separate drilling rigs for drilling and associated services to begin in April 2011. Four initial drilling locations have been approved, two for the East Zhagabulak field and two wells offsetting a competitor's discovery at Sakramabas. All necessary permits are in place. A contract with a local gas utilization firm was signed during September 2010, which provides for a gas utilization plant to be constructed within 18 months of execution. A gas pipeline will be built to tie-in the East Zhagabulak field to the plant and enable gas produced at the field to be processed and conserved.

The Company has initiated the development process for East Zhagabulak. The preparation of the official State Reserves Report for East Zhagabulak is complete and was approved by the government on October 16, 2008. The preparation of the Technology Scheme, which outlines the detailed plan of development of the field, was completed on December 8, 2008. Supported by the completed and approved Reserves Report and Technology Scheme an application for a development contract for the field has been prepared and submitted. Local engineering firm KazNIPIMunaigas completed the draft final version of the Technology Scheme for East Zhagabulak field.

Reprocessing of the 3-D seismic lines previously shot across the East Zhagabulak field, with a cost of US$ 300m, to confirm future drilling locations was conducted.

A workover is under way on producing well EZ #213 in the East Zhagabulak field. The workover will install a new deep well pump, with the objective of lifting production from that well to approach 400 barrels per day.

Well EZ #308 spud on July 16, 2011 and is estimated take about 120 days to reach approximately 4,700 metres target depth, The objective is the same carboniferous structure of Bashkirian layer from which the two earlier successful wells are currently producing. The EZ #308 site lies roughly midway between the Company's two producing wells in the East Zhagabulak field, some 15 kilometres northeast of the Sakramabas location. EZ #308 is currently drilling ahead at approximately 4,376 metres after coring the interval 4,280 – 4,284 metres.

Sakramabas #316 spud on July 22, 2011 and is estimated take about 120 days to reach approximately 4,500 metres target depth. The objective, again, is the same carboniferous structure of Bashkirian layer. The area around the well is locally known as Sakramabas, but officially designated Greater Zhagabulak II and III. S #316 is currently drilling ahead at 3,285 metres.

In the event of a good result at Sakramabas #316, the partners will complete the EZ #308 well and move that rig to a location northeast of Sakramabas, where it would test for oil between Sakramabas and East Zhagabulak. An additional drilling rig would then be contracted in October 2011 to pursue identified targets within East Zhagabulak.

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 diaper 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.

Aral has decided to release the drilling rig following plugging operations to further evaluate the portfolio of existing prospects identified in the block.

**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 US$ 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$^{th}$ 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.

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 currently holds 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 agreement is subject to a number of conditions precedent that must be satisfied in order for the transaction to close, and also remains subject to the receipt of all regulatory approvals including without limitation the approval of the government of Kazakhstan. The successful completion of the twenty-five year Production Contract discharged an important Condition Precedent to closing this deal. AsiaStar Petroleum Limited has agreed to be replaced by Asia Sixth Energy Resources Limited as the party to all agreements and contracts regarding this transaction.

As a precursor to the finalization of the Share Purchase Agreement and Escrow Agreement, the Facility Agreement entered into with Asia Sixth Energy Resources Limited regarding the sale of a 10% stake in Aral was executed on October 22, 2010. The Facility Agreement provides accelerated access to US$ funds to Aral to permit the accomplishment of the aforementioned remedial action at East Zhagabulak and drilling activity. Aral has drawn USD 6.7 million pursuant to this Facility. AsiaStar Petroleum Limited has agreed to be replaced by Asia Sixth Energy Resources Limited as the party to all agreements and contracts regarding this transaction.

Asia Sixth filed necessary documents with the Anti-Monopoly Committee of the ROK during the first quarter of 2011. The partners in Aral have completed their filings for approval of the transaction with the Ministry of Oil and Gas of the ROK, during the second quarter.

On October 3, 2011, Caspian received formal notification from the Ministry of Oil and Gas that it was waiving its pre-emptive right to purchase any of the shares in Aral alienated by the prosposed sales transactions of both Azden and Caspian to Asia Sixth. The Ministry elected to refer to the Anti-Monopoly Commission the details of the proposed sales transactions for their review of concentrated rights. Verbally, we have been informed that a favourable decision was issued from the Anti-Monopoly Commission. Our application is to be included on the agenda at the next session of the Commission of Experts, the date of which has not yet been established, but is expected prior to November month-end. The Commission will issue a minute of decisions reached. All participants must ratify this minute prior to notarization and presentation to accomplish the re-registration of APC and completion of our transaction.

Subsequently, the Commission will issue a protocol and on the basis of the protocol, the MOG (Ministry of Oil and Gas) will review the application at the Work Group session. The session will make a resolution that the MOG permits the implementation of the transaction and issues a protocol to complete the process.

As part of the transaction, it will be the Purchaser's responsibility to make a significant effort to secure US$ 80mm in debt financing for Aral for further exploration and development. If Asia Sixth is able to arrange this debt financing, this transaction will achieve several strategic imperatives. 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.

In consideration of acquiring a 10% interest in Aral from Caspian, Asia Sixth is required to enter into a facility agreement with Caspian which will provide for an advance of up to US$ 6mm in loans to Caspian in three, US$ 2mm tranches over a two year period. These loans will have a ten year term, and will bear interest at a rate of 10% per annum during the first five years and 18% per annum during the second five years. The loans are to be repaid from dividends received by Caspian from Aral.

The agreement with Asia Sixth, which expired on March 31, 2011, has been extended by mutual consent of both parties. The Company's objectives continue to be focused on executing this agreement or another similar arrangement to maximize value to shareholders through development of its oil and gas properties.

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

| ***Period*** | ***4Q-09*** | ***1Q-10*** | ***2Q-10*** | ***3Q-10*** | ***4Q-10*** | ***1Q-11*** | ***2Q-11*** | ***3Q-11*** |
|---|---|---|---|---|---|---|---|---|
| Oil and gas –Boe/d | 209 | 87 | 85 | 208 | 168 | 44 | 3 | 167 |
| Oil and gas sales price – per Boe | 63.69 | 63.12 | 63.54 | 69.40 | 72.07 | 77.23 | 20.30 | 93.11 |
| Oil and gas revenues | 1,206 | 492 | 492 | 1,331 | 1,017 | 304 | 5 | 1,428 |
| Cash flow from operating activities | 336 | (314) | (790) | (813) | (129) | (751) | (298) | 7,317 |
| Net and comprehensive income (loss) | (46,545) | (2,051) | (2,749) | (2,306) | (4,563) | (2,185) | (761) | 5,066 |
| Net and comprehensive income (loss) per share basic and diluted | (0.38) | (0.01) | (0.02) | (0.01) | (0.02) | (0.01) | (0.00) | 0.03 |
| | | | | | | | | |

The original producing well, EZ#213 and the second well EZ#301 have both suffered expected primary production declines, 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.

Daily gross field production rate average over the second quarter of 2010 was 340 Bopd. The East Zhagabulak field continued producing on an uninterrupted basis throughout the third quarter. Daily field production rate average over the third quarter of 2010 was 340 Bopd. Daily field production rate average over the fourth quarter of 2010 was 331 Bopd.

The East Zhagabulak field was shut-in concurrent with the expiration of the gas flaring permit on December 31, 2010.

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, well EZ #213 is producing an average 284 barrels per day

Currently, well EZ #301 is producing an average 226 barrels per day by natural pressure, after being permitted by regulators to return to production June 15, 2011 on the premise that both wells will begin capturing solution gas by year-end. The EZ field produced 13,990 barrels of oil during September, 2011.

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

During the fourth quarter of 2008, large unrealized foreign exchange losses and depletion charges resulted in an approximate $17.4 million loss. The Canadian dollar continues to fluctuate dramatically versus the British Pound Sterling and the US dollar, resulting in both realized and unrealized foreign exchange gains and/or losses in virtually every quarter, materially affecting the corresponding net income (loss). 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.

Beginning with 1Q 09, certain of the Company's debentures holders have requested that the interest earned on their holdings be paid in cash affecting cash flow in these quarters. Since the first quarter of 2009, although requests have been made by the debentures holders, no cash interest payments have been made pending the conclusion of negotiations with the debentures holders. At a special meeting of its shareholders held on Tuesday, December 1, 2009, shareholders of the Company approved certain amendments to the terms of the Secured Convertible Debentures of the Company. The amendments were implemented and the Company agreed to issue common shares and common share purchase warrants to the debentures holders in satisfaction of the interest payments owing.

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 (3Q 2011) has resulted in an unrealized gain equal to $4,826,000 as the fair value of the conversion option has decreased due to the deteriorating market value per share of the Company's common shares.

To the close of 3Q 2011, due to the deterioration in the Canadian dollar versus the United States dollar, mostly unrealized foreign exchange gains of $2,413,000 were recorded.

In conjunction with Protocol No. 188/2010 (issued February 5, 2010), by Zapkaznedra ITD Technical Council (the appropriate regulatory body), 55% of the contractual territory wase returned to the ROK in the 4th quarter of 2010, anticipation of a potential sale of 20% of the Company's interest in Aral and the reduction of proven reserves by the Company's independent reservoir engineers, an impairment charge to property, plant and

equipment of $33,140,715 was suffered during the 4th quarter of 2009. ***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 US$20.8 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. During the third quarter of this fiscal year, the work program was extended to December 2009 and contains a 2009 exploration commitment which aggregates US$10.5 million. As at December 31, 2007, Aral had incurred US$119.7 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 US$7.1 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 US$138.5 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 US$10.5 million to US$38.9 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. 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 and as at September 30, 2011 has expended USD 4.51 million for the 2011 calendar year. The present cumulative shortfall for 2011 is USD 14.91 million.

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.

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Set forth below is a summary reconciliation of the minimum work program requirements of Aral under the Exploration Contract as at September 30, 2011:

| **Fiscal Year** | **Minimum Work Program (US $000's)** | **Amount Paid to Date (US $000's)** | **Shortfall (Overpayment) (US $000's)** |
|---|---|---|---|
| **2003** | 5,642.4 | 550.6 | 5,091.8 |
| **2004** | 9,707.9 | 14,333.3 | (4,625.4) |
| **2005** | 20,914.4 | 23,961.7 | (3,047.3) |
| **2006** | 58,371.2 | 54,034.6 | 4,336.6 |
| **2007** | 32,159.1 | 26,867.9 | 5,291.2 |
| **2008** | 9,049.4 | 18,751.9 | (9,702.5) |
| **2009** | 21,400.0 | 10,362.0 | 11,038.0 |
| **2010** | 2,097.0 | 8,512.1 | (6,415.1) |
| **2011** | 25,840.0 | 4,511.6 | 21,328.4 |
| **2012** | 22,463.0 | | |
| **Total** | 207,644.4 | 161,885.7 | 45,758.7 |

## 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 provided $6,268,000 of cash for the nine months ended September 30, 2011 and used $1,917,000 of cash for the nine months ended September 30, 2010

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

| (000's except per share) | **9 months 2011** | **9 months 2010** |
|---|---|---|
| **Cash provided by (used in) operating activities** | $6,268 | $(1,917) |
| **Basic** | $0.03 | $(0.01) |
| **Diluted** | $0.03 | $(0.01) |

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

For 3Q 2011, net income (loss) and comprehensive income (loss) was $5,066,000(3Q 2010 – $(2,306,000)). Finance expense recovery of $6,302,000 (3Q 10 charge – $(94,000)) contribute to this amount.

For the nine months ended 2011, net income (loss) and comprehensive income (loss) was $2,120,000 (nine months ended 2010 – $(7,089,000)).

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 (3Q 2011) has resulted in an unrealized gain equal to $4,826,000 as the fair value of the conversion option has decreased due to the deteriorating market value per share of the Company's common shares.

To the close of 3Q 2011, due to the deterioration in the Canadian dollar versus the United States dollar, mostly unrealized foreign exchange gains of $2,413,000 were recorded (to the close of 3Q 2010 – a charge of $141,000).

| (000's except per share) | **3Q 2011** | **3Q 2010** |
|---|---|---|
| **Net and comprehensive income (loss):** | $5,066 | $(2306) |
| **Basic** | $0.03 | $(0.01) |
| **Diluted** | $0.03 | $(0.01) |

| (000's except per share) | **9 months 2011** | **9 months 2010** |
|---|---|---|
| **Net and comprehensive income (loss):** | $2,120 | $(7,089) |
| **Basic** | $0.01 | $(0.04) |
| **Diluted** | $0.01 | $(0.04) |

**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 167 Bopd (3Q 10 – 208 Bopd) at a price of $93.11 (3Q 10 - $69.40), per barrel, net of ROK takes, during the quarter ended September 30, 2011. Production during 2011 included natural gas and natural gas liquids from minor domestic working interests.

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 $1.17 million may be levied.

**Revenues**

For 3Q 2011, revenues before transportation costs were $1,428,000. For 3Q 2010, revenues before transportation costs were $1,513,000 (oil and gas sales were $1,331,000, sales of materials inventory was $182,000). During 2011, the average sales rate decreased from 208 Bopd in 2010 to 167 Bopd, while the average price per barrel increased from $69.40 to $93.11, due to the volatility of international oil markets and nature of the commodity. The cost of sales of the materials inventory in 2010 was $1,859,000.

**Operating Expenses**

For 3Q 2011, operating costs were $965,000 (3Q 10 - $(204,000)) and transportation costs were $(548,000) (3Q 10 - $40,000) Operating costs aggregated $62.92 per barrel.

**Operating Netbacks**

Operating netback for the quarter ended September 30, 2011 was $(85,000).

| (000's except per boe) | **Total ($)** | **Per Boe ($)** |
|---|---|---|
| **Sales, net** | 1,428 | 93.11 |
| **Operating costs** | 965 | 62.92 |
| **Transportation** | 548 | 35.73 |
| | | |
| **Netback** | (85) | (5.54) |

Operating netback for the quarter ended September 30, 2010 was $1,495,000.

| (000's except per boe) | **Total ($)** | **Per Boe ($)** |
|---|---|---|
| **Sales, net** | 1,331 | 69.40 |
| **Operating costs** | (204) | (10.63) |
| **Transportation** | 40 | 2.08 |
| | | |
| **Netback** | 1,495 | 77.95 |

**General and Administrative Expenses (000's)**

| | **3Q 2011** | **3Q 2010** |
|---|---|---|
| Office expenses | $29 | $80 |
| Travel and entertainment | 61 | 57 |
| Salaries/benefits | 188 | 339 |
| Audit | - | 1 |
| Legal | 73 | 10 |
| Third parties | 169 | 106 |
| Social tax | 7 | 6 |
| Transportation | - | - |
| Other | 10 | 40 |
| **Total expense** | **$537** | **$639** |

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.

## CAPITAL EXPENDITURES

Capital expenditures of $7,167,000 for the nine months ended 3Q 2011 (2Q 10 - $(83,000)) were incurred.

## DEPLETION, DEPRECIATION AND ACCRETION

Depletion, depreciation and accretion expense was $612,000 ($40.03 per Boe) for the quarter ended September 30, 2011 and $557,000 ($29.11 per Boe) for the quarter ended September 30, 2010.

## 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 income of $5,066,000 and funds generated from operating activities of $7,317,000 for the quarter ended September 30, 2011. The Company had a net working capital deficiency of $613,742,000 and a cumulative deficit equal to $138,782,000 at quarter end.

On April 7, 2011, the Company concluded an arrangement with its Debentureholders 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

Subsequent to period end the Company has received advice from its Debenture holders that they will accept units of the Company (1 unit = 1 common share + 1/2 share purchase warrant) to satisfy the interest obligations of the amended Convertible

Debentures pertinent to the third quarter of this fiscal year. The deemed price of the stock issued is $0.106879 per share and the warrant exercise price is $0.146256. It is anticipated that 3,034,470 common shares and 1,517,235 share purchase warrants will be issued to satisfy the 3Q 2011 interest obligation.

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.

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 US$10.5 million to US$38.9 million. On November 25, 2009, during a Zapkaznedra ITD Technical Council (the regulatory body) session, the Council decreed that the Aral Petroleum Capital LLP Updated Work Program has financial obligations of US$ 21.4 million. Aral has a 2009 deficiency in qualifying expenditures equal to US$ 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. 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 and as at September 30, 2011 has expended USD 4.51 million for the 2011 calendar year. The present cumulative shortfall for 2011 is USD 14.91 million.

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.

Currently, Caspian does not have the cash resources to discharge its 50% share of this commitment.

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 currently holds 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 agreement is subject to a number of conditions precedent that must be satisfied in order for the transaction to close, and also remains subject to the receipt of all regulatory approvals including without limitation the approval of the government of Kazakhstan.

In consideration of acquiring a 10% interest in Aral from Caspian, AsiaStar is required to enter into a facility agreement with Caspian which will provide for an advance of up to

US$ 6mm in loans to Caspian in three, US$ 2mm tranches over a two year period. These loans will have a ten year term, and will bear interest at a rate of 10% per annum during the first five years and 18% per annum during the second five years. The loans are to be repaid from dividends received by Caspian from Aral.

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Asia Sixth filed necessary documents with the Anti-Monopoly Committee of the ROK during the first quarter of 2011. The partners in Aral have completed their filings for approval of the transaction with the Ministry of Oil and Gas of the ROK, during the second quarter.

On October 3, 2011, Caspian received formal notification from the Ministry of Oil and Gas that it was waiving its pre-emptive right to purchase any of the shares in Aral alienated by the prosposed sales transactions of both Azden and Caspian to Asia Sixth. The Ministry elected to refer to the Anti-Monopoly Commission the details of the proposed sales transactions for their review of concentrated rights. Verbally we have been informed that a favourable decision was issued from the Anti-Monopoly Commission. Our application is to be included on the agenda at the next session of the Commission of Experts, the date of which has not yet been established, but is expected prior to November month-end. The Commission will issue a minute of decisions reached. All participants must ratify this minute prior to notarization and presentation to accomplish the re-registration of APC and completion of our transaction.

Subsequently, the Commission will issue a protocol and on the basis of the protocol, the MOG (Ministry of Oil and Gas) will review the application at the Work Group session. The session will make a resolution that the MOG permits the implementation of the transaction and issues a protocol to complete the process.

As part of the transaction, it will be the purchaser's responsibility to make a significant effort to secure US$ 80mm in debt financing for Aral for further exploration and development. This transaction will achieve several strategic imperatives. 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.

The agreement with Asia Sixth, which expired on March 31, 2011, has been extended by mutual consent of both parties. The Company's objectives continue to be focused on executing this agreement or another similar arrangement to maximize value to shareholders through development of its oil and gas properties.

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

***See also "Contractual Obligations".***

On April 17, 2008, the Company announced a Rights Offering, which was subsequently significantly oversubscribed and raised gross proceeds of $4,347,635, through subscriptions for 17,390,543 units at a price of $0.25 per unit. The Offering closed May 28, 2008. Each unit comprised one common share in Caspian and one-half of one share purchase warrant. Each warrant is exercisable at an exercise price of $0.45 until the earlier of May 28, 2011 or 30 days following the receipt of a notice from Caspian that the closing price of the Shares for any 20 consecutive trading days exceeded $0.75.

445,030 share purchase warrants, at an exercise price of $0.03669, 995,517 share purchase warrants, at an exercise price of $0.06057 and 878,346 share purchase warrants, at an exercise price of $0.0652059, which expire on December 23, 2011, were issued pursuant to the Convertible Debentures interest obligation for 1Q, 2Q and 3Q 2009, are outstanding as at March 31, 2011..

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.

Subsequent to period end the Company has received advice from its Debentureholders that they will accept units of the Company (1 unit = 1 common share + 1/2 share purchase warrant) to satisfy the interest obligations of the amended Convertible Debentures pertinent to the third quarter of this fiscal year. The deemed price of the stock issued is $0.106879 per share and the warrant exercise price is $0.146256. It is anticipated that 3,034,470 common shares and 71,517,235share purchase warrants will be issued to satisfy the 3Q 2011 interest obligation.

Caspian must rely on access to debt and capital markets to supplement internally generated cash flow to fund its capital commitments on a go-forward basis and to finance its growth plans. The Company's current expenditures are subject to future uncertainty and there can be no assurance that Caspian will be successful in obtaining the funds required to meet its capital needs on a timely basis or, if successful, that the terms will be advantageous to Caspian. ***See "Forward-Looking Statements and Other Information".***

## OUTSTANDING SHARE DATA

At November 4, 2011 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:

| Common Shares | Number |
|---|---|
| Outstanding | 220,386,854 |
| Issuable under options | 17,110,585 |
| Issuable pursuant to debentures warrants (max) | 15,788,739 |
| Issuable pursuant to convertible debentures outstanding (max) | 151,714,499 |

## 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.

Prior to the end of the fourth quarter 2005, EZ#301 was drilled to a total depth of 4,846 metres and logged. The well was completed with the drilling rig before the rig was moved to the EZ#302 location. EZ#301 was matrix acidized and the two potentially productive hydrocarbon bearing zones were flow-tested. The lower zone (KT-2) was tested at 2,532 Bopd. The upper zone (KT-1) had difficulty maintaining an independent flow, so it was commingled with the lower zone and the well was tied-in to the Zhagabulak production facility. Subsequently, productions logs were ran and it was determined that the KT-1 was producing 100 Bopd. Well 301 was flowing 284 Bopd, 7 Bwpd and 382 Mcfd with a flowing tubing pressure of 338 psig on a 12 mm choke. The flow rate decreased since the November test due to a suspected asphaltene build-up in the flowline which has 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. On December 31, 2009, 301 was 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 second exploration effort, EZ#302, was spud on December 25, 2005. Acidizing and testing of the well were performed following removal of the drilling rig. The well showed indications of hydrocarbons while drilling and logging; however, the stimulation efforts failed to cause the well to flow naturally. In well 302 a workover 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 location, EZ#303 is about 5.2 km southwest of EZ#302. EZ#303 spud on May 28, 2006. The well was permitted to a depth of 5,700 metres. EZ#303 reached a total depth of 4,630 metres in a sidetrack wellbore after the initial wellbore reached a depth of 5,430 metres, but was lost due to a drill string parting, while pulling out of the hole for logging. A total of 70 meters were perforated and acidized in both the KT-1 and KT-2 intervals. A combined test of both intervals yielded water with small amounts of oil, while the separate test on the KT-1 yielded water. In well 303 a workover is being written to isolate intervals and test separately to identify which perforations are producing water.

The original producing well, EZ#213, drilled and completed during the Soviet period, was re-entered in November 2006 and perforations were added in the KT-1 reservoir. Due to different casing weights, problems were encountered with packer setting for the acid operation and consequently, only one-half of the productive zones were acidized. Despite the limits on the acidization, a significant improvement of daily production over the pre-workover rates was achieved. Well 213 flowed for 22 days after the field was brought back on-line, but died on November 14, 2008. During December 2009, an electric submersible pump was installed in Well 213 and production resumed. On December 31, 2009, 213 was 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 on August 31, 2008 upon expiration of the term of the gas flaring permit. Although the Amended Gas Utilization Program was ready for presentation and defense to the Gas Working Committee at the Ministry of Energy, ROK, the defense was postponed as the Ministry was unavailable during September, 2008. The Program was successfully defended on October 3, 2008 and approval was received for the continuation of flaring through the end of calendar 2009. The field resumed production on October 24, 2008, after receipt of the new flare permit, but was shut in again for three days at the beginning of December, due to the expiration of the pilot production approval. The Author's Control Report (ACR) was approved on December 5, 2008 and the field was brought back on line on that date. In conjunction with the ACR, the pilot production period was approved and extended through December 2009.

Well EZ #308 spud on July 16, 2011 and is estimated take about 120 days to reach approximately 4,700 metres target depth, The objective is the same carboniferous structure of Bashkirian layer from which the two earlier successful wells are currently producing. The EZ #308 site lies roughly midway between the Company's two producing wells in the East Zhagabulak field, some 15 kilometres northeast of the Sakramabas location. EZ #308 is currently drilling ahead at approximately 4,376 metres after coring the interval 4,280 – 4,284 metres.

Sakramabas #316 spud on July 22, 2011 and is estimated take about 120 days to reach approximately 4,500 metres target depth, The objective, again, is the same carboniferous structure of Bashkirian layer. The area around the well is locally known as Sakramabas, but officially designated Greater Zhagabulak II and III. S #316 is currently drilling ahead at 3,285 metres.

In the event of a good result at Sakramabas #316, the partners will complete the EZ #308 well and move that rig to a location northeast of Sakramabas, where it would test for oil between Sakramabas and East Zhagabulak. An additional drilling rig would then be contracted in October 2011 to pursue identified targets within East Zhagabulak.

On December 31, 2010, both 213 and 301 were shut-in when the pilot production permit expired.

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, well EZ #213 is producing an average 284 barrels per day

Currently, well EZ #301 is producing an average 226 barrels per day by natural pressure, after being permitted by regulators to return to production June 15, 2011 on the premise that both wells will begin capturing solution gas by year-end. The EZ field produced 13,990 barrels of oil during September, 2011.

The Geology Committee of the ROK has extended the Pilot Production period for the East Zhagabulak field for an additional two years, to December 30, 2012. The Ministry of Oil and Gas has approved the gas utilization program. The Project Report of Maximum Permissible Norms of Emissions of Contaminants is currently in the process of review and approval. The Amendment to the Pilot Production Project and Environmental Project Report are in the process of completion.

In connection with the extension of the Pilot Production period for the East Zhagabulak field for an additional two years, the operations at the East Zhagabulak field will be executed pursuant to this project report. Together with the approved Production Contract, at the East Zhagabulak field dated July 22, 2010, the Production Program is under development, soon to be approved and ratified by the necessary government bodies. Upon expiration of the Pilot Production period, operations at the East Zhagabulak field will be conducted under the Production Contract and developed pursuant to the Production Program.

The twenty-five year Production Contract for East Zhagabulak was executed and received by the Company on July 28, 2010. The Company tendered two separate drilling rigs for drilling and associated services to begin in April 2011. Four initial drilling locations have been approved, two for the East Zhagabulak field and two wells offsetting a competitor's discovery at Sakramabas. All necessary permits are in place. A contract with a local gas utilization firm was signed during September 2010, which provides for a gas utilization plant to be constructed within 18 months of execution. A gas pipeline will be built to tie-in the East Zhagabulak field to the plant and enable gas produced at the field to be processed and conserved.

The Company has initiated the development process for East Zhagabulak. The preparation of the official State Reserves Report for East Zhagabulak is complete and was approved by the government on October 16, 2008. The preparation of the Technology Scheme, which outlines the detailed plan of development of the field, was completed on December 8, 2008. Supported by the completed and approved Reserves Report and Technology Scheme an application for a development contract for the field has been prepared and submitted. Local engineering firm KazNIPIMunaigas completed the draft final version of the Technology Scheme for East Zhagabulak field.

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

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

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

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 have been 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 diaper 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.

Aral released the drilling rig following plugging operations to further evaluate the portfolio of existing prospects identified in the block.

Soviet-era seismic data interpretation, mapping and the associated shallow well drilling in the Itisay, Kozdesay and West Kozdesay areas, located in the southwestern portion of the North Block, yielded minor positive tests and shows of oil associated with the post-salt sediments of Jurassic, Triassic and Upper Permian ages. A review of this data has resulted in the identification of several prospects and leads ranging from 600 to 1,800 metres in trapping positions against Permian salt ridges and under-salt overhangs. Several lines from the Company's 2006 2-D seismic program were shot across certain of these leads and prospects to verify this premise. 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.

The relatively shallow post salt targets at Baktygaryn offer a completely new series of opportunities for the Company. The 3-D and 2-D seismic data have enabled several new prospects to be identified.

The Company's work program extension, with the ROK, to December 2007 was extended for an additional two-year period, subject to the terms of the original exploration contract. The 2008 work program committed the Company to undertake US$8.5 million of exploration expenditures prior to the close of that calendar year. 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. The 2009 work program commitment was initially increased from US$10.5 million to US$ 38.9 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 US$ 21.4 million. Aral has a 2009 deficiency in qualifying expenditures equal to US$ 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. 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 and as at September 30, 2011 has expended USD 4.51 million for the 2011 calendar year. The present cumulative shortfall for 2011 is USD 14.91 million.

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.

Protocol No. 188/2010 (issued February 5, 2010), by Zapkaznedra ITD Technical Council, stipulated that 55% of the contractual territory must be and was returned to the ROK in the 4th 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.

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.

At September 30, 2011, the Company had a working capital deficiency of $13,742,000.

The Company's existing sources of financing and expected cash flow from operating activities are not sufficient to meet: (i) the repayment of the Loan payable of $5,252,000; and (ii) the Convertible Debentures plus accrued interest, totaling $8,366,000 on September 30, 2011, which will mature on June 2, 2013.

Caspian, through Aral, had a commitment to expend US$ 24.5 million during calendar 2010 to discharge its exploration obligations pursuant to its exploration license with the ROK. As at December 31, 2010, Aral had expended US$ 8.5million toward discharging these obligations.

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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 currently holds 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 agreement is subject to a number of conditions precedent that must be satisfied in order for the transaction to close, and also remains subject to the receipt of all regulatory approvals including without limitation the approval of the government of Kazakhstan.

In consideration of acquiring a 10% interest in Aral from Caspian, AsiaStar is required to enter into a facility agreement with Caspian which will provide for an advance of up to US$ 6mm in loans to Caspian in three, US$ 2mm tranches over a two year period. These loans will have a ten year term, and will bear interest at a rate of 10% per annum during the first five years and 18% per annum during the second five years. The loans are to be repaid from dividends received by Caspian from Aral.

As a precursor to the finalization of the Share Purchase Agreement and Escrow Agreement, the Facility Agreement entered into with Asia Sixth Energy Resources Limited regarding the sale of a 10% stake in Aral was executed on October 22, 2010. The Facility Agreement provides accelerated access to US$ funds to Aral to permit the accomplishment of the aforementioned remedial action at East Zhagabulak and drilling activity. Aral has drawn USD 6.7 million pursuant to this Facility. AsiaStar Petroleum Limited has agreed to be replaced by Asia Sixth Energy Resources Limited as the party to all agreements and contracts regarding this transaction.

Asia Sixth filed necessary documents with the Anti-Monopoly Committee of the ROK during the first quarter of 2011. The partners in Aral have completed their filings for approval of the transaction with the Ministry of Oil and Gas of the ROK, during the second quarter.

On October 3, 2011, Caspian received formal notification from the Ministry of Oil and Gas that it was waiving its pre-emptive right to purchase any of the shares in Aral alienated by the prosposed sales transactions of both Azden and Caspian to Asia Sixth. The Ministry elected to refer to the Anti-Monopoly Commission the details of the proposed sales transactions for their review of concentrated rights. Verbally we have been informed that a favourable decision was issued from the Anti-Monopoly Commission. Our application is to be included on the agenda at the next session of the Commission of Experts, the date of which has not yet been established, but is expected prior to November month-end. The Commission will issue a minute of decisions reached. All participants must ratify this minute prior to notarization and presentation to accomplish the re-registration of APC and completion of our transaction.

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The agreement with Asia Sixth, which expired on March 31, 2011, has been extended by mutual consent of both parties. The Company's objectives continue to be focused on executing this agreement or another similar arrangement to maximize value to shareholders through development of its oil and gas properties.

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

Canadian publicly accountable enterprises have implemented International Financial Reporting Standards ("IFRS") for the fiscal years beginning on or after January 1, 2011. The transition date to IFRS was January 1, 2010 and comparative figures for 2010 and Caspian's financial position as at January 1, 2010 have been restated to IFRS from the previous Canadian generally accepted accounting principles ("Previous GAAP"). Reconciliations to IFRS from Previous GAAP financial statements including the impact of the transition on the Company's reported financial position and financial performance, including the nature and effect of significant changes in accounting policies from those used in the Company's financial statements for the year ended December 31, 2010, are summarized in note 17 to the unaudited financial statements. The following discussion

explains the significant differences between IFRS and the Previous GAAP followed by the Company.

a) Property and equipment

Under Previous GAAP, the Company, like many Canadian oil and gas reporting issuers, applied the "full cost" concept in accounting for its oil and gas assets. Under full cost, capital expenditures were maintained in a single cost centre for each country, and the cost centre was subject to a single depletion and depreciation calculation and impairment test. Under IFRS, the Company makes a much more detailed assessment of its oil and gas assets that impact depletion and impairment calculations. Included in this assessment is an ongoing appraisal of exploration and evaluation expenditures ("E&E"). Under Canadian GAAP, it was only necessary to track costs associated with unproved properties that would be excluded from depletion and depreciation calculations. Under IFRS, a company may choose to account for E&E under its previous GAAP and capitalize such costs without recording depreciation expense until the technical feasibility and commercial viability of the project is determined, at which time the costs are moved to development properties or expensed accordingly. Caspian capitalizes E&E costs except for costs incurred before the acquisition of rights to explore in a separate asset account, and to moves these costs into property and equipment when technically feasible and commercially viable.

Under Previous GAAP the Company did not recognize gains or losses on the disposal of oil and gas properties unless such dispositions would change the depletion rate by 20% or more while IFRS requires such recognition. This results in a change to the carrying value and a gain or loss on sale of property, plant and equipment.

b) Depletion and depreciation

For Previous GAAP purposes, the full cost method of accounting for oil and gas properties requires a single calculation of depletion and depreciation of the carrying value of PP&E based on proved reserves. However, IFRS requires an allocation of the amount recognized as PP&E to each significant identified component and each component depleted separately, utilizing an appropriate method of depletion. This component depletion of PP&E results in an increased number of calculations of depreciation expense and impacts the amount of depletion expense recognized. IFRS also permits the option of using either proved or proved and probable reserves in the depletion calculation. Caspian has utilized proved and probable reserves to calculate depletion expense as we believe it represents a better approximation of useful life and depletion of reserves.

c) Impairment of Assets

Under Canadian GAAP, impairment calculations are prepared according to a two-step test generally conducted at a country level and are not subsequently reversed. Under IFRS, impairment testing is completed at an individual asset group or "Cash Generating Unit" level ("CGU") when indicators suggest there may be impairment. A CGU is defined as the smallest group of assets that produce independent cash flows. Impairment of assets at

a CGU level use a one-step approach for testing and measuring asset impairment, with asset carrying values compared to the higher of "Value in Use" and "Fair Value less Costs to Sell". The IFRS methodology may result in the possibility of more frequent impairments in the carrying value of PP&E. However, under IFRS previous impairment losses must be reversed where circumstances change such that the previously recognized impairment has been reduced.

d) Decommissioning Liabilities

Both Canadian GAAP and IFRS require a company to provide for a liability related to decommissioning PP&E. Both methodologies are similar and we have determined there to be no significant difference for Caspian, other than a difference related to discount rates. Canadian GAAP requires that the decommissioning liability be discounted at a credit-adjusted risk-free rate while IFRS requires that the decommissioning liability be discounted at an appropriate rate with either the cash flows or rate adjusted for risks. Caspian has selected to use the risk-free rate for discounting purposes as we believe this accurately represents a market-based rate for such a liability.

e) Share based Payments

Under previous GAAP, the Company accounted for stock-based compensation plans on a straight-line basis over the term of the vesting period. Under IFRS each tranche in an award is considered a separate grant with different vesting date and fair value. Each grant is separately accounted for using applicable assumptions for those specific dates and different fair values and accounted for using graded vesting recognition of expense.

Under previous GAAP, forfeitures of awards are recognized as they occur. The calculation of share-based compensation under IFRS reflects an estimate of the number of awards expected to vest, which is revised if subsequent information indicates that actual forfeitures are likely to differ from the estimate.

f) Deferred Income Taxes

Deferred income tax calculated according to IFRS is substantially similar to Previous GAAP and arises from differences between the accounting and tax bases of assets and liabilities. To the extent that assets and liabilities have changed from transition to IFRS, the amount of deferred income tax liability has been impacted. Additionally, under Previous GAAP deferred income tax liabilities were required to be disclosed as either current or long-term. Under IFRS, all deferred income tax liabilities are considered to be noncurrent liabilities.

h) First Time Adoption of International Financial Reporting Standards

IFRS 1 provides the framework for the first time adoption of IFRS and specifies that an entity shall apply the principles under IFRS retrospectively. IFRS 1 also specifies that the adjustments that arise on retrospective conversion to IFRS from other GAAP should be directly recognized in retained earnings. Certain optional exemptions and mandatory

exceptions to retrospective application are provided under IFRS 1. The Company has taken the following exemptions:

• Companies using full-cost accounting are allowed to measure their oil and gas assets at the amount determined under the Previous GAAP at the date of transition. This amount is pro-rated to the underlying assets based upon the value of proved and probable reserves values at transition date, discounted at 10%.

• Companies using the full cost book value as deemed cost exemption are allowed to measure the liabilities for decommissioning, restoration and similar liabilities at the date of transition and recognize directly in deficit any difference between that amount and the carrying amount determined under Previous GAAP.

• IFRS 3 Business Combinations has not been applied to acquisitions of subsidiaries or of interests in associates and joint ventures that occurred before January 1, 2010.

• IFRS 2 Share-based Payment has not been applied to any equity instruments that were granted, nor has it been applied to equity instruments that vested before January 1, 2010.

• IAS 23 Borrowing Costs will not be applied before January 1, 2010.

i) New standards and interpretations not yet adopted

IFRS 11 - Joint Arrangements

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures,* and SIC-13, *Jointly Controlled Entities—Non-monetary Contributions by Venturers.* The Company has yet to assess the full impact of IFRS 11.

IFRS 13 - Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures. The Company has yet to assess the full impact of IFRS 13.

Standards issued but not yet effective up to the date of issuance of the Company's financial statements are listed below. This listing is of standards and interpretations issued which the Company reasonably expects to be applicable at a future date. The Company intends to adopt those standards when they become effective.

IFRS 9 Financial Instruments: Classification and Measurement

IFRS 9 was issued in November 2009. This standard is the first step in the process to replace IAS 39 Financial Instruments:

Recognition and Measurement. IFRS 9 introduces new requirements for classifying and measuring assets and liabilities, which may affect the Company's accounting for its financial assets. The standard is not applicable until January 1, 2013 but is available for early adoption. The Company has yet to assess the full impact of IFRS 9.

j) Internal Controls

In accordance with the Company's approach to certification of internal controls required under Canadian Securities Administrators' National instrument 52-109 and SOX 302 and 404, all entity level, information technology, disclosures and business process controls will require updating and testing to reflect changes arising from our conversion to IFRS. Upon review, we have determined there to be minimal updating of processes, controls and documentation required.

## 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 September 30, 2011 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 50% shareholdings in the Kazakh joint-venture, Aral Petroleum Capital LLP (Aral), with its own financial data. Aral is audited by the same firm of external auditors as Caspian; however, 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 September 30, 2011**

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

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| **ASSETS** | | |
| | | |
| Total current assets | 5,703 | 3,097 |
| Total non-current assets | 83,392 | 70,370 |
| **TOTAL ASSETS** | 89,095 | 73,467 |
| | | |
| **LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)** | | |
| Total current liabilities | 21,536 | 15,775 |
| Total non-current liabilities | 131,926 | 107,552 |
| Total shareholders' equity (deficit) | (64,367) | (49,860) |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)** | 89,095 | 73,467 |

**ARAL PETROLEUM CAPITAL LLP**

**Statement of Operations – For the nine months ended September 30, 2011**

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

| | **2011** | **2010** |
|---|---|---|
| Revenue | 3,449 | (814) |
| Operating costs | 5,644 | 5,376 |
| Finance expense | 9,151 | (624) |
| **Operating Income/(Loss)** | (11,346) | (5,566) |

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.