



ARAWAK ENERGY CORPORATION

**CONSOLIDATED FINANCIAL STATEMENTS AND NOTES
(UNAUDITED – PREPARED BY MANAGEMENT)**

For the three and six months ended June 30, 2007

ARAWAK ENERGY CORPORATION
INTERIM CONSOLIDATED BALANCE SHEETS
(Expressed in thousands of U.S. dollars)
Unaudited – prepared by management

As at	Note	June 30, 2007	December 31, 2006
ASSETS			
Cash and cash equivalents		14,150	9,663
Accounts receivable		4,496	9,483
Inventory		7,998	4,992
Other current assets		10,589	9,457
		<u>37,233</u>	<u>33,595</u>
Property and equipment	3	204,367	201,314
Future income tax assets		2,766	2,365
		<u>244,366</u>	<u>237,274</u>
LIABILITIES			
Accounts payable and accrued liabilities		14,836	15,873
Corporate income taxes payable		235	2,936
Crude oil sales prepayment facility	4	41,000	30,000
Current portion of long term debt	5	6,900	6,900
Current portion of other long term liabilities		1,104	1,354
		<u>64,075</u>	<u>57,063</u>
Future income tax liabilities		16,497	18,531
Long term debt	5	12,351	15,785
Other long term liabilities		16,367	15,023
Asset retirement obligation		3,037	2,820
		<u>112,327</u>	<u>109,222</u>
SHAREHOLDERS' EQUITY			
Share capital	6	115,051	114,553
Contributed surplus	6	7,312	5,617
Accumulated other comprehensive income	2	1,759	1,541
Retained earnings		7,917	6,341
		<u>132,039</u>	<u>128,052</u>
		<u>244,366</u>	<u>237,274</u>

See accompanying notes to the interim consolidated financial statements.

ARAWAK ENERGY CORPORATION
INTERIM CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS (DEFICIT)
(Expressed in thousands of U.S. dollars)
Unaudited – prepared by management

For the period ended June 30	Three months 2007	Three months 2006	Six months 2007	Six months 2006
Revenue				
Crude oil and gas sales	30,650	33,975	66,454	61,694
Interest and other income	494	204	793	359
	31,144	34,179	67,247	62,053
Expenses				
Royalties and taxes	8,449	7,538	16,959	12,442
Production costs	3,444	2,441	7,470	4,236
Transportation and selling costs	3,576	3,296	7,692	6,323
General and administrative expenses	4,666	3,805	7,796	6,218
Stock option compensation	983	1,113	1,829	1,733
Depletion, depreciation and amortisation	6,563	5,740	14,495	11,050
Accretion expense	81	61	156	117
Interest expense	1,742	681	3,590	1,283
Foreign exchange loss (gain)	99	(106)	(51)	(610)
	29,603	24,569	59,936	42,792
Income before income taxes	1,541	9,610	7,311	19,261
Current income tax	2,264	5,728	8,127	10,775
Future income tax recovery	(1,031)	(1,144)	(2,392)	(1,832)
	1,233	4,584	5,735	8,943
Net income for the period	308	5,026	1,576	10,318
Retained earnings (deficit) beginning of the period	7,609	(806)	6,341	(6,098)
Retained earnings end of the period	7,917	4,220	7,917	4,220
Net income per share				
Basic	0.002	0.029	0.009	0.060
Diluted	0.002	0.029	0.009	0.059

See accompanying notes to the interim consolidated financial statements.

ARAWAK ENERGY CORPORATION
INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME AND
ACCUMULATED OTHER COMPREHENSIVE INCOME
(Expressed in thousands of U.S. dollars)
Unaudited – prepared by management

For the period ended June 30	Three months 2007	Three months 2006	Six months 2007	Six months 2006
<u>Comprehensive income</u>				
Net income for the period	308	5,026	1,576	10,318
Other comprehensive income				
Foreign currency translation adjustment	342	376	218	757
Comprehensive income	650	5,402	1,794	11,075
 <u>Accumulated other comprehensive income</u>				
Accumulated other comprehensive income, beginning of the period	1,417	(159)	1,541	(540)
Other comprehensive income	342	376	218	757
Accumulated other comprehensive income, end of the period	1,759	217	1,759	217

See accompanying notes to the interim consolidated financial statements.

As at June 30, 2007 the accumulated other comprehensive income consists of foreign currency translation adjustments of \$1,759 (June 30, 2006 – \$217; December 31, 2006 – \$1,541).

ARAWAK ENERGY CORPORATION
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in thousands of U.S. dollars)
Unaudited – prepared by management

For the period ended June 30	Three months 2007	Three months 2006	Six months 2007	Six months 2006
<u>Operating Activities</u>				
Net income for the period	308	5,026	1,576	10,318
Items not affecting cash:				
Stock option compensation	983	1,113	1,829	1,733
Depletion, depreciation and amortisation	6,563	5,740	14,495	11,050
Accretion expense	81	61	156	117
Foreign exchange loss	341	375	217	756
Future income tax recovery	(1,031)	(1,144)	(2,392)	(1,832)
Funds from operations	7,245	11,171	15,881	22,142
Changes in non-cash working capital	6,337	5,228	(2,886)	(251)
	13,582	16,399	12,995	21,891
<u>Financing Activities</u>				
Changes in crude oil sales prepayment facility	3,000	10,000	11,000	12,500
Long term debt repayments	(1,825)	(1,500)	(3,550)	(3,000)
Change in other long term liabilities	392	685	1,094	684
Proceeds from issue of common shares	498	153	498	181
	2,065	9,338	9,042	10,365
<u>Investing Activities</u>				
Acquisitions in Russia	-	(8,473)	-	(8,473)
Purchase of property and equipment	(9,850)	(13,080)	(17,550)	(22,707)
	(9,850)	(21,553)	(17,550)	(31,180)
Net change in cash during the period	5,797	4,184	4,487	1,076
Cash, beginning of the period	8,353	11,177	9,663	14,285
Cash, end of the period	14,150	15,361	14,150	15,361

See accompanying notes to the interim consolidated financial statements.

ARAWAK ENERGY CORPORATION
NOTES TO THE INTERIM FINANCIAL STATEMENTS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2007
UNAUDITED – prepared by management

All amounts are in thousands of U.S. dollars unless otherwise stated except per share amounts and number of shares.

1. SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The interim consolidated financial statements of Arawak Energy Corporation (“Arawak” or the “Company”) have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) following the same accounting principles and methods of application as the audited consolidated financial statements for the year ended December 31, 2006. The disclosures provided herein are incremental to those included in the annual consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto in the Company’s annual report for the year ended December 31, 2006.

Presentation of comparative figures

Certain comparative figures have been reclassified to conform to the presentation adopted for the current period.

2. CHANGES IN ACCOUNTING POLICIES

Effective April 1, 2007 the operations in Azerbaijan reached commercial production and accordingly the Company’s proportionate share of revenues and expenses have been recognized in the statement of operations for the quarter ended June 30, 2007. In prior periods, all revenues and expenses were reflected in the carrying value of the Azerbaijani assets.

Effective January 1, 2007 the Company adopted the Canadian Institute of Chartered Accountants Handbook Section 1530 “Comprehensive income”, Section 3251 “Equity”, Section 3865 “Hedges” and Section 3855 “Financial instruments – recognition and measurement”. As required by the new standards, prior periods have not been restated, except to reclassify the foreign currency translation balance as described under “Comprehensive income”. The adoption of these Handbook sections had no impact on opening retained earnings or accumulated other comprehensive income.

Comprehensive income

This standard introduces a new “Statement of comprehensive income” and establishes accumulated other comprehensive income as a separate component of shareholders’ equity. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources and includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Other comprehensive income comprises revenues, expenses, gains and losses that, in accordance with GAAP, are recognised in comprehensive income but excluded from net income. Amounts included in accumulated other comprehensive income are reclassified to net income when realised. Upon adoption of Section 1530, cumulative translation adjustments relating to self-sustaining foreign operations were reclassified to accumulated other comprehensive income and comparative amounts have been restated.

Equity

The equity section establishes standards for the presentation of equity and changes in equity during the reporting period.

Hedges

This section prescribes new hedge accounting standards. Hedge accounting continues to be optional. At the inception of the hedge, the Company must formally document the designation of the hedge, the risk management objectives, the hedging relationships between the hedged items and the hedging

instruments and the methods for testing the hedge's effectiveness. The Company assesses at inception and throughout its term whether the hedging instruments are highly effective in offsetting changes in fair values or cash flows of hedged items.

Financial instruments

The accounting standard on financial instruments establishes the recognition and measurement criteria for financial assets, liabilities and derivatives. All financial instruments are required to be measured at fair value on initial recognition while measurement in subsequent periods depends on its classification as "held-for-trading", "available-for-sale", "held-to-maturity", "loans and receivables" or "other financial liabilities" as defined by the standard.

Financial instruments "held-for-trading" are measured at fair value with changes to fair value recognised in net income, "available-for-sale" are measured at fair value with changes to fair value recognised in other comprehensive income and "held-to-maturity", "loans and receivables" and "other financial liabilities" are measured at amortised cost using the effective interest rate method of amortisation.

Cash and cash equivalents are classified as "held-for-trading" and are measured at carrying value, which approximates fair value due to their short term nature. Accounts receivable and other current assets are classified as "loans and receivables". Accounts payable and accrued liabilities, corporate income taxes payable, crude oil sales prepayment facility, long term debt and other long term liabilities are classified as "other liabilities".

Upon adoption of this standard and its transition provisions, with respect to the amortised cost using the effective interest rate method of long term debt, deferred financing costs of \$0.9 million previously included in deferred charges have been reclassified as unamortised debt issue costs which reduce the carrying value of the long term debt.

3. PROPERTY AND EQUIPMENT

	Cost	Accumulated depletion and depreciation	Net book value
June 30, 2007			
Oil and gas properties	253,594	52,742	200,852
Office equipment	3,971	456	3,515
	257,565	53,198	204,367
December 31, 2006			
Oil and gas properties	237,207	38,893	198,314
Office equipment	3,342	342	3,000
	240,549	39,235	201,314

For the three months ended June 30, 2007, the Company capitalised \$0.9 million of general and administrative costs (three months ended June 30, 2006 – \$0.9 million).

Capitalised costs of \$26.2 million relating to unproved properties in Kazakhstan (2006 – \$25.6 million) have been excluded from the depletion calculation.

4. CRUDE OIL SALES PREPAYMENT FACILITY

Subject to certain conditions, Vitol S.A., an affiliated company of a significant shareholder, has the right to be the exclusive buyer of crude oil exported from the Company's subsidiary in Kazakhstan until May, 2011 and provides a crude oil prepayment facility allowing the Company to draw prepayments on future oil sales. The amount available for prepayment is up to 90 percent of the expected value of the next nine months crude oil export sales from Kazakhstan, subject to a

maximum of \$45.0 million (December 31, 2006 maximum – \$35.0 million). A financing charge of LIBOR plus 3.5% is charged on the outstanding balance held in the Netherlands while LIBOR plus 4.4%, which includes local withholding taxes, is charged on the outstanding balance held in Kazakhstan. Interest is due monthly. The balance outstanding at June 30, 2007 is \$41.0 million (December 31, 2006 – \$30.0 million).

5. LONG TERM DEBT

The Company's 50% owned operating companies in Russia have a bank borrowing base facility agreement carrying interest at LIBOR plus 4.4%. The facility is repayable in equal \$1.725 million quarterly payments and interest is paid quarterly. The borrowing is secured against Russian export crude oil sales and proportionate shareholder guarantees.

	June 30, 2007	December 31, 2006
Bank loan	20,000	23,550
Short term portion	(6,900)	(6,900)
Unamortised debt issue costs	(749)	(865)
Long term debt	12,351	15,785

6. SHARE CAPITAL

Authorised:

Unlimited common shares, without par value

Unlimited preference shares, without par value

Common shares outstanding as at:	June 30, 2007		December 31, 2006	
	Number of shares	Amount	Number of shares	Amount
<u>Issued:</u>				
Balance, beginning of period	171,181,702	112,626	170,184,729	111,565
Exercise of stock options	200,000	498	366,667	511
Exchanged during period	1,999,205	1,743	630,306	550
Issued and outstanding	173,380,907	114,867	171,181,702	112,626
<u>Exchangeable shares:</u>				
Balance, beginning of period	2,210,163	1,927	2,840,469.0	2,477
Exchanged	(1,999,205)	(1,743)	(630,306)	(550)
Exchangeable shares outstanding	210,958	184	2,210,163	1,927
Balance, end of period	173,591,865	115,051	173,391,865	114,553

In 2005, the Company funded an acquisition by issuing 13.9 million exchangeable shares of Arawak Acquisition Inc., a wholly-owned subsidiary of Arawak. The exchangeable shares are exchangeable for Arawak common shares on a one for one basis. An aggregate of 210,958 exchangeable shares are outstanding as of June 30, 2007 (2,210,958 as of December 31, 2006) and are expected to be exchanged into Arawak common shares in due course.

Earnings per share

Per share amounts are calculated using the weighted average number of common shares outstanding during the period as follows:

For the period ended June 30	Three months		Six months	
	2007	2006	2007	2006
Basic	173,567,689	173,279,638	173,480,263	173,159,751
Diluted	174,963,878	174,754,663	174,719,371	174,628,559

For the purposes of calculating the weighted average number of shares, the exchangeable shares have been treated as common shares issued.

The stock options granted are the reconciling items between the weighted average basic and diluted number of common shares, though not all of the outstanding stock options are dilutive.

Stock options

On June 5, 2007 the Company adopted an amended stock option plan under which the Board of Directors may grant options for the purchase of common shares to directors, officers, consultants and employees for up to 12% of the outstanding common shares. The exercise price of each option shall not be lower than the closing price of common shares on the Toronto Stock Exchange on the last trading day immediately prior to the date the stock option is granted. The options are granted for a maximum term of five years and are fully vested after 36 months from the date of grant. Options granted prior to June 2007 were granted under the 1998 and 2003 stock option plans.

	Number of options	Weighted average exercise price
Outstanding December 31, 2005	5,700,000	CAD 2.01
Granted February 3, 2006	300,000	CAD 2.50
Granted May 10, 2006	5,235,000	CAD 2.94
Exercised	(366,667)	CAD 1.20
Cancelled	(83,333)	CAD 2.34
Outstanding December 31, 2006	10,785,000	CAD 2.50
Granted June 15, 2007	3,042,500	CAD 2.69
Exercised	(200,000)	CAD 2.10
Outstanding June 30, 2007	13,627,500	CAD 2.55

The number of stock options outstanding and exercisable at June 30, 2007, is as follows:

Options outstanding		Options exercisable	
Number outstanding	Average remaining life in years	Number outstanding	Average remaining life in years
13,627,500	3.7	8,756,655	3.2

Contributed surplus

As at:	June 30, 2007	December 31, 2006
Balance, beginning of period	5,617	1,818
Stock based compensation expense	1,829	3,928
Exercised options	(134)	(129)
Balance, end of period	7,312	5,617

7. FINANCIAL INSTRUMENTS

Market risk

The Company is exposed to changes in oil and gas prices in world and domestic markets. From time to time the Company enters into derivative contracts to manage its crude oil price exposure. The instruments are not used for trading purposes. The Company manages its exposure to petroleum commodity prices by entering into crude oil options when deemed appropriate. These derivative contracts are not accounted for as hedges.

Foreign currency exchange risk

Due to our operations in Russia, Kazakhstan and Azerbaijan, the Company is exposed to foreign currency fluctuations as domestic oil sales in Russia and Kazakhstan and a large portion of local expenses are denominated in local currencies.

Credit risk

A substantial portion of accounts receivable is related to export oil sales from Russia and Kazakhstan with one major customer. As described in Note 4, this customer also provides a crude oil prepayment facility allowing the Company to draw prepayments on future oil sales and diminishing the risk of collection. The Company's credit risk is mitigated on domestic sales by receiving full or majority payment in advance of each sale.

Interest rate risk

The Company is exposed to interest rate cash flow risk related to the variable interest rates on the crude oil sales prepayment facility, long term debt and interest-bearing other long term liabilities.

8. RELATED PARTY BALANCES AND TRANSACTIONS

Crude oil sales

Export crude oil sales from Russia and Kazakhstan to Vitol S.A. during the three months ended June 30, 2007 is \$22.3 million (three months ended June 30, 2006 – \$27.8 million). Related accounts receivable at June 30, 2007 include \$2.4 million and at December 31, 2006 include \$6.7 million.

Crude oil sales prepayment facility

The balance of the crude oil sales prepayment facility provided by Vitol S.A. at June 30, 2007 is \$41.0 million (December 31, 2006 – \$30.0 million) with related interest expense for the three months ended June 30, 2007 of \$0.9 million (three months ended June 30, 2006 – \$0.1 million).

These transactions were, to the knowledge of management, at terms and rates no more and no less favourable than those with unrelated parties.

9. SEGMENTED INFORMATION

The commercial activities of the Company are concentrated in Kazakhstan, Russia and Azerbaijan and are considered separate business segments for operational and presentation purposes. The table below sets out key financial data for the Company by geographical segment.

	Kazakhstan	Russia	Azerbaijan	Other	Total
<u>For the three months ended June 30, 2007</u>					
Revenue:					
Crude oil and gas sales	13,586	16,734	330	-	30,650
Interest and other income	187	37	-	270	494
Expenses:					
Royalties and taxes	362	8,087	-	-	8,449
Production costs	1,794	1,491	159	-	3,444
Transportation and selling costs	3,053	523	-	-	3,576
General and administrative	1,135	537	291	2,703	4,666
Stock option compensation	-	-	-	983	983
Depletion, depreciation and amortisation	3,190	3,070	225	78	6,563
Accretion expense	37	44	-	-	81
Interest expense	919	849	-	(26)	1,742
Foreign exchange loss (gain)	184	(125)	-	40	99
Current income tax	1,194	1,070	-	-	2,264
Future income tax recovery	(404)	(627)	-	-	(1,031)
Net income	2,309	1,852	(345)	(3,508)	308
<u>For the six months ended June 30, 2007</u>					
Revenue:					
Crude oil and gas sales	35,381	30,743	330	-	66,454
Interest and other income	262	96	-	435	793
Expenses:					
Royalties and taxes	895	16,064	-	-	16,959
Production costs	4,424	2,887	159	-	7,470
Transportation and selling costs	6,559	1,133	-	-	7,692
General and administrative	2,249	1,304	291	3,952	7,796
Stock option compensation	-	-	-	1,829	1,829
Depletion, depreciation and amortisation	7,825	6,337	225	108	14,495
Accretion expense	73	83	-	-	156
Interest expense	1,902	1,665	-	23	3,590
Foreign exchange loss (gain)	106	(257)	-	100	(51)
Current income tax	6,549	1,578	-	-	8,127
Future income tax recovery	(1,126)	(1,266)	-	-	(2,392)
Net income	6,187	1,311	(345)	(5,577)	1,576
<u>As at June 30, 2007</u>					
Property and equipment	113,970	57,600	31,732	1,065	204,367
Total assets	136,728	69,033	34,180	4,425	244,366
Total liabilities	68,625	32,485	9,892	1,325	112,327

	Kazakhstan	Russia	Azerbaijan	Other	Total
<u>For the three months ended June 30, 2006</u>					
Revenue:					
Crude oil sales	20,296	13,679	-	-	33,975
Interest and other income	6	71	-	127	204
Expenses:					
Royalties and taxes	434	7,104	-	-	7,538
Production costs	1,467	974	-	-	2,441
Transportation and selling costs	2,920	376	-	-	3,296
General and administrative	947	452	-	2,406	3,805
Stock option compensation	-	-	-	1,113	1,113
Depletion, depreciation and amortisation	3,957	1,775	-	8	5,740
Accretion expense	32	29	-	-	61
Interest expense	84	540	-	57	681
Foreign exchange loss (gain)	41	(152)	-	5	(106)
Current income tax	4,708	1,020	-	-	5,728
Future income tax recovery	(1,030)	(114)	-	-	(1,144)
Net income	6,742	1,746	-	(3,462)	5,026
<u>For the six months ended June 30, 2006</u>					
Revenue:					
Crude oil sales	37,570	24,124	-	-	61,694
Interest and other income	28	123	-	208	359
Expenses:					
Royalties and taxes	805	11,637	-	-	12,442
Production costs	2,284	1,952	-	-	4,236
Transportation and selling costs	5,772	551	-	-	6,323
General and administrative	1,687	883	-	3,648	6,218
Stock option compensation	-	-	-	1,733	1,733
Depletion, depreciation and amortisation	7,573	3,412	-	65	11,050
Accretion expense	62	55	-	-	117
Interest expense	118	1,108	-	57	1,283
Foreign exchange loss (gain)	(196)	(424)	-	10	(610)
Current income tax	8,821	1,954	-	-	10,775
Future income tax recovery	(1,415)	(417)	-	-	(1,832)
Net income	12,087	3,536	-	(5,305)	10,318
<u>As at June 30, 2006</u>					
Property and equipment	77,389	58,627	26,055	471	162,542
Total assets	104,340	76,407	27,009	4,005	211,761
Total liabilities	35,120	44,526	8,338	1,566	89,550