

MANAGEMENT'S DISCUSSION & ANALYSIS

For the three and nine months ended September 30, 2007

This report is dated November 13, 2007

The following Management's Discussion and Analysis ("MD&A") of the financial condition and results of our operations should be read in conjunction with the consolidated financial statements of Arawak Energy Corporation ("Arawak" or the "Company") and Notes relating thereto as at and for the three and nine months ended September 30, 2007 (unaudited) and for the year ended December 31, 2006. Our financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are presented in US dollars, unless otherwise indicated.

This MD&A contains certain "forward-looking statements". Forward-looking statements are not based on historical facts but rather on management's expectations regarding the Company's future growth, results of operations, production, future capital and other expenditure, competitive advantages, plans for and results of drilling activity, environmental matters, business prospects and opportunities. Forward-looking statements are based on the opinions and estimates of management at the date the statements are made, and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements. These risks and uncertainties include, but are not limited to, risks associated with the oil and gas industry (for example operational risks in development, exploration and production; delays or changes in plans with respect to exploration or development projects or capital expenditure; the uncertainty of reserve estimates; the uncertainty of estimates and projections in relation to production, costs and expenses and health, safety and environmental risks), the risk of commodity price and foreign exchange rate fluctuations, the uncertainty associated with negotiating with foreign governments and risk associated with international activity. Due to the risks, uncertainties and assumptions inherent in forward-looking statements, prospective investors in the Company's securities should not place undue reliance on these forward-looking statements.

Certain financial measures referred to in this MD&A are not prescribed by Canadian GAAP. These non-GAAP financial measures do not have any standardised meaning and therefore may not be comparable to similar measures presented by other companies. Funds from Operations (dollars and per share amounts) are included because some investors use this information to analyse operating performance and liquidity. The additional information should not be considered in isolation or as a substitute for measures of performance prepared in accordance with Canadian GAAP. Funds from operations per share and funds from operations are expressed before changes in non-cash working capital. A reconciliation of funds from operations to cash flow from operating activities is provided within the statement of cash flows.

This MD&A uses certain terms which are specific to the oil and gas industry. These are non-GAAP terms and are defined within our document. Except as otherwise required by the context, reference in this MD&A to "our", "we" or "us" refer to the combined business of Arawak and all subsidiaries and associated companies.

Additional information relating to the Company is available on SEDAR at www.sedar.com and the Company's website at www.arawakenergy.com.

OVERALL PERFORMANCE AND OPERATIONS REVIEW

Arawak Energy Corporation (“Arawak” or the “Company”) enjoyed an increase in production of 27% to 11,125 barrels of oil equivalent per day (“boepd”) on average in the third quarter of 2007 compared with the corresponding quarter of 2006, and up 20% over the second quarter of 2007. This figure includes production of 215 boepd from Azerbaijan net to Arawak.

Sales volumes increased 43% from 712,296 barrels of oil equivalent (“boe”) in the second quarter of 2007 to 1,018,824 boe in the third quarter in line with increase in production.

Oil and gas sales revenues reached a record level of \$56.6 million in the third quarter of 2007 (compared with \$39.6 million in the corresponding quarter of 2006 and \$30.7 million in the second quarter of 2007). The net income was \$7.8 million (compared with \$5.8 million in the third quarter of 2006 and \$0.3 million in the second quarter of 2007) after accruing for higher overall taxation in Kazakhstan as the producing fields move to the excess profit tax environment, following increases in production and profit. Income tax for the quarter was \$12.0 million compared to \$2.3 million for the previous quarter, with \$10.3 million accounted for in Kazakhstan. Funds from operations were \$19.3 million in the third quarter of 2007 and capital expenditure was \$15.7 million excluding acquisitions.

Arawak continues to recognise its share of the income and expenditure of the Azerbaijani operations in Arawak’s own consolidated income and expenditure statement. In the third quarter of 2007, the Azerbaijani operations contributed a loss of \$0.2 million to the consolidated result of Arawak for the period.

The Company’s aggressive drilling program in Kazakhstan continued to meet with success with new discoveries in both the Besbolek and the Akzhar blocks.

At Besbolek, well 60, tested at 125 bopd, continuing the trend of discoveries in the new pool at the south of the block. Well 62 also discovered oil accumulations in the west wing which have yet to be fully quantified. The final well of the 18 well Besbolek appraisal and exploration program, well 56, has identified 12 metres of net pay in the target Triassic zone, extending the fault block at the east of the contract territory. In all, 11 of the 18 wells have been successful.

At Akzhar, well 81 was drilled in a previously untested area between the two wings of the original 3.8 sq km blocks, and this has now tested oil at 125 bopd. A follow up well, well 82, has also encountered pay on logs but has yet to be tested. A further exploration well, well 80, drilled in an untested fault wedge has tested 50 bopd of heavy oil. So far, 15 wells have been drilled at Akzhar in 2007, of which 8 have been completed as commercial producers. A further well is being completed. Four more wells will be drilled before the end of the year.

At Alimbai, the first of two workovers of existing wells has been undertaken, and test data obtained. Flow rates from the old well of 125 bopd have been obtained on pump from a depth of approximately 400 metres, and the Company now plans to re-perforate this well. A second well is in the process of being worked over and is showing signs of oil. The results of the workover prove up reserves in a block where currently no proved or probable reserves have been assigned. The company remains on track to drill two new wells in Alimbai before the year end.

Also in Kazakhstan, the Company has signed a contract with Munaitas, the Chinese-Kazakhstani joint venture company which owns the line from Kenkiyak to Atyrau. Consequently, the Company will enjoy immediate transportation cost savings of almost \$1 per bbl for export of Akzhar crude. Furthermore, following the signing of this contract, the route for the Akzhar pipeline has been changed to the shorter route to Kenkiyak, resulting in a lower capital cost of approximately \$20 million compared to the original proposed route cost of approximately \$50 million. The pipeline, which is planned for 2008, will result in further cost savings of over \$3 per bbl as well as improvements in operational efficiency.

In Russia, development drilling has continued as planned. At the North Israel block licensed to Recher-Komi, in which the Company has a 50% interest, a third well has been completed in the new pool discovered in 2006. With this well now flowing at a rate of over 500 bopd production from Recher-Komi is in excess of 2,000 bopd. 3D seismic will be shot over this block in December 2007 and January 2008 with interpretation scheduled to be available mid 2008.

In Azerbaijan, the operator has faced further operational difficulties with gas production, as a consequence of which gross production dropped to 19,770 boe from 26,626 boe in the second quarter 2007. 2D seismic acquisition over the central and north blocks have now been completed, and this seismic will be interpreted together with 3D on the coast block which has now been processed with results expected mid 2008.

FINANCIAL HIGHLIGHTS

(In thousands, except per share amounts)

For the three months ended September 30	2007	2006
Crude oil sales	\$56,619	\$39,638
Net income	\$7,761	\$5,841
Per share - basic	\$0.045	\$0.034
Per share - diluted	\$0.044	\$0.034
Funds from operations*	\$19,293	\$13,804
Per share - basic	\$0.111	\$0.080
Per share - diluted	\$0.110	\$0.079
Capital expenditure	\$15,692	\$13,878
Shareholders' equity	\$143,700	\$129,729
Shares outstanding - basic	173,592	171,140
Shares outstanding - diluted	174,699	171,980
Weighted average shares - basic	173,592	173,285
Weighted average shares - diluted	174,711	174,125

* Funds from operations is a non-GAAP measure that represents cash generated from operating activities before changes in non-cash working capital.

OPERATIONAL HIGHLIGHTS

For the three months ended September 30	2007	2006
Production - boe	1,023,523	808,747
Average daily production - boe	11,125	8,791
Sales – boe	1,018,824	804,301
<u>Revenue and expenses per boe sold</u>		
Crude oil and gas sales	\$55.57	\$49.28
Interest and other income	\$0.73	\$2.16
Royalties and taxes	(\$10.51)	(\$11.80)
Production costs	(\$5.53)	(\$3.60)
Transportation and selling expenses	(\$5.31)	(\$5.37)
Net operating income	\$34.95	\$30.67

NETBACK TABLE

The following table presents the operations and earnings netbacks on a per boe basis calculated by dividing total Company revenues and costs by total sales volumes.

For the period ended September 30

Per boe	Three months 2007	Three months 2006	Nine months 2007	Nine months 2006
Crude oil and gas sales	55.57	49.28	48.11	48.32
Interest and other income	0.73	2.16	0.60	1.00
Total revenue	56.30	51.44	48.71	49.32
Royalties and taxes	(10.51)	(11.80)	(10.82)	(10.46)
Production costs	(5.53)	(3.60)	(5.12)	(3.40)
Transportation and selling expenses	(5.31)	(5.37)	(5.12)	(5.07)
Net operating income	34.95	30.67	27.65	30.39
General and administrative expenses	(4.37)	(4.25)	(4.79)	(4.60)
Realised foreign exchange gain	1.45	0.03	0.68	0.74
Interest expense	(1.32)	(1.57)	(1.93)	(1.21)
Current income tax expense	(11.78)	(7.72)	(7.87)	(8.10)
Funds from operations	18.93	17.16	13.74	17.22
Depletion, depreciation and amortisation	(10.28)	(9.26)	(9.76)	(8.82)
Stock option compensation	(1.05)	(1.74)	(1.13)	(1.49)
Accretion expense	(0.08)	(0.08)	(0.09)	(0.09)
Unrealised foreign exchange gain (loss)	-	-	(0.08)	(0.43)
Future income tax recovery	0.09	1.17	0.97	1.32
Net income	7.61	7.25	3.65	7.71

PRODUCTION

For the period ended September 30

	Three months 2007	Three months 2006	Nine months 2007	Nine months 2006
<u>Production – boe</u>				
Kazakhstan	610,225	469,896	1,489,739	1,108,668
Russia	393,528	338,851	1,161,114	960,465
Azerbaijan	19,770	-	46,396	-
Total	1,023,523	808,747	2,697,248	2,069,132
<u>Average daily production - boe</u>				
Kazakhstan	6,633	5,108	5,457	4,061
Russia	4,277	3,683	4,253	3,518
Azerbaijan	215	-	507	-
Total	11,125	8,791	10,217	7,579

Overall, the Company's production increased 27% to 1,023,523 boe or the equivalent of 11,125 boepd in the third quarter of 2007 versus 808,747 boe or 8,791 boepd for the third quarter of 2006.

Production from our Kazakhstani operations increased 30% to 610,225 bbls or the equivalent of 6,633 boepd in the third quarter of 2007 versus 469,896 bbls or 5,109 boepd for the same period in 2006.

In Russia, production increased 16% to 393,528 bbls in the third quarter of 2007 or the equivalent of 4,277 boepd versus 338,851 bbls or 3,683 boepd for the third quarter of 2006.

Production in Azerbaijan commenced in the second quarter of 2007, with third quarter production of 19,770 boe or 215 boepd.

SALES

For the period ended September 30

	Three months 2007	Three months 2006	Nine months 2007	Nine months 2006
Sales – boe				
Kazakhstan	618,573	457,036	1,379,246	1,139,883
Russia	381,738	347,265	1,134,969	957,392
Azerbaijan	18,513	-	43,877	-
Total	1,018,824	804,301	2,558,092	2,097,275
Average sales price per boe				
Kazakhstan	\$60.64	\$52.16	\$52.85	\$53.87
Russia	\$49.43	\$45.49	\$43.71	\$41.70
Azerbaijan	\$12.95	\$0.00	\$12.98	\$0.00
Total	\$55.57	\$49.28	\$48.11	\$48.32

Sales volume increased 27% to 1,018,824 boe in the three months ended September 30, 2007 from 804,301 boe in the same period in 2006 reflecting our production growth. The average sales price received in the third quarter increased 13% to \$55.57 per boe in 2007 from \$49.28 in the third quarter of 2006. The average selling price per barrel is dependent upon world benchmark and domestic prices, and is impacted by the sales mix between export and domestic, crude oil and gas, as well as between Kazakhstan, Russia and Azerbaijan as detailed in the marketing section below.

For the nine months ended September 30

Sales composition by volume	2007	2006
Kazakhstan export	48%	46%
Russian domestic	21%	24%
Russian export	17%	19%
Kazakhstan domestic	13%	11%
Azerbaijan (including gas)	1%	0%
Total	100%	100%

MARKETING

The majority of Kazakhstani crude is exported by pipeline and sold as Urals Export Blend, FOB (free on board) Odessa, Ukraine while crude is also exported by train and sold as Brent Export Blend, FCA (free carrier) Poland. Russian crude is exported by pipeline and sold as Urals Export Blend FOB Primorsk, Russia. In Kazakhstan, domestic oil sales are sold either ex-field or delivered to the local refinery. In Russia, domestic sales are sold ex-field. Azerbaijani oil is exported FOB Novorossiysk while gas and condensate are sold ex-field.

For the nine months ended September 30, 2007

Export oil sales	Kazakhstan	Russia	Azerbaijan	Total
Volume - bbls	490,037	170,458	1,449	661,943
Percentage of total sales by country	79%	45%	8%	65%
Revenue (thousands)	\$33,760	\$11,817	\$92	\$45,669
Average export price per bbl	\$68.89	\$69.33	\$63.41	\$68.99
Domestic oil and gas sales				
Volume - boe	128,535	211,280	17,064	356,880
Percentage of total sales by country	21%	55%	92%	35%
Revenue (thousands)	\$3,751	\$7,051	\$148	\$10,950
Average domestic price per boe	\$29.18	\$33.37	\$8.67	\$30.68

For the nine months ended September 30, 2006

Export oil sales	Kazakhstan	Russia	Azerbaijan	Total
Volume - bbls	368,978	154,618	-	523,596
Percentage of total sales by country	81%	45%	-	65%
Revenue (thousands)	\$21,953	\$9,256	-	\$31,209
Average export price per bbl	\$59.50	\$59.86	-	\$59.61

Domestic oil sales				
Volume - bbls	88,058	192,647	-	280,705
Percentage of total sales by country	19%	55%	-	35%
Revenue (thousands)	\$1,886	\$6,543	-	\$8,429
Average domestic price per bbl	\$21.42	\$33.96	-	\$30.03

Kazakhstan

Total sales volume in Kazakhstan increased 35% in the third quarter of 2007 versus the same period in 2006 as a result of a 30% production increase. The sales mix in Kazakhstan during the third quarter of 2007 was 21% domestic and 79% export versus 19% domestic and 81% export in the third quarter of 2006.

Revenues from Kazakhstan export sales increased 54% to \$33.8 million from \$22.0 million due to a 33% increase in the export volume to 490,037 bbls from 368,978 bbls and a 16% increase in the average export price per bbl to \$68.89 from \$59.50.

Domestic sales revenues in Kazakhstan increased 99% to \$3.8 million from \$1.9 million due to a 46% increase in sales volume to 128,535 bbls from 88,058 bbls and a 36% increase in the average domestic price per bbl to \$29.18 from \$21.42.

Russia

Total sales volume in Russia increased 10% in the three months ended September 30, 2007 versus the same period in 2006 as a result of a 16% increase in production. The sales mix in Russia during the third quarter of 2007 was 55% domestic and 45% export same as in the third quarter of 2006.

Revenues from Russian export sales increased 28% to \$11.8 million from \$9.3 million due to a 10% sales volume increase to 170,428 bbls from 154,618 bbls and an increase in the average export price per barrel of 16% to \$69.33 from \$59.86.

Domestic sales revenues in Russia increased 8% to \$7.1 million from \$6.5 million due to 10% increase in sales volume to 211,280 bbls from 192,647 bbls while the domestic sales price decreased slightly to \$33.37 from \$33.96.

Azerbaijan

Sales in Azerbaijan consist of domestic gas sales of 16,734 boe at \$1.35 per mcf, equivalent to \$8.12 per boe, domestic condensate sales of 330 bbls at \$36.00 per barrel and export oil sales of 1,449 bbls at \$63.41 per barrel.

CRUDE OIL INVENTORY

Crude oil inventory consists of amounts produced and in storage tanks at the end of each period and is recorded at the lower of cost, determined on a weighted average basis, and net realisable value. The table below summarises the current period oil movement and inventory balances.

For the nine months ended September 30

In barrels	2007	2006
Crude oil inventory - beginning	211,637	54,277
Production	1,023,523	808,747
Sales	(1,018,824)	(804,301)
Field usage and shipping losses	(12,354)	(4,756)
Crude oil inventory - ending	203,983	53,968

ROYALTIES AND TAXES

For the period ended September 30

In thousands of US dollars	Three months 2007	Three months 2006	Nine months 2007	Nine months 2006
Mineral resource extraction tax	4,371	4,334	12,779	11,310
Export duties	4,918	4,613	12,574	9,275
Royalties	1,422	543	2,317	1,347
Total	10,711	9,490	27,670	21,932

Mineral resource extraction tax

The Company is subject to production taxes in Russia at a rate established monthly by the state based on current world oil prices. The tax increased slightly to \$4.4 million in the third quarter of 2007 from \$4.3 million in the same period.

Export duties

Export sales in Russia are subject to export duties with rates established by the state two months in advance based on prevailing world oil prices. The export duties decreased 3% to \$28.85 per barrel of Russian export sales in the third quarter of 2007 compared to \$29.83 in the third quarter of 2006.

Royalties

For our producing fields in Kazakhstan, Arawak pays royalties monthly to the Government using stabilised rates that are graduated and increase with cumulative annual production. The Company was also paying over-riding royalties on two of its properties in Kazakhstan at fixed rates per barrel sold until the Company acquired the over-riding royalty interests in December 2006 and the elimination of this royalty resulted in the decrease in royalties expense in the quarter ended September 30, 2007 versus the same period of the prior year. However, royalties increased to 4.6% of Kazakhstani sales revenues for the current quarter versus 2.3% for the prior year's quarter due mainly to higher production at the Besbolek field resulting in the Company reaching a higher royalty tier earlier in the year in 2007 compared with 2006. The Company expects to reach the next tier of 9% in October of 2007.

PRODUCTION COSTS

Production costs increased to \$5.53 per boe sold in the quarter ended September 30, 2007 compared to \$3.60 in third quarter of 2006. This increase in production costs on a per boe basis was due to a combination of factors including the inclusion of higher cost production from Recher, local currency cost inflation in both Russia and Kazakhstan, and the effect of a weak US dollar increasing local currency costs in US dollar terms.

TRANSPORTATION AND SELLING COSTS

Transportation and selling expenses include pipeline, trucking and other selling costs associated with marketing and delivering crude oil and gas to markets. On a per boe basis, these costs decreased slightly to \$5.31 in the third quarter of 2007 from \$5.37 in the third quarter of 2006 in line with the same sales mix in the third quarter of 2007 and 2006.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses increased slightly to \$4.4 million in the third quarter of 2007 from \$3.4 million in the third quarter of 2006 due primarily to the recognition of the Company's proportion of Azerbaijan costs and higher Head Office expenses in line with the growth of the business.

INTEREST EXPENSE

Interest expense stayed the same at \$1.3 million in the third quarter of 2007 as in the same period in 2006 due mainly to the decreases in the BNP Paribas loan balance payable offset by higher interest on the increased Vitol PPF balance.

CURRENT INCOME TAX EXPENSE

Current income tax expense for the nine months of 2007 increased to \$20.1 million versus \$17.0 million for 2006 year reflecting higher profitability in the current period and the higher Excess Profit Tax ("EPT") rate reached on the Akzhar field.

Arawak is subject to EPT on the Akzhar, Besbolek and Karataikyz hydrocarbon contracts in Kazakhstan at incremental tiered rates based on each contract's cumulative internal rate of return in excess of 20%. The EPT rates for these fields range from 0 to 30%. For the Alimbai field and East Zharkamys III block in Kazakhstan, EPT rates range from 0 to 60% and are calculated based on the ratio of net income to deductions in excess of 20%.

DEPLETION, DEPRECIATION AND AMORTISATION

Depletion, depreciation and amortisation expense increased to \$10.28 per boe in the third quarter of 2007 from \$9.26 in the same period of 2006. The depletion rate per barrel in a given period varies with the sales mix since Kazakhstan sales have a slightly higher associated depletion cost compared to Russian or Azerbaijani sales.

CAPITAL EXPENDITURE

In the third quarter of 2007 a total of \$15.7 million was spent on capital expenditure compared to \$13.9 million in the same period last year, excluding acquisitions. Capital expenditure included purchases of property, plant and equipment of \$10.0 million in Kazakhstan, \$4.0 million in Russia and \$1.7 million in Azerbaijan.

Under the terms of the expanded Akzhar license area in Kazakhstan, the Company is responsible for repaying to the Government certain historical costs incurred in the development of the field. Additional historical costs of \$5.8 million have been recognised in the third quarter of 2007 as an increase in the balance sheet value of the Akzhar license, with a corresponding increase in long term liabilities. The total of the historical cost liability on Akzhar license will be repaid over the next 21 years in equal quarterly instalments of \$81K.

OUTSTANDING SHARE DATA

The table below sets out the Company's outstanding shares.

As at:	November 13, 2007	September 30, 2007	December 31, 2006
Common Shares	173,591,865	173,591,865	171,181,702
Exchangeable Shares	-	-	2,210,163
Total outstanding	173,591,865	173,591,865	173,391,865
Stock Options	13,477,500	13,477,500	10,785,000

LIQUIDITY AND CAPITAL RESOURCES

The levels of cash, current assets and current liabilities are as set out below and expressed in thousands of US dollars.

As at	September 30, 2007	December 31, 2006
Cash and cash equivalents	13,488	9,663
Current assets	55,892	33,595
Current liabilities	(77,544)	(57,063)
Net current assets	(21,652)	(23,468)

The Company's cash deposits are held principally in US dollars and are centrally managed. Surplus funds are placed on short term deposit. Operational funds are kept in Azerbaijan, Russia and Kazakhstan.

The Company has a crude oil sales prepayment facility which allows Arawak to draw prepayments on future oil sales up to a maximum of \$50.0 million. The amount drawn as at September 30, 2007 was \$42.0 million and at December 31, 2006 was \$30.0 million.

Arawak's 50% owned joint venture in Russia has a bank borrowing base facility agreement with a \$60.0 million limit (Arawak share – \$30.0 million). The facility carries interest at LIBOR plus 4.4% and is repayable via quarterly repayments of \$3.45 million (Arawak share - \$1.7 million). The balance outstanding as at September 30, 2007 is \$40.0 million (Arawak share – \$20.0 million) and at December 31, 2006 was \$47.1 million (Arawak share – \$23.55 million). There are no penalties for early repayment and in certain circumstances accelerated repayments are required. The borrowing is secured by Russian export crude oil sales and by proportionate partner guarantees.

The Company continues to seek additional business opportunities in Kazakhstan, Russia, Azerbaijan and potentially elsewhere in the Former Soviet Union. Funding of any such further transactions will be considered on a case-by-case basis, depending on materiality and the expected cash flow profile of the opportunity.

SUMMARY OF QUARTERLY RESULTS

The following financial data is derived from the Company's consolidated financial statements for each of the nine most recently completed quarters.

(In thousands of US dollars except for per share amounts)

Quarter ended	Crude oil sales	Net income (loss)	Net income (loss) per share	
			Basic	Diluted
2007 September 30	56,619	7,761	0.045	0.044
June 30	30,650	308	0.002	0.002
March 31	35,804	1,268	0.007	0.007
2006 December 31	29,123	(3,720)	(0.021)	(0.021)
September 30	39,638	5,841	0.034	0.034
June 30	33,975	5,026	0.029	0.029
March 31	27,719	5,292	0.031	0.030
2005 December 31	20,323	(317)	(0.002)	(0.002)
September 30	27,575	7,355	0.043	0.041

RELATED PARTY TRANSACTIONS

Crude oil sales

Export crude oil sales from Russia and Kazakhstan to Vitol S.A. during the three months ended September 30, 2007 were \$45.9 million (three months ended September 30, 2006 – \$31.4 million). Related accounts receivable at September 30, 2007 include \$15.3 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 September 30, 2007 is \$42.0 million (December 31, 2006 – \$30.0 million) with related interest expense for the three months ended September 30, 2007 of \$1.0 million (three months ended September 30, 2006 – \$0.2 million).

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

CRITICAL ACCOUNTING ESTIMATES AND POLICIES

Principles of consolidation

Arawak is an international oil and gas exploration, development and production company with activities in Kazakhstan, Russia and Azerbaijan. The consolidated financial statements have been prepared in US dollars following Canadian GAAP and include the financial statements of Arawak and

its wholly owned subsidiaries, which are registered under the laws of Anguilla (British West Indies), Netherlands, Kazakhstan, Alberta (Canada), Cyprus and England & Wales. The Company's shares are listed on the Toronto Stock Exchange (TSX Venture Exchange until October 30, 2006) under the symbol "ABG".

Substantially all of the Company's operations in Russia and Azerbaijan are conducted through joint ventures and accordingly these financial statements reflect only the Company's proportionate interest.

Foreign currency translation

In Kazakhstan and Azerbaijan, operations are financially and operationally integrated and the functional currency is the US dollar. Arawak translates foreign currency denominated transactions using the temporal method whereby monetary assets and liabilities are translated at year end rates; non-monetary assets and liabilities are translated at rates in effect on the date of the transactions; revenue and expenses are translated at rates in effect on the date of the transaction with the exception of depreciation and amortisation, which are translated at historic rates. Foreign exchange gains and losses are included in earnings.

The functional currency of the Russian operations is the Russian rouble as it reflects the economic substance of the underlying events and circumstances of the self sufficient Russian activities. Transactions and amounts are translated using the current rate method whereby assets and liabilities are translated at the rate in effect on the balance sheet date; revenues and expenses are translated at the rate in effect on the transaction date. Foreign exchange gains or losses are recorded as cumulative translation adjustments which are a separate component in shareholders' equity.

Oil and gas properties

Arawak follows the full cost method of accounting, whereby all costs incurred in exploring for and developing oil and gas reserves are capitalised. Such costs include land acquisition, geological and geophysical, drilling of both productive and unproductive wells, plant and equipment and administration costs that are reasonably allocated to these activities. Proceeds from disposals are recorded as a reduction of the related expenditure without recognition of a gain or loss unless the disposal would result in a change of 20% or more in the depletion rate.

Capitalised costs are accumulated on a country by country basis and are depreciated and depleted using the unit of production method based upon estimated proved reserves. The carrying values of unproved properties are excluded from the depreciation and depletion calculation.

The Company applies a ceiling test to capitalised costs to ensure that such costs do not exceed estimated future net revenues from production of proved reserves using forecasted sales prices less expected future capital, production, royalties and asset retirement obligation, together with the cost of unproved properties. An impairment loss is recognised when the carrying amount is not recoverable and exceeds its fair value.

Asset retirement obligation

The Company recognises a liability for the fair value of legal obligations associated with the retirement of long-lived tangible assets in the period incurred with a corresponding increase in the carrying amount of the related asset, which is depleted as a component of oil and gas properties. The liability is adjusted each reporting period to reflect revisions to the estimated future cash flows and for the passage of time. The liability accretes until the date of expected settlement of the retirement obligations. The related accretion expense is charged to earnings. Actual expenditure incurred for site reclamation and abandonment is charged against the liability to the extent it exists on the balance sheet with the difference recognised as a gain or loss in the period in which settlement occurs.

Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of commitments and contingent liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting periods. Amounts recorded for the depletion of oil and gas properties and asset retirement obligations are based on estimates of proved reserves and future development costs. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices and future costs. By their nature, these estimates are subject to

measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be material.

Income tax

The Company follows the liability method of accounting for future income taxes. Under this method, income tax assets and liabilities are recognised based on the estimated tax effects of temporary differences in the carrying values of assets and liabilities in the financial statements and their respective tax bases, using income tax rates enacted on the balance sheet date. The effect of a change in income tax rates on the future income tax assets and liabilities is recognised in income or loss in the period of the change.

Stock-based compensation costs

The Company has a stock-based compensation plan. Compensation expense is based on the fair value at the grant date and recognised over the vesting periods of the respective options with a corresponding increase to contributed surplus. Any consideration received upon exercise of the options, together with the amount previously recognised in contributed surplus, is recorded as an increase to share capital.

ADOPTION OF NEW ACCOUNTING POLICIES AND SIGNIFICANT ACCOUNTING PRONOUNCEMENTS

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 commencing for the quarter ended June 30, 2007 and quarter ended September 2007. In prior periods, all revenues and expenses were capitalized as oil and gas properties reflected in the carrying value of the Azerbaijan asset.

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.

COMMITMENTS AND CONTINGENT LIABILITIES

Work commitments

Pursuant to its contracts, Arawak has minimum spending commitments for each oilfield in Kazakhstan. For the contract years ended in 2006, cumulative spending commitments were \$41.7 million comprising \$34.7 million for Akzhar, \$2.9 million for Besbolek, \$3.5 for Karataikyzy and \$0.6 million for Alimbai. As of December 31, 2006 the Company believes these commitments have been satisfied. Non-fulfilment of contractual work commitments could result in punitive actions by the Government, including suspending or revoking the licenses for which the work commitment was not fulfilled.

The work commitments for each of the next five years and in total are as follows (in thousands of US dollars):

	2007	2008	2009	2010	2011	Thereafter	Total
Akzhar	1,351	934	-	-	-	-	2,285
Besbolek	1,864	95	-	-	-	-	1,959
Karataikyzy	267	100	-	-	-	-	367
Alimbai	315	613	980	643	643	9,550	12,744
East Zharkamys III	1,616	9,039	15,605	36,865	-	-	63,125
	5,413	10,781	16,585	37,508	643	9,550	80,480

BUSINESS RISKS

As a junior oil and gas exploration, development and production company, Arawak is subject to risks and uncertainties inherent in the oil and gas industry and to risks inherent to a company of its size and stage of development. Due to the international nature of the Company's operations, it is subject to additional risks, including currency fluctuations, political risk, price controls and varying forms of fiscal regimes.

Oil and gas industry risks

Risks in the oil and gas industry include price fluctuations for commodity prices, operational risks and environmental concerns. Oil and natural gas prices have fluctuated widely during recent years and are determined by supply and demand factors. Arawak manages its operations in order to keep exposure

to these risks to reasonable levels, including the use of hedging instruments and forward sale, fixed price contracts to hedge its exposure.

Operational risks in the oil and gas industry include exploration and reserve estimate risks, costs and availability of services and materials, premature reservoir declines, blowouts, well bore collapse, equipment failure and other accidents and adverse weather conditions. Arawak attempts to mitigate these risks by employing experienced field personnel, consultants and contractors.

The oil and gas industry is subject to extensive environmental and other regulation imposed by governmental authorities. Arawak has existing policies and practices that ensure its operations conform to the standards and government regulations required for each jurisdiction in which it operates.

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. 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.

Political and economic conditions in Russia, Kazakhstan and Azerbaijan

While there have been improvements in the economic situation in Russia, Kazakhstan and Azerbaijan in recent years, their economies continue to display some characteristics of emerging markets. These characteristics include, but are not limited to, the existence of currencies that are not freely convertible outside of the respective countries, a low level of liquidity of debt and equity securities in the markets and relatively high inflation.

Additionally, the oil and gas sectors in Russia, Kazakhstan and Azerbaijan are 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 respective Governments, 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 Russia, Kazakhstan and Azerbaijan. 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 Russia, Kazakhstan and Azerbaijan 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.

Need for capital

Arawak must rely on access to debt and capital markets to supplement internally generated cash flow to fund its capital commitments and to finance its growth plans. There can be no assurance that Arawak 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 Arawak.