



**ARAWAK ENERGY CORPORATION**

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

**For the three months ended March 31, 2007**

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

As at	Note	March 31, 2007	December 31, 2006
<b>ASSETS</b>			
Cash and cash equivalents		8,353	9,663
Accounts receivable		17,607	9,483
Inventory		5,498	4,992
Other current assets		10,475	9,457
		<u>41,933</u>	<u>33,595</u>
Property and equipment	3	201,117	201,314
Future income tax assets		2,651	2,365
		<u>245,701</u>	<u>237,274</u>
<b>LIABILITIES</b>			
Accounts payable and accrued liabilities		14,964	15,873
Corporate income taxes payable		4,268	2,936
Crude oil sales prepayment facility	4	38,000	30,000
Current portion of long term debt	5	6,900	6,900
Current portion of other long term liabilities		1,354	1,354
		<u>65,486</u>	<u>57,063</u>
Future income tax liabilities		17,430	18,531
Long term debt	5	14,118	15,785
Other long term liabilities		15,726	15,023
Asset retirement obligation		2,899	2,820
		<u>115,659</u>	<u>109,222</u>
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	6	114,553	114,553
Contributed surplus	6	6,463	5,617
Accumulated other comprehensive income	2	1,417	1,541
Retained earnings		7,609	6,341
		<u>130,042</u>	<u>128,052</u>
		<u>245,701</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

<b>For the three months ended March 31</b>		<b>2007</b>	<b>2006</b>
	Note		
<b><u>Revenue</u></b>			
Crude oil sales		35,804	27,719
Interest and other income		299	155
		<b>36,103</b>	<b>27,874</b>
<b><u>Expenses</u></b>			
Royalties and taxes		8,510	4,904
Production costs		4,026	1,795
Transportation and selling costs		4,116	3,027
General and administrative expenses		3,130	2,413
Stock option compensation		846	620
Depletion, depreciation and amortisation		7,932	5,310
Accretion expense		75	56
Interest expense		1,848	602
Foreign exchange gain		(150)	(504)
		<b>30,333</b>	<b>18,223</b>
<b>Income before income taxes</b>			
		<b>5,770</b>	<b>9,651</b>
Current income tax		5,863	5,047
Future income tax recovery		(1,361)	(688)
		<b>4,502</b>	<b>4,359</b>
<b>Net income</b>		<b>1,268</b>	<b>5,292</b>
Retained earnings (deficit) beginning of the period		6,341	(6,098)
<b>Retained earnings (deficit) end of the period</b>		<b>7,609</b>	<b>(806)</b>
<b>Net income per share</b>			
Basic	6	0.007	0.031
Diluted	6	0.007	0.030

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

<b>For the three months ended March 31</b>	<b>2007</b>	<b>2006</b>
<b><u>Comprehensive income</u></b>		
Net income	1,268	5,292
Other comprehensive income		
Foreign currency translation adjustment	(124)	381
<b>Comprehensive income</b>	<b>1,144</b>	<b>5,673</b>
<b><u>Accumulated other comprehensive income</u></b>		
Accumulated other comprehensive income, beginning of the period	1,541	(540)
Other comprehensive income	(124)	381
<b>Accumulated other comprehensive income, end of the period</b>	<b>1,417</b>	<b>(159)</b>

See accompanying notes to the interim consolidated financial statements.

As at March 31, 2007 the accumulated other comprehensive income consists of foreign currency translation adjustments of \$1,417 (March 31, 2006 – \$(159); 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

<b>For the three months ended March 31</b>	<b>2007</b>	<b>2006</b>
<b><u>Operating Activities</u></b>		
Net income	1,268	5,292
Items not affecting cash:		
Stock option compensation	846	620
Depletion, depreciation and amortisation	7,932	5,310
Accretion expense	75	56
Foreign exchange (gain) loss	(124)	381
Future income tax recovery	(1,361)	(688)
<b>Funds from operations</b>	<b>8,636</b>	<b>10,971</b>
Changes in non-cash working capital	(9,223)	(5,479)
	(587)	5,492
<b><u>Financing Activities</u></b>		
Changes in crude oil sales prepayment facility	8,000	2,500
Long term debt repayments	(1,725)	(1,500)
Change in other long term liabilities	702	(1)
Proceeds from issue of common shares	-	28
	6,977	1,027
<b><u>Investing Activities</u></b>		
Purchase of property and equipment	(7,700)	(9,627)
	(7,700)	(9,627)
Net change in cash during the period	(1,310)	(3,108)
Cash, beginning of the period	9,663	14,285
Cash, end of the period	8,353	11,177

See accompanying notes to the interim consolidated financial statements.

**ARAWAK ENERGY CORPORATION  
NOTES TO THE INTERIM FINANCIAL STATEMENTS  
FOR THE THREE MONTHS ENDED MARCH 31, 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 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

	<b>Cost</b>	<b>Accumulated depletion and depreciation</b>	<b>Net book value</b>
March 31, 2007			
Oil and gas properties	243,973	45,977	197,996
Office equipment	3,522	401	3,121
	<u>247,495</u>	<u>46,378</u>	<u>201,117</u>
December 31, 2006			
Oil and gas properties	237,207	38,893	198,314
Office equipment	3,342	342	3,000
	<u>240,549</u>	<u>39,235</u>	<u>201,314</u>

For the three months ended March 31, 2007, the Company capitalised \$0.7 million of direct general and administrative costs (three months ended March 31, 2006 – \$0.8 million).

Capitalised costs of \$26.2 million relating to unproved properties in Kazakhstan (2006 – \$25.6 million) and all costs related to Azerbaijan 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 4.4%, which includes local withholding taxes, is charged on the outstanding prepayment balance and due monthly. The balance outstanding at March 31, 2007 is \$38.0 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.

	March 31, 2007	December 31, 2006
Bank loan	21,825	23,550
Short term portion	(6,900)	(6,900)
Unamortised debt issue costs	(807)	(865)
Long term debt	14,118	15,785

## 6. SHARE CAPITAL

Authorised:

Unlimited common shares, without par value

Unlimited preference shares, without par value

Outstanding as at:	March 31, 2007		December 31, 2006	
	Number of common shares	Amount	Number of common shares	Amount
<u>Issued:</u>				
Balance, beginning of period	171,181,702	112,626	170,184,729	111,565
Exercise of stock options	-	-	366,667	511
Exchanged during period	1,999,205	1,743	630,306	550
Issued and outstanding	173,180,907	114,369	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	173,391,865	114,553	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 March 31, 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 three months ended March 31	2007	2006
Basic	173,391,865	173,038,531
Diluted	174,475,842	174,486,174

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

The granted stock options 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**

The Company has a 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 11,370,000 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 eighteen months from the date of grant.

	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 during 2006	(366,667)	CAD 1.20
Cancelled during 2006	(83,333)	CAD 2.34
Outstanding December 31, 2006 and March 31, 2007	10,785,000	CAD 2.50

The number of stock options outstanding and exercisable at March 31, 2007, is as follows:

Options outstanding		Options exercisable	
Number outstanding	Average remaining life in years	Number outstanding	Average remaining life in years
10,785,000	3.5	7,211,675	3.3

**Contributed surplus**

As at:	March 31, 2007	December 31, 2006
Balance, beginning of period	5,617	1,818
Stock based compensation expense	846	3,928
Exercised options	-	(129)
Balance, end of period	6,463	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 March 31, 2007 is \$29.6 million (three months ended March 31, 2006 – \$20.0 million). Related accounts receivable at March 31, 2007 include \$15.5 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 March 31, 2007 is \$38.0 million (December 31, 2006 – \$30.0 million) with related interest expense for the three months ended March 31, 2007 of \$1.0 million (three months ended March 31, 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 March 31, 2007</u>					
Revenue:					
Crude oil sales	21,795	14,009	-	-	35,804
Interest and other income	75	59	-	165	299
Expenses:					
Royalties and taxes	533	7,977	-	-	8,510
Production costs	2,630	1,396	-	-	4,026
Transportation and selling costs	3,506	610	-	-	4,116
General and administrative	1,114	767	-	1,249	3,130
Stock option compensation	-	-	-	846	846
Depletion, depreciation and amortisation	4,635	3,267	-	30	7,932
Accretion expense	36	39	-	-	75
Interest expense	983	816	-	49	1,848
Foreign exchange (gain) loss	(78)	(132)	-	60	(150)
Current income tax	5,355	508	-	-	5,863
Future income tax recovery	(722)	(639)	-	-	(1,361)
Net income	3,878	(541)	-	(2,069)	1,268
<u>As at March 31, 2007</u>					
Property and equipment	111,156	58,199	30,733	1,029	201,117
Total assets	138,289	70,932	32,308	4,172	245,701
Total liabilities	69,288	36,261	9,429	681	115,659

	Kazakhstan	Russia	Azerbaijan	Other	Total
<u>For the three months ended March 31, 2006</u>					
Revenue:					
Crude oil sales	17,274	10,445	-	-	27,719
Interest and other income	22	52	-	81	155
Expenses:					
Royalties and taxes	371	4,533	-	-	4,904
Production costs	817	978	-	-	1,795
Transportation and selling costs	2,852	175	-	-	3,027
General and administrative	740	431	-	1,242	2,413
Stock option compensation	-	-	-	620	620
Depletion, depreciation and amortisation	3,616	1,637	-	57	5,310
Accretion expense	30	26	-	-	56
Interest expense	34	568	-	-	602
Foreign exchange (gain) loss	(237)	(272)	-	5	(504)
Current income tax	4,113	934	-	-	5,047
Future income tax recovery	(385)	(303)	-	-	(688)
Net income	5,345	1,790	-	(1,843)	5,292
<u>As at December 31, 2006</u>					
Property and equipment	111,142	59,440	29,782	950	201,314
Total assets	132,896	68,746	30,063	5,569	237,274
Total liabilities	60,028	38,800	9,585	809	109,222