

MANAGEMENT'S DISCUSSION & ANALYSIS

For the three months ended June 30th, 2005.

This report is dated August 25th, 2005

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 unaudited consolidated financial statements of Arawak Energy Corporation ("Arawak" or the "Company") and Notes relating thereto as at and for the three and six months ended June 30th, 2005 and the audited consolidated financial statements of Arawak as at and for the year ended December 31st, 2004. Our financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are presented in US dollars.

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 expenditures, 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 expenditures; 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.

This MD&A contains disclosure in respect of crude oil and natural gas production expressed as barrels of oil equivalent ("boe"). All crude oil and natural gas equivalency volumes have been derived by converting gas to oil in the ratio of six thousand cubic feet of gas to one barrel of crude oil. Equivalency measures may be misleading, particularly if used in isolation. This conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

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 of its subsidiaries.

All dollar amounts in this report are in US dollars unless otherwise indicated.

Additional information relating to the Company is available on SEDAR at www.sedar.com.

OVERALL PERFORMANCE AND OPERATIONS REVIEW

The Company has continued to make significant progress in Kazakhstan, Russia and Azerbaijan during the three months ended June 30th, 2005. Overall, average daily oil production increased by approximately 20% from that for the first three months of 2005, and the foundations have been laid for further production capacity increases in all three countries. We have continued to invest in seismic surveys, new wells and production facilities that are expected to result production capacity increasing to 9,000 barrels of oil equivalent per day by the end of 2005.

This progress continues to build on the two significant events of the first quarter of 2005 which materially improved the outlook and development potential of the Company. The first of these was the acquisition of 100% of Altius Energy Corporation (“Altius”) in Kazakhstan and 50% of RF Energy Investments Limited (“RF Energy”), the holding company of ZAO PechoraNefteGas (“PNG”), in Russia. The second significant event was the raising of Cdn. \$58.8 million (before fees and expenses) through the placing of 28 million shares at Cdn. \$2.10 per share.

In Kazakhstan, average production in the second quarter of 2005 increased by 34% to 2,685 bopd from 2,000 barrels of oil per day (“bopd”) in the first quarter. This increase in the production rate was due both to the recommencement of development drilling operations in the Akzhar field and the end of adverse weather conditions, which disrupted production in the first quarter and in April. June production in Kazakhstan was approximately 3,350 bopd on average, reflecting the success of development wells in the Akzhar field.

In Russia, where Arawak operates via its 50% owned affiliate PNG, production in the second quarter averaged 3,045 bopd net to Arawak compared to 2,795 bopd in the first quarter, an increase of approximately 9%.

In Azerbaijan, pilot oil production continued in the second quarter from the South West Gobustan fields and, together with crude oil inventory at the beginning of the period, two sales totaling approximately 7,400 barrels were made via SOCAR’s pipeline for export to Novorossiysk. The installation of gas processing facilities to service the existing gas wells in the Duvanny field is progressing to schedule and first gas is expected, as planned, in October 2005.

RESULTS OF OPERATIONS

Prior to the acquisition of the Kazakhstan and Russian assets on January 7th, 2005, the Company did not have any sales or production. Accordingly, sales and production data for the comparative three and six months ended June 30th, 2004 are not presented below.

Summary of netbacks

| | 3 months ended June 30 th , 2005 | | 6 months ended June 30 th , 2005 | |
|--|--|------------|--|------------|
| | US Dollars (thousands) | Per Barrel | US Dollars (thousands) | Per Barrel |
| Crude oil sales | \$13,756 | \$34.31 | \$27,175 | \$32.63 |
| Interest and other income | \$324 | \$0.81 | \$544 | \$0.65 |
| Total revenue | \$14,080 | \$35.12 | \$27,719 | \$33.28 |
| Royalties and taxes | \$(4,086) | \$(10.19) | \$(7,139) | \$(8.57) |
| Production costs | \$(944) | \$(2.35) | \$(2,432) | \$(2.92) |
| Transportation and other selling costs | \$(1,306) | \$(3.26) | \$(2,951) | \$(3.54) |
| Net operating income | \$7,744 | \$19.32 | \$15,197 | \$18.25 |
| General and administrative expenses | \$(2,581) | \$(6.44) | \$(4,483) | \$(5.38) |
| Realized foreign exchange loss | \$(244) | \$(0.61) | \$(371) | \$(0.45) |
| Interest expense | \$(294) | \$(0.73) | \$(1,140) | \$(1.37) |
| Current income tax expense | \$(1,533) | \$(3.82) | \$(2,880) | \$(3.46) |
| Cash flow from operations | \$3,092 | \$7.72 | \$6,323 | \$7.59 |
| Depletion, depreciation and amortization | \$(2,837) | \$(7.07) | \$(5,752) | \$(6.91) |
| Stock based compensation costs | \$(444) | \$(1.11) | \$(469) | \$(0.56) |
| Accretion expense | \$(188) | \$(0.47) | \$(237) | \$(0.28) |
| Loss on disposal of office equipment | \$(7) | \$(0.02) | \$(7) | \$(0.01) |
| Unrealized foreign exchange gain | \$78 | \$0.19 | \$90 | \$0.11 |
| Future income tax recovery | \$872 | \$2.18 | \$1,512 | \$1.82 |
| Net income | \$566 | \$1.42 | \$1,460 | \$1.76 |

Production

The Company's production from its Kazakhstan and Russian operations amounted to 521,472 barrels for the three months ended June 30th, 2005, 5,730 bopd on average compared to 431,502 barrels, 4,795 bopd on average for the previous quarter. The increase is due to the success of the drilling programs in Kazakhstan and Russia.

| Production for the three months ended June 30 th , 2005 | Kazakhstan | Russia | Total |
|---|------------|---------|---------|
| Production - barrels | 244,499 | 276,973 | 521,472 |
| Average daily production - barrels | 2,685 | 3,045 | 5,730 |

Sales

Sales for the three months ended June 30th, 2005 totaled 400,984 barrels, 4,406 bopd on average, compared to 431,840 barrels, 4,798 bopd on average for the three months ended March 31st, 2005. The average price received in the second quarter was \$34.31 per barrel versus \$31.07 per barrel in the first quarter.

| Sales for the three months ended June 30th, 2005 | | | |
|--|-------------------|---------------|--------------|
| | Kazakhstan | Russia | Total |
| Sales - barrels | 135,968 | 265,016 | 400,984 |
| Average daily sales - barrels | 1,494 | 2,912 | 4,406 |
| Average sales price per barrel | \$38.16 | \$32.33 | \$34.31 |

The Company sells oil to export, near abroad and domestic markets. PNG's export oil sales are made by pipeline and sold as Urals Export Blend free on board ("FOB") Butinge, Lithuania. Altius crude is exported by pipeline and sold as Urals Export Blend, FOB Odessa, Ukraine or Butinge, Lithuania. Near-abroad oil sales refer to sales by PNG to Belarus, which is party to customs union arrangements with Russia and exempted from export duty, while also being zero rated for VAT purposes. The basis of domestic sales is ex-field in Russia and delivered to the local refinery in Kazakhstan.

| Sales for the three months ended June 30th, 2005 | | | |
|--|-------------------|---------------|--------------|
| Export oil sales | Kazakhstan | Russia | Total |
| Volume - barrels | 99,502 | 106,636 | 206,138 |
| Percentage of total sales | 73% | 40% | 51% |
| Revenue (thousands) | \$4,648 | \$4,707 | \$9,355 |
| Average price per barrel | \$46.71 | \$44.14 | \$45.38 |
| Near-abroad oil sales | | | |
| Volume - barrels | - | 23,137 | 23,137 |
| Percentage of total sales | - | 9% | 6% |
| Revenue (thousands) | - | \$707 | \$707 |
| Average price per barrel | - | \$30.54 | \$30.54 |
| Domestic oil sales | | | |
| Volume - barrels | 36,466 | 135,243 | 171,709 |
| Percentage of total sales | 27% | 51% | 43% |
| Revenue (thousands) | \$541 | \$3,153 | \$3,694 |
| Average price per barrel | \$14.83 | \$23.32 | \$21.51 |

General and administrative expenses

The Company's general and administrative expenses, including stock based compensation costs, were \$3.0 million for the three months ended June 30th, 2005 versus \$0.4 million for the same period in 2004. The increase is largely due to the current year acquisitions and the related increase in activity. During the three months ended June 30th, 2005, the Company capitalized \$0.2 million of general and administrative costs (6 months ended June 30th, 2005: \$0.4 million).

Interest expense

Interest expense includes interest amounts payable in respect of the loan facility put in place to fund the acquisition of RF Energy and the prepayment facility which Altius utilized during the period. Interest expense for the three months ended June 30th, 2005 was \$0.29 million (2004: nil), and for the six months ended June 30th, 2005 was \$ 1.14 million (2004: nil).

Depletion, depreciation and amortization expense

Depletion, depreciation and amortization expense for the three months ended June 30th, 2005 has increased to \$2.8 million from \$1,673 for the same period of 2004 as a result of the acquisitions of operations in Kazakhstan and Russia.

Depletion expense has been calculated in accordance with the Company's accounting policies set out herein. The base for the country-by-country depletion calculations include amounts resulting from the respective acquisition purchase price allocations.

Future development costs and proved reserve estimates are derived from the respective independent reserve reports for Kazakhstan and Russia. Future development costs on proved undeveloped reserves of \$35.1 million for Kazakhstan and \$12.2 million for Russia (total of \$47.3 million) are included in the depletion calculation.

Capital expenditures

The major investments made by the Company during 2005 were the acquisition of a 50% share in RF Energy and 100% of Altius. Significant development programs were under way in the second quarter in both Russia and Kazakhstan, and capital expenditures in the second quarter in these countries were \$1.5 million and \$2.6 million respectively net to Arawak.

SHARE CAPITAL

As of June 30th, 2005 and as of the date of this report the Company had the following securities outstanding:

| As at: | June 30th 2005 | August 25th 2005 |
|--|--------------------------------------|--|
| Common Shares | 169,676,564 | 170,040,502 |
| Exchangeable Shares of Arawak Acquisition Inc. | 2,698,634 | 2,384,396 |
| Stock Options | 6,375,000 | 6,325,000 |

Of the 6,375,000 stock options outstanding as of June 30th, 2005, 950,000 were vested and fully exercisable. Subsequent to June 30th, 2005, 50,000 stock options were exercised leaving 6,325,000 stock options outstanding, of which 900,000 were vested and fully exercisable as of August 25th, 2005.

LIQUIDITY AND CAPITAL RESOURCES

The levels of cash, current assets and current liabilities as at June 30th, 2005 and December 31st, 2004 are as set out below:

| (In thousands of US dollars) | June 30th 2005 | Dec. 31st 2004 |
|-------------------------------------|--------------------------------------|--------------------------------------|
| As at: | | |
| Cash and cash equivalents | 15,311 | 1,345 |
| Total current assets | 28,302 | 1,393 |
| Total current liabilities | 8,009 | 1,616 |

The Company had working capital of \$20.3 million at June 30th, 2005 and negative working capital of \$0.2 million at December 31st 2004.

The Company's cash deposits are held principally in US dollars and are managed centrally; surplus funds are placed on time deposit. Limited funds are kept in the Azerbaijan Republic or, subsequent to the acquisitions of RF Energy and Altius, in Russia or Kazakhstan respectively.

A share placement of 28 million shares at Cdn. \$2.10 per share was announced on February 28th, 2005 and completed on March 18th, 2005, resulting in net proceeds after underwriters' fees of \$45.8 (Cdn. \$55.3). From this amount, \$29.0 has been used to temporarily reduce indebtedness of the group and the balance has been retained to fund, in part, the 2005 capital expenditures program, of which the Company's share is expected to be \$32 million in total (\$18.2 million in Kazakhstan, \$7.3 million in Russia and \$6.5 million in Azerbaijan). The balance of the 2005 capital expenditures program is expected to be funded from operating cash flow.

Subsequent to the repayments described above, group indebtedness at June 30th, 2005 was \$20.0 of which \$0.67 is repayable during the remainder of 2005. The Company expects however to refinance this borrowing in full during the third quarter of 2005 from the proceeds of a senior debt facility expected to be put in place at the Company's 50% affiliate PNG. The Company and its partner in PNG, Valkyries Petroleum Corp., are expected each to guarantee up to 50% of PNG's borrowing.

In addition, the Company continues to seek additional business opportunities in Kazakhstan, Russia, and 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 eight most recently completed quarters.

| Quarter ended | (In thousands of US dollars except for per share amounts) | | | Net Income (loss) | |
|----------------------------------|---|--|-------------------|------------------------|---------------|
| | Total Revenues | Income (loss) before extraordinary items | Net income (loss) | Per Common Share Basic | Fully Diluted |
| 2005 June 30th | 13,756 | 566 | 566 | 0.003 | 0.003 |
| March 31 st | 13,419 | 894 | 894 | 0.006 | 0.006 |
| 2004 December 31 st | - | (198) | (198) | (0.002) | (0.002) |
| September 30 th | - | (596) | (596) | (0.006) | (0.006) |
| June 30 th | - | (328) | (328) | (0.004) | (0.004) |
| March 31 st | - | (363) | (363) | (0.004) | (0.004) |
| 2003 December 31 st | - | 667 | 667 | 0.007 | 0.007 |
| September 30 th | - | (472) | (472) | (0.006) | (0.006) |

RELATED PARTY TRANSACTIONS

Business transactions

On January 7th, 2005, the Company completed two business transactions which are considered related party transactions.

The first was the acquisition of 50% of the shares of RF Energy, the holding company of PNG. The 50% stake was acquired from an affiliate of Rosco S.A. (the Company's largest shareholder). The consideration paid by Arawak was \$40.8 million in cash. The consideration and transaction costs were satisfied by drawing \$41.5 million from a loan facility with Vitol Holding B.V. (also an affiliate of Rosco S.A.), as described below.

The second transaction, also completed on January 7th, 2005, was the acquisition of all of the outstanding shares of Altius in consideration for the issuance by Arawak of 37,374,480 common shares and the issuance by Arawak Acquisition Inc. (a wholly-owned subsidiary of Arawak incorporated for the purposes of the Altius transaction) of 13,873,971 exchangeable shares. These exchangeable shares are exchangeable for Arawak common shares on a one-for-one basis on or before January 7th, 2007. The Altius transaction will result in the issuance by Arawak of an aggregate of 51,248,451 shares, including 27,555,986 common shares issued to Rosco S.A, which owned 45.3% of Altius prior to the transaction.

Loan from Vitol Holding B.V. - Tranche A

Interest expense for the three months ended June 30th, 2005 includes \$0.2 million related to Tranche A of the loan provided by Vitol Holding B.V. The loan balance at June 30th, 2005 was \$14 million.

Loan from Vitol Holding B.V. - Tranche B

Interest expense for the three months ended June 30th, 2005 includes \$0.1 million related to Tranche B of the loan provided by Vitol Holding B.V. The loan balance at June 30th, 2005 was \$6 million.

Crude oil sales

Revenues from Russian and Kazakhstan export crude oil sales during the three months ended June 30th, 2005 received from Vitol S.A (an affiliate of Rosco S.A) were \$8.9 million. Accounts receivable at June 30th, 2005 includes revenues from export crude oil sales to Vitol S.A. of \$3.6 million.

Crude oil sales prepayment facility

The Company repaid \$0.5 million of the crude oil sales prepayment facility provided by Vitol S.A. The outstanding balance at June 30th, 2005 is nil. Related interest expense for the current quarter is \$0.006 million and there are no related accounts payable and accrued liabilities outstanding at June 30th, 2005.

Price insurance

Put options were purchased from Vitol S.A. for \$0.12 million during the first quarter of 2005 for price insurance for the period from March through to December 2005. An amount of \$0.036 million was charged to earnings in the second quarter. Prepaid expenses at June 30th, 2005 include \$0.072 million related to the put options.

Legal fees

During the three months ended June 30th, 2005, the Company incurred legal fees totaling \$0.1 million (three months ended June 30th, 2004: \$0.007 million) from a legal firm of which a

director of the Company is a partner. Legal fees included in accounts payable and accrued liabilities are \$0.04 million as at June 30th, 2005 and \$0.2 million as at December 31st, 2004.

Loan One to associate

Interest revenue on Loan One to Commonwealth Gobustan Limited ("CGL") during the three months ended June 30th, 2005 was \$0.05 million (three months ended June 30th, 2004: \$0.033 million). CGL repaid \$0.035 million during the three months ended June 30th, 2005 (three months ended June 30th, 2004: \$0.074 million).

Loan Two to associate

Interest revenue on Loan Two to CGL during the three months ended June 30th, 2005 was \$0.127 million (three months ended June 30th, 2004: nil).

Transactions with shareholder

During the three months ended June 30th, 2005, the Company reimbursed the Vitol group, of which Rosco S.A. is an affiliate, for transactions with a value of \$0.23 million (three months ended June 30th, 2004: \$0.075 million) which were all charged at cost. The balance owed to the Vitol group at June 30th, 2005 was \$0.14 million (December 31st, 2004: \$0.076 million).

Standby facility

Included in the current liabilities acquired from Altius in 2005 was \$3.6 million standby financing facility provided by Vitol S.A. which charged 7% interest per annum. The standby facility and related interest accrued was repaid in full in January 2005.

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

INVESTMENT IN AZERBAIJAN

During the three months ended June 30th, 2005, pilot oil production continued from the South West Gobustan fields, and together with crude oil inventory at the beginning of the first quarter, two sales totaling approximately 7,250 barrels were made via SOCAR's pipeline for export to Novorossiysk.

During the first quarter of 2005, the Kyanizadag 101 well in the Coastal block of the South West Gobustan fields was drilled to a depth of 3,611 meters compared to the target depth of 3,800 meters when Arawak's non-operated associate, CGL encountered mechanical difficulties. The well has been successfully cased to 3,000 meters and encouraging hydrocarbon shows were encountered in the development sections of the well (above 3,000 meters) and in the exploration section of the well (below 3,000 meters). The rig has subsequently been moved to the Duvanny field in the Coastal block to drill a further gas well, Duvanny 108, which is now under way. Following the completion of this well, the rig will be moved back to Kyanizadag to sidetrack well Kyanizadag 101 and to drill to target depth. Once this operation is complete, the well will be logged and tested, with results expected in the fourth quarter of 2005.

In 2004, CGL established potential gas deliverability of approximately 12 million cubic feet of gas per day. The installation of gas processing facilities to service the existing gas wells in the Duvanny field is progressing to schedule and first gas is expected, as planned, in October 2005.

Revenue from test production for the three months ended June 30th, 2005 of \$0.175 million (three months ended June 30th, 2004: \$0.177) has been offset against capitalized costs and not recognized as turnover.

CRITICAL ACCOUNTING ESTIMATES AND ADOPTION OF NEW ACCOUNTING POLICIES

Principles of consolidation

The Company's unaudited consolidated financial statements have been prepared in US dollars following Canadian generally accepted accounting principles and include the financial statements of Arawak and its wholly owned subsidiaries, which are registered under the laws of Anguilla (British West Indies), the Netherlands, Kazakhstan, British Columbia, Alberta & Ontario (Canada) and England & Wales.

Operations in Russia are conducted through a joint venture and accordingly, these financial statements reflect only the Company's proportionate interest.

The Company's operations in Azerbaijan are recognized as an equity investment and accordingly, these financial statements reflect the Arawak share of the net results and net assets.

Foreign currency translation

In Kazakhstan, 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 amortization, which are translated at historic rates; and foreign exchange gains and losses are included in earnings.

The functional currency of the Russian operations is the Russian ruble 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; and exchange gains or losses are recorded directly as cumulative translation adjustment which is 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 capitalized. Such costs include land acquisition, geological and geophysical, drilling of both productive and unproductive wells, plant and equipment and administration costs reasonably allocable to these activities. Proceeds from disposals are recorded as a reduction of the related expenditures without recognition of a gain or loss unless the disposal would result in a change of 20% or more in the depletion rate.

Capitalized 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 capitalized 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 value of unproved properties at the lower of cost and net realizable value. An impairment loss is recognized when the carrying amount is not recoverable and exceeds its fair value. The carrying amount is not recoverable if it exceeds the sum of the undiscounted cash flows expected from the proved reserves.

Asset retirement obligation

The Company recognizes 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 on a unit-of-production basis over the life of the proved reserves. 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 expenditures incurred for site reclamation and abandonment are charged against the liability to the extent it exists on the balance sheet with the difference recognized as a gain or loss in the period in which settlement occurs.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles 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.

Stock based compensation costs

Compensation expense is based on the fair value at the grant date and recognized in income over the vesting periods of the respective options for options granted on or after January 1st, 2003 with a corresponding increase to contributed surplus. Any consideration received upon exercise of the options, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

Financial instruments and financial risk

The fair value of cash, accounts receivable, other current assets, accounts payable and accrued liabilities and the crude oil prepayment facility approximate their carrying values due to the short term nature of these instruments. The fair value of loans to associates approximates their carrying amounts as interest rates approximate market interest rates. The other long-term liabilities are non-interest bearing and therefore do not approximate fair value, however the fair value cannot be practically estimated.

The Company uses various financial instruments to manage its crude oil price exposure. The instruments are not used for trading purposes. The Company hedges its exposure to petroleum commodity prices by entering into crude oil options when deemed appropriate. These derivative contracts are not accounted for as hedges and are recorded at fair value on the balance sheet with changes in fair value recognized in earnings. Premiums paid are deferred and amortized to earnings over the term of the contract.

WORK COMMITMENTS

Arawak has contractual work commitments for each of its three oilfields in Kazakhstan as summarized below:

| Contract and contract year end (in millions of US dollars) | 2005 | 2006 | 2007 | 2008 | Total |
|---|-------------|-------------|-------------|-------------|--------------|
| Besbolek - July 30th | - | 1.0 | 1.0 | 1.0 | 3.0 |
| Karataikyz - July 30th | - | 0.7 | 0.7 | 0.6 | 2.0 |
| Akhzar - September 14th | 11.0 | - | - | - | 11.0 |
| Total commitments | 11.0 | 1.7 | 1.7 | 1.6 | 16.0 |
| Expenditures in current period | 8.4 | - | - | - | 8.4 |
| Outstanding commitments | 2.6 | 1.7 | 1.7 | 1.6 | 7.6 |

Work programs for 2005

The 2005 work programs have been approved by the Government for each field and contain any 2004 work commitment shortfalls. Although management expects that these inclusions will rectify the breaches, management cannot say with certainty that there will not be any further ramifications which might affect these financial statements. Non-fulfilment of contractual work commitments could result in other actions by the Government, including suspending or revoking licenses.

Carried working interest

Arawak has 100% of the Besbolek and Karataikyz Licenses and Contracts in Kazakhstan subject to a minority interest partner receiving a 10% interest in the project net cash flow after payout of capital invested. The Company is to provide 100% of the start-up capital for the project.

BUSINESS RISKS

As a junior oil and gas exploration, development and production company, Arawak is subject to risks and uncertainties inherent to the oil and gas industry and to risks inherent to a company of its size and at its 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.

Political and economic conditions in Russia and Kazakhstan

Whilst there have been improvements in the economic situation in Russia and Kazakhstan 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 and Kazakhstan 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 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. Management is unable to predict the extent and duration of these uncertainties, nor quantify the impact, if any, on the financial statements.

Taxation

Russian and Kazakhstan tax legislation and practice 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 assessed 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 it is successful, that the terms on which such funds are obtained will be advantageous to Arawak.