



**ARAWAK ENERGY CORPORATION**

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

**For the three and nine months ended September 30, 2006**

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

As at		September 30, 2006	December 31, 2005
<b>ASSETS</b>			
	Note		
Cash and cash equivalents		13,188	14,285
Accounts receivable		17,974	7,525
Inventory		3,850	3,040
Other current assets		9,130	5,879
		<u>44,142</u>	<u>30,729</u>
Property and equipment		169,263	140,279
Deferred charges		863	1,086
Future income tax assets		2,739	2,977
		<u>217,007</u>	<u>175,071</u>
<b>LIABILITIES</b>			
Accounts payable and accrued liabilities		11,155	8,883
Corporate income taxes payable		7,015	255
Crude oil sales prepayment facility	3	12,500	-
Current portion of long term debt	4	6,900	4,500
Current portion of other long term liabilities		26	336
		<u>37,596</u>	<u>13,974</u>
Future income tax liabilities		18,763	19,915
Long term debt	4	18,600	21,000
Other long term liabilities		9,715	8,870
Asset retirement obligation		2,604	2,090
		<u>87,278</u>	<u>65,849</u>
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	5	114,447	114,042
Contributed surplus		4,848	1,818
Cumulative translation adjustment		373	(540)
Retained earnings (deficit)		10,061	(6,098)
		<u>129,729</u>	<u>109,222</u>
		<u>217,007</u>	<u>175,071</u>

See accompanying notes to the interim consolidated financial statements.

**ARAWAK ENERGY CORPORATION**  
**INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT**  
(Expressed in thousands of U.S. dollars, except per share amounts)  
Unaudited – prepared by management

For the period ended September 30	Three months 2006	Three months 2005	Nine months 2006	Nine months 2005
<b>Revenue</b>				
Crude oil sales	39,638	27,575	101,332	54,750
Interest and other income	1,739	323	2,098	867
	<u>41,377</u>	<u>27,898</u>	<u>103,430</u>	<u>55,617</u>
<b>Expenses</b>				
Royalties and taxes	9,490	5,300	21,932	12,439
Production costs	2,896	1,738	7,132	4,170
Transportation and selling costs	4,317	2,539	10,640	5,490
General and administrative expenses	3,420	2,250	9,638	6,740
Stock option compensation	1,397	931	3,130	1,400
Depletion, depreciation and amortization	7,445	3,797	18,495	9,549
Accretion expense	64	(94)	181	143
Interest expense	1,264	327	2,547	1,467
Foreign exchange loss (gain)	(22)	(19)	(632)	262
	<u>30,271</u>	<u>16,769</u>	<u>73,063</u>	<u>41,660</u>
Income before income taxes	<u>11,106</u>	<u>11,129</u>	<u>30,367</u>	<u>13,957</u>
Current income tax	6,208	5,039	16,983	7,919
Future income tax recovery	(943)	(1,265)	(2,775)	(2,777)
	<u>5,265</u>	<u>3,774</u>	<u>14,208</u>	<u>5,142</u>
<b>Net income for the period</b>	<b>5,841</b>	<b>7,355</b>	<b>16,159</b>	<b>8,815</b>
Retained earnings (deficit) beginning of the period	4,220	(13,136)	(6,098)	(14,596)
<b>Retained earnings (deficit) end of the period</b>	<b>10,061</b>	<b>(5,781)</b>	<b>10,061</b>	<b>(5,781)</b>
<b>Net income per share (note 5)</b>				
Basic	0.034	0.043	0.093	0.054
Diluted	0.034	0.041	0.093	0.052

See accompanying notes to the interim consolidated financial statements.

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

For the period ended September 30	Three months 2006	Three months 2005	Nine months 2006	Nine months 2005
<b><u>Operating Activities</u></b>				
Net income for the period	5,841	7,355	16,159	8,815
Items not affecting cash				
Stock option compensation	1,397	931	3,130	1,400
Depletion, depreciation and amortization	7,445	3,797	18,495	9,549
Accretion expense	64	(94)	181	143
Foreign exchange loss (gain)	156	24	912	(59)
Future income tax recovery	(943)	(1,265)	(2,775)	(2,777)
<b>Funds from operations</b>	<b>13,960</b>	<b>10,748</b>	<b>36,102</b>	<b>17,071</b>
Changes in non-cash working capital	(5,230)	1,553	(5,481)	(53)
	<b>8,730</b>	<b>12,301</b>	<b>30,621</b>	<b>17,018</b>
<b><u>Financing Activities</u></b>				
Repayment of standby facility	-	-	-	(3,603)
Changes in prepayment facility	-	-	12,500	(6,500)
Long term debt repayments	(1,500)	(20,000)	(4,500)	(41,500)
Proceeds from long term debt	4,500	25,500	4,500	67,000
Change in other long term liabilities	(149)	(2,144)	535	(5,122)
Proceeds from issue of common shares	124	-	305	45,810
	<b>2,975</b>	<b>3,356</b>	<b>13,340</b>	<b>56,085</b>
<b><u>Investing Activities</u></b>				
Acquisition of RF Energy	-	-	-	(39,713)
Acquisition of Altius (cash component)	-	-	-	(2,589)
Acquisition of Recher	-	-	(8,473)	-
Purchase of property and equipment	(13,878)	(5,791)	(36,585)	(15,816)
	<b>(13,878)</b>	<b>(5,791)</b>	<b>(45,058)</b>	<b>(58,118)</b>
<b><u>Acquisitions</u></b>				
Net cash acquired with subsidiaries	-	-	-	8,846
Net change in cash during the period	(2,173)	9,866	(1,097)	23,831
Cash, beginning of the period	15,361	16,720	14,285	2,755
Cash, end of the period	<b>13,188</b>	<b>26,586</b>	<b>13,188</b>	<b>26,586</b>

See accompanying notes to the interim consolidated financial statements.

**ARAWAK ENERGY CORPORATION**  
**NOTES TO THE INTERIM FINANCIAL STATEMENTS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006**  
**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 following the same accounting principles and methods of application as the audited consolidated financial statements for the year ended December 31, 2005. 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, 2005.

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

**2. ACQUISITIONS**

**OOO NK Recher-Komi**

On June 27, 2006 the Company’s 50% owned RF Energy Investments Limited acquired OOO NK Recher-Komi (“Recher”) which owns and operates the North Israel oil field in the Komi Republic in the Russian Federation. The acquisition was accounted for using the purchase method. The Company’s 50% portion of the purchase price was as follows (in millions of dollars):

Purchase consideration	9.0
Working capital adjustment	0.5
Transaction costs	0.2
<b>Total consideration</b>	<b>9.7</b>

The total purchase price of \$9.7 million was assigned to the net assets acquired based on their fair values as follows (in millions of dollars)

Current assets	0.9
Property and equipment	11.4
Current liabilities	(0.7)
Future income taxes	(1.9)
	<b>9.7</b>

The purchase consideration includes \$1.4 million due in instalments over the next three years. As at September 30, 2006, accounts payable and accrued liabilities includes related costs of \$0.4 million and other long term liabilities includes \$1.0 million.

### 3. CRUDE OIL SALES PREPAYMENT FACILITY

On June 12, 2006 the Company increased the limit on its crude oil sales prepayment facility. Subject to certain conditions, Vitol S.A., which is a related party, is the exclusive buyer of crude oil exported from the Company's subsidiary in Kazakhstan until May, 2011 (previously until May, 2008) and provides a crude oil sales prepayment facility allowing the Company to draw prepayments on future oil sales. The amount available for prepayment is up to 90% of the expected value of the next nine months crude oil export sales, subject to a maximum of \$15.0 million (previously \$8.0 million). A financing charge of LIBOR plus 4.4% including local withholding taxes (previously 3.5% excluding taxes) is charged on the outstanding prepayment balance and paid monthly. There is an outstanding facility balance of \$12.5 million at September 30, 2006 and a nil balance at December 31, 2005.

### 4. LONG TERM DEBT

The Company's 50% owned operating company in Russia has 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 monthly. The borrowing is secured against Russian export crude oil sales and proportionate shareholder guarantees.

	September 30, 2006	December 31, 2005
Bank loan	25,500	25,500
Short term portion	6,900	4,500
Long term debt	18,600	21,000

### 5. SHARE CAPITAL

Authorized:

Unlimited common shares, without par value

As at:	September 30, 2006		December 31, 2005	
	Number of shares	Amount	Number of shares	Amount
<u>Issued:</u>				
Balance, beginning of period	170,184,729	111,565	92,945,497	23,570
Issued for cash	-	-	28,000,000	45,778
Exercise of options	324,667	405	831,250	154
Issued for Altius shares	-	-	37,374,480	32,587
Exchanged during period	630,306	550	11,033,502	9,620
Share issue costs	-	-	-	(144)
Issued and outstanding	171,139,702	112,520	170,184,729	111,565
<u>Exchangeable shares:</u>				
Balance, beginning of period	2,840,469	2,477	-	-
Issued	-	-	13,873,971	12,097
Exchanged	(630,306)	(550)	(11,033,502)	(9,620)
Exchangeable shares outstanding	2,210,163	1,927	2,840,469	2,477
Balance, end of period	173,349,865	114,447	173,025,198	114,042

### Earnings per share

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.

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

For the period ended September 30	Three months		Nine months	
	2006	2005	2006	2005
Basic	173,283,198	172,404,546	173,201,352	163,437,961
Diluted	174,123,075	178,729,546	174,041,229	169,762,961

### 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 TSX Venture 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, 2004	1,131,250	CAD 0.22
Granted	5,675,000	CAD 2.10
Exercised	(831,250)	CAD 0.22
Cancelled	(275,000)	CAD 1.93
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	(324,667)	CAD 1.09
Cancelled	(33,333)	CAD 2.10
Outstanding September 30, 2006	10,877,000	CAD 2.50

The number of stock options outstanding and exercisable at September 30, 2006, is as follows:

Options outstanding		Options exercisable	
Number outstanding	Average remaining life in years	Number outstanding	Average remaining life in years
10,877,000	4.0	5,358,667	3.5

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions:

	2006	2005
Fair value of options granted (\$ per share)	CAD 0.90	CAD 0.81
Expected life (years)	2.0	2.0
Risk-free interest rate (%)	4.5%	4.9%
Expected volatility (%)	102.7%	122.8%
Expected dividend yield (%)	0.0%	0.0%

## 6. 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 September 30, 2006</u>					
Revenue:					
Crude oil sales	23,839	15,799	-	-	39,638
Interest and other income	-	930	-	809	1,739
Expenses:					
Royalties and taxes	543	8,947	-	-	9,490
Production costs	1,895	1,001	-	-	2,896
Transportation and selling costs	3,740	577	-	-	4,317
General and administrative expenses	820	903	-	1,697	3,420
Depletion, depreciation and amortization	4,946	2,463	-	36	7,445
Interest expense	315	916	-	33	1,264
Net income	6,809	1,402	-	(2,370)	5,841
<u>For the nine months ended September 30, 2006</u>					
Revenue:					
Crude oil sales	61,409	39,923	-	-	101,332
Interest and other income	19	1,062	-	1,017	2,098
Expenses:					
Royalties and taxes	1,348	20,584	-	-	21,932
Production costs	4,179	2,953	-	-	7,132
Transportation and selling costs	9,512	1,128	-	-	10,640
General and administrative expenses	2,507	1,786	-	5,345	9,638
Depletion, depreciation and amortization	12,519	5,875	-	101	18,495
Interest expense	433	2,024	-	90	2,547
Net income	18,896	4,938	-	(7,675)	16,159
<u>As at September 30, 2006</u>					
Property and equipment	82,619	59,056	26,877	711	169,263
Total assets	113,216	70,388	28,658	4,745	217,007
Total liabilities	37,184	40,917	7,510	1,667	87,278

## 6. SEGMENTED INFORMATION (continued)

	Kazakhstan	Russia	Azerbaijan	Other	Total
<u>For the three months ended September 30, 2005</u>					
Revenue:					
Crude oil sales	17,034	10,541	-	-	27,575
Interest and other income	2	-	-	321	323
Expenses:					
Royalties and taxes	376	4,924	-	-	5,300
Production costs	922	816	-	-	1,738
Transportation and selling costs	2,196	343	-	-	2,539
General and administrative expenses	964	98	-	1,188	2,250
Depletion, depreciation and amortization	2,527	1,263	-	7	3,797
Interest expense	-	34	-	293	327
Net income	6,692	2,769	-	(2,106)	7,355
<u>For the nine months ended September 30, 2005</u>					
Revenue:					
Crude oil sales	29,021	25,729	-	-	54,750
Interest and other income	18	-	-	849	867
Expenses:					
Royalties and taxes	643	11,796	-	-	12,439
Production costs	2,097	2,073	-	-	4,170
Transportation and selling costs	4,518	972	-	-	5,490
General and administrative expenses	2,408	1,101	-	3,231	6,740
Depletion, depreciation and amortization	5,527	4,011	-	11	9,549
Interest expense	117	40	-	1,310	1,467
Net income	9,433	4,481	-	(5,099)	8,815
<u>As at December 31, 2005</u>					
Property and equipment	72,591	45,470	22,206	12	140,279
Total assets	88,269	55,186	23,490	8,126	175,071
Total liabilities	20,148	35,714	9,082	905	65,849