Consolidated Financial Statements of

CASPIAN ENERGY INC.

January 31, 2005

Deloitte.

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Auditors' Report

To the Shareholders of
Caspian Energy Inc.:

We have audited the consolidated balance sheet of **Caspian Energy Inc.** as at January 31, 2005 and the consolidated statements of loss and deficit and cash flows for the period from incorporation on April 13, 2004 to January 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at January 31, 2005 and the results of its operations and its cash flows for the period from incorporation on April 13, 2004 to January 31, 2005 in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta
April 27, 2005

(signed) "Deloitte & Touche LLP"
Chartered Accountants

CASPIAN ENERGY INC.
Consolidated Balance Sheet

Expressed in Canadian Dollars

January 31, 2005

Assets

Current assets:		
Cash and cash equivalents	$	43,066,470
Accounts receivable		181,387
Prepaids and other deposits		486,992
Other assets		11,731
		43,746,580
Property, plant and equipment (note 4)		40,419,409
Accumulated depletion and depreciation		(76,139)
		40,343,270
	$	84,089,850

Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable and accrued liabilities	$	1,366,096
Loan payable (note 8)		7,336,841
		8,702,937
Asset retirement obligation (note 5)		70,540
Future income taxes (note 9)		644,376
		9,417,853
Shareholders' equity:		
Share capital (note 6)		75,376,278
Warrants to purchase common shares (note 6)		667,738
Contributed surplus (note 7)		3,629,436
Deficit		(5,001,455)
		74,671,997
	$	84,089,850

See accompanying notes to consolidated financial statements.

Approved by the Board:

"William Ramsay"

Director

"Gordon Harris"

Director

CASPIAN ENERGY INC.

Consolidated Statement of Loss and Deficit

Expressed in Canadian Dollars

Period from incorporation on April 13, 2004 to January 31, 2005

Revenues:		
Oil and gas revenue, net	$	1,618,511
Interest		238,385
Other income		45,764
		1,902,660
Expenses:		
General and administrative		2,113,461
Operating		545,099
Transportation		68,601
Stock-based compensation (note 7)		3,629,436
Unrealized foreign exchange loss		57,642
Depletion, depreciation and accretion		83,606
		6,497,845
Loss before income taxes		(4,595,185)
Future income taxes		406,270
Net loss for the period		(5,001,455)
Retained earnings, beginning of period		-
Deficit, end of period	$	(5,001,455)
Basic and diluted loss per share (note 6)	$	(0.09)

See accompanying notes to consolidated financial statements.

CASPIAN ENERGY INC.

Consolidated Statement of Cash Flows

Expressed in Canadian Dollars

Period from incorporation on April 13, 2004 to January 31, 2005

Cash provided by (used in):		
Operating:		
Net loss for the period	$	(5,001,455)
Add non-cash items:		
Stock-based compensation		3,629,436
Unrealized foreign exchange loss		57,642
Depletion, depreciation and accretion		83,606
Future income taxes		406,270
Changes in non-cash working capital		(680,110)
		(1,504,611)
Financing:		
Issuance of common shares		65,794,363
Share issue expenses		(6,209,585)
		59,584,778
Investing:		
Acquisition of property, plant and equipment		(17,314,947)
Cash acquired on acquisition (note 3)		2,301,250
Changes in non-cash working capital		1,366,096
		(15,013,697)
Increase in cash and cash equivalents		43,066,470
Cash and cash equivalents, beginning of period		-
Cash and cash equivalents, end of period	$	43,066,470
Interest paid and received:		
Interest paid	$	-
Interest received	$	201,811

See accompanying notes to consolidated financial statements.

1. Nature of operations:

The Company is engaged in the exploration and development of oil and gas properties in Kazakhstan.

During the period ended January 31, 2005 Northway Explorations Limited (“Northway”), a Toronto Stock Exchange listed company, acquired a private Ontario company, Caspian Energy Ltd. (“CEL”) and subsequently raised US$9.75 million through the issuance of common shares. Under the terms of an exploration program entered into between the government of Kazakhstan and Aral Petroleum Capital LLP (“Aral”) (the “Exploration Contract”), Aral has agreed to spend a minimum of US$20.8 million during the initial three year term of the program. As of January 31, 2005, US$15.6 million had been incurred with the remaining US$5.2 million required to be spent by December 29, 2005. The expenditures include processing and reinterpretation of geological and geophysical data of prior years, two dimensional and three dimensional seismic shoots and surveys, drilling exploration wells, well reactivations and well surveys and testing. Under terms of a shareholders’ agreement dated June 25, 2004, between Caspian, Azden Management Limited (“Azden”) and Aral, Caspian committed to fund the US$20.8 million for this initial work program.

CEL’s assets include a 50% indirect interest in Aral, and a temporary 100% beneficial interest in the currently producing well of Aral. Through Aral it will have the right to explore and develop certain oil and gas properties known as the North Block, a 2348 square kilometer area, located in the vicinity of the Kazakh pre-Caspian basin. Following the acquisition of CEL, Northway changed its name to Caspian Energy Inc. (the “Company” or “Caspian”) and became actively engaged in the exploration, production and development of oil and gas in Kazakhstan. The Company also has minor resource interests in Canada. The acquisition has been accounted for as a reverse takeover for accounting purposes (note 3).

2. Significant accounting policies:

The consolidated financial statements of Caspian are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles.

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

(a) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and short-term investments with an initial maturity date of three months or less.

(b) Joint ventures:

The Company’s oil and gas exploration and development activities are conducted in Kazakhstan through Aral and accordingly, these consolidated financial statements reflect only the Company’s proportionate interest in such activities.

(c) Property, plant and equipment:

Capitalized costs:

The Company follows the full cost method of accounting for oil and natural gas operations, whereby all costs related to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical costs, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells, the cost of petroleum and natural gas production equipment and overhead charges directly related to exploration and development activities. Proceeds from the sale of oil and gas properties are applied against capital costs, with no gain or loss recognized, unless such a sale would change the rate of depletion and depreciation by 20% or more, in which case, a gain or loss would be recorded.

Depletion, depreciation and amortization:

The capitalized costs are depleted and depreciated using the unit-of-production method based on proven petroleum and natural gas reserves, as determined by independent consulting engineers. Oil and natural gas liquids reserves and production are converted into equivalent units of natural gas based on relative energy content.

Ceiling test:

The Company follows the Canadian accounting guideline on full cost accounting. In applying this full cost guideline, Caspian calculates its ceiling test for each cost centre by comparing the carrying value of oil and natural gas properties and production equipment to the sum of undiscounted cash flows expected to result from Caspian's proved reserves. If the carrying value is not fully recoverable, the amount of impairment is measured by comparing the carrying value of oil and gas properties and production and equipment to the estimated net present value of future cash flows from proved plus probable reserves using a risk-free interest rate and expected future prices. Any excess carrying value above the net present value of the future cash flows is recorded as a permanent impairment.

Costs of acquiring and evaluating unproven properties in Canada and costs of exploration and land in international cost centres are excluded initially from costs subject to depletion, until it is determined whether or not proved reserves are attributable to the properties or, in the case of major development projects, commercial production has commenced, or impairment has occurred. Impairment occurs whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When proven reserves are determined or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion for the country's cost centre. Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets unless the disposal represents a significant disposition of reserves, in which case a gain or loss will be recorded.

(c) Property, plant and equipment: (continued)

Unproved property:

Costs of acquiring and evaluating unproven properties in Canada and costs of exploration and land in Kazakhstan are excluded initially from costs subject to depletion, until it is determined whether or not proved reserves are attributable to the properties or, in the case of major development projects, commercial production has commenced, or impairment has occurred. Impairment occurs whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When proven reserves are determined or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion for that country's cost centre.

Asset retirement obligation:

The Company has adopted the Canadian accounting standard for asset retirement obligations. In accordance with the new standard, Caspian records the fair value of an asset retirement obligation ("ARO") as a liability in the period in which it incurs a legal obligation to restore an oil and gas property, typically when a well is drilled or other equipment is put in place. The associated asset retirement costs are capitalized as part of the carrying amount of the related asset and depleted using a unit-of-production method over the life of the proved reserves. Subsequent to initial measurement of the obligations, the obligations are adjusted at the end of each reporting period to reflect the passage of time and changes in estimated future cash flows underlying the obligation. Actual costs incurred on settlement of the ARO are charged against the ARO.

(d) Income taxes:

Income taxes are calculated using the liability method of tax accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying value amount on the balance sheet are used to calculate future income tax assets and liabilities. Future income tax assets and liabilities are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse.

(e) Stock-based compensation:

The Company grants options to purchase common shares to employees and directors under its stock option plan. The Company has adopted the new Canadian accounting standard relating to stock-based compensation and other stock-based payments as it applies to stock-based compensation granted to employees, officers and directors. Under this standard, future awards are accounted for using the fair value of accounting for stock-based compensation. Under the fair value method, an estimate of the value of the option is determined at the time of grant using a Black-Scholes option-pricing model. The fair value of the option is recognized as an expense and contributed surplus over the vesting period of the option. Proceeds received on exercise of stock options, along with amounts previously included in contributed surplus, are credited to share capital.

(f) Revenue recognition:

Revenue from the sale of oil and natural gas is recognized based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating and maintenance costs, transportation, and production-based royalty expenses will be recognized in the same period in which the related revenue is earned and recorded.

(g) Measurement uncertainty:

The amounts recorded for depletion and depreciation of property, plant and equipment, the provision for asset retirement obligations and the amounts used for ceiling test calculations are based on estimates of reserves and/or future costs. The Company's reserve estimates are reviewed annually by an independent engineering firm. The amounts disclosed relating to fair values of stock options issued are based on estimates of future volatility of the Company's share price, expected lives of options, and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty.

(h) Earnings (loss) per share:

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Diluted per share amounts are calculated based on the treasury stock method whereby the weighted average number of shares is adjusted for the dilutive effect of options.

(i) Foreign currency:

All operations are considered financially and operationally integrated. Results of operations are translated to Canadian dollars, using average rates for revenues and expenses, except depreciation which is translated at the rate of exchange applicable to the related assets. Monetary items denominated in foreign currency are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Foreign exchange gains and losses are recorded in the statement of operations.

3. Acquisition of Caspian Energy Ltd.:

On September 21, 2004, Caspian (formerly Northway) acquired all of the issued and outstanding shares of Caspian Energy Ltd. ("CEL"), an Ontario private company, by issuing 39,590,909 common shares. The transaction between Caspian (legal parent) and CEL (legal subsidiary) is accounted for as a reverse-takeover ("RTO"), using the purchase method of accounting. The shareholders of CEL owned the majority of the shares after the acquisition. In addition, the management team of CEL became the management team of Caspian and the CEL directors became Caspian directors. As a result, for accounting purposes, CEL was identified as the acquirer. Application of RTO accounting results in CEL being deemed the parent company for accounting purposes. The financial statements of the combined entity, issued under the name of the legal parent, are considered a continuation of the financial statements of the legal subsidiary, CEL.

Application of reverse takeover accounting results in the following:

(i) the Caspian consolidated financial statements are a combination of CEL at its historical cost and Caspian at its fair value. There are no comparative figures presented as CEL was not incorporated until April 13, 2004.

(ii) shareholders' equity is presented as a continuation of CEL; however, the capital structure is that of Caspian.

(iii) the purchase price of $9,699,090, being the aggregate of the fair value of the equity interest in Caspian deemed to be given by CEL to the shareholders of Caspian was allocated to the assets and liabilities of Caspian as follows:

Cash	$	2,301,250
Accounts receivable and other assets		140,527
Accounts payable		(13,851)
Petroleum and natural gas property		7,271,164
Total	$	9,699,090

At the time of the acquisition, Caspian had approximately $1 million in tax loss carryforwards and other deductions. The Corporation has not recorded any tax benefit related to these losses due to the uncertainty of realization.

4. Property, plant and equipment:

All of the Company's property, plant and equipment at January 31, 2005, relates to petroleum and natural gas properties, the majority of which relates to a contract for exploration work in the North Block located in the Aktyubinsk area of Kazakhastan.

The majority of the Company's property, plant and equipment is under development, with $623,598 of costs being subject to depletion and depreciation for 2005.

During 2005, the Company capitalized $153,000 of general and administrative expenses related directly to exploration and development activities.

5. Asset retirement obligation:

The Company records the fair value of asset retirement obligations as a liability in the period in which it incurs the legal obligation.

The asset retirement obligation results from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations at January 31, 2005 is approximately US$100,000, which will be incurred between 2014 and 2019. A credit-adjusted risk-free rate was used to calculate the fair value of the asset retirement obligations.

A reconciliation of the asset retirement obligations is provided below:

Balance, beginning of period	$	-
Net liabilities incurred on acquisition		70,540
Balance, end of period	$	70,540

Under the terms of the Exploration Contract (note 3), the Company is required to create a fund to finance actual future restoration costs, equal to 1% of the capital costs of exploration. At January 31, 2005, $47,514 has been placed in a restricted bank account related to the funding requirement.

6. Share capital:

(a) Authorized:

Unlimited number of voting common shares, without stated par value.

(b) Common shares issued:

Common shares of CEL	Number	Amount
Issued on incorporation	1	$ 1
Private placement	23,045,454	13,069,048
Public offerings	27,360,000	51,469,066
Issued on acquisition of oil and gas properties(ii)	16,545,454	9,430,909
Issued and outstanding as at September 20, 2004	66,950,909	73,969,024
Exercise of warrants/options(iii)	2,068,333	1,256,250
Issued and outstanding as at January 31, 2005	69,019,242	75,225,274
Common shares of Caspian issued on business combination of Caspian and CEL(i) to former Caspian shareholders	21,012,012	9,699,090
Adjustment on RTO	(5,909,091)	(3,338,500)
Share issue costs (iv)	-	(6,209,585)
Total issued and outstanding as at January 31, 2005	84,122,163	$ 75,376,278

(i) On September 21, 2004, Caspian entered into a merger agreement with CEL to combine the companies on the basis of one share of Caspian for every one share of CEL.

(ii) In June 2004 CEL acquired a 50% indirect interest in Aral. The cost of the purchase of $9,430,909 was assigned to petroleum and natural gas property.

(iii) During the period from the date of the RTO to January 31, 2005, 1,633,333 warrants and 435,000 options to purchase common shares of CEL were exercised. The warrants had an exercise price of $0.66 per common share and the stock options were priced at $0.35, $0.40 and $0.50 per common share.

(iv) Share issue costs have not been tax-effected.

(c) Stock options:

The Company has a stock option plan (the “Plan”) under which it may grant options to directors, officers and employees for the purchase of up to 10,350,000 common shares. Options are granted at the discretion of the board of directors. The exercise price, vesting period and expiration period are also fixed at the time of grant at the discretion of the Board of Directors.

On September 21, 2004 options were granted to acquire 2,079,090 common shares at $0.75 per share and 4,044,138 at $2.15 per share. Of the total, 2,461,614 options vest yearly in one-third tranches beginning on the first anniversary of the grant date and 3,661,614 vest immediately. On December 5, 2004, options were granted to acquire 1,050,000 common shares at $0.75 per share, which vest one-quarter on the date of the grant and one-quarter for each of the next three years. All expire five years after grant date.

Changes to the Company’s stock options are summarized as follows:

	Number of Options	2004 Wt. Avg. Option Price
Balance, beginning of period	-	$ -
Granted	7,173,228	$ 1.72
Exercised	-	$ 0.57
Expired	-	$ -
Balance, end of period	7,173,228	$ -
Exercisable, end of period	7,173,228	$ 1.60

The following is a summary of stock options outstanding and exercisable as at January 31, 2005:

Range of Exercise Price	Options Outstanding Number of Options	Wt. Avg. Life (Years)	Wt. Avg. Exercise Price	Exercisable Options Number of Options
$0.75	2,079,090	4.7	$ 0.75	891,363
$2.00	1,050,000	4.9	$ 2.00	262,500
$2.15	4,044,138	4.7	$ 2.15	2,770,251
	7,173,228	4.7	$ 1.60	3,924,114

(d) Per share amounts:

The weighted average number of common shares outstanding during the period ended January 31, 2005 of 58,485,792 was used to calculate earnings per share amounts.

(e) Warrants:

205,000 share purchase warrants are outstanding at January 31, 2005. No value was ascribed to the warrants at the date of grant. Each warrant entitles the holder to purchase one common share at a price of $0.66 until March 19, 2005. All of the warrants were exercised subsequent to year-end. 1,368,000 broker warrants are outstanding at January 31, 2005. Each warrant entitles the holder to purchase one common share at a price of $2.00 until September 20, 2006. The fair value of the warrants using the Black-Scholes method was $667,738.

7. Stock-based compensation:

Options granted to both employees and non-employees are accounted for using the fair value method. The fair value of common share options granted in the period ended January 31, 2005 was estimated to be $3,629,436 as at the grant date using a Black-Scholes option-pricing model and the following assumptions:

Risk free interest rate	3%
Expected life	5 year average
Expected volatility	30%
Expected dividend yield	0%

The estimated fair value of the options is amortized to expense and credited to contributed surplus over the option vesting period on a straight-line basis.

8. Loan payable:

Aral is indebted to Azden, the other 50% partner in Aral, in the amount of $7,336,841. The amount is non-interest bearing and is to be repaid prior to January 1, 2006. Caspian is obligated to fund Aral's operations, consequently $7,336,841 has been added to property, plant and equipment of Caspian and shown as a current liability.

9. Income taxes:

Future income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. The Company has provided for certain taxes based upon statutory regulations of Kazakhstan. The Company is subject to permanent tax differences due to the fact that certain expenses are not deductible for income tax purposes under Kazakh law.

The provision for taxes differs from that computed using the combined Canadian federal and provincial statutory rate as follows:

Loss before income taxes	$	(4,595,185)
Expected recovery at statutory tax rate of 38.62%		(1,774,660)
Tax rate difference of foreign jurisdiction		(55,461)
Non-deductible stock-based compensation		1,401,688
Other non-taxable amounts in foreign jurisdiction		(14,937)
Losses for which no benefit is being recognized		849,640
Future income taxes	$	406,270

The tax effect on major temporary differences that give rise to the future tax liability as at January 31, 2005 are as follows:

Future tax asset:		
Tax losses available for carryfoward	$	849,640
Valuation allowance		(849,640)
Future income taxes	$	-

Future tax liability:		
Difference in the tax bases and carrying values of property, plant and equipment	$	644,376

At January 31, 2005, the Company had Canadian non-capital losses available to be carried forward in the amount of $2.2 million, expiring in 2012. The benefit of these losses has not been recognized due to the uncertainty of realization.

10. Financial instruments:

Caspian's financial instruments included in the consolidated balance sheet are comprised of cash and cash equivalents, accounts receivable, other deposits, accounts payable and loan payable. The fair values of these financial instruments approximate their carrying amounts due to the short-term nature of the instruments, except for the loan payable, for which the estimated fair value at January 31, 2005 is $6,750,000.

11. Foreign exchange risk:

A substantial portion of Caspian's activities are settled in foreign currencies and consequently, the Company is subject to fluctuations in currency translation rates.

12. Segmented information

The Company's activities are conducted in two geographic segments: Canada and Kazakhstan. All activities relate to exploration for and development of petroleum and natural gas.

	Canada ($)	Kazakhstan ($)	Total ($)
Revenues	293,522	1,609,138	1,902,660
Expenses	5,564,501	933,344	6,497,845
Income taxes	-	406,270	406,270
Net income (loss)	(5,270,979)	269,524	5,001,455
Capital expenditures	-	17,314,947	17,314,947

13. Reconciliation to International Financial Reporting Standards

The Company has evaluated and determined there are no significant differences between Canadian generally accepted accounting principles and International Financial Reporting Standards. Accordingly, no differences in the Company's reported financial position at January 31, 2005 or results of operations or cash flows for the period from incorporation on April 13, 2004 to January 31, 2005 have been presented.