

CASPIAN ENERGY INC.

Management's Discussion and Analysis

March 30, 2006 – The following Management's Discussion and Analysis ("MD&A") of financial results is provided by the management of Caspian Energy Inc. ("Caspian" or the "Company") and should be read in conjunction with the audited consolidated financial statements and notes for the period from February 1, 2005 to December 31, 2005 and the audited consolidated financial statements and notes for the period from incorporation on April 13, 2004 to January 31, 2005. This commentary is based upon information available to March 30, 2006.

The intention of this MD&A is for Caspian to explain to its shareholders and the investment community three analyses from management's perspective:

1. Caspian's performance in fiscal 2005;
2. Caspian's current financial condition; and
3. Caspian's future prospects.

This MD&A complements and supplements the disclosures in our audited consolidated financial statements which have been prepared according to Canadian generally accepted accounting principles ("GAAP").

References to "we", "us" and "our" in this MD&A are to the Company and all references to dollars are in Canadian dollars, unless otherwise indicated. Additional information relating to the Company, including its annual information form, is available on SEDAR at www.sedar.com.

FORWARD-LOOKING STATEMENTS & OTHER INFORMATION

Certain statements contained in this MD&A constitute forward-looking statements. Forward-looking statements are included under "Business Prospects and Outlook" and elsewhere in this MD&A. These statements relate to future events or the Company's future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar words suggesting future outcomes or statements regarding an outlook. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to: the performance characteristics of the Company's oil and natural gas properties; drilling plans and the timing and location thereof; plans for the exploration and development of the North Block; plans for seismic acquisition and surveys; production capacity and levels, and the timing of achieving such capacity and levels; the level of expenditures for compliance with environmental regulations; the size of oil and natural gas reserves; projections of market prices and costs; supply and demand for oil and natural gas; expectations regarding the ability to raise capital and to continually add to reserves through acquisitions and development; and capital expenditure programs.

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such

forward-looking statements. The Company believes the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and readers are cautioned not to place undue reliance on forward-looking statements contained in this MD&A. Some of the risks and other factors which could cause results to differ materially from those expressed in the forward-looking statements contained in this MD&A include, but are not limited to: volatility of oil and natural gas prices; liabilities inherent in oil and natural gas operations; uncertainties associated with estimating oil and natural gas reserves; competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel; geological, technical, drilling and processing problems; fluctuations in currency and interest rates; product supply and demand; risks inherent in the Company's foreign operations; changes in environmental and other regulations or the interpretation of such regulations; political and economic conditions in the Republic of Kazakhstan; and the other factors discussed in this MD&A.

Statements relating to “reserves” are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described can be profitably produced in the future. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward-looking statements contained in this MD&A are made as of the date hereof and the Company undertakes no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except in accordance with applicable securities laws. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

Finally, in the presentation of the MD&A, Caspian uses two terms that are universally applied in analyzing corporate performance within the oil and gas industry but which regulators require that we provide disclaimers.

Barrel of Oil Equivalent (BOE) – The oil and gas industry commonly expresses production volumes and reserves on a “barrel of oil equivalent” basis (“BOE”) whereby natural gas volumes are converted at the ratio of six thousand cubic feet to one barrel of oil. The intention is to sum oil and natural gas measurement units into one basis for improved analysis of results and comparisons with other industry participants. Throughout this MD&A, Caspian has used the 6:1 BOE measure which is the approximate energy equivalency of the two commodities at the burner tip. BOE does not represent a value equivalency at the plant gate, which is where Caspian sells its production volumes, and therefore may be a misleading measure if used in isolation.

Cash Flow from Operations (cash flow) – This measure is considered critical within the oil and gas industry both in terms of measuring success in our historical operations and being an indicator of funding sources for on-going efforts to replace production volumes and increase reserve volumes. Canadian GAAP requires that “cash flow from operating activities” be the measurement focus. This latter term is derived from “cash flow” as defined by Caspian adjusted for the change in non-cash working capital. Caspian believes “cash flow” and “cash flow per share” to be more meaningful measures of our performance and therefore have used these terms throughout this MD&A. Accordingly, we are required to advise the reader that: (a) these are non-GAAP measure for purposes of Canadian accounting standards and (b) our determinations may not be comparable to those reported by other companies.

BUSINESS OF THE COMPANY

Caspian has a 50% interest in Aral Petroleum Capital LLP (“Aral”), which is held by Caspian Energy Ltd. (“Caspian Ltd.”), the Company’s wholly-owned subsidiary, through which it has the right to explore and develop certain oil and gas properties in the Republic of Kazakhstan (“ROK”) known as the North Block, a 3,458 square kilometre area located in the vicinity of the Kazakh pre-Caspian basin. The Company’s strategy is to focus on the operations of Aral and the significant opportunity it presents in the North Block.

Aral’s exploration and development rights in the North Block were granted pursuant to an exploration contract dated December 29, 2002 between Aral and the Ministry of Energy and Mineral Resources of the ROK (the “Exploration Contract”). Under the terms of the Exploration Contract, Aral agreed to spend at least US\$20.8 million under a minimum work program in respect of the North Block, during the initial three-year term of the contract. Eligible expenditures include such things as 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. As discussed below, funds raised by the Company are used to discharge the obligations of Aral relating to the minimum work program. As at December 31, 2005, Aral’s financial obligation under the minimum work program had been discharged in full. The initial term of the Exploration Contract has been extended for a two-year period through to December 2007, and may be extended for an additional two-year period, subject to the terms of the exploration contract. The work program extension to December 2007 includes drilling three wells to a combined total of 8,500 metres with a monetary obligation of US\$20.6 million.

Under the terms of a shareholders’ agreement dated June 25, 2004 among Caspian Ltd., Azden and Aral, Caspian is obligated to fund Aral’s initial work program. Further, under the terms of the shareholders’ agreement, Caspian is committed to use all reasonable commercial efforts to raise financing of US\$84.0 million (to be loaned to Aral) to fund the first stage of Aral’s exploration program under the Exploration Contract. Funds are transferred to Aral via monthly instalments. To date, Caspian has forwarded approximately US\$46.0 million to Aral.

Terms of the Exploration Contract include a 3% royalty during the pilot phase, a 10% fee, based upon sales, after VAT (value-added tax), a 30% corporate income tax and the liability for an excess profits tax based upon a sliding scale.

Caspian accesses western capital markets and utilizes western technology to explore and exploit its Kazakh assets. The proceeds from its financing activities are used to fund the exploration program and support pilot production in the North Block. The operational strategy of the Company is as follows:

- To prove-up the maximum amount of reserves with the minimum number of wells
- To utilize 3-D seismic and international standards and evaluation technology

- To focus initially on the Zhagabulak area in the North Block, where the pilot production exists, then move to the Baktygaryn area and, subsequently, other areas within the North Block
- To position the Company to maximize value to the investor through sale of the North Block
- To be aware of competitive efforts and resultant opportunities that may manifest themselves in the form of reserves/production acquisitions

On November 30, 2005, Caspian announced that it will be changing its fiscal year end date from January 31 to December 31 commencing with the year starting February 1, 2005. The December 31, 2005 reporting period is comprised of 11 months, February 2005 to December 2005, inclusive. In the new financial year, Caspian's interim financial statements will be filed for the periods ending March 31, 2006; June 30, 2006 and September 30, 2006, with annual financial statements for the new financial year to be filed for the period ending December 31, 2006.

The Company's common shares trade on the Alternative Investment Market (AIM) of the London Stock Exchange and the Toronto Stock Exchange under the symbol CEK.

East Zhagabulak (EZ)

The East Zhagabulak Area is located in the southeastern corner of the North Block. The Government of Kazakhstan has estimated that this Area contains 622 million barrels of oil in place with 187 million barrels classified as recoverable. These Kazakh estimates were based upon the results of Soviet era 2-D seismic data and stratigraphic test wells. Caspian neither accepts nor denies these estimates, but expects to validate this data through its exploration program. The Company presently considers the East Zhagabulak Area its primary target due to the coverage density of the Soviet age 2-D seismic survey and the existence of significant, neighbouring oil producing fields, as well as the presence of the Company-operated producing well EZ#213, in the northern part of the East Zhagabulak field.

To date, the initial 3-D seismic program covering 406 square kilometres has been completed, processed and interpreted, indicating significant structures. Processing through Pre-Stack Time Migration (PSTM) of the Zhagabulak 3-D seismic data set was completed at the end of August 2005. The processing was performed by PGD-Dank (a division of Paradigm Geophysical) in Almaty, ROK. Following processing, the data set was transferred to Halliburton's Landmark Geophysical office in Moscow, Russia for interpretation. Processing through Pre-Stack Depth Migration (PSDM) was completed in December 2005 and transferred to Landmark for interpretation. The presence of a broad, extensive structure separating Zhagabulak from neighboring producing fields has been noted and several potential drilling locations have been identified. The location for the first well on the block, EZ#301, 1.1 km southwest of well EZ#213, was chosen from an earlier fast-track interpretation of the 3D seismic data set. A contract with Nabors Drilling International was concluded in April 2005 and the well spud on July 16, 2005. The well reached a total depth of 4,846 metres on November 7, 2005, logs were run, production casing was set and testing began in mid-December. Acid treatment of the perforated intervals was scheduled for early February 2006. A second well location, EZ#302 was

selected approximately 3.6 km southwest of EZ#301 and based on seismic data is structurally updip to that well. EZ#302 spud on December 25, 2005.

Baktygaryn

The Baktygaryn Area is located in the northwestern corner of the North Block. The Government of Kazakhstan has estimated that this Area contains 863 million barrels of oil in place with 259 million barrels classified as recoverable. These Kazakh estimates were based upon the results of Soviet era 2-D seismic data and stratigraphic test wells. Caspian neither accepts nor denies these estimates, but expects to validate this data through its exploration program.

The tender for the acquisition of 235 square kilometres of 3-D seismic was released and responses were received. In September 2005, Azimut Energy Services began work in the Baktygaryn Area. The acquisition program was completed during November 2005 and the data transferred to PGS-GIS in Almaty for processing. The Baktygaryn Area is anticipated to contain drilling targets in both the below salt Lower Permian and Carboniferous sections and the above salt Upper Permian and Mesozoic sections and will provide a second tier of exploration to the Company's drilling portfolio.

Other Areas Within The North Block

Following are some of the other exploration areas within the North Block and their reserve estimates as put forth by the Government of Kazakhstan. Again, Caspian neither accepts nor denies these estimates, but expects to validate this data through its exploration program: Kozdysay – 567 million barrels oil in place and 170 million barrels recoverable, Tashir – 126 million and 38 million, respectively, Bulash – 116 million and 35 million, respectively, and Shegelshy – 90 million and 31 million, respectively. The grand totals estimated by the Kazakh Government for these prospects in the North Block are 899 million barrels oil in place and 274 million barrels oil recoverable.

Beginning in the fourth quarter of calendar 2004, the Company undertook to reprocess and interpret approximately 3,000 kilometres of Soviet age 2-D seismic data in other areas of the original concession. Although the reprocessing effort continues at the time of this report, from this effort the Company identified the Baktygaryn Area for acquiring additional 3-D seismic.

During March 2005, Aral was awarded the exploration rights over an additional 1,110 square kilometre area adjacent to the north and west portions of the North Block. This new territory contains additional seismic and well data and efforts to identify that data for incorporation into the electronic database have begun. Evaluation of the North Block extension, the preliminary identification of potential drilling areas and plans on how to explore are in process.

Digitization and calibration of the existing Soviet age well log data across the entire North Block territory for those wells penetrating into the formations below the Permian salt complex has been completed and petrophysical analysis of these wells will commenced during December 2005.

<i>Annual Analysis</i>		
<i>Period</i>	<i>Feb. 1, 2005 – Dec. 31, 2005</i>	<i>Apr. 13, 2004 – Jan. 31, 2005</i>
Production volumes		
Oil (bbls/day)	329	400
Average selling price		
Oil-US\$/bbl	20.86	15.45
Revenues (\$000s)	3,674	1,903
Cash flow (\$000s)	(1,506)	(825)
Per share – basic	(0.02)	(0.01)
Per share – diluted	(0.02)	(0.01)
Net income (\$000s)	(8,408)	(5,001)
Per share – basic & diluted	(0.10)	(0.10)
Capital expenditures (\$000s)	27,868	18,681
Total assets (\$000s)	80,377	84,090
Total indebtedness (\$000s)	-	-

Summary of Selected Quarterly Financial Results \$

<i>Period</i>	<i>2Q-04</i>	<i>3Q-04</i>	<i>4Q-04</i>	<i>1Q-05</i>	<i>2Q-05</i>	<i>3Q-05</i>	<i>4Q-05</i>
Oil and gas revenues	250,740	640,781	726,990	594,652	575,965	843,847	644,523
Operating expenses	72,667	185,706	355,327	345,736	419,062	345,392	316,511
Operating income	178,073	455,075	371,663	248,916	156,903	498,455	328,012
Interest and other income	1,120	42,782	240,247	443,771	260,615	231,438	79,250

<i>Period</i>	<i>2Q-04</i>	<i>3Q-04</i>	<i>4Q-04</i>	<i>1Q-05</i>	<i>2Q-05</i>	<i>3Q-05</i>	<i>4Q-05</i>
General & administrative	446,193	705,818	571,403	709,438	795,785	565,679	656,711
Realized Foreign exchange	-	-	-	-	-	-	1,025,305
Cash flow	(657,047)	(207,961)	40,507	(16,751)	(378,267)	164,214	(1,274,754)
Depletion, depreciation & accretion	8,626	22,046	52,934	35,826	38,067	37,173	82,139
Stock-based compensation	-	3,157,292	472,144	424,078	2,492,362	673,354	448,903
Unrealized Foreign exchange	-	1,185,222	(1,127,580)	542,351	2,704,843	1,071,839	(1,055,812)
Future income taxes	-	-	406,270	(1,713)	203,732	240,114	(1,034,880)
Net income	(275,626)	(4,572,521)	236,739	(1,017,293)	(5,817,271)	(1,858,266)	284,896
Net income per share basic and diluted	(0.01)	(0.08)	0.00	(0.01)	(0.07)	(0.02)	0.00

During the fourth quarter of calendar 2005 (a two month period as opposed to the normal three month quarter, resulting from the change in fiscal year ends adopted, effective this fiscal period), Caspian fully realized the increase to the sales price of oil it marketed and sold in the ROK, which had been negotiated during the prior quarter. Interest income continues to decrease as the capital program is executed, due to a diminishing magnitude of cash available to invest in term deposits. General and administrative expenses, during this last period of the fiscal year, include accruals for audit, tax, reservoir engineering and annual reporting expenses, not present in previous quarters. Depletion, depreciation and accretion expense has increased due to the inclusion of capital expenditures pertinent to well EZ#301 in the depletable base. The Canadian dollar continues to appreciate versus the British Pound Sterling and the US dollar, resulting in foreign exchange losses. Future income taxes have been recovered due to a review of the tax environment in the ROK.

CONTRACTUAL OBLIGATIONS

In accordance with the shareholders' agreement in respect of Aral, Caspian was obligated to fund the initial work program of Aral pursuant to the Exploration Contract.

The minimum work program was US\$20.8 million and matured at the end of calendar 2005. As at December 31, 2005, this financial obligation was fully discharged. The work program was extended to December 2007 and includes drilling three wells to a combined total of 8,500 metres with a monetary obligation of US\$20.6 million. No additional seismic is required. The Company's calendar 2006 minimum work program with the ROK has been approved for US\$12.2 million.

<i>Year</i>	<i>USD (millions)</i>
2006	12.2
2007	8.4
Total contractual obligations	20.6

CASH PROVIDED BY (USED IN) OPERATIONS AND LOSS FOR THE PERIOD

Cash Provided by (used in) Operations

Caspian's operations used \$1,505,558 in net cash for the eleven months ended December 31, 2005 as compared to a net use of \$824,501 for period from April 13, 2004 to January 31, 2005. The Company was incorporated on April 13, 2004.

	Feb. 1, 05 - Dec. 31, 05	Apr. 13, 04 – Jan. 31,05
Cash used in operations:	\$ (1,505,558)	\$ (824,501)
Basic	\$ (0.02)	\$ (0.01)
Diluted	\$ (0.02)	\$ (0.01)

Net Loss

For the eleven months ended December 31, 2005, the Company incurred a net loss of \$8,692,830 (as compared to a net loss of \$8,407,934 for the period from April 13, 2004 to January 31, 2005). Stock-based compensation charges for the eleven months ended December 31, 2005, a non-cash item equal to \$4,038,697, and unrealized foreign exchange losses of \$4,253,350 are major components of the loss, the remaining components being primarily lease operating costs and general and administrative expenses.

	Feb. 1, 05 – Dec. 31, 05	Apr. 13, 04 – Jan. 31,05
Net loss:	\$8,407,934	\$5,001,455
Basic	\$0.10	\$0.09
Diluted	\$0.10	\$0.09

Sales Volumes

Previous to the production month of September 2005, crude oil production was purchased at the wellhead by two different buyers and sold to Kazakh domestic markets. During August 2005, the contract for crude oil was renegotiated to a price superior to US\$30.00 per barrel, from US\$18.17 per barrel at the wellhead. Presently, our oil is shipped by rail to Kaliningrad, due to its inability to meet pipeline specifications, a consequence of the lack of facilities that can desalt our feedstock and remove the mercaptans. The Company produced and sold an average 325 Bopd at a price of \$23.99 (net of ROK takes) per barrel during the eleven month period ended December 31, 2005 and 438 Bopd at \$19.42 from April 13, 2004 to January 31, 2005. During the two month period ended December 31, 2005, the Company produced and sold an average 307 Bopd at a price of \$33.63 per barrel.

Under the Exploration Contract, Aral is required to pay royalties at a rate of 3% of the volume of hydrocarbons produced and sold based upon the average selling price (less transportation expenses) of the production. Aral is also obligated to allocate 10% of produced hydrocarbons to the ROK. The government is paid in cash (rather than in kind) after the production has been sold.

Net gas sales from Caspian's Canadian non-operated production totaled \$57,687 (\$50.52 per Boe) and contributed an average 4.1 Boepd during the eleven month period ended December 31, 2005. The production rate was 4.6 Boepd and net gas sales were \$22,744 for the previous fiscal period.

Revenues

For the eleven month period ended December 31, 2005, revenues before transportation costs were \$2,658,987, as compared to revenues before transportation costs of \$1,618,511 for the period ended January 31, 2005.

Interest of \$1,010,872 (previous year's period - \$238,385) was earned during the period on short-term investment of the Company's cash reserves. Caspian holds the majority of its cash in British Pounds Sterling, which command a higher interest rate than either Canadian or US dollars.

Operating Expenses

For the eleven month period ended December 31, 2005, operating costs were \$1,415,595 (\$545,099 for the period ended January 31, 2005) and transportation costs were \$11,106 (\$68,601 for the period ended January 31, 2005). Operating costs aggregated \$12.88 per barrel for the eleven month period ended December 31, 2005 (\$6.76 for the period ended January 31, 2005) and transportation costs were \$0.10 per barrel (\$0.85 for the period ended January 31, 2005). During this fiscal period, production from EZ#213 declined requiring remedial workover activities which have caused the per unit expense to increase. Also, initiated during this fiscal period was the sale of product at our lease line as opposed to a small trucking distance previously.

Operating Netbacks

Operating netback for the eleven month period ended December 31, 2005 was \$1,232,286.

	Total (\$)	Per Boe (\$)
Sales	2,658,987	24.31
Operating costs	1,415,595	12.88
Transportation	11,106	0.10
Netback	1,232,286	11.32

Operating netback for the period ended January 31, 2005 was \$1,004,811.

	Total (\$)	Per Boe (\$)
Sales	1,618,511	20.07
Operating costs	545,099	6.76
Transportation	68,601	0.85
Netback	1,004,811	12.46

General and Administrative Expenses

	Feb. 1, 05 – Dec. 31, 05	Apr. 13, 04 – Jan. 31, 05
Office expenses	\$112,082	\$91,771
Travel and entertainment	420,392	187,765
Salaries/benefits	919,595	584,657
Professional fees	423,381	901,548
Contract fees	18,908	-
Public listing	341,106	57,298
Aral	405,899	290,422
Insurance	86,250	-
Total expense	\$2,727,613	\$2,113,461

Significant travel expenses are incurred as the operations of the Company are centered in the ROK, a Calgary, Alberta office is maintained for financial reporting and investor relations, the CEO is resident in the UK, the COO is an American citizen and financing activities span North America, the British Isles and Europe. Salaries and benefits relate to the remuneration packages of the Chief Executive Officer, Chief Operating Officer and the Chief Financial Officer, while professional fees are legal, audit, taxation and engineering services. Contract fees of \$18,908

relate to the Company's interest in Aral. Administrative expenses of \$405,899 for the eleven months ending December 31, 2005 and \$290,422 for the period ending January 31, 2005 relating to Aral operations have been included upon consolidation. The insurance charge relates to Directors' and Officers' Liability coverage.

CAPITAL EXPENDITURES

Capital expenditures of \$27.9 million were incurred for the eleven month period ended December 31, 2005 (\$18.7 million for the period ended January 31, 2005). Capital expenditures are composed of advances to Aral and the expenditure of funds by Aral.

DEPLETION, DEPRECIATION AND ACCRETION

Depletion, depreciation and accretion expense was \$193,205 (\$1.76 per Boe) for the eleven month period ended December 31, 2005 and \$83,606 (\$1.04 per Boe) for the period ended January 31, 2005. The per Boe charges are relatively low due to the level of costs subject to depletion, as the majority of the Company's property, plant and equipment is in the development stage.

LIQUIDITY AND CAPITAL RESOURCES

The Company operates within several parameters affecting its liquidity and capital resources:

- Its business is capital intensive, requiring cash infusions on a regular basis as it seeks to grow its business.
- Its inventory of product for sale – its reserves – needs to be constantly replenished and augmented.
- It is a price taker when selling its inventory of oil and natural gas reserves.

Given these constraints, Caspian finances its operations through equity sources and cash flows.

Caspian's working capital at December 31, 2005 was \$1.8 million.

Dramatic growth, enhanced by the acquisition of 50% of the shares of Aral is projected for the future of Caspian. Aral has operated in Kazakhstan since December 2002 and has assembled a team of both Kazakh and international executives who have extensive experience in the Kazakh operating and regulatory environment. See "Business of the Company".

The Company expects to be able to fund its capital expenditure program to the end of 2006 using cash flow from operations, working capital and, to the extent required or desirable, through funds raised in the capital markets.

On March 1, 2006, Caspian announced the closing of a private placement of U.S. \$16 million principal amount, 10% interest rate, convertible debentures which mature on March 2, 2011.

On March 3, 2006, Caspian announced that it had entered into an underwritten private placement to issue between 13,726,000 and 19,609,000 common shares at a price of \$2.55 per share. Closing is expected during April 2006.

OUTSTANDING SHARE DATA

At March 30, 2006, the number of common shares of the Company outstanding and the number of common shares issuable pursuant to other securities of the Company outstanding are as follows:

<u>Common Shares</u>	<u>Number</u>
Outstanding	84,327,163
Issuable under options	9,166,499
Issuable under warrants	1,368,000
Issuable pursuant to convertible debentures	7,510,204
Issuable pursuant to debentures interest	3,757,405

BUSINESS PROSPECTS AND OUTLOOK

The Company has been successful in establishing itself as an operating entity in the ROK and expects to continue with future growth through continued work there.

Prior to the end of the fourth quarter, EZ#301 was drilled to a total depth of 4,846 meters and logged. The well was completed with the drilling rig before the rig was moved to the EZ#302 location. EZ#301 was acid-washed and the two potentially productive hydrocarbon bearing zones were flow-tested. The lower zone (KT-2) was tested at 2,532 bopd. The upper zone (KT-1) had difficulty maintaining an independent flow, so it was commingled with the lower zone and the well was tied-in to the Zhagabulak production facility. The KT-1 interval is a candidate for further stimulation to enhance its productive capacity. The second exploration effort, EZ#302, was spud on December 25, 2005. Comparison of petrophysical analyses of Company-owned wells has suggested that bypassed pay may exist in wells EZ#211 and EZ#213, which were drilled during the Soviet period. Most KT-2 wells in the area have never been acidized, which includes EZ#213. The Company plans to workover EZ#213 in 2006, which may include additional perforations and acid stimulation work to increase flow rates. EZ#211 is being investigated as a potential re-entry candidate to evaluate both KT-1 and KT-2 potential. Subsequent to the completion of drilling at EZ#302, the drilling rig will move to the third exploration effort, EZ#303, located 5.2 km. southwest of EZ#302, which is expected to spud during April 2006.

Landmark's interpretation of the PSTM seismic data set at Zhagabulak was completed in early November 2005 and efforts are continuing on completing the interpretation of the PSDM data set. Internal interpretation is also ongoing. Logging, coring and well test data from EZ#301 are being incorporated into the understanding of the targeted Carboniferous reservoirs both

internally and through the development of geological and seismic facies modeling being created by RES - Kazakhstan Reservoir Evaluation Services, Almaty and Oslo, Norway.

Ongoing petrophysical analyses of all wells penetrating the below salt reservoirs is partially completed and correlations of these wells will aid in the identification of future drilling locations in the North Block. Identification and acquisition of well data within the extended territory will also be evaluated for inclusion into this process.

Reprocessing of the existing Soviet 2-D seismic data is expected to be completed in the first quarter 2006 and the interpretation of that data will be added to the evaluation of the North Block and aid in the identification of future seismic acquisition areas and drilling locations.

The Baktygaryn 3-D seismic program was completed in early November 2005. PGS-GIS, in Almaty, ROK was awarded the processing contract. Due to the presence of large salt bodies in the Baktygaryn Area, the 3-D data set will be processed through PSDM. Completion of processing and interpretation of this data will take place through May 2006.

Beginning in late February 2006, the Company began the acquisition of a regional, strategically-placed, 366 km 2D seismic program covering a widespread area of the North Block. The knowledge gained from this 2D acquisition program will add to the effort of identifying a third 3D seismic acquisition area currently scheduled to begin in the second half of 2006, depending on equipment availability and other ongoing activities. Drilling locations from the 3D data are expected to be identified in late 2006 to early 2007.

ADDITIONAL DISCLOSURES

Critical Accounting Estimates

In the preparation of the financial statements, it was necessary for Caspian to make certain estimates that were critical to determining our assets, liabilities and net income. None of these estimates affect the determination of cash flow but do have a significant impact in the determination of net income. The most critical of these estimates is the reserves estimations and the resulting effect on various income statement and balance sheet measures.

Caspian engaged an independent engineering firm to evaluate 100% of our oil and natural gas reserves and prepare a report thereon. Their report was utilized in: a) the calculations of depletion and depreciation expense, b) the application of the ceiling test, and c) the calculation of asset retirement obligations. The estimation of the reserve volumes and future net revenues set out in the report is complex and subject to uncertainties and interpretations. Judgments are based upon engineering data, projected future rates of production, forecasts of commodity prices, and the timing of future expenditures. Inevitably the estimates of reserve volumes and future net revenues will vary over time as new data becomes available and estimates of future net revenues do not represent fair market value. The impact of such revisions in fiscal 2006 was not significant.

The significant accounting policies used by the Company are disclosed in the notes to the Company's interim consolidated financial statements. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and

assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The following discussion outlines such accounting policies and is included in this MD&A to aid the reader in assessing the critical accounting policies and practices of the Company and the likelihood of materially different results being reported. The Company's management reviews its estimates regularly.

The following significant accounting policies outline the major policies involving critical estimates.

Proved Oil and Gas Reserves

Proved reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated proved reserves. The estimated quantities of proved crude oil, natural gas liquids and natural gas are derived from geological and engineering data that demonstrate with reasonable certainty the amounts that can be recovered in future years from known reservoirs under existing economic and operating conditions. Reserves are considered proved if they can be produced economically as demonstrated by either actual production or conclusive formation tests. The oil and gas reserve estimates are made using all available geological and reservoir data as well as historical production data. Estimates are reviewed and revised as appropriate. Revisions occur as a result of changes in prices, costs, fiscal regimes, reservoir performance or a change in the Company's plans.

Depletion Expense

The Company uses the full cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development are capitalized whether successful or not. The aggregate of net capitalized costs and estimated future development costs less estimated salvage values is amortized using the unit-of-production method based upon proved oil and gas reserves. An increase in estimated proved oil and gas reserves would result in a corresponding reduction in depletion expense. A decrease in estimated future development costs would result in a corresponding reduction in depletion expense.

Withheld Costs

Certain costs related to unproved properties may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly and any impairment is transferred to the costs being depleted.

Impairment of Long Lived Assets

The Company is required to review the carrying value of all property, plant and equipment, including the carrying value of oil and gas assets, for potential impairment.

The carrying value of the Company's petroleum and natural gas properties must not exceed their fair value. The fair value is equal to the estimated future cash flows from proved and probable reserves using future price forecasts and costs discounted at a risk-free rate. If impairment is

indicated, the amount by which the carrying value exceeds the estimated fair value of the long lived asset is charged to income.

Asset Retirement Obligations

Asset retirement obligations are initially measured at fair value when they are incurred, which is the discounted future value of the estimated liability. This requires an estimate to be made of the future costs of retiring the asset at the point in time the asset is acquired.

Changes in Accounting Policies

There were no changes in accounting policies calendar 2005.

Credit Risk Management

We are exposed to credit risk on our commodity contracts due to the potential for non-performance by the counter parties. We mitigate this risk by only dealing with well established marketing companies.

Fair Value Measurement

The carrying values of cash, cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair values due to their short term to maturity.

Related Party Transactions

For the eleven months ending December 31, 2005, Caspian paid \$27,000 of administrative fees to a venture capital firm in which one of Caspian's directors is a principal. At January 31, 2005 accounts payable and accrued liabilities included \$27,000 due to this related party.

Critical Accounting Disclosure

As at the financial year ended December 31, 2005, an evaluation was carried out under the supervision of and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective as at December 31, 2005 to provide reasonable assurance that material information relating to the Company would be made known to them by others within those entities.