

31st March 2006

CASPIAN ENERGY INC.

**Caspian Energy Inc. announces final results
for eleven months ended 31 December 2005**

Caspian Energy Inc. (the “Company” or “CEK”) (TSX and AIM: CEK) an oil and gas exploration and development corporation operating in the Republic of Kazakhstan, announced today its financial results for the eleven months ending December 31, 2005. The Company has also filed its statement of reserves data and related reports in accordance with National Instrument 51-101 – Standards of Disclosure for Oil and Gas Activities of the Canadian securities regulatory authorities. The statement and related reports are included in the Company’s annual information form which was filed today with the applicable Canadian securities regulatory authorities and is available for viewing at www.sedar.com, along with the Company’s audited financial statements and related management’s discussion and analysis for its 2005 fiscal year.

Caspian’s first exploration well, EZ #301 has been tested at rate of 2632 barrels of oil per day (b/d) of 39o API gravity oil. Its second well, EZ #302 has reached total depth of 5012 meters and is currently running logs. . It has selected the location for its third well, EZ #303 which will be about 5.2 km. southwest of EZ #302 and drilling is expected to commence in Q2 2006.

Since the period end, Caspian has also completed two rounds of fundraising. It raised US\$16m through the issue of convertible loan stocks and CAD\$35m through the Placing of 13,726,000 shares. Caspian intends to use the proceeds of this financing to drill two wells on the Baktygaryn Block, to repay Aral Petroleum Capital for Caspian’s share of the bonus previously paid to Aral Capital and for general corporate purposes.

For the eleven months ending December 31, 2005, CEK’s net loss was \$8,407,934 and for the period from incorporation on April 13, 2004 to January 31, 2005, CEK’s net loss was \$5,001,455. Large non-cash items equal to \$4,038,697 (prior period - \$3,629,436) relating to stock-based compensation charges and \$3,263,221 (prior period - \$57,642) pertaining to unrealized foreign exchange losses contributed to this loss. For the current fiscal period the loss included a recovery of Kazakh future income taxes of \$592,747 while in the prior fiscal period the Company reflected a charge of \$406,270.

CEK’s operations used \$1,505,558 in cash during the eleven month period and \$824,501 for the period from incorporation on April 13, 2004 to January 31, 2005. Realized foreign exchange losses of \$1,025,305 in the current period (prior period – nil) are included in this figure.

Oil revenues before transportation costs for the eleven month period were \$2,658,987 and for the period from incorporation on April 13, 2004 to January 31, 2005 were \$1,618,511.

For the period ended December 31, 2005 operating costs were \$1,415,595 and for the period from incorporation on April 13, 2004 to January 31, 2005, operating costs were \$545,099 and

transportation expenses were \$11,106 and \$68,601, respectively. Administrative expenses for the same periods were \$2,727,613 and \$2,113,461, respectively.

Capital expenditures were \$27,867,530 for the eleven months ending December 31, 2005 and \$18,681,043, for the period from incorporation on April 13, 2004 to January 31, 2005. Capital expenditures are composed of advances to Aral and the Company's share of the expenditure of funds by Aral.

CEK today filed on SEDAR financial statements and MD&A with respect to its December 31, 2005 fiscal year-end.

Caspian 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.

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CAUTIONARY NOTE

Some of the statements and information contained in this news release may include certain estimates, assumptions and other forward-looking information. The actual performance, developments and/or results of the Company may differ materially from any or all of the forward-looking statements, which include current expectations, estimates and projections, in all or in part attributable to general economic conditions, and other risks, uncertainties and circumstances partly or totally outside the control of the Company, including oil prices, imprecision of reserve estimates, drilling risks, future production of gas and oil, rates of inflation, changes in future costs and expenses related to the activities involving the exploration, development, production and transportation of oil, hedging, financing availability and other risks related to financial activities, and environmental and geopolitical risks. Further information which may cause results to differ materially from those projected in the forward-looking statements is contained in the Company's filings with Canadian securities regulatory authorities. The Company disclaims any intention or obligation to update or revise forward-looking

information, whether as a result of new information, future events or otherwise, except in accordance with applicable securities laws.

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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.

Consolidated Balance Sheet

As at December 31, 2005

	December 31, 2005	January 31, 2005
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	10,094,086	43,066,470
Accounts receivable	505,815	181,387
Prepays and other deposits	420,879	107,416
Inventory (note 4)	887,617	36,795
Other assets	-	11,731
	<hr/>	<hr/>
	11,908,397	43,403,799
Restricted cash (note 2)	136,884	47,514
Property, plant and equipment (note 5)	<hr/>	<hr/>
	68,331,221	40,638,537
	<hr/>	<hr/>
	80,376,502	84,089,850
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	3,216,450	1,366,096
Loan payable (note 11)	<hr/>	<hr/>
	6,872,279	7,336,841
	<hr/>	<hr/>
	10,088,729	8,702,937
Asset retirement obligation (note 6)	88,900	70,540
Future income taxes (note 7)	<hr/>	<hr/>
	51,629	644,376
	<hr/>	<hr/>
	10,229,258	9,417,853
Shareholders' Equity		
Share capital (note 8)	75,220,762	75,376,278
Warrants to purchase common shares (note 8)	667,738	667,738
Contributed surplus (note 10)	7,668,133	3,629,436
Deficit	<hr/>	<hr/>
	(13,409,389)	(5,001,455)
	<hr/>	<hr/>
	70,147,244	74,671,997
	<hr/>	<hr/>
	80,376,502	84,089,850

See accompanying notes to these consolidated financial statements.

Consolidated Statement of Loss and Deficit

	Eleven months \$	Period from Ap 2004 to January 31, 2 \$
Revenue		
Oil and gas revenue, net	2,658,987	1,618,511
Interest	1,010,872	238,385
Other	4,202	45,764
	<u>3,674,061</u>	<u>1,902,660</u>
Expenses		
General and administrative	2,727,613	2,113,461
Operating	1,415,595	545,099
Transportation	11,106	68,601
Stock-based compensation (note 9)	4,038,697	3,629,436
Foreign exchange loss	4,288,526	57,642
Depletion, depreciation and accretion	193,205	83,606
	<u>12,674,742</u>	<u>6,497,845</u>
Loss before income taxes	(9,000,681)	(4,595,185)
Future income taxes (recovery) (note 7)	<u>(592,747)</u>	<u>406,270</u>
Net loss for the period	(8,407,934)	(5,001,455)
Deficit – Beginning of period	<u>(5,001,455)</u>	<u>-</u>
Deficit – End of period	<u>(13,409,389)</u>	<u>(5,001,455)</u>
Basic and diluted loss per share (note 8)	<u>(0.10)</u>	<u>(0.09)</u>

See accompanying notes to these consolidated financial statements.

Consolidated Statement of Cash Flows

For the eleven month period ended December 31, 2005

	Eleven months \$	Period from Ap 2004 to January 31, 2 \$
Cash provided by (used in)		
Operating activities		
Net loss for the period	(8,407,934)	(5,001,455)
Items not affecting cash		
Stock-based compensation	4,038,697	3,629,436
Unrealized foreign exchange loss	3,263,221	57,642
Depletion, depreciation and accretion	193,205	83,606
Future income taxes	(592,747)	406,270
	<hr/>	<hr/>
	(1,505,558)	(824,501)
Changes in non-cash working capital balances	(1,667,579)	(680,110)
	<hr/>	<hr/>
	(3,173,137)	(1,504,611)
Financing activities		
Restricted cash	89,370	-
Loan payable	(464,562)	-
Issuance of common shares	135,300	65,794,363
Share issue expenses	(290,816)	(6,209,585)
	<hr/>	<hr/>
	(530,708)	59,584,778
Investing activities		
Acquisition of property, plant and equipment	(27,867,530)	(18,681,043)
Business acquisition	-	2,301,250
Changes in non-cash working capital balances	(1,401,009)	1,366,096
	<hr/>	<hr/>
	(29,268,539)	(15,013,697)
(Decrease) increase in cash and cash equivalents	(32,972,384)	43,066,470
Cash and cash equivalents – Beginning of period	<hr/>	<hr/>
	43,066,470	-
Cash and cash equivalents – End of period	<hr/>	<hr/>
	10,094,086	43,066,470
Supplementary information		
Interest received	1,114,062	201,811

See accompanying notes to these consolidated financial statements.

Notes to Consolidated Financial Statements

1 Nature of operations

Caspian Energy Inc. (“Caspian” or the “Company”) is engaged in the exploration for and development and production of oil and gas in the Republic of Kazakhstan. Its primary operating activities are carried out through its wholly-owned subsidiary, Caspian Energy Ltd. (“Caspian Ltd.”).

Caspian’s principal assets are a 50% interest in Aral Petroleum Capital LLP (“Aral”), held by Caspian Ltd. Through its interest in Aral, Caspian has the right to explore and develop certain oil and gas properties in Kazakhstan, known as the North Block, a 3,458 square kilometre area located in the vicinity of the Kazakh pre-Caspian basin. The Company also has minor resource interests in Canada.

Aral’s exploration and development rights to the North Block were granted pursuant to the terms of an exploration contract between the government of Kazakhstan and Aral (the “Exploration Contract”). The initial three-year term of the Exploration Contract has been extended for a two-year period (expiring in December 2007) and is subject to a further extension of two years thereafter, in accordance with the terms of the contract.

Under the terms of the Exploration Contract, Aral is obligated 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. 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. As of December 31, 2005, Aral’s financial obligation under the minimum work program has been discharged.

Under terms of a shareholders’ agreement dated June 25, 2004, among Caspian Ltd., Azden Management Limited (“Azden”) and Aral, Caspian is committed to fund Aral’s US\$20.8 million obligation under the initial work program. This financial commitment has been satisfied, in full, by the Company. In addition, Caspian Ltd. has undertaken, on a best efforts basis, to raise financing of US\$84.0 million to fund Aral’s operations pursuant to the Exploration Contract.

Caspian was incorporated on April 13, 2004, accordingly, the comparative figures presented in these financial statements reflect the period from incorporation to January 31, 2005.

On November 30, 2005, Caspian announced a change in 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 will be comprised of 11 months, February 2005 to December 2005, inclusive.

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.

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.

Inventory

Inventory is recorded at the lower of cost calculated using the weighted average method, and net realizable value. Cost comprises direct materials and where applicable direct labour costs and those overheads which have been incurred in bringing the inventories to their present location and condition. Net realizable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Joint ventures

The Company's oil and gas exploration and development activities are conducted mainly in Kazakhstan through its 50% interest in Aral and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

Property, plant and equipment

a) 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.

b) 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 on a ratio of six thousand cubic feet of gas to one barrel of oil. Significant development projects and expenditures on exploration properties are excluded from calculation of depletion prior to assessment of the existence of proved reserves.

Other property, machinery and equipment are recorded at historical cost. Depreciation is calculated on a straight-line basis at the following annual rates:

Buildings	8%
Machinery and equipment	8%
Vehicles	7%
Other fixed assets	10%

c) Ceiling test

The Company follows the Canadian accounting guideline on full cost accounting. In applying the 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.

d) Unproved property

Costs of acquiring and evaluating unproven properties are initially excluded 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.

e) Asset retirement obligation

Caspian records the fair value of asset retirement obligations (“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.

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.

Stock-based compensation

The Company grants options to purchase common shares to employees and directors under its stock option plan. 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.

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.

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 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.

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. The Company applies the treasury stock method for the calculation of diluted net income (loss) per share whereby the effect of the “in the money” instruments such as stock options and warrants affect the calculation. The treasury stock method assumes that the proceeds from the exercise are used to repurchase common shares of the Company at the weighted average market price during the year.

Financial instruments

Fair values

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

Credit risk

Substantially all of the Company’s accounts receivable are due from companies in the oil and gas industry and are subject to the normal industry credit risks. The carrying value of accounts receivable reflects management’s assessment of the associated credit risks.

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 loss.

Restricted cash

Under the terms of the Exploration Contract, Aral has accrued 1% of the capital costs of exploration (the “Liquidation Fund”) in an amount of US \$235,600 and US \$76,600 as of December 31, 2005 and January 31, 2005, respectively (Cdn. \$136,884 and Cdn. \$47,514, respectively) and deposited the cash in a restricted bank account. It is anticipated that the Liquidation Fund will be used to finance the restoration of the License Area upon expiration of the Exploration Contract, unless a production contract is awarded.

3 Acquisition of Caspian Energy Ltd.

On September 21, 2004, Caspian (formerly Northway Explorations Limited) acquired all of the issued and outstanding shares of Caspian Ltd., an Ontario private company, by issuing 39,590,909 common shares. The transaction between Caspian (legal parent) and Caspian Ltd. (legal subsidiary) is accounted for as a reverse-takeover (“RTO”), using the purchase method of accounting. The shareholders of Caspian Ltd. owned the majority of the shares after the acquisition. In addition, the management team of Caspian Ltd. became the management team of Caspian and the Caspian Ltd. directors became Caspian directors. As a result, for accounting purposes, Caspian Ltd. was identified as the acquirer. Application of RTO accounting results in Caspian Ltd. 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, Caspian Ltd.

Application of reverse takeover accounting results in the following:

- a) The Caspian consolidated financial statements are a combination of Caspian Ltd. at its historical cost and Caspian at its fair value.
- b) Shareholders’ equity is presented as a continuation of Caspian Ltd.; however, the capital structure is that of Caspian.
- c) 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 Caspian Ltd. 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	<u>7,271,164</u>
	<u>9,699,090</u>

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

4 Inventory

	December 31, 2005	January 31, 2005
	\$	\$
Drilling materials	752,163	-
Oil inventory	39,651	2,929
Fuel	5,081	5,142
Construction materials	2,126	1,995
Spare parts	1,165	417
Other materials	87,431	26,312
	<u>887,617</u>	<u>36,795</u>

5 Property, plant and equipment

	December 31, 2005	January 31, 2005
	\$	\$
Petroleum and natural gas assets	67,414,481	40,140,444
Other assets	1,186,085	574,232
	<u>68,600,566</u>	<u>40,714,676</u>
Accumulated depletion and depreciation	(269,345)	(76,139)
	<u>68,331,221</u>	<u>40,638,537</u>

Excluded from the depletable base of oil and gas assets at December 31, 2005 are unproved properties of \$35,869,797 (January 31, 2005 – \$15,987,422).

The Company applied the ceiling test to its capitalized assets at December 31, 2005 and determined that there was no impairment of such carrying costs.

The benchmark crude oil selling prices used in the December 31, 2005 ceiling test calculations are as follows:

	WTI Crude oil \$US/bbl	Company average \$US/bbl
2006	57.50	25.50
2007	55.40	24.30
2008	52.50	22.05
2009	49.50	19.73
2010	46.90	17.78

The prices increase at a rate of 2.5% per year after 2010. Adjustments were made to the benchmark prices to reflect varied delivery points and quality differentials in the products delivered.

During the eleven month period ended December 31, 2005, the Company capitalized \$387,660 (January 31, 2005 – \$153,000) of general and administrative expenses related directly to exploration and development activities.

6 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 December 31, 2005 is approximately \$123,933, which will be incurred between 2014 and 2019. A credit-adjusted risk-free rate of 12.2% was used to calculate the fair value of the asset retirement obligations, and an inflation factor of 7.6%.

A reconciliation of the asset retirement obligation is provided below:

	December 31, 2005
	\$
Balance – beginning of period	70,540
Liabilities incurred	22,414
Change in estimates	(18,305)
Accretion	<u>14,251</u>
Balance – end of period	<u>88,900</u>

Under the terms of the Exploration Contract (note 1), the Company is required to create a fund to finance actual future restoration costs, equal to 1% of the capital costs of exploration. At December 31, 2005 and January 31, 2005, \$136,884 and \$47,514 respectively have been placed in a restricted bank account related to the funding requirement.

7 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:

	December 31, 2005	January 31, 2005
	\$	\$
Loss before income taxes	(8,407,934)	(4,595,185)
Expected recovery at statutory tax rate of 37.62% (January 31, 2005 – 38.62%)	(3,163,065)	(1,774,660)
Tax rate difference of foreign jurisdiction	588,555	(55,461)
Non-deductible stock-based compensation	1,519,358	1,401,688
Other non-taxable amounts in foreign jurisdiction	-	(14,937)
Losses for which no benefit is being recognized	1,647,899	849,640
Future income taxes	592,747	406,270

The tax effect on major temporary differences that give rise to the future tax liability are as follows:

	December 31, 2005	January 31, 2005
	\$	\$
Future tax asset		
Tax losses available for carryforward	999,595	209,408
Other	15,040	-
Valuation allowance	-	(209,408)
Net future tax asset	1,014,635	-
Future tax liability		
Difference in the tax bases and carrying values of property, plant and equipment	(1,053,288)	(644,376)
Other	(12,976)	-
Net future tax liability	(1,066,264)	(644,376)
	(51,629)	(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.

8 Share capital

Authorized

Unlimited number of voting common shares, without stated par value

Issued

	Number of shares	Amount \$
Common shares		
Issued on incorporation	1	1
Private placement	23,045,454	13,069,048
Public offerings	27,360,000	51,469,066
On acquisition (ii)	16,545,454	9,430,909
Exercise of warrants/options (iii)	2,068,333	1,256,250
Issued on business combination of Caspian and CEL to former Caspian shareholders (i)	21,012,012	9,699,090
Adjustment on RTO	(5,909,091)	(3,338,500)
Share issue costs (v)	-	(6,209,586)
	<hr/>	<hr/>
Issued and outstanding as at January 31, 2005	84,122,163	75,376,278
Exercise of warrants (iv)	205,000	135,300
Share issue costs (v)	-	(290,816)
	<hr/>	<hr/>
Issued and outstanding as at December 31, 2005	84,327,163	75,220,762

- 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% interest in Aral Petroleum Capital LLP ("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 period end, 1,633,000 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) During the period, 205,000 warrants were exercised. The warrants had an exercise price of \$0.66 per common share.
- v) Share issue costs have not been tax effected.

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 15% of the number of common shares outstanding from time to time. 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 and in accordance with the terms of the Plan.

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

	Number of options	Weighted average option price \$
Balance – April 13, 2004	-	-
Granted	7,173,228	1.72
Balance – January 31, 2005	7,173,228	1.72
Granted	1,993,271	1.69
Balance – December 31, 2005	9,166,499	1.72
Exercisable – December 31, 2005	7,587,628	1.72

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

Range of exercise price	Options outstanding		Options exercisable	
	Options outstanding	Weighted average remaining contractual life in years	Weighted average exercise price	Options exercisable
\$0.75	2,079,090	4.2	\$0.75	1,483,181
\$1.61	843,271	4.7	\$1.61	843,271
\$1.75	1,150,000	4.7	\$1.75	916,667
\$2.00	1,050,000	4.4	\$2.00	525,000
\$2.15	4,044,138	4.2	\$2.15	3,819,509
	<u>9,166,499</u>		<u>\$1.72</u>	<u>7,587,628</u>

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

Range of exercise price	Options outstanding		Options exercisable	
	Options outstanding	Weighted average remaining contractual life in years	Weighted average exercise price	Options exercisable
\$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
	<u>7,173,228</u>		<u>\$1.72</u>	<u>3,924,114</u>

Per share amounts

The weighted average number of common shares outstanding during the period ended December 31, 2005 of 84,327,163 (January 31, 2005 – 54,485,792 shares) was used to calculate loss per share amounts.

In computing diluted loss per share, no shares were added to the weighted average number of common shares outstanding during the period ended December 31, 2005 (January 31, 2005 – nil) as they are anti-dilutive. The fully-diluted number as at December 31, 2005 was 94,861,662 shares (January 31, 2005 – 82,549,509).

Warrants

205,000 share purchase warrants issued September 20, 2004 entitling the holder to purchase one common share at a price of \$0.66 were exercised during the first quarter. No value was ascribed to the warrants at the date of grant. 1,368,000 broker warrants are outstanding at December 31, 2005 and have all vested. 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.

9 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 amortized in the period ended December 31, 2005 was estimated to be \$4,038,697 (period ended January 31, 2005 – \$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	72%
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.

10 Contributed surplus

	December 31, 2005 \$	January 31, 2005 \$
Balance – Beginning of period	3,629,436	-
Stock options issued to employees, officers and directors	4,038,697	3,629,436
	<hr/>	<hr/>
Balance – End of period	7,668,133	3,629,436

The term and vesting conditions of each option may be fixed by the board when the option is granted, but the term cannot exceed 5 years from the date upon which the option is granted.

The options granted to directors, officers and employees may be exercised over five years from the date of granting and expire from time to time to June 2010.

11 Loan payable

Aral is indebted to Azden, which holds the other 50% interest in Aral, in the amount of \$6,872,279 (January 31, 2005 – \$7,336,841). The amount is unsecured and is non-interest bearing and was to be repaid prior to January 1, 2006. Caspian is obligated to fund Aral's operations. During November 2005, Aral agreed to defer the repayment obligation of this loan to April 2006.

12 Commitments

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 obligation was fully discharged. 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. No additional seismic is required. The Company's calendar 2006 minimum work program with the Republic of Kazakhstan has been approved for US \$12.2 million.

	US \$ (millions)
2006	12.2
2007	8.4
	<hr/>
	20.6

13 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. A substantial portion of Caspian's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

14 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.

15 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 \$
Revenue	1,068,559	2,605,502	3,674,061
Expenses	11,344,496	1,330,246	12,674,742
Income taxes	-	(592,747)	(592,747)
Net loss	(10,275,937)	1,868,000	(8,407,934)
Capital expenditures	-	27,867,530	27,867,530
Depletion, depreciation and accretion	4,600	188,605	193,205
Interest revenue	1,010,872	-	1,010,872
Current assets	7,514,141	4,394,256	11,908,397
Restricted cash	-	136,884	136,884
Property, plant and equipment, net	105,841	68,225,380	68,331,221
Total assets	7,619,982	72,756,520	80,376,502
Current liabilities	4,050,296	6,038,433	10,088,729
Total liabilities	4,050,296	6,178,962	10,229,258

16 Subsequent events

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.

17 Comparative figures

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

18 Reconciliation of International Financial Reporting Standards

Accounting practices under Canadian GAAP and International Financial Reporting Standards (“IFRS”) are, as they affect these financial statements, substantially the same except for the following:

Property and equipment

Under Canadian GAAP, an impairment loss should be recognized when the carrying amount of a cost centre is not recoverable and exceeds its fair value. The carrying amount is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. Unproved properties and major development projects are included in this recoverability test. A cost centre impairment loss should be measured as the amount by which the carrying amount of assets capitalized in a cost centre exceeds the sum of:

- the fair value of proved and probable reserves; and
- the costs (less any impairment) of unproved properties that have been subject to a separate test for impairment and contain no probable reserves

IFRS requires (i) an impairment to be recognized when the recoverable amount of an asset (cash generating unit) is less than the carrying amount, rather than when there is a significant or prolonged decline in value below the carrying amount; (ii) the impairment loss to be determined as the excess of the carrying amount above the recoverable amount (the higher of fair value less costs to sell and value in use, calculated as the present value of future cash flows from the asset), rather than the excess of the carrying amount above the undiscounted future cash flows of the asset; and (iii) the reversal of an impairment loss when the recoverable amount changes. IFRS 6, which has been adopted effective January 1, 2005, provides limited guidance on the financial reporting for exploration for, and evaluation of, mining resources. Upon adoption of IFRS 6, continued application of an entity’s existing policy is permitted with modified procedures on impairment tests.

In the absence of specific guidance on the applicability of full cost accounting under IFRS, the Company continues to apply the full cost method for IFRS purposes. A ceiling test based on cash generating units did not reveal the need for an impairment charge.

This difference in accounting policy had no impact on these financial statements.

Impairment of long-lived assets

Under Canadian GAAP, a long-lived asset should be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. An impairment loss should be recognized when the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. Under IFRS, the carrying amounts of the Company's assets, other than oil and gas properties, inventories and deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amounts are estimated. An impairment loss is recognized when the carrying amount of an asset exceeds its recoverable amount. Impairment losses, if any, are recognized in the income statement. This difference in accounting policy has no impact on these financial statements.

Under Canadian GAAP, the carrying amount of a long-lived asset is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. This assessment is based on the carrying amount of the asset at the date it is tested for recoverability, whether it is in use or under development. Under IFRS, the recoverable amount of the Company's assets other than oil and gas properties is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflect current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. This difference in accounting policy has no impact on these financial statements.

In respect of impairment of assets other than oil and gas properties, under Canadian GAAP, an impairment loss is not reversed if the fair value subsequently increases. For IFRS, an impairment loss may be reversed if there has been a change in the estimates used to determine the recoverable value.

An impairment loss, on assets other than oil and gas properties, is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized. This difference in accounting policy has no impact on these financial statements.

Asset retirement obligation

In re-measuring an asset retirement obligation for the passage of time, Canadian GAAP requires re-measurement based on the risk-free rate that existed when the liability was initially measured. IFRS requires the use of current market assessed interest rates in each estimate. This difference did not result in a material reconciling item.

Inventory

Under Canadian GAAP, the Company measures its supplies inventory at the lower of historical cost or net replacement cost. Under IFRS, the lower of cost or net realizable value principle would apply. This difference did not result in a material reconciling item.