TETHYS Petroleum

MANAGEMENT'S DISCUSSION AND ANALYSIS

AND

FINANCIAL STATEMENTS FOR THE YEAR ENDED

DECEMBER 31, 2007

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

Tethys Petroleum Limited ("Tethys" or the "Company") (name changed from Tethys Petroleum Investments Limited in September 2006) was incorporated in Guernsey on August 12, 2003, to hold certain interests of CanArgo Energy Corporation ("CanArgo") in Central Asia. CanArgo is a US public oil and gas company, listed on both the American Stock Exchange in New York and the Oslo Stock Exchange in Norway. In January 2006 CanArgo obtained convertible debt which was ring-fenced for use on Tethys and which could be converted into either CanArgo or Tethys equity effectively establishing Tethys as a separately financed entity within the CanArgo group. Later in 2006 the CanArgo board made a decision to spin-out Tethys as an independent entity and in January 2007 Tethys closed a private placement resulting in proceeds of approximately US$17.4 million. Tethys then sought a listing on the main list of the Toronto Stock Exchange ("TSX") and on June 27, 2007, the Company completed an Initial Public Offering (IPO) raising gross proceeds of US$50,000,000 and the Company's ordinary shares commenced trading on the TSX. In August 2007 CanArgo sold its remaining Tethys shares leaving the Company completely independent.

Tethys, through its wholly-owned Kazakh subsidiaries BN Munai LLP ("BNM") and Kul-Bas LLP ("Kul-Bas") holds the Production Contract for the Kyzyloi gas field, the Exploration Contract for the Akkulka Block and the Exploration and Production Contract for the Kul-Bas Block. In addition, Tethys' wholly-owned subsidiary Tethys Tajikistan Limited has interests in the Kulob area of Tajikistan with rights to negotiate a Production Sharing Agreement ("PSA") for the Kulob Area and an Investment and Operating Agreement giving rights to incremental production on certain oil and gas fields in the Kulob area.

This Management's Discussion and Analysis ("MD&A") for the Company is dated March 28, 2008 and should be read in conjunction with the Company's audited Consolidated Financial Statements and related notes for the period ended December 31, 2007. The accompanying financial statements of the Company have been prepared by management and approved by the Company's Audit Committee and Board of Directors. These financial statements have been prepared in accordance with USA Generally Accepted Accounting Principles ("US GAAP"). Additional information relating to the Company can be found on the SEDAR website at *www.sedar.com*. Readers should also read the "Forward-Looking Statements" legal advisory contained at the end of this MD&A.

Results of Operations

	Three months ending			
	March 31 2007	**June 30 2007**	**Sept 30 2007**	**Dec 31 2007**
Financials (US$000's)				
Revenue	-	-	-	194*
Per share – basic (US$)	-	-	-	0.01
diluted (US$)	-	-	-	-
Net Loss	(2,321)	(20,117)	(2,969)	(16,372)
Basic and diluted loss (US$) per share	(0.15)	(0.62)	(0.07)	(0.36)

Capital Expenditure	2,285	20,249	3,845	11,622
Total Assets	33,751	89,648	85,749	71,656
Cash and working capital surplus/ (deficit)	11,901	43,205	37,161	25,773

***This revenue was realized in the period from December 19 to December 31, 2007. See "Revenue" and "Royalties" sections within this MD&A.**

Commentary

- There were no changes in accounting policies during the course of the year.
- On December 19, 2007 gas commenced flowing from the Kyzyloi gas field into the Bukhara-Urals pipeline generating the first revenue for the Company.
- The large net loss in Q2 was primarily the result of US$17,900,000 relating to the US GAAP required treatment of costs associated with the issue of share warrants and options and US$1,900,000 relating to the amortization of the debt discount associated with the US$5 million loan that was repaid at the end of June, 2007.
- The primary factor in the loss in the final quarter was the requirement under US GAAP ceiling test for a US$12,800,000 impairment. Under US GAAP no recognition is taken of probable reserves, only proved reserves.
- The high level of capital expenditure in Q2 can be attributed to the fact that Tethys, through its wholly–owned subsidiary Tethys Kazakhstan Limited, acquired the 30% share of BNM it did not already own in exchange for Company shares to the value of US$ 15,000,000.
- Q4 saw the completion of the construction of the 56 km (35 miles) gas pipeline from the Kyzyloi gas field to tie into the main Bukhara-Urals pipeline plus the drilling of three exploration and appraisal wells in the Akkulka Block in Kazakhstan.
- In June the Company successfully completed an IPO on the TSX raising gross proceeds of US$50,000,000.

The three months ended December 31, 2007 compared to the three months ended December 31, 2006

	Three months ended December 31		
	2007	**2006**	**% Change**
Financials (US$000's)			
Revenue	194*	-	-
Net Loss	(16,372)	(3,158)	425
Basic and diluted loss (US$) per share	(0.36)	(0.22)	63

Capital Expenditure	11,622	2,530	359
Total Assets	71,656	19,587	265
Cash and working capital surplus/ (deficit)	25,773	765	3,269

***This revenue was realized in the period from December 19 to December 31, 2007. See "Revenue" and "Royalties" sections within this MD&A.**

<u>Highlights</u>

- In November 2007 the Company completed the construction of a 56 km (35 miles) gas pipeline from the Kyzyloi gas field to tie into the main Bukhara-Urals pipeline that carries gas from Central Asia through Kazakhstan and into the Russian export system.
- On December 19, 2007 gas commenced flowing from the Kyzyloi gas field into the Bukhara-Urals pipeline generating the first revenue for the Company.
- The Company drilled 3 exploration and appraisal wells in the Akkulka Block in Kazakhstan all three of which successfully tested gas.
- In Tajikistan the Company reached agreement to create a joint venture company, "Seven Stars Energy Corporation" to hold its assets in Tajikistan and in which the Company, through its wholly-owned subsidiary Tethys Tajikistan Limited, would hold a 51% interest.
- A net loss of US$ 16,372,000 recorded in the three months to December 31, 2007 compared to a loss of US$3,158,000 for the same period in 2006. An impairment adjustment of US$12,800,000 was required under the US GAAP ceiling test which is calculated using proved reserves only at constant prices.

<u>Net (Loss)</u>

A net loss of US$16,372,000 was recorded in the three months to December 31, 2007, compared to US$3,158,000 in the three months to December 31, 2006. The principal differences between the two periods were:

- An impairment adjustment of US$12,800,000 was required under the US GAAP ceiling test which is calculated on proved reserves only at constant prices. Under Canadian GAAP an allowance would have been made for probable reserves and there would have been no need for the impairment adjustment.
- In Q4 2007 US$ 606,000 of costs relating to the issuance of share options and share warrants to employees.
- Business development costs were incurred in the three months to December 31, 2007 notably in relation to Tajikistan that the Company was not in a position to pursue in 2006.
- There was an increase in professional fees of some US$412,000 that in previous years was the responsibility of the Company's parent, CanArgo as it was then a 100% subsidiary.

<u>Capital Expenditure</u>

Capital expenditure in the three months to December 31, 2007 was US$11,622,000 compared to US$2,530,000 in the same period of 2006. The primary areas of expenditure in 2007 were:

- In November 2007, the Company completed the construction of a 56km (35 miles) gas pipeline from the Kyzyloi gas field to tie into the main Bukhara-Urals pipeline that carries gas from Central Asia through Kazakhstan and into the Russian export system.
- The Company drilled 3 exploration and appraisal wells in the Akkulka Block in Kazakhstan all three of which successfully tested gas.
- US$1,300,000 was spent in seismic and geological studies of the Kul Bas Contract in Kazakhstan. A drilling program is planned for this contract to commence in the spring of 2008.

Revenue

On January 5, 2006, Tethys' Kazakh subsidiary, BNM executed a natural gas supply contract with Gaz Impex S.A. ("Gaz Impex") relating to gas sales from BNM's Kyzyloi gas field in Kazakhstan. In December 2007 this contract was assigned to Kazakhstani Petrochemical Company Kemikal LLP ("PCK"), who will utilise the gas in the domestic Kazakh market. The agreed price is US$36.16 per thousand cubic metres (Mcm) (US$1.02 per thousand cubic feet (Mcf)) including Value Added Tax (VAT) which can be offset against VAT costs on the Kyzyloi project. A run-in period of approximately two months was agreed with the buyer at a planned average rate of 500 Mcm/d (17.6 million cubic feet per day (MMcf/d)). Current production is averaging approximately 580 Mcm/d (20.5 MMcf/d) from an initial six wells. The Gas Supply Contract, which has a term until the earlier of June 13, 2014 and the date on which all contracts and licences pursuant to which the gas to be delivered under the Gas Supply Contract terminate, is based on a take–or–pay principle and covers all gas produced from the Kyzyloi gas field Licence and Production Contract area up to a maximum of 850,000 Mcm (30 Bcf). The Revenue realised in the period from December 19 to December 31, 2007 was US$194,000.

No Revenue was realized by the Company in 2006.

Royalties

The Royalty on the Kyzyloi gas field is set at 2%. Royalties range from 2% to 6% under the Akkulka Exploration License and Contract with the rate to be set thirty days before the commencement of production and being dependent on the level of reserves. Based on current analysis the Company believes that the royalty level for the current Akkulka discoveries will be set at 2%. A Royalty rate of between 4% to 6% will apply under the Kul-Bas Exploration and Production Contract depending on the size of the reserves and once again the rate will be set thirty days before the commencement of production. Payment of royalties is due to start one month after sales commence.

General and Administrative Expenses

The main areas of difference between Q4 in 2007 and Q4 in 2006 were:

- In Q4 2007 US$606,000 of costs relating to the issuance of share options and share warrants to employees.
- Business development costs were incurred in the three months to December 31, 2007 notably in relation to Tajikistan that the Company was not in a position to pursue in 2006.
- There was an increase in professional fees of some US$412,000 that in previous years were the responsibilities of the Company's parent, CanArgo as it was then a 100% subsidiary.

Interest

In the quarter to December 31, 2007 the Company benefited from the funds raised in the IPO in the amount of US$378,000 in interest earned on these funds compared to minimal amount of interest in 2006 when it was being funded by its parent, CanArgo.

Depletion, Depreciation and Accretion

Impairment

Under US GAAP the ceiling test is calculated as the sum of the present value of future net cash flows related to estimated production of proved reserves only using current pricing, discounted at 10%. Under this test if the capitalized cost of the full cost pool exceeds the ceiling limitation, the excess is charged as an impairment expense. As a result of this test the Company incurred an impairment expense in 2007 in the amount of US$12,800,000. Under Canadian GAAP where probable reserves can be included this impairment expense would not have been necessary.

The depreciation charge for the quarter to December 31, 2007 of US$209,000 included US$175,000 for the amortization of Kyzyloi property costs, on a unit of production basis, following the commencement of production on December 19, 2007. The charge for 2006 was US$16,000 when there had been no amortization of resource property cost.

Taxes

With losses being generated in both 2007 and 2006 there was no tax due in either year. The company has tax losses carried forward for which no benefit has been recorded in these financial statements.

Year ended December 31, 2007 compared to the year ended December 31, 2006

	Year ended December 31		
	2007	**2006**	**2005**
Financials (US$000's)			
Revenue	194*	-	-
Per share – basic (US$)	0.01	-	-
diluted (US$)	-	-	-
Net Loss	(41,779)	(6,943)	(2,065)
Basic and diluted loss (US$) per share	(1.26)	(2.47)	(20.82)
Capital Expenditure	38,001	10,390	1,315
Total Assets	71,656	19,587	5,686
Cash and working capital surplus/ (deficit)	25,773	765	(7,776)

***This revenue was realized in the period from December 19 to December 31, 2007. See "Revenue" and "Royalties" sections within this MD&A.**

Highlights

- In June 2007 the Company successfully completed an IPO on the TSX raising gross proceeds of US$50,000,000.
- In November 2007 the Company completed the construction of a 56km (35 miles) gas pipeline from the Kyzyloi gas field to tie into the main Bukhara-Urals pipeline that carries gas from Central Asia through Kazakhstan and into the Russian export system.
- On December 19, 2007 gas commenced flowing from the Kyzyloi gas field into the Bukhara-Urals pipeline generating the first revenue for the Company.
- The Company drilled eight exploration and appraisal wells in the Akkulka Block in Kazakhstan of which six successfully tested gas.
- Proved Natural Gas Reserves net to the Company's interest increased from 38.442 Billion Cubic Feet (Bcf) at March 31, 2007 to 42.350 Bcf at December 31, 2007 and Proved plus Probable Natural Gas Reserves increased from 64.488 Bcf to 69.809 Bcf.
- In Tajikistan the Company reached agreement to create a joint venture company, "Seven Stars Energy Corporation" to hold its assets in Tajikistan and in which the Company, through its wholly-owned subsidiary Tethys Tajikistan Limited, would hold a 51% interest.
- A net loss of US$41,779,000 recorded in the year ended December 31, 2007 compared to a loss of US$6,943,000 for the same period in 2006. The 2007 loss included non cash items of US$17,900,000relating to the US GAAP required treatment of costs associated with the issue of share warrants and options and US$1,900,000 relating to the amortization of the discount associated with the US$5 million loan that was repaid at the end of June, 2007.
- An impairment adjustment of US$12,800,000 was required under the US GAAP ceiling test which is calculated on proved reserves only at constant prices. Under Canadian GAAP an allowance would have been made for probable reserves and there would have been no need for the impairment adjustment.
- Through Tethys Kazakhstan Limited (a wholly-owned subsidiary) the Company acquired the 30% share of BNM not previously owned. This purchase was settled by the issuing of shares in the Company valued at US$15,000,000.
- In addition to the BNM purchase capital expenditure in 2007 totaled US$23,001,000 compared to US$10,390,000 in the same period of 2006. At December 31, 2007 the Company had also made prepayments on further capital expenditure of US$3,062,000 compared to prepayments of US$3,882,000 at December 31, 2006.

Net (Loss)

A net loss of US$41,779,000 was recorded in the year ended December 31, 2007, an increase of US$34,836,000 on 2006.

The increase in the loss generated in 2007 can be attributed principally to three non-cash items:

1. US$17,862,000 of costs relating to the issuing of share options and share warrants.
2. US$1,916,000 as a result of the amortization of the remaining debt discount associated with the US$5,000,000 originally provided in September 2006, which in compliance with the terms of the loan was settled in full upon completion of the IPO. (See note below "Interest");
3. An impairment adjustment of US$12,800,000 was required under the US GAAP ceiling test which is calculated on proved reserves only at constant prices. Under Canadian GAAP an allowance would have been made for probable reserves and there would have been no need for the impairment adjustment.

Cash expenditure saw the following increases:

- within Kazakhstan both in pursuing the objective of gas production in Kyzyloi and increasing the reserves in Akkulka;
- in business development costs in looking to develop opportunities in areas other than Kazakhstan, e.g. Tajikistan; and
- in the employment of senior technical personnel to improve the Company's exploration and development prospects and in strengthening the finance function.

Capital Expenditure

Capital expenditure in 2007 was US$38,001,000 compared to US$ 10,390,000 in 2006. The primary areas of expenditure in 2007 included:

- The purchase by Tethys Kazakhstan Limited (a wholly-owned subsidiary of the Company) of the 30% share of BNM not previously owned by the Company. This purchase was settled by the issuing of shares in the Company valued at US$15,000,000.
- The completion of the construction of the 56km gas pipeline, the associated infield lines and compressor plant required to initiate gas production from the Kyzyloi gas field. The total cost of this project was US$13,232,000 of which US$4,700,000 had been incurred in 2006.
- The exploration program on the Akkulka contract that was initiated in 2006 with the drilling of five wells was continued in 2007 with the drilling of a further seven wells at a cost of US$5,500,000. Two further wells are planned for 2008 which will take the total spending up to US$10,675,000.
- Initial exploration costs totaling US$2,470,000 relating primarily to seismic costs were incurred in 2007 on the Kul Bas contract. In addition a prepayment of some US$2,200,000 was made for the planned drilling of three shallow exploration wells in 2008.

Revenue

On January 5, 2006, Tethys' Kazakh subsidiary, BNM executed a natural gas supply contract with Gaz Impex S.A. ("Gaz Impex") relating to gas sales from BNM's Kyzyloi gas field in Kazakhstan. In December 2007 this contract was assigned to Kazakhstani Petrochemical Company Kemikal LLP ("PCK"), who will utilise the gas in the domestic Kazakh market. The agreed price is US$36.16 per thousand cubic metres (Mcm) (US$1.02 per thousand cubic feet (Mcf)) including Value Added Tax (VAT) which can be offset against VAT costs on the Kyzyloi project. A run-in period of approximately two months was agreed with the buyer at a planned average rate of 500 Mcm/d (17.6 million cubic feet per day (MMcf/d)). Current production is averaging approximately 580 Mcm/d (20.5 MMcf/d) from an initial six wells. The Gas Supply Contract, which has a term until the earlier of June 13, 2014 and the date on which all contracts and licences pursuant to which the gas to be delivered under the Gas Supply Contract terminate, is based on a take–or–pay principle and covers all gas produced from the Kyzyloi gas field Licence and Production Contract area up to a maximum of 850,000 Mcm (30 Bcf). The Revenue realised in the period from December 19 to December 31, 2007 was US$194,000.

Royalties

The Royalty on the Kyzyloi gas field is set at 2%. Royalties range from 2% to 6% under the Akkulka Exploration License and Contract with the rate to be set thirty days before the commencement of production and being dependent on the level of reserves. Based on current analysis the Company believes that the royalty level for the current Akkulka discoveries will be set at 2%. A Royalty rate of between 4% to 6% will apply under the Kul-Bas Exploration and Production Contract depending on the size of the reserves and once again the rate will be set thirty days before the commencement of production. Payment of royalties is due to start one month after sales commence.

General and Administrative Expenses

Warrants and Options

In Q4 2007 US$606,000 of costs were incurred that related to the issuing of share options and share warrants to employees. This took the total cost relating to the issuing of share options and share warrants to employees and a related party (Provincial Securities) for the year to US$17,862,000. There were no such costs in the same period of 2006. *Please see "Note 16 – Stock Based Compensation" per the Company's 2007 audited Consolidated Financial Statements for full details.*

Other

The increase in costs within Kazakhstan of US$1,500,000 was the result of a continued build up of resources to meet the operational and administrative requirements resulting from the company's increased activities in Kazakhstan. The increases encompassed additional local staffing costs, new office accommodation, increased activity, including travel costs related to the construction of the pipeline and drilling additional exploration wells. There was also an increase in the training and education commitments as a result of increased capital expenditure on the three contracts.

Elsewhere general costs increased reflecting an all round increase in activity within the company as it seeks to develop further commercial opportunities, including:

- the recruitment of senior technical staff to ensure the exploration and development opportunities are maximized and gas reserves increased
- the pursuit of further business opportunities both within Kazakhstan and in some of its neighbouring states
- employment of suitably qualified management and staff to meet the needs of a growing company recently listed on the TSX.

Interest

On September 7, 2006 Tethys had completed a US$5,000,000 short-term loan financing ("Short-Term Loan") to fund its development activities in Kazakhstan. This loan was repaid upon successful completion of the IPO at the end of June and the interest incurred of US$375,000 was also settled. Under the terms of the Short–Term Loan, the noteholders were entitled to receive additional consideration for the advance of the loan in the form of warrants to subscribe for ordinary shares in the Company at the closing of the IPO. The allocation of these warrants resulted in the Company recording a discount to the loan based on the relative fair value of the warrants. This discount was being amortized over the life of the loan and the balance remaining on the date the loan was repaid was US$1,873,000. This remaining balance was then amortized in full to interest expense in June 2007.

In the year to December 31, 2007 the Company earned US$1,040,000 on interest primarily on the funds raised in the IPO in June. The cash balance at December 31, 2007 was US$26,692,000 compared to US$1,763,000 at December 31, 2006.

Depletion, Depreciation and Accretion

Impairment

Under US GAAP the ceiling test is calculated as the sum of the present value of future net cash flows related to estimated production of proved reserves only using current pricing, discounted at 10%. Under this test if the capitalized cost of the full cost pool exceeds the ceiling limitation, the excess is charged as an impairment expense. As a result of this test the Company incurred an impairment expense in 2007 in the amount of US$12,800,000. Under Canadian GAAP where probable reserves can be included this impairment expense would not have been necessary.

The depreciation charge for 2007 of US$257,000 included US$175,000 for the amortization of Kyzyloi property costs, on a unit of production basis, following the commencement of production on December 19, 2007. The charge for 2006 was US$32,000 when there had been no amortization of resource property cost.

Taxes

Tethys and its domestic subsidiary, Tethys Kazakhstan Limited, have been granted exemption from Guernsey Income Tax under the Income Tax (Exempt Bodies) (Guernsey) Ordinance, 1989 and hence are liable for a payment of a Guernsey exemption fee at a fixed rate of US$1,000 (£600) per annum. With effect from January 1, 2008 Guernsey has restructured its tax regime and the standard rate of income tax for companies has moved to 0%. Tethys Petroleum Limited and Tethys Kazakhstan Limited will therefore be taxed at the standard rate of 0%.

The Company has foreign subsidiaries based in the Republic of Kazakhstan where the statutory rate of income tax is 30% for all periods presented. No provision for income taxes has been provided in the consolidated financial information as Tethys combined Kazakhstan subsidiaries recorded losses for all periods presented. Tethys' Kazakhstan subsidiaries had calculated the aggregate net operating losses carried forward of US$2,377,000, US$77,000 and US$27,000 as at December 31, 2007, 2006 and 2005 respectively. Tethys' Kazakhstan net operating losses carried forward expire from 2012 to 2014. Tethys' available net operating losses carried forwards may be used to offset future taxable income, if any, prior to their expiration. A deferred tax asset existed as at December 31, 2007, 2006 and 2005 but due to uncertainty in the realizability of these tax assets the Company has recorded a full valuation allowance at the end of each of these periods.

Tethys' subsidiaries in Tajikistan would be subject to a statutory rate of income tax of 25%.

Liquidity and Capital Resources

As at December 31, 2007 the Company had a working capital surplus, including cash, of US$25,773,000 while at December 31, 2006 the working capital surplus was US$765,000.

IPO

On June 27, 2007 Tethys successfully completed an IPO and listed on the TSX having placed 18,181,818 ordinary shares at a price of US$ 2.75 raising US$50,000,000 (gross).

Private Placement

On January 24, 2007, Tethys closed a private placement whereby it issued 34,674,390 pre-consolidation ordinary shares (6,934,878 ordinary shares after giving effect to the 1 for 5 share consolidation carried out May 8, 2007) for gross proceeds of approximately US$17,400,000. These pre-consolidation ordinary shares were issued at a price of US$0.50 per share or US$2.50 after giving effect to the share consolidation. The funds raised were used both in the construction of the pipeline system and compression plant in connection with the gas production from the Kyzyloi gas field that came on stream in December 2007 and to fund the drilling of additional exploration wells and for general working capital purposes. The subscribers to this private placement consisted of a small group of sophisticated investors.

BNM

On March 13, 2007, Tethys reached an agreement with the owner of the minority interest in BNM whereby Tethys, through its wholly–owned subsidiary Tethys Kazakhstan Limited, acquired the 30% of BNM it did not already own in exchange for 30,000,000 pre–consoldation ordinary shares (or 6,000,000 ordinary shares after giving effect to the share consolidation), thereby making BNM an indirect wholly–owned subsidiary of Tethys. This acquisition was completed on May 8, 2007.

Aral Vostochniy

On May 10, 2007, Tethys had entered into an agreement with the owner of NBC (Nursat Bauyr and Co) to acquire the rights to the large Aral Vostochniy Block by agreeing to acquire NBC from the owner through its wholly-owned subsidiary Tethys Kazakhstan Limited in exchange for, among other things, an initial payment of US$2,500,000 (including an immediate US$100,000 deposit to be paid which would have been forfeited, under certain circumstances, if the contract had become null and void) and 1,500,000 Ordinary shares, thereby making NBC an indirect wholly-owned subsidiary of Tethys. Closing of this acquisition was conditional upon, among other things, NBC revising the work program for the Aral Vostochniy Block and Tethys raising gross proceeds of at least US$25,000,000 pursuant to the IPO, which it duly achieved. On September 7, 2007 it was announced that Tethys had been informed by the seller that as it was unlikely that the necessary contract changes would be agreed with the appropriate Kazakh authorities in the foreseeable future then it was not in a position to meet its obligations under the conditional agreement. As such it was agreed to terminate the agreement by mutual consent. None of the purchase price had been paid, and the ordinary shares issued into escrow with respect to this transaction have been forfeited.

Short–Term Loan

On September 7, 2006 the Company completed the Short–Term Loan financing to fund its development activities in Kazakhstan. The funds from the Short–Term Loan were used primarily for the purchase of pipeline, compressors and related equipment and services for the Kyzyloi gas field development. This financing took the form of the issue of US$5,000,000 senior secured notes in Tethys, redeemable on August 31, 2008. These notes were repayable immediately after listing and consequently they were repaid at the end of June 2007. The rate of interest incurred in the six months to the end of June was 15% per annum. Under the terms of the Short–Term Loan, the noteholders were entitled to receive additional consideration for the advance of the loan in the form of warrants to subscribe for ordinary shares in the Company at the closing of the IPO.

Loans from Related Parties

Prior to October 23, 2006 other than the Short–Term Loan, all funding for the Company had been provided in the form of a loan from its then parent company CanArgo. On October 23, 2006 the Company removed this debt by capitalizing the total inter–company loan of US$22,077,693 into 69,000,000 pre-consolidation ordinary shares that were issued to CanArgo pursuant to such capitalization. As a result of the Private Placement and the issuance of shares in return for the remaining 30% of BNM CanArgo's holding in the company dropped to 52% and then following the IPO was reduced to 17.3%. CanArgo subsequently sold its remaining shares in Tethys in mid-July so that at December 31, 2007 it no longer held any shares in the Company.

Shareholder Equity

As at December 31, 2007 the Company had authorized share capital of 500,000,000 ordinary shares of US$0.10 par value of which 45,116,696 had been issued. There had been no change in the period between December 31, 2007 and the date of this MD&A. As at the date of this MD&A, there are 4,497,000 stock options and 8,857,504 warrants to purchase ordinary shares in the company issued and outstanding.

Outlook

The Company is anticipating an increase in activities in the coming months as it looks towards the second phase of its gas production, which will involve production from five Akkulka wells and is due to commence by the end of 2008. Additional compressors will be needed and there will be a further tie-in but this will be approximately 14 km as opposed to the 56 km needed for Kyzyloi. Exploration activities will continue in Akkulka, Kul-Bas and Tajikistan. The Company will also continue to look for suitable acquisition opportunities in Central Asia for properties with good potential and in line with the Company's strategy.

Gas Production

Gas production commenced on December 19, 2007 following the completion and commissioning of a pipeline to take the gas to a tie–in point on the Bukhara–Urals gas trunkline approximately 56km (35 miles) east of the Kyzyloi gas field. Space had been allocated in the Bukhara Urals pipeline by the pipeline owners, Intergas Central Asia, and gas sales commenced from that date. Initial gas sales are to be sold under the Kyzyloi base load contract with PCK, which it is understood will be sold domestically. Tethys is carrying out additional work on the Kyzyloi gas field itself to ensure sustained gas production at the maximum level possible through the currently installed compressor capacity.

Tajikistan

On September 7, 2007 the Company announced that its wholly-owned subsidiary, Tethys Tajikistan Limited, had signed an Investment and Operating Agreement (the "IOA") with Southern Oil and Gas Exploration State Unitary Enterprise ("SOG SUE") relating to oil and gas fields in Southern Tajikistan. The IOA had been agreed to and supported by the Ministry of Energy and Industry of the Republic of Tajikistan (the "Ministry"). SOG is a wholly state-owned oil and gas company reporting to the Ministry that holds the production licenses to a number of fields in the Kulob Area in southern Tajikistan over which Tethys is negotiating a Production Sharing Agreement ("PSA"). The IOA allows Tethys to commence initial production operations in the Kulob Area whilst the Tajikistan government finalizes certain necessary legislative changes to enable the recently adopted Production Sharing Legislation to become effective. Once the legislative changes are in place Tethys intends to progress and finalize negotiations on the PSA, and the Ministry recommended that the IOA be entered into as a precursor to the execution of the PSA and to provide assistance to Tethys in obtaining a PSA for the Kulob Area**.** On December 24, 2007 Tethys announced that it had signed an agreement to take a partner in its projects in Tajikistan by the creation of a joint venture company named Seven Stars Energy Corporation ("SSEC") in which Tethys, through its wholly-owned subsidiary Tethys Tajikistan Limited, will hold a 51% interest. It is planned that the IOA and the future PSA will be held through SSEC.

Purchase of Drilling Rig

On October 16, 2007 the Company announced that it had placed an order for a new 2,000 horsepower (1,470 kN) ZJ70/4500L drilling rig from a Chinese supplier. This rig, which has a nominal drilling depth of 23,000 feet (7,000 metres), is due to be completed within 6 months and is due to be delivered at the factory in Chengdu, China, in April 2008. The rig will initially be transported to Akkulka for use on the Akkulka deep exploration program which is planned to commence in the summer of 2008. It is planned that the rig will be operated by Tethys utilizing its current Kazakh drilling contractor under a management agreement. The rig would also be suitable for drilling in the Kul-Bas area and on the potentially large prospects Tethys has identified in the Kulob area of Tajikistan over which Tethys is currently finalising a Production Sharing Agreement and where work is commencing under its Investment Operating Agreement. The cost of the rig and initial supporting equipment to be purchased is anticipated to be approximately US$9.2 million.

While Company paid the deposit of US$1,878,900 in October and a stage payment of the same amount in January 2008 on March 19, 2008 it was announced that the Company's wholly owned subsidiary Tethys Petroleum Inc. ("TPI") to which the rig had been assigned had secured financing in the amount of US$5,300,000 for purchase of the drilling rig from China. The financing is in the form of a 3 year loan with monthly payments of interest and capital and a final balloon payment while the average annual interest payable expressed as a percentage of the total borrowed funds is 9.3%. Some 795,000 warrants to purchase Tethys shares were also issued to the lenders with a term of 3 years and an exercise price of CAD$3.25. Lenders have security over the shares of TPI which has no other assets except the drilling rig. No corporate guarantees or security are being provided by Tethys itself.

Sensitivities

The price of gas sales from gas produced from the Kyzyloi gas field under the Gas Supply Contract is fixed in US dollars and there is no sensitivity to currency movements or market movements in the gas price. The price of gas sales from gas produced from the Akkulka Block has yet to be agreed and there is therefore sensitivity to movements in the market price of gas.

Transactions with Related Parties

Upon completion of the private placement of shares in February 2007 Kraken Financial Group, which has one common director with the Company, was duly registered as a shareholder in the Company having received 2% commission in the form of 411,271 ordinary shares (pre-share consolidation). During the course of the placement process Kraken Financial Group had managed the Escrow Bank Account into which funds were paid by each of the investors until all of the funds were present at which point they were paid over to the Company and the shares issued. For the provision of this service Kraken Financial Group was paid the sum of US$19,500 (£10,000). A fee of US$60,000 was paid to Paul Murphy (a non-executive director of the Company) for his part in introducing the investors. Kraken Financial Group also acted as broker for Tethys in the placement of the D&O insurance for which the annual premium was US$112,000.

Up to the date of the listing of Tethys on the TSX CanArgo had provided administrative services, which generally consisted of office space, telephones, utilities and other administrative type costs, to Tethys via a management services agreement between CanArgo, Tethys and Vazon Energy Limited ("Vazon"). Vazon is a corporation organized under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, Chief Executive Officer, is the sole owner and managing director. In addition, a management services agreement existed between CanArgo and Vazon Energy whereby the services of Dr. Robson, Mrs. Landles (Corporate Secretary and Executive Vice President) and other Vazon Energy employees, were provided to CanArgo. Fees paid to by the Company to CanArgo during this period amounted to US$600,000. A management services contract directly with Vazon Energy came into effect from June 27th, 2007 whereby a monthly fee is paid for the services of Dr Robson, a separate monthly fee for other Vazon employees and an invoice for all other services and costs is to be issued to Tethys at the end of each month. The total costs charged to Tethys in the year to December 31, 2007 by Vazon were US$522,537.

Financial Instruments and Other Instruments

On January 5, 2006 Tethys' Kazakh subsidiary, BNM executed a natural gas supply contract with Gaz Impex S.A. ("Gaz Impex") relating to gas sales from BNM's Kyzyloi gas field in Kazakhstan. In December 2007 this contract was assigned to Kazakhstani Petrochemical Company Kemikal LLP ("PCK"), who will utilize the gas in the domestic Kazakh market. Gaz Impex is one of the leading independent gas marketing companies in Kazakhstan and is currently involved in gas purchase and supply contracts both within Kazakhstan and in surrounding countries.

See “Liquidity and Capital Resources” section within this MD&A and Note 14 “Commitments and Contingencies” to the Tethys 2007 audited consolidated financial statements for further description of the contracts and future commitments of the Company.

The nature of the Company’s natural gas operations exposes the Company to risks associated with fluctuations in commodity prices and foreign currency exchange rates. To date, the Company has not utilized derivative instruments to manage these risks.

Critical Accounting Policies and Estimates

The Company’s financial statements are prepared in accordance with US GAAP, which require management to make judgments, estimates and assumptions which may have a significant impact on the financial statements. A summary of the Company’s significant accounting policies can be found in Note 2 to its audited financial statements for the year ended December 31, 2007. The following is a discussion of those accounting policies and estimates that are considered critical in the determination of the Company’s financial results.

Oil & Gas Properties — Full Cost Accounting
The Company follows the full cost method of accounting as described in Note 2 to its audited financial statements for the year ended December 31, 2007. Alternatively, the Company could follow the successful efforts method of accounting whereby all costs related to non–productive wells are expensed in the period in which they are incurred.

Under the full cost method of accounting, capitalized costs are subject to a country–by–country cost centre impairment test. Under the successful efforts method of accounting, the costs are aggregated on a property–by–property basis and the carrying value of each property is subject to an impairment test. These policies may result in a different carrying value for capital assets and a different net income. The Company has elected to follow the full cost method and it is the method most commonly followed. The Company applies a ceiling test to the capitalized cost in the full cost pool. The ceiling test limits such cost to the estimated present value, using a ten percent discount rate, of the future net revenue from proved reserves, based on current economic and operating conditions.

Reserve Estimates
Reserve estimates can have a significant impact on net income and the carrying value of capital assets. The Company engaged independent third party specialists in reserve engineering, McDaniel International Inc’, to evaluate the prospective resources of all of the Company’s contracts in Kazakhstan as at December 31, 2007 accordance with NI 51-101. The process of estimating reserves requires significant judgment based on available geological, geophysical, engineering, and economic data, projected rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to interpretation and uncertainty. Reserve estimates can impact net income through depletion expense and the application of impairment tests. Revisions or changes in reserve estimates can have either a positive or a negative impact on net income and can impact the carrying amount of capital assets. *See Risk Factors – Production variances from Reported Reserves.*
Potential lenders may also use reserve estimates to assess the allowable borrowing base under a secured credit facility. Changes to the reserve estimates can result in borrowing base increases or decreases, which could impact the Company’s financial position.

Asset Retirement Obligations
The Company recognizes liabilities for asset retirement obligations associated with tangible long–lived assets, such as producing well sites, with a corresponding increase in the related long–lived asset. The Company estimates the liability based on the estimated costs to abandon and reclaim its net ownership in tangible long–lived assets and the estimated timing of the costs to be incurred in future periods. The Company’s asset retirement obligations consist of costs related to the plugging of wells, the removal of facilities and equipment, and site restoration on oil and gas properties. Actual payments to settle the obligations may differ from estimated amounts.

CHANGES TO ACCOUNTING POLICIES

There were no changes in accounting policies during the course of the year.

Recently Issued Accounting Pronouncements

Accounting for Certain Hybrid Financial Instruments

In February 2006, SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140* was issued. This Statement resolves issues addressed in Statement 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets*. SFAS No. 155 will become effective for the fiscal year beginning after December 31, 2006. The Company adopted this Interpretation in the first quarter of 2007 and the adoption did not have a material impact on the Company's financial position or results of operations for the year ended December 31, 2007.

Accounting for Uncertainty in Income Taxes

In July 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes* – An interpretation of FASB Statement No. 109" ("FIN 48"). This Interpretation provides a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The Company adopted this Interpretation in the first quarter of 2007 and does not anticipate the adoption to have a material impact on its financial position or results of operations.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *"Fair Value Measurements."* This Statement replaces multiple existing definitions of fair value with a single definition, establishes a consistent framework for measuring fair value and expands financial statement disclosures regarding fair value measurements. This Statement applies only to fair value measurements that already are required or permitted by other accounting standards and does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning subsequent to November 15, 2007. The Company will adopt this Statement in the first quarter of 2008 and does not expect the adoption to have a material impact on its financial position or results of operations.

The Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities*," which permits an entity to measure certain financial assets and financial liabilities at fair value. The objective of SFAS No. 159 is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. Under SFAS No. 159, entities that elect the fair value option (by instrument) will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option election is irrevocable, unless a new election date occurs. SFAS No. 159 establishes presentation and disclosure requirements to help financial statement users understand the effect of the entity's election on its earnings, but does not eliminate disclosure requirements of other accounting standards. Assets and liabilities that are measured at fair value must be displayed on the face of the balance sheet. This statement is effective beginning January 1, 2008 and the Company does not expect the adoption to have a material impact on its financial position or results of operations.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Chief Executive Officer and the Chief Financial Officer of Tethys are responsible for designing a system of internal controls over financial reporting, or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with both Canadian and US GAAP.

Management of Tethys has designed and implemented a system of internal controls over financial reporting as of December 31, 2007 which it believes is effective for a company of its size. During the review and design of the Company's control system over financial reporting a number of weaknesses were noted as were some during the course of the annual audit. The management of Tethys has already put in place a number of procedures to mitigate these risks including the recruitment of additional staff and further steps will be taken in the coming months.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures have been designed by the Tethys Management to ensure that information required to be disclosed by the company is accumulated, recorded, processed and reported to the company's management as appropriate to allow timely decisions regarding disclosure. The company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by this MD&A, that the company's disclosure controls and procedures as of the end of such period are effective to provide reasonable assurance that material information related to the company, including its consolidated subsidiaries, is communicated to them as appropriate to allow timely decisions regarding required disclosure.

FORWARD-LOOKING STATEMENTS

In the interest of providing Tethys shareholders and potential investors with information regarding the Company and its subsidiaries, including management's assessment of Tethys' and its subsidiaries' future plans and operations, certain statements contained in this MD&A constitute forward-looking statements or information (collectively referred to herein as "forward-looking statements") within the meaning of the "safe harbour" provisions of applicable securities legislation. Forward-looking statements are typically identified by words such as "anticipate", "believe", "expect", "plan", "intend", "forecast", "target", "project" or 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 projected 2008 capital investments projections, the Company's projected capital investment levels for 2007 and the source of funding therefore; the effect of the Company's risk management program. Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause the Company's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements. These risks and uncertainties include, among other things: volatility of and assumptions regarding oil and gas prices; assumptions based upon Tethys' current guidance; fluctuations in currency and interest rates; product supply and demand; market competition; risks inherent in the Company's and its subsidiaries' marketing operations, including credit risks; imprecision of reserve estimates and estimates of recoverable quantities of oil and natural gas and other sources not currently classified as proved; the Company's and its subsidiaries' ability to replace and expand oil and gas reserves; refining and marketing margins; potential disruption or unexpected technical difficulties in developing new products and manufacturing processes; potential failure of new products to achieve acceptance in the market; unexpected cost increases or technical difficulties in constructing or modifying manufacturing or refining facilities; unexpected difficulties in manufacturing, transporting or refining synthetic crude oil; risks associated with technology; the Company's ability to generate sufficient cash flow from operations to meet its current and future obligations; the Company's ability to access external sources of debt and equity capital; the timing and the costs of well and pipeline construction; the Company's and its subsidiaries' ability to secure adequate product transportation; changes in royalty, tax, environmental and other laws or regulations or the interpretations of such laws or regulations; political and economic conditions in the countries in which the Company and its subsidiaries operate; the risk of international war, hostilities, civil insurrection and instability affecting countries in which the Company and its subsidiaries operate and terrorist threats; risks associated with existing and potential future lawsuits and regulatory actions made against the Company and its subsidiaries; and other risks and uncertainties described from time to time in the reports and filings made with securities regulatory authorities by Tethys. Statements relating to "reserves" or "resources" or "resource potential" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described exist in the quantities predicted or estimated, and can be profitably produced in the future. Although Tethys believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. Readers are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this MD&A are made as of the date of this MD&A, and except as required by law Tethys does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

RISK FACTORS

The risks and uncertainties below are not the only ones the Company is facing. In addition, there are additional risks and uncertainties of which the Company is not presently aware or that the Company currently considers immaterial but which may also impair the Company's business operations and cause the price of the Ordinary shares to decline. If any of the following risks actually occur, the Company's business may be harmed and the Company's financial condition and results of operations may suffer significantly.

Risks Related to the Company and its Business

Competition

The oil and gas industry is intensely competitive. Competition is particularly intense in the acquisition of prospective oil properties and oil and gas reserves. Tethys' competitive position depends on its geological, geophysical and engineering expertise, its financial resources, its ability to develop its properties and its ability to select, acquire and develop proved reserves. Tethys competes with a substantial number of other companies having larger technical staff and greater financial and operational resources. Many such companies not only engage in the acquisition, exploration, development and production of oil and gas reserves, but also carry on refining operations and market refined products. Tethys also competes with major and independent oil and gas companies and other industries supplying energy and fuel in the marketing and sale of oil and gas to transporters, distributors and end users, including industrial, commercial and individual consumers. Tethys also competes with other oil and gas companies in attempting to secure drilling rigs and other equipment necessary for drilling and completion of wells. Such equipment may be in short supply from time to time, and has been in particularly short supply recently due to the increase in the market price of oil and gas. In addition, equipment and other materials necessary to construct production and transmission facilities may be in short supply from time to time. Finally, companies not previously investing in oil and gas may choose to acquire reserves to establish a firm supply or simply as an investment. Such companies will also provide competition for Tethys.

Marketability of Production

The marketability and ultimate commerciality of oil and gas acquired or discovered is affected by numerous factors beyond the control of Tethys. These factors include reservoir characteristics, market fluctuations, the proximity and capacity of oil and gas pipelines and processing equipment and government regulation. Oil and gas operations (exploration, production, pricing, marketing and transportation) are subject to extensive controls and regulations imposed by various levels of government, which may be amended from time to time. Restrictions on the ability to market the Company's production could have a material adverse effect on the Company's revenues and financial position.

Commodity Price Fluctuations

Oil and gas prices are unstable and are subject to fluctuation. Any material decline in natural gas prices could result in a reduction of Tethys' net production revenue and overall value and could result in ceiling test write downs. It may become uneconomic to produce from some wells as a result of lower prices, which could result in a reduction in the volumes and value of Tethys' reserves. Tethys might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in Tethys' net production revenue causing a reduction in its acquisition and development activities. A substantial material decline in prices from historical average prices could reduce the Company's ability to borrow funds.

Nature of the Oil and Gas Business

An investment in Tethys should be considered speculative due to the nature of the Company's involvement in the exploration for, and the acquisition, development and production of, oil and natural gas in Kazakhstan. The volume of production from oil and natural gas properties generally declines as reserves are depleted, with the rate of decline depending on reservoir characteristics. The Company's proved reserves will decline as reserves are produced from its properties unless it is able to acquire or develop new reserves. The business of exploring for, developing or acquiring reserves is capital intensive. To the extent cash flow from operations is reduced and external sources of capital become limited or unavailable, the Company's ability to make the necessary capital investment to maintain or expand the Company's asset base of oil and natural gas reserves will be impaired. In addition, there can be no assurance that even if the Company is able to raise capital to develop or acquire additional properties to replenish the Company's reserves, the Company's future exploration, development and acquisition activities will result in additional proved reserves or that the Company will be able to drill productive wells at acceptable costs.

The cost of drilling, completing and operating wells is often uncertain, and drilling operations may be curtailed, delayed or cancelled as a result of a variety of factors, including unexpected drilling conditions, pressure or irregularities in formations, equipment failures or accidents, adverse weather conditions, compliance with governmental requirements and shortages or delays in the availability of drilling rigs and the delivery of equipment.

Management Services Provided by Vazon and Dependence on Key Personnel

The services of each executive officer of the Company, other than the Chief Financial Officer and Finance Director, the Executive Vice President, Corporate Development and Chief Commercial Officer, the Vice President Exploration and the Vice President Investor Relations are provided under the terms of two management services agreements with a corporate entity, Vazon. As a result, the executive officers of the Company, although officers of the Company, are not employed directly by the Company but rather by Vazon. Vazon is a corporation wholly-owned by Dr David Robson, the Company's President, Chief Executive Officer and Chairman. Either management services agreement may be terminated on six months' notice by Vazon or the Company. Should Vazon (acting through Dr Robson) determine to terminate either or both management services agreements, the Company would be required to enter into an employment or other relationship directly with the executive officers or, failing which, would be required to retain the services of alternate executive officers. There is no certainty that the Company would be able to attract and retain suitable candidates should either of the management services agreements be terminated and the executive officers choose not to be employed or retained by the Company. Any such termination may materially and adversely affect the Company. Moreover, the Company is dependent on its eight executive officers to manage its affairs and operations. The departure of any one executive officer may negatively impact on certain of the Company's operations until a suitable replacement candidate is appointed.

Hedging Activities

The Company's subsidiary, BNM, has entered into the Gas Supply Contract and from time to time the Company may enter into agreements to receive fixed prices on its oil and natural gas production to offset the risk of revenue losses if commodity prices decline; however, if commodity prices increase beyond the levels set in such agreements, the Company will not benefit from such increases. Similar risks will apply to any hedging agreements the Company may enter into to set exchange rates or fix interest rates on its debt.

Financial Resources

The Company's cash flow from operations may not be sufficient to fund its ongoing activities and implement its business plans. From time to time the Company may enter into transactions to acquire assets or the shares of other companies. These transactions along with the Company's ongoing operations may be financed partially or wholly with debt, which may increase the Company's debt levels above industry standards and lead to increased borrowing costs, reducing the Company's income. Depending on future exploration and development plans, the Company may require additional financing, which may not be available or, if available, may not be available on favourable terms. Failure to obtain such financing on a timely basis could cause the Company to forfeit or forego various opportunities that would otherwise be beneficial to the Company and its shareholders.

International Operations

International operations are subject to political, economic and other uncertainties, including but not limited to, risk of terrorist activities, revolution, border disputes, expropriation, renegotiations or modification of existing contracts, import, export and transportation regulations and tariffs, taxation policies, including royalty and tax increases and retroactive tax claims, exchange controls, limits on allowable levels of production, currency fluctuations, labour disputes and other uncertainties arising out of foreign government sovereignty over the Company's international operations. The Company's operations may also be adversely affected by applicable laws and policies of Kazakhstan, Tajikistan or other countries in which it operates in the future, the effect of which could have a negative impact on the Company.

Foreign Currency and Fiscal Matters

The Company's operations and expenditures are to some extent paid in foreign currencies. As a result, the Company is exposed to market risks resulting from fluctuations in foreign currency exchange rates. A material drop in the value of any such foreign currency could result in a material adverse effect on the Kazakhstan cash flow and revenues. Currently, there are no significant restrictions on the repatriation of capital and distribution of earnings from Kazakhstan to foreign entities. There can be no assurance, however, that restrictions on repatriation of capital or distributions of earnings from

Kazakhstan will not be imposed in the future. Amendments to current taxation laws and regulations which alter tax rates and/or capital allowances could have a material adverse impact on Tethys.

To the extent revenues and expenditures denominated in or strongly linked to the U.S. dollar are not equivalent; the Company is exposed to exchange rate risk. The Company is exposed to the extent U.S. dollar revenues do not equal U.S. dollar expenditures. In addition, a portion of expenditures in Kazakhstan are denominated in Tenge, which are difficult to hedge. The Company is not currently using exchange rate derivatives to manage exchange rate risks but is attempting to negotiate exchange rate stabilization conditions in new local Tenge denominated service and supply contracts in Kazakhstan. In addition, the Company's results will be reported in U.S. dollars and foreign currency denominated monetary balances could result in gains and losses that may increase the variability of earnings. Moreover, the Company's ordinary shares trade in Canadian dollars on the TSX.

Political and Regulatory

The oil and gas industry in general is subject to extensive government policies and regulations, which result in additional cost and risk for industry participants. Environmental concerns relating to the oil and gas industry's operating practices are expected to increasingly influence government regulation and consumption patterns which favour cleaner burning fuels such as natural gas. The Company is uncertain as to the amount of operating and capital expenses that will be required to comply with enhanced environmental regulation in the future. The Company is also subject to changing and extensive tax laws, the effects of which cannot be predicted. Among other things, the Company and TKL are subject to regulatory filings with respect to the repatriation of funds to its shareholders which must be complied with to avoid sanctions. Legal requirements are frequently changed and subject to interpretation, and the Company is unable to predict the ultimate cost of compliance with these requirements or their effect on its operations. Existing laws or regulations, as currently interpreted or reinterpreted in the future, or future laws or regulations may change in the future and materially adversely affect the Company's results of operations and financial condition.

Tethys is conducting exploration and development activities in Kazakhstan, and is dependent on receipt of government approvals or permits to develop its properties. Based on past performance, Tethys believes that the government of Kazakhstan supports the exploration and development of its oil and gas properties by foreign companies. Nevertheless, there is no assurance that future political conditions in Kazakhstan will not result in the government adopting different policies respecting foreign development and ownership of oil and gas, environmental protection and labour relations. This may affect the Company's ability to undertake exploration and development activities in respect of present and future properties, as well as its ability to raise funds to further such activities. Any delays in receiving government approvals or permits or no objection certificates may delay the Company's operations or may affect the status of the Company's contractual arrangements or its ability to meet its contractual obligations. Similar risks apply to the Company's proposed activities in Tajikistan and in other countries in which the Company may operate in the future.

Legal Systems

The Company is incorporated in Guernsey. Tethys Kazakhstan Limited, which represents substantially all of the Company's assets, is incorporated in Guernsey and through its subsidiaries carries on all of its material operations in Kazakhstan. Accordingly, the Company is subject to the legal systems and regulatory requirements of a number of jurisdictions with a variety of requirements and implications for shareholders of the Company. Shareholders of the Company will not have rights identical to those available to shareholders of a corporation incorporated under the federal laws of Canada. For example, the Companies Laws does not contemplate "appraisal rights" in the event of certain fundamental changes. Moreover, in certain circumstances, the Company may require a shareholder to divest itself of its Ordinary shares if the ownership or holding of such ordinary shares would be in breach of laws or a legal requirement of any country or if such shareholder is not qualified to hold the ordinary shares and if such ownership or holding would in the reasonable opinion of the Board of Directors cause a pecuniary or tax disadvantage to the Company or any other shareholder.

Exploration and development activities outside Canada may require protracted negotiations with host governments, national oil and gas companies and third parties. Foreign government regulations may favour or require the awarding of drilling contracts to local contracts or require foreign contractors to employ citizens of, or purchase supplies from, a particular jurisdiction. If a dispute arises with foreign operations, the Company may be subject to the exclusive jurisdiction of foreign courts or may not be successful in subjecting foreign persons, especially foreign oil and gas ministries and national oil and gas companies, to the jurisdiction of the Canada.

Kazakhstan may have a less developed legal system than jurisdictions with more established economies, which may result in risks such as: (i) effective legal redress in the courts of such jurisdictions, whether in respect of a breach of law or regulation or in an ownership dispute, being more difficult to obtain; (ii) a higher degree of discretion on the part of governmental authorities; (iii) the lack of judicial or administrative guidance on interpreting applicable rules and regulations; (iv) inconsistencies or conflicts between and within various laws, regulations, decrees, orders and resolutions; or (v) relative inexperience of the judiciary and courts in such matters. In certain jurisdictions the commitment of local business people, government officials and agencies and the judicial system to abide by legal requirements and negotiated agreements may be more uncertain, creating particular concerns with respect to licences and agreements for business. These may be susceptible to revision or cancellation and legal redress may be uncertain or delayed. There can be no assurance that joint ventures, licences, licence applications or other legal arrangements will not be adversely affected by the actions of government authorities or others and the effectiveness of and enforcement of such arrangements in these jurisdictions cannot be assured.

Production Variances from Reported Reserves

The Company's reserve evaluations have been prepared in accordance with NI 51-101. There are numerous uncertainties inherent in estimating quantities of reserves and cash flows to be derived there from, including many factors that are beyond the control of the Company. The reserves information set forth in this Annual Information Form represent estimates only. The reserves from the Company's properties have been independently evaluated by McDaniel in the McDaniel Reserve Report. The McDaniel Reserve Report includes a number of assumptions relating to factors such as initial production rates, production decline rates, ultimate recovery of reserves, timing and amount of capital expenditures, marketability of production, future prices of natural gas, operating costs and royalties and other government levies that may be imposed over the producing life of the reserves. These assumptions were based on price forecasts in use at the date the relevant evaluations were prepared and many of these assumptions are subject to change and are beyond the control of the Company. Actual production and cash flows derived there from will vary from these evaluations, and such variations could be material. These evaluations are based, in part, on the assumed success of exploitation activities intended to be undertaken in future years. The reserves and estimated cash flows to be derived there from contained in such evaluations will be reduced to the extent that such exploitation activities do not achieve the level of success assumed in the evaluations.

The Company is subject to risks related to its operations in Kazakhstan, including those related to the development, production, marketing, transportation of natural gas, taxation and environmental and safety matters. The Company may be adversely affected by changes in governmental policies or social instability or other political or economic developments in Kazakhstan that are outside the Company's control including among other things, expropriation, risks of war and terrorism, foreign exchange and repatriation restrictions, changing political conditions and monetary fluctuations and changing governmental policies including taxation policies.

Conclusion of Agreements in Tajikistan

The Company's current contractual position in Tajikistan is based solely on a Protocol of Intent and the Investment Operating Agreement ("IOA") giving the Company the exclusive rights to negotiate for a PSA or similar binding contract giving the Company rights to carry out oil and gas exploration and production activities in certain areas of Tajikistan. The IOA gives certain rights to the development and re-development of certain fields in the area but this is a commercial agreement and does not give the Company any rights to hydrocarbons in the ground, nor the licence or title to the production of sub-soil resources. As such the IOA is less robust than would be a licence, concession or production sharing agreement. Although negotiations on the PSA are proceeding satisfactorily, there can be no guarantee that the Company will be able to negotiate suitable contracts or agreements with acceptable commercial terms, and if so proceed with its planned activities in Tajikistan.

Availability of Equipment and Access Restrictions

Oil and gas exploration and development activities are dependent on the availability of drilling and related equipment in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to the Company and may delay exploration and development activities. There can be no assurance that sufficient drilling and completion equipment, services and supplies will be available when needed. Shortages could delay the Company's proposed exploration, development, and sales activities and could have a material adverse effect on the Company's financial condition. If the demand for, and wage rates of, qualified rig crews rise in the drilling industry then the oil and gas industry may experience shortages of qualified personnel to operate drilling rigs. This could delay the Company's drilling operations and adversely affect the Company's financial condition and results of operations. To the extent Tethys is not the operator of its oil and gas properties, Tethys will be dependent on such operators for the timing of activities related to such properties and will be largely unable to direct or control the activities of the operators.

Operating Hazards

Oil and gas exploration, development and production operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts and oil spills, each of which could result in substantial damage to oil wells, production facilities, other property and the environment or in personal injury. In accordance with industry practice, the Company is not fully insured against all of these risks, nor are all such risks insurable. Although Tethys maintains liability insurance in an amount that it considers adequate and consistent with industry practice, the nature of these risks is such that liabilities could exceed policy limits, in which event Tethys could incur significant costs that could have a material adverse effect upon its financial condition. Oil and gas production operations are also subject to all the risks typically associated with such operations, including premature decline of reservoirs and the invasion of water into producing formations.

Gas Pipeline

The Company is economically dependent on the Bukhara-Urals pipeline in that should anything adverse happen to this pipeline then the sales revenue would cease. This pipeline carries gas from Central Asia through Kazakhstan and into the Russian export system and consequently as any problems would have adverse implications for the economy of Uzbekistan in particular and to a lesser extent the Russian economy it is anticipated that there would be significant efforts to minimize any break in supply.

Environmental

All phases of the oil business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and state and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to foreign governments and third parties and may require the Company to incur significant costs to remedy such discharge. No assurance can be given that changes in environmental laws or their application to the Company's operations will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect the Company's financial condition, results of operations or prospects.

Reliance on Third Party Operators and Key Personnel

To the extent that the Company is not the operator of its properties, as the Company will be dependent upon other guarantors or third parties' operations for the timing of activities and will be largely unable to control the activities of such operators. In addition, the Company's success depends, to a significant extent, upon management and key employees. The loss of key employees could have a negative effect on the Company. Attracting and retaining additional key personnel will assist in the expansion of the Company's business. The Company faces significant competition for skilled personnel. There is no assurance that the Company will successfully attract and retain personnel required to continue to expand its business and to successfully execute its business strategy.

Cost of New Technologies

The oil and gas industry is characterized by rapid and significant technological advancements and introductions of new products and services utilizing new technologies. Other oil and gas companies may have greater financial, technical and personnel resources that allow them to enjoy technological advantages and may in the future allow them to implement new technologies before the Company does. There can be no assurance that the Company will be able to respond to such competitive pressures and implement such technologies on a timely basis or at an acceptable cost. One or more of the technologies currently utilized by the Company or implemented in the future may become obsolete. In such case, the Company's business, financial condition and results of operations could be materially adversely affected. If the Company is unable to utilize the most advanced commercially available technology, the Company's business, financial condition and results of operations could be materially adversely affected.

Production Delays

There is a possibility of delays in obtaining the necessary governmental approvals to commence or increase production. Any such delays could reduce the Company's revenues and income below those anticipated in the Company's business plan.

Property Interests and Governmental Approvals

The interest of the Company's subsidiaries in the Kyzyloi gas field, Akkulka Block and Kul-Bas Block are represented by contracts and licenses with Kazakhstan governmental agencies (the "**Kazakh Contracts**") which grant the holder the exploration and production rights over a defined area. Ownership of the land covered by the Kazakh Contracts remains with the relevant governmental agencies. The Kazakh Contracts to which the Company's subsidiaries are a party, and pursuant to which a licence(s) is granted to the Company's subsidiaries, are subject to certain conditions, including minimum expenditure and reimbursement requirements, and requirements to minimum contributions to socio-economic development funds. In addition, the Kazakh Contracts are subject to periodic renewal. While the Company expects that the Kazakh Contracts will be renewed in the ordinary course throughout the life of the relevant area, there is a risk that the Kazakh Contracts may not be renewed on a timely basis or may not be renewed on terms satisfactory to the Company. There is also a risk that prior renewals or extensions of the Kazakh Contracts may be challenged by third parties as a result of delayed renewals or extensions. Moreover, as any transfer of the Kazakh Contracts requires governmental consent, the ability of the Company to transfer the Kazakh Contracts in the future or use the Kazakh Contracts as a security for future borrowing may be restricted. There is also a risk that governmental agencies may seek compensation for foregone revenue resulting from prior delays in execution of certain of the Kazakh Contracts, including the Kyzyloi gas field Licence and Production Contract.

In addition to consents described above in respect of the Kazakh Contracts, the purchase and sale of oil and gas properties and oil and gas businesses in Kazakhstan is subject to approval of the MEMR and the Kazakhstan government's waiver of its priority right to purchase the alienated oil and gas assets and businesses. Business acquisitions may also be subject to review by the Committee for Protection of Competition of the Ministry of Industry and Trade (the "**Antimonopoly Committee**") under Kazakhstan antimonopoly legislation and may be subject to findings of non-compliance with other regulatory authorities. Although the Company is of the view that it has obtained the required consents of the MEMR and the necessary Kazakhstan government's waiver in respect of its acquisitions to date, the Company is not in a position to verify its compliance with the antimonopoly legislation, if required. Failure to obtain the Antimonopoly Committee's approval does not make the transaction invalid, although Kazakhstan's antimonopoly legislation gives the Antimonopoly Committee authority to intervene in cases of activities considered to be monopolistic, including the right to file a claim in a court to invalidate prior acquisitions if the transactions violated the antimonopoly legislation. Prior and future acquisitions and divestitures by the Company may be subject to review and possible invalidation by a court if considered to be contrary to antimonopoly legislation.

Disclosure Controls and Procedures; Internal Control Over Financial Reporting

The Company will be required to design disclosure controls and procedures to ensure that information required to be disclosed under applicable securities legislation is recorded, processed, summarized and reported within prescribed time periods. As the Company has not previously been subject to statutory disclosure requirements, the disclosure controls and procedures which the Company will adopt will not have been tested and may require changes to ensure their effectiveness. The Company will also need to design new systems for its internal control over financial reporting. The Company will need to implement certain controls over information technology to ensure that the design of its internal control over financial reporting is effective. There is a risk that these new controls, once implemented, may not provide reasonable assurance regarding the reliability of its financial reporting. Development and implementation of these disclosure controls and internal controls over financial reporting (and compliance with securities laws generally) will add to the Company's general and administrative expenses above levels recorded historically.

Conflicts of Interest

Certain of the directors of the Company may have associations with other oil and gas companies or with other industry participants with whom the Company does business. The directors of the Company are required by applicable corporate law to act honestly and in good faith with a view to the Company's best interests and to disclose any interest which they may have in any project or opportunity to the Company. However, their interests in the other companies may affect their judgment and cause such directors to act in a manner that is not necessarily in the best interests of the Company.

Risks Related to the Republic of Kazakhstan

Political, Economic, Legal and Fiscal Instability

Kazakhstan is a former constituent republic of the Soviet Union. At the time of its independence in 1991, it became a member of the CIS. Because Kazakhstan has a relatively short history of political stability as an independent nation, there is significant potential for social, political, economic, legal and fiscal instability. These risks include, among other things:

- local currency devaluation;
- civil disturbances;
- exchange controls or availability of hard currency;
- changes in crude oil, export and transportation regulations;
- changes with respect to taxes, royalty rates, import and export tariffs, and withholding taxes on distributions to foreign investors;
- changes in antimonopoly legislation;
- nationalisation or expropriation of property; and
- interruption or blockage of oil exports.

The occurrence of any of these factors could have a material adverse affect on the Company's business, financial condition and results of operations.

Further, Kazakhstan also depends on neighbouring states to access world markets for a number of its major exports, including oil, steel, copper, ferro-alloys, iron ore, alumina, coal, lead, zinc and wheat. Kazakhstan is thus dependent upon good relations with its neighbours to ensure its ability to export. In January 1995, Kazakhstan, Russia, the Kyrgyz Republic and Belarus, joined by Tajikistan in 1999, signed a customs union which, among other things, provides for the removal of trade tariffs between these nations, and Kazakhstan has taken other steps to promote regional economic integration. Government policy advocates further economic integration within the CIS, one of the aims of which is to assure continued access to export routes. However, should access to those routes be materially impaired, this could adversely impact the economy of Kazakhstan.

Like other countries in Central Asia, Kazakhstan could be affected by military action taken in the region, including in Afghanistan and the effect such military action may have on the world economy and political stability of other countries. In particular, countries in Central Asia, such as Kazakhstan, whose economies and state budgets rely in part on the export of oil, oil products and other commodities, the import of capital equipment and significant foreign investments in infrastructure projects, could be adversely affected by any resulting volatility in oil and other commodity prices and by any sustained fall in them or by the frustration or delay of any infrastructure projects caused by political or economic instability in countries engaged in such projects.

Economic Conditions in Kazakhstan

Kazakhstan became an independent sovereign state in 1991 as a result of the dissolution of the former Soviet Union. Since then, Kazakhstan has experienced significant change as it emerged from a single-party political system and a centrally-controlled command economy to a market-oriented model. The transition was marked in the earlier years by political uncertainty and tension, a recessionary economy marked by high inflation and instability of the local currency and rapid, but incomplete, changes in the legal environment.

Since 1992, Kazakhstan has actively pursued a program of economic reform designed to establish a free market economy through privatization of state enterprises and deregulation and is more advanced in this respect than many other countries of the CIS. However, as with any transition economy, there can be no assurance that such reforms and other reforms described elsewhere in this Annual Information Form will continue or that such reforms will achieve all or any of their intended aims.

In addition, instability in other countries, such as Russia, has affected in the past, and may materially affect in the future, economic conditions in Kazakhstan. The Company's results of operations are significantly dependent on the Kazakh economy. Although the government of Kazakhstan has adopted policies aimed to mitigate any such negative effect, low commodity prices and weak demand in its export markets and economic instability elsewhere in the world may adversely affect Kazakhstan's economy. Adverse economic conditions in Kazakhstan could have a material adverse affect on the Company's business, financial condition and results of operations.

Changes in the Political and Legal Environment in Kazakhstan

Kazakhstan's foreign investment, petroleum, subsoil use, licensing, corporate, tax, customs, currency, banking and antimonopoly laws and legislation are still developing and uncertain. From time to time, including the present, draft laws on these subjects are prepared by government ministries and some have been submitted to Parliament for approval. Legislation in respect of some or all of these areas could be passed. Currently, the regulatory system contains many inconsistencies and contradictions. Many of the laws are structured to provide substantial administrative discretion in their application and enforcement. In addition, the laws are subject to changing and different interpretations. These factors mean that even the Company's best efforts to comply with applicable law may not always result in compliance. Non-compliance may have consequences disproportionate to the violation. The uncertainties, inconsistencies and contradictions in Kazakh laws and their interpretation and application could have a material adverse affect on the Company's business and results of operations.

The judicial system in Kazakhstan may not be fully independent of outside social, economic and political forces, and court decisions can be difficult to predict. In addition, senior Kazakh government officials may not be fully independent of outside economic forces owing to the underdeveloped regulatory supervision system enabling improper payments to be made without detection. The government of Kazakhstan has stated that it believes in continued reform of the corporate governance processes and will ensure discipline and transparency in the corporate sector to promote growth and stability. However, there can be no assurance that the Kazakh government will continue such policy, or that such policy, if continued, will ultimately prove to be successful. Therefore, it is not possible to predict the effect of future legislative developments on the Company's business and prospects.

The Company's exploration and production licences, hydrocarbon contract and other agreements may be susceptible to revision or cancellation, and legal redress may be uncertain, delayed or unavailable. In addition, it is often difficult to determine from governmental records whether statutory and corporate actions have been properly completed by the parties or applicable regulatory agencies. Ensuring the Company's ongoing rights to licences and its hydrocarbon contracts will require a careful monitoring of performance of the terms of the licences and hydrocarbon contracts, and monitoring the evolution under Kazakh laws and licencing practices.

Foreign Exchange Fluctuations

To the extent that the Company or its subsidiaries or affiliates hold Tenge positions, there is a risk from foreign exchange fluctuations. Although the Tenge has between relatively stable of late, between its introduction in 1993 and 2002, the Tenge depreciated significantly against the U.S. dollar, in two cases over a short period of time. The Company cannot assure prospective investors that the Tenge will not experience further depreciation against the U.S. dollar. The Company also cannot assure prospective investors that Tenge will continue to be freely exchangeable into U.S. dollars or that the Company will be able to exchange sufficient amounts of Tenge into U.S. dollars to pay interest to meet its other foreign currency obligations. Although some of its expenses and revenues are in Tenge, the Company's financial statements are reported in U.S. dollars, consistent with the practice in the oil and gas industry. If the exchange rate of the Tenge fluctuates substantially or the rate of inflation materially increases in Kazakhstan in the future, the Company's financial statements may not be indicative of its future performance and may not accurately reflect the U.S. dollar value of its assets or current operations.

Taxation Risks and Issues

The taxation system in Kazakhstan is at an early stage of development and the tax risks and problems with respect to its operations and investment in Kazakhstan are significant. Tax legislation is evolving and is subject to different and changing interpretations as well as inconsistent enforcement at both the local and state levels. Laws related to these taxes have not been in force for significant periods in contrast to more developed market economies, therefore, regulations are often unclear or nonexistent. Accordingly, few precedents with regard to issues have been established.

Tax declarations, together with other legal compliance areas (as examples, customs and currency control matters) are subject to review and investigation by a number of authorities, who are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax and other risks in Kazakhstan substantially more significant than typically found in countries with more developed tax systems.

All legal entities carrying on activities in Kazakhstan must be registered with the local tax committee. Taxes in Kazakhstan include income tax, value added tax, excise tax, social tax, land tax, property tax, transport tax, as well as required contributions to various funds, duties and fees for licences. In addition, the Company has, through its various operations, been making and expects to continue to make, contributions to various social funds.

Additional payments, such as signing bonuses, commercial discovery bonuses, royalties and excess profit taxes, are required from oil and gas companies and other subsoil users. A signing bonus is a one-time payment for the rights to explore and/or develop and produce resources. A commercial discovery bonus is a one-time payment for each commercial discovery and is payable once a discovery of commercial value is made in a contract territory as well as for any increase in reserves. Excess profit tax is payable pursuant to all subsurface use contracts executed before January 1, 2004, applying sliding scale rates with increasing rates of excess profit tax of up to 30% if the project IRR is greater than 30%. For subsurface use contracts executed after January 1, 2004, excess profit tax is calculated using as the tax base the net income of a subsurface user in excess of 20% of tax deductions. The rates of excess profit tax are established on a sliding scale ranging from 10% to 60%, using the after tax profit as the tax base, and depends on the net income and deductions of a subsurface user.

On January 1, 2004, the Kazakh government adopted changes to the tax regime covering subsoil users. Such changes include: (i) there being no tax stability for contracts, other than production sharing agreements signed after January 1, 2004; (ii) changes to the current procedures for establishing royalties (including those for oil and gas producers); (iii) changes to the current procedures for determining the value of extracted hydrocarbons; (iv) the establishment of a new rent tax for exported crude oil; (v) increased excess profit taxes; and (vi) changes to the tax regime for production sharing agreements. The above changes will generally only impact subsoil users that have entered into hydrocarbon contracts after January 1, 2004, including any new hydrocarbon contracts entered into by the Company.

The uncertainty of application and the evolution of tax laws creates a risk of additional payment of tax by the Company, especially for contracts entered into after January 1, 2004, which could have a material adverse affect on the Company's business, financial condition and results of operations.

Risks Related to the Republic of Tajikistan

Political Instability

Tajikistan has, since its independence from the former Soviet Union, suffered a destructive civil war which not only caused significant damage to the infrastructure and industry of the country, but also led to regional and ethnic rivalries. Although the situation has stabilized since 1997, there is still the potential for instability, particularly with respect to these regional rivalries, and the potential for the emergence of radical Islamist groups. Tajikistan is the poorest country in Central Asia, and this poverty may lead to further civil unrest and potential disruption to the Company's business. Tajikistan's proximity to Afghanistan may lead to further instability dependent on the situation in that country. Certain areas of the country are still military exclusion zones, especially towards the Afghanistan border, and in some areas there may be uncleared landmines, a product of both the civil war and the troubles in Afghanistan.

Legal and Regulatory Framework

The legal and regulatory framework for oil and gas is undeveloped in Tajikistan, and given this, even in the event that the Company is successful in executing a PSA, given that there are no precedents for this, it is possible that the terms of such a PSA may be challenged, additional taxes may be imposed, or may be found to conflict with other Tajik laws and regulations even though the Company is working on amendments to Tajik legislation to enable such PSAs.. There may also be problems with repatriation of currency from Tajikistan, and in the use of the banking system.

Lack of Infrastructure

Tajikistan depends on neighbouring countries to access world markets, and this could lead to problems bringing in equipment and services to the country, as well as exporting products. There are currently no modern oil refineries in Tajikistan, and as such any crude oil will require export, either to regional refineries or to world markets. There are no guarantees that this export will be allowed by the surrounding countries, and/or additional taxes or levies imposed, or prices offered being substantially less than world market prices. Similarly the gas infrastructure is poorly developed and maintained in Tajikistan, and although pipelines exist, and it would be the Company's intention to enshrine access to such pipelines and infrastructure in any PSA, it is possible that such infrastructure would not be available to the Company on commercially attractive terms, or may be unsuitable. Similarly export of gas to world markets would require access to pipelines and infrastructure in neighbouring countries and such access may not be given, or not be given on commercially attractive terms.

Tethys Petroleum Limited
(formerly known as Tethys Petroleum Investments Limited)

Consolidated Financial Statements
December 31, 2007 and 2006

PRICEWATERHOUSECOOPERS

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March 28, 2008

Auditors' Report

To the Shareholders of Tethys Petroleum Limited

We have audited the consolidated balance sheet of Tethys Petroleum Limited as at December 31, 2007 and the consolidated statements of operations and comprehensive loss, stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

The financial statements as at December 31, 2006 and for the year then ended were audited by PricewaterhouseCoopers LLP, London, United Kingdom who expressed an opinion without reservation on those financial statements in their report dated May 10, 2007.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Alberta

AUDITORS' REPORT

To the Board of Directors and Stockholders of
TETHYS PETROLEUM LIMITED

May 10, 2007

Dear Sirs

In our opinion, the accompanying balance sheets and the related statements of operations, stockholders' equity, and cash flows present fairly, in all material aspects, the financial position of Tethys Petroleum Limited at December 31, 2006, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with International Standards on Auditing (UK and Ireland). Those standards require that we plan and perform the audit to obtain reasonable assurance about 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable a basis for our opinion.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company's limited capital resources, negative cash flows and recurring losses from operations raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also addressed in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

(Signed) *"PricewaterhouseCoopers LLP"*
Chartered Accountants

TETHYS PETROLEUM LIMITED
(formerly known as Tethys Petroleum Investments Limited)

Consolidated Balance Sheet

	Note	As at December 31, 2007	As at December 31, 2006
		(Expressed in 000's United States dollars)	
ASSETS			
Current Assets			
Cash and cash equivalents		26,692	1,763
Prepayments	**4**	351	331
Accounts Receivable		219	-
Other current assets		790	2
Total current assets		28,052	2,096
Non Current Assets			
Prepayments	**4**	3,062	3,882
Restricted Cash	**5**	318	205
Value added tax recoverable	**6**	2,752	1,086
Capital assets	**7**	37,472	12,318
Total Assets		71,656	19,587
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current Liabilities			
Accounts payable	**8**	1,388	878
Accrued and other liabilities		891	453
Total current liabilities		2,279	1,331
Non Current Liabilities			
Long term debt	**9**	-	3,084
Other non current liabilities	**10**	776	32
Asset retirement obligation	**11**	661	451
Total Liabilities		3,716	4,898
Stockholder Equity			
Ordinary shares, authorized - 500,000,000 shares; shares issued and outstanding - 45,116,696 at December 31, 2007 and 14,000,000 at December 31, 2006.	**15**	99,483	22,315
Contributed Surplus		3,527	-
Warrants	**16**	16,555	2,220
Accumulated deficit		(51,625)	(9,846)
Total stockholders' equity		67,940	14,689
Total Liabilities and Stockholders' Equity		71,656	19,587
Commitments and contingencies	**13**		

See accompanying notes to these financial statements

Approved by the board of directors on March 28, 2008

"D. Robson" Director

"B. Murphy" Director

TETHYS PETROLEUM LIMITED
(formerly known as Tethys Petroleum Investments Limited)

Consolidated Statements of Operations and Comprehensive Loss

	Note	Year ended December 31st	
		2007	2006
		(Expressed in 000's United States dollars except share data)	
Operating Revenue			
Oil and gas sales		194	-
		194	-
Operating Expenses:			
Selling, general and administrative		27,342	5,124
Depreciation, depletion and amortization		13,057	32
		40,399	5,156
Operating Loss		(40,205)	(5,156)
Other Income (Expense):			
Interest, net		(1,437)	(1,701)
Foreign exchange gains (losses)		(96)	72
Other		(41)	(158)
Total Other Expense		(1,574)	(1,787)
Loss Before Income Taxes		(41,779)	(6,943)
Income taxes	**15**	-	-
Net Loss and Comprehensive Loss		(41,779)	(6,943)
Weighted average number of common shares outstanding	**18**	33,274,413	2,808,767
Basic and diluted loss (US$) per share		(1.26)	(2.47)

See accompanying notes to these financial statements

TETHYS PETROLEUM LIMITED
(formerly known as Tethys Petroleum Investments Limited)

Consolidated Statement of Cash Flows

	Note	Year ended December 31st 2007	2006
		(Expressed in 000's United States dollars)	
Operating activities:			
Loss from operations		(41,779)	(6,943)
Share warrants & options		17,862	-
Non-cash interest expense		1,916	1,809
Depreciation, depletion and amortization		13,057	32
Accounts Receivable		(1,885)	(1,084)
Other current debtors		(788)	
Prepayments		(20)	(71)
Accounts payable		510	410
Accrued and other liabilities		438	448
Net cash used in operating activities		(10,689)	(5,399)
Investing activities:			
Capital expenditures	**13**	(23,001)	(10,390)
Investments		(113)	(205)
Change in oil & gas suppliers prepayments		820	(766)
Net cash used in investing activities		(22,294)	(11,361)
Financing activities:			
Proceeds from issue of common stock		67,337	-
Share issue costs		(5,169)	-
Repayment of loans		(5,000)	18,115
Other non-current liabilities		744	(30)
Net cash provided by financing activities		57,912	18,085
Net increase in cash and cash equivalents		24,929	1,325
Cash and cash equivalents, beginning of year		1,763	438
Cash and cash equivalents, end of year		26,692	1,763
Interest paid		375	207

See accompanying notes to these financial statements

TETHYS PETROLEUM LIMITED
(formerly known as Tethys Petroleum Investments Limited)

Consolidated Statements of Changes in Stockholders Equity

	Common Stock					
	No of Shares Issued	Share Capital	Contributed Surplus	Warrants Reserve	Accumulated Deficit	Total Stockholders Equity
			(Expressed in 000's United States dollars except share data)			
Total December 31, 2005	100,000	19			(2,903)	(2,884)
Stock split pursuant to Capital reorganization	900,000	-	-	-	-	-
Shares issued pursuant to capitalization pf parent inter-company loan	69,000,000	22,296	-	-	-	22,296
Discount recorded for issue of warrants to purchase 5 million shares pursuant to a loan agreement	-	-	-	2,220	-	2,220
Net loss in 2006	-	-	-	-	(6,943)	(6,943)
Total December 31, 2006	70,000,000	22,315	-	2,220	(9,846)	14,689
Shares Issued pursuant to Private Placement	34,674,390	17,337	-	-	-	17,337
	104,674,390	39,652	-	2,220	(9,846)	32,026
Share restructure 1:5	20,934,878	39,652	-	2,220	(9,846)	32,026
Issue of shares to acquire 30% of BN Munai	6,000,000	15,000	-	-	-	15,000
Initial Public Offering (IPO)	18,181,818	50,000	-	-	-	50,000
Share Warrants and Options	-	-	3,527	14,335	-	17,862
Finance Costs	-	(5,169)	-	-	-	(5,169)
Net loss in 2007	-	-	-	-	(41,779)	(41,779)
Total, December 31, 2007	45,116,696	99,483	3,527	16,555	(51,625)	67,940

See accompanying notes to these financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007

NOTE 1 - NATURE OF OPERATIONS AND GOING CONCERN

Tethys Petroleum Limited (formerly known as Tethys Petroleum Investments Limited), incorporated and headquartered in Guernsey, British Isles, and its consolidated subsidiaries (collectively "Tethys"), is an oil and gas company operating within the Republic of Kazakhstan. Within the first quarter of 2007 the Company established a position in the Republic of Tajikistan which is currently being developed. Tethys' principal activity is the acquisition of interests in and development of crude oil and natural gas fields.

Significant Business Risks and Basis of Presentation

Since inception, the Company has incurred significant losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2007. The ability of the Company to successfully carry out its business plan is primarily dependent upon its ability not only to maintain the current level of gas production but also to achieve further production of commercial oil and gas and to control the costs of operating and capital expenditures. While these factors create doubt about the Company's ability to continue as a going concern management is confident of achieving the Company's short term plans, including phase two of gas production, and optimistic about the longer term prospects for the Company.

The Company completed an Initial Public Offering of equity securities on Toronto Stock Exchange on June 27, 2007 that generated sufficient funds to secure its future at least in the short term. In the event the Company is unable to generate significant revenues and cash flows from operations it may need to seek further funding from its shareholders or alternative sources. There can be no assurances that management will be successful with these initiatives.

The financial statements have been prepared on the basis that the Company will continue to operate as a going concern, which contemplates the realisation of assets and the settlement of liabilities and commitments in the normal course of business. These financial statements do not reflect adjustment in the carrying values of assets and liabilities reported, revenue or expenses and the balance sheet classification used that would be necessary if the going concern assumption was not appropriate. Such adjustment could be material.

Foreign Operations

Tethys' future operations and earnings will depend upon the results of Tethys' operations in the Republics of Kazakhstan and Tajikistan. There can be no assurance that Tethys will be able to successfully conduct such operations, and a failure to do so would have a material adverse effect on Tethys' financial position, results of operations and cash flows. Also, the success of Tethys' operations will be subject to numerous contingencies, some of which are beyond management control. These contingencies include general and regional economic conditions, prices for crude oil and natural gas, competition and changes in regulation. Since Tethys is dependent on international operations, specifically those in Kazakhstan, Tethys will be subject to various additional political, economic and other uncertainties. Among other risks, Tethys' operations may be subject to the risks and restrictions on transfer of funds, import and export duties, quotas and embargoes, domestic and international customs and tariffs, and changing taxation policies, foreign exchange restrictions, political conditions and regulations.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements and notes thereto are prepared in accordance with accounting principles generally accepted in the United States of America. All tabular amounts are in thousands of U.S. dollars.

Consolidation

The consolidated financial statements include the accounts of Tethys and its wholly owned subsidiaries. All significant inter-company transactions and accounts have been eliminated.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates, judgements and assumptions that affect the reported amounts 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 reporting period. Actual results could differ from those estimates.

Management believes that it is reasonably possible the following material estimates affecting the financial statements could significantly change in the coming year: (1) estimates of proved oil and gas reserves, (2) estimates as to the expected future cash flow from proved oil and gas properties, (3) estimates of future dismantlement and restoration costs, (4) estimates of the useful life of the assets and, (5) estimate of the valuation allowance against deferred taxes.

Cash and Cash Equivalents

Cash and cash equivalents, which include all liquid investments with an original maturity of three months or less, are considered to be cash equivalents.

Fair Value of Financial Instruments

The carrying amounts reflected in the consolidated balance sheets for cash and equivalents, short-term receivables and short-term payables approximate their fair value due to the short maturity of the instruments.

Concentration of Credit Risk

Although Tethys' cash and temporary investments and accounts receivable are exposed to potential credit loss, Tethys does not believe such risk to be significant. Even though a substantial amount of funds were in accounts at financial institutions which were not covered under bank guarantees, management does not believe that maintaining balances in excess of bank guarantees resulted in a significant risk to the Company.

Market Risks

As an independent oil and gas producer, Tethys' revenue, profitability and future rate of growth are substantially dependent upon prevailing prices for oil and gas, which are dependent upon numerous factors beyond Tethys' control, such as economic, political and regulatory developments and competition from other sources of energy. The energy markets have historically been very volatile, and there can be no assurance that oil and gas prices will not be subject to wide fluctuations in the future. A substantial or extended decline in oil and gas prices could have a material adverse effect on Tethys' financial position, results of operations, cash flows and Tethys' access to capital and on the quantities of oil and gas reserves that may be economically produced.

On January 5, 2006 Tethys' Kazakh subsidiary, BNM executed a natural gas supply contract with Gaz Impex S.A. ("Gaz Impex") relating to gas sales from BNM's Kyzyloi field in Kazakhstan. In December 2007 this contract was assigned to Kazakhstani Petrochemical Company Kemikal LLP ("KNK"), who will utilise the gas in the domestic Kazakh market. The agreed price is US$36.2 per thousand cubic metres (Mcm) (US$1.02 per thousand cubic feet (Mcf)) including VAT which can be offset against VAT costs on the Kyzyloi project. The Gas Supply Contract, which has a term until the earlier of June 13, 2014 and the date on which all contracts and licences pursuant to which the gas to be delivered under the Gas Supply Contract terminate, is based on a take–or–pay principle and covers all gas produced from the Kyzyloi Field Licence and Production Contract area up to a maximum of 850,000 Mcm (30 Bcf).

Gas Pipeline

The Company is economically dependent on the Bukhara-Urals pipeline in that should anything adverse happen to this pipeline then the sales revenue would cease. This pipeline carries gas from Central Asia through Kazakhstan and into the Russian export system and consequently as any problems would have adverse implications for the economy of Uzbekistan in particular and to a lesser extent the Russian economy it is anticipated that there would be significant efforts to minimize any break in supply.

Capital Assets

Capital assets are recorded at cost less accumulated provisions for depreciation, depletion and amortization unless the carrying amount is viewed as not recoverable in which case the carrying value of the assets is reduced to the estimated recoverable amount. See "Impairment of Long-Lived Assets" below. Expenditures for major renewals and betterments, which extend the original estimated economic useful lives of applicable assets, are capitalized. Expenditures for normal repairs and maintenance are charged to expense as incurred. The cost and related accumulated depreciation of assets sold or retired are removed from the accounts and any gain or loss thereon is reflected in operations. Unproved properties are not deemed to be impaired until the right to drill on those properties is lost and planned development has ceased.

Oil And Gas Properties - Tethys accounts for oil and gas properties and interests under the full cost method. Under the full cost method, all acquisition, exploration and development costs, including certain directly related employee costs incurred for the purpose of finding oil and gas are capitalized and accumulated in pools on a country–by–country basis. Capitalized costs include the cost of drilling and equipping productive wells, including the estimated costs of dismantling and abandoning these assets, dry hole costs, lease acquisition costs, seismic and other geological and geophysical costs, delay rentals and costs related to such activities. Employee costs associated with production and other operating activities and general corporate activities are expensed in the period incurred.

Where proved reserves have been established, capitalized costs are limited on a country–by–country basis (the ceiling test). The ceiling test is calculated as the sum of the present value of future net cash flows related to estimated production of proved reserves, using end–of–the-current-period prices, discounted at 10%, and takes into account expected future costs to develop proved reserves, and operating expenses and income taxes. Under the ceiling test, if the capitalized cost of the full cost pool exceeds the ceiling limitation, the excess is charged as an impairment expense.

Unit-of-production depreciation is applied to capitalized cost of the full cost pool. Unit-of-production rates are based on the amount of proved developed reserves of oil, gas and other minerals that are estimated to be recoverable from existing facilities using current operating methods.

Tethys utilizes a single cost centre for each country where Tethys has operations for amortization purposes. Any conveyances of properties are treated as adjustments to the cost of oil and gas properties with no gain or loss recognized unless the operations are suspended in the entire cost centre or the conveyance is significant in nature.

The costs of investments in unproved properties and portions of costs associated with major development projects are excluded from the depreciation, depletion and amortization ("DD&A") calculation until the project is evaluated.

Unproved property costs include leasehold costs, seismic costs and other costs incurred during the exploration phase. In areas where proved reserves have been established, significant unproved properties are evaluated periodically, but not less than annually, for impairment. If a reduction in value has occurred, these property costs are considered impaired and are transferred to the related full cost pool. Unproved properties whose acquisition costs are not individually significant are aggregated and the portion of such costs estimated to be ultimately non-productive, based on experience is amortized to the full cost pool over an average holding period.

Where the existence of proved reserves has not yet been determined, leasehold costs, seismic costs and other costs incurred during the exploration phase remain capitalized in unproved property cost centres until proved reserves have been established or until exploration activities cease or impairment and reduction in value occurs. If exploration activities result in the establishment of a proved reserve base, amounts in the unproved property cost centre are reclassified as proved properties and become subject to depreciation, depletion and amortization and the application of the ceiling test. If exploration efforts are unsuccessful in establishing proved reserves, it may be determined that the value of exploratory costs incurred there have been permanently diminished in part or in whole. Therefore, based on the impairment evaluation and future exploration plans, the unproved property cost centres related to the area of interest could be impaired, and accumulated costs charged against earnings.

Plant and Equipment - Depreciation of plant and equipment is computed using the straight-line method over the estimated useful lives of the assets ranging from three to five years for office furniture and equipment to three to fifteen years for oil and gas related equipment.

Revenue Recognition

Tethys recognizes revenues when hydrocarbons have been produced and delivered and payment is reasonably assured.

Foreign Currency Translation

The U.S. dollar is the functional currency for Tethys and its subsidiaries' operations. All monetary assets and liabilities denominated in foreign currency are translated into U.S. dollars at the rate of exchange in effect at the balance sheet date and the resulting unrealized translation gains or losses are reflected in operations. Non-monetary assets are translated at historical exchange rates. Revenue and expense items (excluding depreciation and amortization which are translated at the same rates as the related assets) are translated at the average rate of exchange for the year.

Income Taxes

The Company accounts for income taxes under the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The principal temporary differences arise from depreciation on property, plant and equipment, and tax losses carried forward and, in relation to acquisitions, on the differences between the fair values of the net assets acquired and their tax base. Tax rates enacted by the balance sheet date are used to determine the deferred income tax. Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will either expire before the Company is able to realize the benefit, or that future deductibility is uncertain.

Impairment of Plant & Equipment

The Company evaluates its plant & equipment for impairment using the guidance of Statement of Financial Accounting Standard ("SFAS") No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* SFAS No. 144 establishes a single accounting model for long-lived assets to be disposed of by sale and requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations.

Asset retirement obligations

Tethys recognizes liabilities for asset retirement obligations associated with tangible long-lived assets, such as producing well sites, with a corresponding increase in the related long-lived asset. The asset retirement cost is depreciated along with the property and equipment in the full cost pool. The asset retirement obligation is recorded at fair value and accretion expense, recognized over the life of the property, increases the liability to its expected settlement value. If the fair value of the estimated asset retirement obligation changes, an adjustment is recorded for both the asset retirement obligation and the asset retirement cost. The Company's asset retirement obligations consist of costs related to the plugging of wells, the removal of facilities and equipment, and site restoration on oil and gas properties. Capitalized costs are depleted as a component of the full cost pool using the units of production method.

Recently Issued Accounting Pronouncements

Accounting for Certain Hybrid Financial Instruments

In February 2006, SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140* was issued. This Statement resolves issues addressed in Statement 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets*. SFAS No. 155 will become effective for the fiscal year beginning after December 31, 2006. The Company adopted this Interpretation in the first quarter of 2007 and the adoption did not have a material impact on the Company's financial position or results of operations for the year ended December 31, 2007.

Accounting for Uncertainty in Income Taxes

In July 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes* – An interpretation of FASB Statement No. 109" ("FIN 48"). This Interpretation provides a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The Company adopted this Interpretation in the first quarter of 2007 and does not anticipate the adoption to have a material impact on its financial position or results of operations.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *"Fair Value Measurements."* This Statement replaces multiple existing definitions of fair value with a single definition, establishes a consistent framework for measuring fair value and expands financial statement disclosures regarding fair value measurements. This Statement applies only to fair value measurements that already are required or permitted by other accounting standards and does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning subsequent to November 15, 2007. The Company will adopt this Statement in the first quarter of 2008 and does not expect the adoption to have a material impact on its financial position or results of operations.

The Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities*," which permits an entity to measure certain financial assets and financial liabilities at fair value. The objective of SFAS No. 159 is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. Under SFAS No. 159, entities that elect the fair value option (by instrument) will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option election is irrevocable, unless a new election date occurs. SFAS No. 159 establishes presentation and disclosure requirements to help financial statement users understand the effect of the entity's election on its earnings, but does not eliminate disclosure requirements of other accounting standards. Assets and liabilities that are measured at fair value must be displayed on the face of the balance sheet. This statement is effective beginning January 1, 2008 and the Company does not expect the adoption to have a material impact on its financial position or results of operations.

Reconciliation between US GAAP and Canadian GAAP

Under US GAAP regulations only proved reserves are included in the ceiling test and consequently the Company had to record an impairment in its 2007 accounts of US$ 12,800,000. Under Canadian GAAP where probable reserves can also be included in the ceiling test this impairment would not have been necessary. *See Note 20*

NOTE 3 – BUSINESS COMBINATIONS

Kul-Bas LLP

On May 5, 2006, Tethys acquired through its subsidiary BNM, 70% of the charter capital of Kul-Bas LLP, a limited liability partnership registered in Kazakhstan, for consideration of US$100,000. Kul-Bas LLP had won the right to negotiate the Greater Akkulka Exploration and Production Contract covering an unexplored area of 2,688,695 acres (10,881 km^2) surrounding the Akkulka area. In November, 2005 Kul-Bas LLP signed the Exploration and Production Contract with the Kazakh authorities, this contract being for a period of 25 years, with an initial six year exploration period. The purchase price of Kul-Bas LLP reflected the fair value of the unevaluated property and was allocated to unevaluated oil and gas properties. On March 13, 2007 the Company, through its wholly owned subsidiary TKL, entered into an agreement with the holders of the remaining 30% of BN Munai to acquire their share in full in return for shares in the Company.

NOTE 4 – PREPAYMENTS

Prepayments consisted of the following:

	December 31, 2007	December 31, 2006
Contractors	3,062	3,882
Other	351	331
Balance	3,413	4,213

Prepaid Contractors relate to a supplier who was paid in advance for materials and services related to the drilling of four wells on the Akkulka and Kul Bas contracts in Kazakhstan. Other prepayments primarily relate to prepaid insurance and other operating expense items.

NOTE 5– RESTRICTED CASH

Restricted Cash at December 31, 2007 consisted of bank deposits with maturity dates of April 27, 2008 and December 28, 2008. These deposits have been placed to satisfy local Kazakhstan requirements in respect of asset retirement obligations.

NOTE 6 – VALUE ADDED TAX RECOVERABLE

VAT recoverable represents VAT on capital expenditures in Kazakhstan that is allowed as an offset against VAT on revenues.

NOTE 7 - CAPITAL ASSETS

Capital assets, net of accumulated depletion, depreciation and amortization ("DD&A") and impairment, include the following at December 31, 2007:

	Cost	Accumulated DD&A And Impairment	Net Capital Assets
Oil and Gas Properties			
Proved properties	39,727	(12,975)	26,752
Unproved properties	7,749	-	7,749
	47,476	(12,975)	34,501
Plant and Equipment			
Oil & Gas Equipment	2,057	-	2,057
Vehicles	579	(19)	560
Office equipment, furniture, fixtures and other	386	(32)	354
	3,022	(51)	2,971
	50,498	(13,026)	37,472

Capital assets, net of accumulated DD&A, include the following at December 31, 2006:

	Cost	Accumulated DD&A And Impairment	Net Capital Assets
Oil and Gas Properties			
Proved properties	8,683	-	8,683
Unproved properties	3,157	-	3,157
	11,840	-	11,840
Plant and Equipment			
Oil & Gas Equipment	179	-	179
Office furniture, fixtures and Equipment and other	337	(38)	299
	516	(38)	478
	12,356	(38)	12,318

An impairment adjustment of US$12,800,000 was required under the US GAAP ceiling test which is calculated on proved reserves only at the constant prices. The prices used in valuing the reserves were US$0.90 per Mcf for the existing Kyzyloi gas sales contract and US$3.38 per Mcf for future gas sales. Under Canadian GAAP an allowance would have been made for probable reserves and there would have been no need for the impairment adjustment. No impairment was necessary in 2006.

Following the commencement of gas production from the Kyzyloi gas field on December 19, 2007 the Kyzyloi costs, included in the Proved Properties, were depreciated on a unit of production basis

Costs of the Akkulka Licence and Contract including a five well exploration program initiated in 2006, and a further ten well program initiated in the second quarter of 2007 have been included in Proved Properties at December 31, 2007. At December 31, 2006 the Akkulka property costs were included in Unproved Properties.

Unproved property additions relate to activity being carried out in properties where as yet there are no proved reserves and at December 31, 2007 this consisted of the Kul Bas Exploration and Production Contract. A well drilling exploration program had been initiated on the Kul bas contract in the final quarter of 2007 but none had been completed by December 31, 2007.

In the period to December 31, 2007 US$ 316,200 was capitalized from G&A while in 2006 the amount was US$143,000.

Oil & gas Equipment in 2007 includes construction in progress in relation to a drilling rig and as such this was not subject to depreciation.

NOTE 8 – CURRENT LIABILITIES

Current liabilities consisted of the following at:

	December 31, 2007	December 31, 2006
Trade payables	1,182	798
Education fund obligations	206	80
Accrued and other liabilities	891	453
Balance	2,279	1,331

Each of the Kyzyloi, Akkulka and Kul Bas contracts in Kazakhstan require that a sum equivalent to 1% of the capital expenditure incurred on the respective work programs is provided for the professional education of its Kazak personnel.

NOTE 9 – LONG TERM DEBT

The Loan included in the accounts to December 31, 2006 was repaid in June 2007, resulting in a loss on retirement of US$1,916,000 that has been included in the interest expense.

	December 31, 2007	December 31, 2006
Tethys Senior Secured Notes	-	5,000
Unamortized debt discount	-	(1,916)
Balance	-	3,084

There was a charge to the Company of US$238,000 in relation to the warrants issued to the lenders under the terms of the Short–Term Loan agreement. This figure has been included in the shares, warrants and options expenses.

NOTE 10 – NON CURRENT LIABILITIES

Other non current liabilities relates to the accrual of Historic Costs due to the Government of Kazakhstan on the Kyzyloi contract in Kazakhstan. The total amount outstanding at December 31, 2007 was US$1,081,000an this is to be paid in quarterly instalments between January 2008 and March 2014. The figure shown reflects the net present value of the US$1,081,000 using an interest rate of 10%.

NOTE 11 – ASSET RETIREMENT OBLIGATION

The asset retirement obligation is comprised the following:

	December 31, 2007	December 31, 2006
Balance at beginning of year	451	354
New obligations incurred	175	62
Accretion of expense	35	35
Balance at end of year	661	451

NOTE 12 – NON-CASH MOVEMENTS

Changes in Capital Expenditures

The following provides the reconciliation between the Balance Sheet movements in Capital Assets to the Changes in Capital Expenditures reported on the Consolidated Statements of Cash Flows:

	December 31, 2007	December 31, 2006
Balance Sheet movement in Capital Assets, net	25,154	10,418
Non Cash Capital Asset movements:		
Purchase in exchange for company shares	(15,000)	-
Ceiling test impairment	12,800	-
Changes in asset retirement obligations	(175)	(60)
Changes in Accumulated DD&A	222	32
Capital Expenditures	23,001	10,390

NOTE 13 - COMMITMENTS AND CONTINGENCIES

Kyzyloi Field Licence and Gas Production Contract

As at December 31, 2007, Tethys' subsidiary BN Munai (BNM) had completed the construction of the pipeline for the Kyzyloi field development in Kazakhstan. BNM owns 100% of the interest in Kyzyloi Field License and Gas Production Contract #1734 dated May 5, 2005. The Kyzyloi Field License and Gas Production Contract was concluded for an initial period until June 12, 2007. The Kyzyloi Field License and Gas Production Contract was further extended on November

8, 2007 until June 13, 2014. According to the Kyzyloi Field License and Gas Production Contract and amendments to the contract BNM is committed to the following obligations:
Until June 13, 2014 BNM is obliged to spend additional US$2,687,000 minimum work program on development of the contractual territory, At least 30% of equipment, materials and goods required for the fulfilment of the Kyzyloi Field License and Gas Production Contract should be produced in Kazakhstan (local content requirement). At least 90% of services required for the fulfilment of the Kyzyloi Field License and Gas Production Contract should be purchased from Kazakh legal entities (local content requirement).

At least 90% of employees of the company should be Kazakh nationals (local content requirement) and at least 1% of the operating costs should be spent on training of Kazakh nationals (local content requirement) and at least US$30,000 annually should be spent on social-economic support of the region. Tethys currently meets these all of these requirements. Under the terms of Kyzyloi Field Licence and Production Contract, historic costs totalling US$1,211,000 are payable in equal portions of US$43,244 on a quarterly basis to the Kazakhstan government from the third year of production. Three quarterly payments in 2007, totalling US$130,000 were included in the year to December 31, 2007 leaving an outstanding balance of US$1,081,000. The quarterly payments are due to continue until March 2014.

Akkulka Field Exploration Licence and Contract

BNM owns 100% of the interest in Akkulka Field Exploration License and Contract #265 dated November 17, 1998. The contract initially granted BNM the exploration rights for a period of 5 years, however, the terms of the contracts have been extended three times; on July 5, 2004 the terms of the Contract were extended until September 17, 2005, on June 26, 2006 the extension was until September 17, 2007, and on November 8, 2007 the terms of the contract were further extended until September 17, 2009.

According to the Akkulka Field Exploration License and Contract and amendments to the contract BNM is committed to a number of obligations. The initial commitment under the agreed work program was US$14,780,000 of expenditures over the initial 5 year term of the Akkulka Field Exploration License and Contract. Then the amendment signed on July 5, 2004 committed BNM to an additional US$2,828,000 minimum work program on exploration of the contractual territory, this expenditure to be incurred prior to September 17, 2005 while the amendment signed on June 26, 2006 required a further minimum work program of US$6,854,000 to be incurred by September 17, 2007. The amendment signed on November 8, 2007 obliged BNM to spend additional US$1,850,000 minimum work program on exploration of the contractual territory (i.e. spend at least US$500,000 on drilling 5 additional exploration wells, spend at least US$250,000 on geological studies etc.). The above expenditures should be incurred prior to September 17, 2009.

In the event that a commercial discovery occurs, royalty rates payable will be established in a production contract for which BNM will have the exclusive right to negotiate. The royalty payable is variable; however, it ranges from between 2% and 6%, depending on the size of the deposit and is set 30 days before production commences. Furthermore, on commencement of commercial production, an additional payment in the amount of US$3,500,000 will also be due to the Kazakh government for the reimbursement of historical expenses; the amount and procedure of reimbursement will be subject to the terms and conditions to be set out in the production contract.

Kul-Bas LLP ("Kul-Bas")

Kul-Bas owns 100% interest in "Kul-Bas Exploration and Production Contract" #1897 dated November 11, 2005 (also known as "Greater Akkulka Exploration and Production Contract"), which was concluded for 25 years (first 6 years of exploration and 19 years of production). According to the Greater Akkulka Exploration and Production Contract Kul-Bas is committed to a number of obligations. At least 20% of produced crude oil should be sent to Kazakh refineries (during production period) and 100% during the exploration period while any associated gas should be utilized in accordance with the applicable environmental legislation. At least 50% of equipment, materials and goods required for the fulfilment of the Greater Akkulka Contract should be produced in Kazakhstan and at least 95% of employees of the company should be Kazakh nationals (local content requirement). .

With regard to services required for the fulfilment of the Greater Akkulka Exploration and Production Contract a minimum of 70% should be purchased from Kazakh legal entities. Only if the required services cannot be provided by Kazakh suppliers may they be purchased from foreign suppliers, provided the competent authority approves such services. During the exploration period at least 1% of the exploration costs and during the production period at least 0.1% of the operating costs should be spent on training of Kazakh nationals. At least US$10,000 annually should be spent on social-economic support of the region. .

The work program on Greater Akkulka Exploration area amounts to a total of approximately US$7,700,000 over the initial six year exploration period, that started with a US$160,000 commitment in 2006, a US$940,000 commitment for 2007 and a US$3,000,000 commitment for 2008. The royalty payable can range from 4% to 6% depending on the size of the deposit and will be set 30 days before production commences. The government is to be compensated for the historical costs related to Greater Akkulka area in the amount of US$3,275,780 in three stages. Stage 1 required that US$4,914 to be paid within 30 days of the conclusion of the Contract then US$44,223 not later than January 1, 2005 and then after commencement of the commercial production US$88,666 quarterly until the remaining historical costs of US$3,226,643 are fully paid.

Sales Contract

On 5 January 2006 Tethys' Kazakhstan subsidiary, BN Munai LLP ("BNM") executed a natural gas supply contract with Gaz Impex S.A. ("Gaz Impex") relating to gas sales from BNM's Kyzyloi field in Kazakhstan. In December 2007 this contract was assigned to Kazakhstani Petrochemical Company Kemikal LLP, who will utilise the gas in the domestic Kazakh market. The agreed price is US$1.02 per thousand cubic feet (Mcf) (US$36.2 per Mcm) including VAT which can be offset against VAT costs on the Kyzyloi project. The average daily contract quantity for the first two months was estimated at 21.2 million cubic feet (MMcf) (600 thousand cubic metres (Mcm)) from an initial six wells and is expected to increase to approximately 22.1 MMcf (625 Mcm) of gas per day by March of 2008.

Tajikistan

On September 7, 2007 the Company announced that its wholly owned subsidiary, Tethys Tajikistan Limited, had signed an Investment and Operating Agreement (the "IOA") with Southern Oil and Gas Exploration State Unitary Enterprise ("SOG") relating to oil and gas fields in Southern Tajikistan. The IOA had been agreed to and supported by the Ministry of Energy and Industry of the Republic of Tajikistan (the "Ministry"). SOG is a wholly state-owned oil and gas company reporting to the Ministry that holds the production licenses to a number of fields in the Kulob Area in southern Tajikistan over which Tethys negotiates a Production Sharing Agreement ("PSA"). The IOA allows Tethys to commence initial production operations in the Kulob Area whilst the Tajikistan government finalizes certain necessary legislative changes to enable the recently adopted Production Sharing Legislation to become effective. Once the legislative changes are in place Tethys intends to progress and finalize negotiations on the PSA, and the Ministry recommended that the IOA be entered into as a precursor to the execution of the PSA and to provide assistance to Tethys in obtaining a PSA for the Kulob Area**.** On December 24, 2007 Tethys announced that it had signed an agreement (the "Agreement") to take a partner in its projects in Tajikistan.

Drilling Rig

On October 16, 2007 Tethys also that it had placed an order for a new 2,000 horsepower (1,470 kN) ZJ70/4500L drilling rig from a Chinese supplier. This rig, which has a nominal drilling depth of 23,000 feet (7,000 metres), is due to be completed within 6 months. The rig will initially be transported to Akkulka for use on the Akkulka deep exploration program which is planned to commence in May/June 2008. It is planned that the rig will be operated by Tethys' current Kazakh drilling contractor under a management agreement. The rig would also be suitable for drilling on the potentially large prospects Tethys has identified in the Kulob area of Tajikistan over which Tethys is currently finalising a Production Sharing Agreement and where work is commencing under its Investment Operating Agreement. The cost of the rig and support equipment to be purchased is anticipated to be US$9.2 million and, whilst the Company paid the deposit of US$1,878,900 in October and a stage payment of the same amount in January 2008.

On March 19, 2008 the Company announced that it had recently completed a financing arrangement for funds of US$5.3 million to assist with the purchase of the rig by means of a 3 year loan with monthly payments of interest and capital and a final balloon payment. The average annual interest payable expressed as a percentage of the total borrowed funds is 9.3%. 795,000 warrants to purchase Tethys shares were also issued to the lenders with a term of 3 years and an exercise price of CAD$3.25. Lenders have security over the shares of TPI which has no other assets except the drilling rig. No corporate guarantees or security are being provided by Tethys. To December 31, 2007 Tethys has incurred US$1,878,900 of costs with respect to this rig.

NOTE 14 – INCOME TAXES

Tethys and its domestic subsidiary Tethys Kazakhstan Limited have been granted exemption from Guernsey Income Tax under the Income Tax (Exempt Bodies) (Guernsey) Ordinance, 1989 and hence are liable for a payment of a Guernsey exemption fee at a fixed rate of US$1,000 (£600) per annum. With effect from January 1, 2008 Guernsey has restructured its tax regime and the standard rate of income tax for companies has moved to 0%. Tethys Petroleum Limited and Tethys Kazakhstan will therefore be taxed at the standard rate of 0%.

The Company has foreign subsidiaries based in the Republic of Kazakhstan where the statutory rate of income tax is 30% for all periods presented. No provision for income taxes have been provided in the consolidated financial information as Tethys combined Kazakhstan subsidiaries recorded losses for all periods presented. Tethys's Kazakhstan subsidiaries had calculated the aggregate net operating losses carried forwards of US$2,377,000, US$77,000 and US$27,000 as at December 31, 2007, 2006 and 2005 respectively. Tethys' Kazakhstan net operating losses carried forwards expire from 2012 to 2014. Tethys' available net operating losses carried forwards may be used to offset future taxable income, if any, prior to their expiration. A deferred tax asset existed as at December 31, 2007, 2006 and 2005 but due to uncertainty in the realizability of these tax assets the Company has recorded a full valuation allowance at the end of each of these periods.

Tethys' subsidiaries in Tajikistan would be subject to a statutory rate of income tax of 25%.

NOTE 15 – SHAREHOLDERS' EQUITY

During the years ended December 31, 2007 and 2006 the following transactions regarding Tethys' Ordinary Shares were consummated pursuant to authorization by Tethys' Board of Directors.

Year ending December 31, 2007

The Company obtained the approval for a 1 for 5 Share Consolidation on May 8, 2007 when an ordinary resolution of shareholders approving such consolidation was filed with the Guernsey companies register. As a result 26,934,878 Ordinary Shares were issued to replace the existing 134,674,390 after giving effect to the issuance of the 30,000,000 shares relating to the BN Munai acquisition. Following the Share Consolidation it was resolved to maintain the number of authorized shares at 500,000,000. Comparative earnings per share data has been restated to reflect the share consolidation.

On June 27, 2007 Tethys successfully completed an IPO and listed on the Toronto Stock Exchange having placed 18,181,818 at a price of US$ 2.75 raising US$ 50 million (gross).

Year Ended December 31, 2006

On October 23, 2006 each of the ordinary shares in the capital of the Company (whether issued or not) were sub-divided into 10 ordinary shares of £0.01 each in the Capital of the Company. The authorized share capital was then increased to £5,000,000 divided into 500,000,000 ordinary shares of £0.01 par value.

On October 23, 2006 the Company capitalized an inter-company loan in the amount of US$22,296,000 from its parent, CanArgo Energy Corporation, into 69,000,000 ordinary shares that were issued to CanArgo Limited pursuant to such capitalization. 69,000,000 were issued at £0.01 par value per share. The par value was recorded at £690,000 and converted to US$1,288,275 at a rate of 1.8671.

No dividend has been declared or paid during the years ended December 31, 2007 or December 31, 2006.

NOTE 16 – STOCK BASED COMPENSATION

The Company has adopted a stock incentive plan referred to as the “2007 Long Term Stock Incentive Plan” pursuant to which the Company may grant stock options to any director, employee or consultant of the Company, or any subsidiary or Vazon (collectively, “Service Providers”). The purpose of the plan is to secure for the Company and its shareholders the benefits of incentives inherent in share ownership by Service Providers who, in the judgment of the Board of Directors, will be largely responsible for its future growth and success.

The maximum number of Ordinary Shares reserved for issuance under the plan equals 10% of the outstanding Ordinary Shares after giving effect to the Treasury Offering. The plan is administered by the Compensation and Nomination Committee of the Board of Directors. Options may be granted pursuant to recommendations of the Compensation and Nomination Committee. The Compensation and Nomination Committee may determine the vesting schedule and term, provided that options may not have a term exceeding ten years. Subject to any resolution passed by the Compensation and Nomination Committee, options will terminate three months after an optionee ceases to be a Service Provider.

The exercise price of options granted under the plan may not be less than the closing price of Ordinary Shares on the principal stock exchange where the Ordinary Shares are listed as of the date of the option grant. The plan contains amendment provisions which allow amendments to the plan by the Board of Directors, without shareholder approval, for amendments of a “housekeeping” nature, changes to vesting or termination provisions, and discontinuance of the plan. The plan also provides that outstanding options will vest immediately on the occurrence of a “change of control” (as defined in the plan). Options granted under the plan are only assignable to certain related entities of an optionee or otherwise with the consent of the Company.

The plan does not contain any restriction on the number of Ordinary Shares which may be reserved for issuance in respect of options granted to insiders under the plan or pursuant to any other share compensation arrangement. Accordingly, amendments to the plan and other compensation arrangements of the Company which require approval of shareholders will require approval of disinterested shareholders for as long as the number of Ordinary Shares reserved for issuance under the options or other share compensation arrangements exceeds 10% of the outstanding Ordinary Shares and the plan or share compensation arrangements do not limit the participation of insiders to 10% of outstanding Ordinary Shares.

The Company has approved the grant to its executive officers of warrants (the “Performance Warrants”) to acquire 6,767,504 Ordinary Shares. The Performance Warrants will be exercisable at US$4.125 through the period ending December 25, 2009 in respect of 1,353,501 Ordinary Shares, US$5.50 through the period ending June 25, 2011 in respect of 2,255,835 Ordinary Shares, and US$6.875 through the period ending December 25, 2012 in respect of 3,158,168 Ordinary Shares.

Annual Activity

Stock options – The following table summarizes the stock option activity under the 2007 Long Term Stock Incentive Plan for the fiscal year ended December 31, 2007.

	Number of Options	Weighted Average Exercise Price	Aggregate Intrinsic Value (thousands)	Weighted Average Remaining Term (in years)
Outstanding at January 1, 2007	0	N/A		
Granted	4,497,000	$2.76		
Forfeited	0	0		
Exercised	0	N/A		
Expired	0	N/A		
Outstanding at December 31, 2007	4,497,000	$2.76	$875	6.51
Exercisable at December 31, 2007	1,499,000	$2.76	$292	6.51

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company’s stock price on December 31, 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders if all option holders had exercised their options on December 31, 2007. This amount changes based on the fair market value of the Company’s stock.

For options granted during the fiscal year ended December 31, 2007, the weighted average fair value on the date of grant, estimated using the Black-Scholes option pricing model was US$1.6108 per option, using the following weighted average assumptions: dividend yield of 0%; expected term of 4.0 years; a risk free interest rate of 4.85%; and an expected volatility of 74.2%.

For the fiscal year ended December 31, 2007, there was US$3.4 million of pre-tax compensation expense for options granted under the 2007 Long Term Stock Incentive Plan. As of December 31, 2007, there was US$3.5 million of total unrecognized compensation expense related to unvested stock options granted under the plan. The Company expects to recognize the expense over a weighted-average period of 1.51 years.

Warrants - The following table summarizes the warrant activity, including Performance Warrants, for the fiscal year ended December 31, 2007.

	Number of Options	Weighted Average Exercise Price	Aggregate Intrinsic Value (thousands)	Weighted Average Remaining Term (in years)
Outstanding at January 1, 2007	0	N/A		
Granted	8,857,504	$5.07		
Forfeited	0	0		
Exercised	0	N/A		
Expired	0	N/A		
Outstanding at December 31, 2007	8,857,504	$5.07	$941	5.20
Exercisable at December 31, 2007	8,857,504	$5.07	$941	5.20

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company's stock price on December 31, 2007 and the exercise price, multiplied by the number of in-the-money warrants) that would have been received by the warrant holders if all warrant holders had exercised their warrants on December 31, 2007. This amount changes based on the fair market value of the Company's stock.

For warrants granted during the fiscal year ended December 31, 2007, the weighted average fair value on the date of grant, estimated using the Black-Scholes pricing model was US$1.5916 per warrant, using the following weighted average assumptions: dividend yield of 0%; expected term of 5.71 years; a risk free interest rate of 4.94%; and an expected volatility of 85.4%.

For the fiscal year ended December 31, 2007, there was US$14.1 million of pre-tax compensation expense for granted warrants. All the granted warrants were immediately vested. As of December 31, 2007, there was no unrecognized compensation expense related to unvested warrants.

NOTE 17 - NET LOSS PER COMMON SHARE

Basic net loss per common share is computed by dividing the net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding during the applicable period. Diluted per share information is calculated, including the dilutive effect of stock options which are determined using the treasury stock method. The treasury stock method assumes that the proceeds that would be obtained upon exercise of "in the money" options would be used to purchase common shares at the average market price during the period. No adjustment to diluted earnings per share is made if the result of this calculation is anti-dilutive.

NOTE 18 - RELATED PARTY TRANSACTIONS

Upon completion of the private placement of shares in February 2007 Kraken Financial Group, which has one common director with the company, was duly registered as a shareholder in the Company having received 2% commission in the form of 411,271 shares (pre-split). During the course of the placement process Kraken Financial Group had managed the Escrow Bank Account into which funds were paid by each of the investors until all of the funds were present at which point they were paid over to the Company and the shares issued. For the provision of this service Kraken Financial Group was paid the sum of US$19,500 (£10,000). A fee of US$60,000 was paid to Paul Murphy for his part in introducing the investors. Kraken Financial Group also acted as broker for Tethys in the placement of the D&O insurance for which the annual premium was US$112,000.

Up to the date of the listing of Tethys on the Toronto Stock Exchange CanArgo Energy Corporation provided administrative services, which generally consisted of office space, telephones, utilities and other administrative type costs, to Tethys via a management services agreement between CanArgo Energy Corporation, Tethys and Vazon Energy Limited. Vazon Energy Limited is a corporation organized under the laws of the Bailiwick of Guernsey, of which Dr. David Robson, Chief Executive Officer, is the sole owner and managing director. In addition, a management services agreement existed between CanArgo Energy Corporation and Vazon Energy whereby the services of Dr. Robson, Ms. Landles (Corporate Secretary and Executive Vice President) and other Vazon Energy employees, were provided to CanArgo Energy Corporation. Fees paid to by the Company to Canargo during this period amounted to US$600,000. A management services contract directly with Vazon Energy came into effect from June 27th, 2007 whereby a monthly fee is paid for the services of Dr Robson, a separate monthly fee for other Vazon employees and an invoice for all other services and costs is to be issued to Tethys at the end of each month. The total costs charged to Tethys in the year to December 31, 2007 by Vazon was US$522,537.

Mr. Russell Hammond, a non-executive director of Tethys and CanArgo Energy Corporation is also an Investment Advisor to Provincial Securities Limited. Provincial Securities Limited had an interest in Tethys Petroleum Limited which was sold in June 2005 to CanArgo Energy Corporation by a share exchange for shares in CanArgo Energy Corporation. Provincial Securities Limited received 5,500,000 shares of Canargo Energy Corporation common stock in relation to the transaction. Mr Hammond did not receive any compensation in connection with these transactions and disclaims any beneficial ownership of Provincial Securities Limited or any of the Company's common stock owned by Provincial Securities Limited.

Transactions with affiliates or other related parties including management of affiliates are to be undertaken on the same basis as third party arms-length transactions. Transactions with affiliates are reviewed and voted on solely by non-interested directors.

NOTE 19 – SUBSEQUENT EVENTS

On January 15, 2008 the Company announced a new gas discovery with the results of the Akkulka AKK13 exploration well in Kazakhstan.

On March 19, 2008 the Company announced that it had secured financing in the amount of US$5,300,000 for purchase of the drilling rig from China by means of a 3 year loan with monthly payments of interest and capital and a final balloon payment. The average annual interest payable expressed as a percentage of the total borrowed funds is 9.3%. 795,000 warrants to purchase Tethys shares were also issued to the lenders with a term of 3 years and an exercise price of CAD$3.25. Lenders have security over the shares of TPI which has no other assets except the drilling rig. No corporate guarantees or security are being provided by Tethys. The ZJ 70 mechanical drilling rig which is capable of drilling 23,000 feet (7,000 metres) will be one of the largest rigs in Kazakhstan. This purchase gives Tethys the benefits of significant flexibility and lower costs over hiring a third party drilling company. The rig would also be available for third party contracts based on Tethys' work programme, and will be used for drilling of the deeper prospects in Tajikistan. Delivery of the rig is expected in Kazakhstan in Q2 of 2008 with drilling expected to commence in Q3 of 2008.

NOTE 20 – CANADIAN ACCOUNTING PRINCIPLES AND REPORTING

The Consolidated Financial Reports have been prepared in accordance with accounting principles generally accepted in the USA (US GAAP) which in most respects conform to accounting principles generally accepted in Canada (Canadian GAAP). The differences between US GAAP and Canadian GAAP that apply to the Company are explained in this note.

RECONCILIATION ON NET EARNINGS BETWEEN US GAAP AND CANADIAN GAAP

	Year ended December 31,	
	2007	**2006**
Net Loss and Comprehensive Loss under US GAAP	(41,779)	(6,943)
Add back:		
Impairment on Proved Properties	12,800	-
Net Loss and Comprehensive Loss under Canadian GAAP	(28,979)	(6,943)
Basic and diluted loss per share under Canadian GAAP	$0.87	$2.47

CONSOLIDATED STATEMENT OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT – CANADIAN GAAP

	2007	**2006**
Operating Revenue	194	-
Expenses		
Selling, General & Admin Exp.	27,342	5,124
Depreciation, depletion & amortization	257	32
Other	1,574	1,787
Net Loss and Comprehensive Loss under Canadian GAAP	(28,979)	(6,943)
Tax	-	-
Net Loss and Comprehensive Loss after tax under Canadian GAAP	(28,979)	(6,943)
Deficit – Beginning of the year	(9,846)	(2,903)
Deficit – End of year	(38,825)	(9,846)

CONDENSED CONSOLIDATED BALANCE SHEET

	2007	**2006**
Assets		
Current Assets	28,052	2,096
Non Current Assets	6,132	5,173
Property, Plant & Equipment	50,498	12,356
Depreciation, depletion & amortization	(226)	(38)
Total Assets	84,456	19,587

Liabilities and Stockholder Equity

Current Liabilities	2,279	1,331
Non Current Liabilities	1,437	3,567
Total stockholder equity	80,740	14,689
Total liabilities and stockholder equity	84,456	19,587

RECENT ACCOUNTING PRONOUNCEMENTS – CANADIAN GAAP

CICA Handbook Section 3031 “Inventories”. The new standard requires inventory to be valued on a first-in, first-out or weighted average basis, which is consistent with Tethys’ current treatment. The adoption of this standard should not have a material impact on Tethys’ Consolidated Financial Statements.

CICA standards, Section 3862 “Financial Instruments – Disclosures” and Section 3863 “Financial Instruments – Presentation”, which will replace Section 3861 “Financial Instruments – Disclosure and Presentation”. The new disclosure standard will increase disclosure regarding the risks associated with financial instruments and how those risks are managed. The adoption of these standards should not have a material impact on Tethys’ Consolidated Financial Statements.

CICA Handbook Section 1535 “Capital Disclosures” which will require the disclosure of the objectives, policies and processes for managing capital.

In January 2006, the CICA Accounting Standards Board (“AcSB”) adopted a strategic plan for the direction of the accounting standards in Canada. As part of that strategic plan, accounting standards for public companies are expected to converge with International Financial Reporting Standards (“IFRSs”). In March 2007, AcSB released an “Implementation Plan for Incorporating IFRSs into Canadian GAAP”, which assumes a convergence date of January 1, 2011. Following a progress review, AcSB is expected to confirm this date by March 31, 2008. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.