THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt *as to any aspect of this circular or as to the action to be taken, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.*

If you have sold or transferred *all your shares in United Energy Group Limited, you should at once hand this circular together with the accompanying form of proxy to the purchaser or other transferee or to the bank, stockbroker or other agent through whom the sale was effected for transmission to the purchaser or transferee.*

The Stock Exchange of Hong Kong Limited takes no responsibility for the contents of this circular, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this circular.

This circular is for information purposes only and does not constitute an offer or invitation to subscribe for or purchase any securities, nor is it calculated to invite any such offer or invitation.

This circular is not for distribution, directly or indirectly, in or into the United States (including its territories and possessions, any State of the United States and the District of Columbia). Any securities mentioned herein have not been, and will not be, registered under the United States Securities Act of 1933 (the "Securities Act").

Any securities mentioned herein may not be offered or sold in the United States or to, or for the account or benefit of, US persons (as such term is defined in Regulation S under the Securities Act) except pursuant to an exemption from the registration requirements of the Securities Act. There will be no public offer of securities in the United States.

UNITED ENERGY GROUP LIMITED
聯合能源集團有限公司

(incorporated in Cayman Islands and continued in Bermuda with limited liability)

(Stock Code: 467)

VERY SUBSTANTIAL ACQUISITION
INVESTMENT IN TRANSMERIDIAN
AND
GENERAL MANDATE
ISSUE OF CONVERTIBLE BONDS

Financial Adviser

Citigroup Global Markets Inc.

A letter from the Board of United Energy Group Limited is set out on pages 9 to 45 of this circular.

A notice convening an SGM (as defined in this circular) to be held at Room 1501-02, 15/F., Hong Kong Club Building, 3A Chater Road, Central, Hong Kong on Thursday, 16 October 2008 at 10:00 a.m. is set out on pages N-1 to N-2 of this circular. Whether or not you are able to attend the SGM, please complete the enclosed form of proxy in accordance with the instructions printed thereon and return it to the office of the Company's branch share registrar and transfer office in Hong Kong, Tricor Secretaries Limited, at 26th Floor, Tesbury Centre, 28 Queen's Road East, Hong Kong, as soon as possible and in any event, not later than 48 hours before the time appointed for the holding of the SGM or any adjourned meeting. Completion and return of the form of proxy will not preclude you from attending and voting in person at the SGM or at any adjourned meeting should you so wish.

30 September 2008

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In this circular, unless the context otherwise requires, the following expressions have the following meanings:

"Additional Return Agreements"	:	the 20% junior redeemable convertible preferred stock Additional Return Agreement, dated 18 June 2007, among Transmeridian, Kenmont Special Opportunities Master Fund, L.P., and other investors and (b) the 20% junior redeemable convertible preferred stock Additional Return Agreement, dated 26 June 2007, among Transmeridian, Capital Ventures International and others investors
"Additional Returns"	:	the total aggregate amount of US$14.1 million to be paid by the Company to the initial purchasers of the Junior Preferred Stock pursuant to the terms of the Investment Agreement and the Junior Preferred Stock Purchase Agreement
"Additional Warrants"	:	has the meaning set out on page 15 of this circular
"Advanced Stage Potential Transaction"	:	The Advanced Stage Potential Transaction as defined in the announcement made by the Company on 10 June 2008
"AG 3.340"	:	has the meaning set out on page I-1 of this circular
"associates"	:	the meaning ascribed to it in the Listing Rules
"Board"	:	the board of Directors of the Company
"business day"	:	any day on which the principal offices of the Securities and Exchange Commission in Washington, D.C., the U.S.A. are open to accept filings, or, in the case of determining a date when any payment is due, any day (other than a Saturday or Sunday) on which banks are not required or authorized to close in Hong Kong and New York
"Capital Excess"	:	has the meaning set out on page 14 of this circular
"Caspi Neft"	:	has the meaning set out on page 35 of this circular

"Change of Control Offer"	:	has the meaning set out on page 15 of this circular
"Consideration"	:	has the meaning set out on page 27 of this circular
"Convertible Bonds"	:	the convertible bonds, the details of which are set out on pages 29 to 35 of this circular
"Conversion Price"	:	has the meaning set out in the indicative terms and conditions of the Convertible Bonds on page 30 of this circular
"Conversion Price Fixing Date"	:	has the meaning set out in the indicative terms and conditions of the Convertible Bonds on page 30 of this circular
"Common Stock"	:	the common stock of par value US$0.0006 per share of Transmeridian
"Company"	:	United Energy Group Limited, a company with limited liabilities incorporated in the Cayman Islands and continued in Bermuda, the Shares of which are listed on the main board of the Stock Exchange
"Closing"	:	closing of those transactions under the Investment Agreement
"Closing Date"	:	date of the Closing
"Directors"	:	the directors of the Company
"DNK"	:	has the meaning set out on page 35 of this circular
"Early Redemption Price"	:	has the meaning set out in the indicative terms and conditions of the Convertible Bonds on page 31 of this circular
"Enlarged Group"	:	the Company and its subsidiaries immediately after Closing
"Escrow Agent"	:	has the meaning set out on page 28 of this circular
"Exchange Offer"	:	has the meaning set out on page 13 of this circular

"Exercise Period"	:	has the meaning set out on page 14 of this circular
"Exercise Price"	:	has the meaning set out on page 19 of this circular
"Field"	:	has the meaning set out on page 35 of this circular
"First Tranche Price"	:	has the meaning set out on page 13 of this circular
"First Tranche Preferred Share(s)"	:	has the meaning set out on page 14 of this circular
"Gasha Field"	:	has the meaning set out on page 35 of this circular
"Group"	:	the Company and its subsidiaries
"HKICPA"	:	has the meaning set out on page III-4 of this circular
"Hong Kong"	:	the Hong Kong Special Administrative Region of the People's Republic of China
"Indenture"	:	the indenture in respect of the Senior Notes dated 12 December 2005 among the issuer of the Senior Notes, Transmeridian and certain of Transmeridian's subsidiaries, as guarantors, and the indenture trustee, as supplemented by the first supplemental indenture dated 22 December 2005 and the second supplemental indenture dated 24 May 2006, in respect of the Senior Notes
"Independent Third Party"	:	person(s) or company(ies) and their respective ultimate beneficial owner(s) which, to the best of the Directors' knowledge, information and belief having made all reasonable enquiry, are third parties independent of the Company and connected persons of the Company
"Investment Agreement"	:	the amended and restated investment agreement entered into by the Company and Transmeridian dated as of 11 June 2008 and amended and restated as of 22 September 2008
"Investor Rights Agreement"	:	the amended and restated investor rights agreement dated as of 11 June 2008 and amended and restated as of 22 September 2008

"Irrevocable Proxy"	:	has the meaning set out on page 26 of this circular
"Junior Preferred Stock"	:	the 20% junior redeemable convertible preferred stock of par value of US$0.0006 per share of Transmeridian
"Junior Preferred Stock Purchase Agreement"	:	the junior preferred stock purchase Agreement dated 11 June 2008 and entered into between the Company and the Key Junior Preferred Stockholders
"Key Junior Preferred Stockholders"	:	holder(s) of 74% of the Junior Preferred Stock
"Key Senior Preferred Stockholders"	:	holder(s) of 83% of the Senior Preferred Stock
"Latest Practicable Date"	:	22 September 2008, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained herein
"Listing Rules"	:	the Rules Governing the Listing of Securities on the Stock Exchange
"Mandatory Warrants"	:	has the meaning set out on page 14 of this circular
"Maximun Issue"	:	has the meaning set out on page 32 of this circular
"Mr. Olivier"	:	has the meaning set out on page 26 of this circular
"New Notes Redemption"	:	has the meaning set out on page 16 of this circular
"New Notes"	:	the notes to be issued by the Senior Notes Issuer pursuant to the Exchange Offer
"New Preferred Stock"	:	collectively, the First Tranche Preferred Shares and the Second Tranche Preferred Shares
"Newly Issued Common Stock"	:	has the meaning set out on page 16 of this circular
"Optional Warrants"	:	has the meaning set out on page 15 of this circular

"Oriental Harbour"	:	has the meaning set out on page V-8 of this circular
"Original Issue Date"	:	has the meaning set out on page 14 of this circular
"Preferred Stock"	:	the Senior Preferred Stock and the Junior Preferred Stock, together
"Proceeds"	:	has the meaning set out on page 28 of this circular
"Public Float Requirement"	:	has the meaning set out on page 33 of this circular
"Redemption Payment"	:	has the meaning set out on page 16 of this circular
"Reference Price"	:	has the meaning set out in the indicative terms and conditions of the Convertible Bonds on page 30 of this circular
"Relevant Periods"	:	has the meaning set out on page II-1 of this circular
"Requisite Noteholder Consent"	:	has the meaning set out on page 17 of this circular
"Remaining Shares"	:	has the meaning set out on page 22 of this circular
"Remaining Shares of the Junior Preferred Stock"	:	has the meaning set out on page 13 of this circular
"Remaining Shares of the Preferred Stock"	:	has the meaning set out on page 13 of this circular
"Remaining Shares of the Senior Preferred Stock"	:	has the meaning set out on page 13 of this circular
"Roll-Over and Stock Purchase Transactions"	:	has the meaning set out on page 12 of this circular
"Sale and Purchase Transactions"	:	has the meaning set out on page 12 of this circular
"Second Tranche Price"	:	has the meaning set out on page 14 of this circular

"Second Tranche Preferred Share(s)"	:	has the meaning set out on page 14 of this circular
"Selli Field"	:	has the meaning set out on page 36 of this circular
"Senior Notes"	:	the outstanding 12% senior secured notes due 2010 issued by the issuer of the Senior Notes and guaranteed by Transmeridian and certain of its subsidiaries pursuant to the Indenture
"Senior Notes Issuer"	:	Transmeridian Exploration Inc., a British Virgin Islands company and wholly owned subsidiary of Transmeridian
"Senior Preferred Stock"	:	the 15% senior redeemable convertible preferred stock of par value of US$0.0006 per share of Transmeridian
"Senior Preferred Stock Purchase Agreements"	:	means the agreements between the Company and the Key Senior Preferred Stockholders dated 11 June 2008, the details of which are set out on pages 23 to 24 of this circular
"SGM"	:	the special general meeting of the Company to be convened and held for the Shareholders to consider and approve (among other things), if thought fit, the Transactions contemplated under the Transaction Agreements (including the issue of any Conversion Shares upon conversion in full of any convertible bonds which may be issued)
"Share(s)"	:	share(s) of HK$0.01 each in the share capital of the Company
"Shareholder(s)"	:	holder(s) of Shares
"Shenyang Dadongfang"	:	has the meaning set out on page VI-9 of this circular
"Stock Exchange"	:	The Stock Exchange of Hong Kong Limited
"subsidiary"	:	shall have the meaning ascribed to that term in the Listing Rules

"Swap Closing"	:	the obligations of the Company under the Investment Agreement upon satisfaction of all of the conditions under Article VIII of the Amended and Restated Investment Agreement and all of the conditions under the Stock Purchase Agreements
"Tender Offer"	:	has the meaning set out on page 13 of this circular
"Total Preferred Stock Value"	:	an amount equal to US$100 multiplied by the number of shares of Junior Preferred Stock and Senior Preferred Stock surrendered by the Company to Transmeridian, pursuant to the terms of the Investment Agreement
"Transaction Agreements"	:	collectively, the Investment Agreement, the Senior Preferred Stock Purchase Agreements, the Junior Preferred Stock Agreement, the Investor Rights Agreement, the Irrevocable Proxy, the respective terms and conditions in relation to the New Preferred Stock and the Warrants and Additional Warrants
"Transactions"	:	collectively, the Roll-Over Transactions, the Sale and Purchase Transactions, the Tender Offer, the Exchange Offer, the change of Control Offer, the New Notes Redemption and all other transactions contemplated under the Transaction Agreements
"Transaction Value"	:	has the meaning set out on pages 27 of this circular
"Transmeridian"	:	Transmeridian Exploration Incorporated, a corporation incorporated under the laws of the State of Delaware, the U.S.A., whose Common Stock is listed on the American Stock Exchange
"Transmeridian Board"	:	has the meaning set out on page 21 of this circular
"Transmeridian Conversion Shares"	:	has the meaning set out on page 22 of this circular
"Transmeridian Group"	:	Transmeridian and its subsidiaries

"Unaudited HKFRS Financial Information"	:	has the meaning set out on page II-1 of this circular
"United Petroleum"	:	has the meaning set out on page III-4 of this circular
"U.S.A."	:	the United States of America
"US GAAP Combined Financial Information"	:	has the meaning set out on page I-7 of this circular
"Warrants"	:	the has the meaning set out on page 15 of this circular
"HK$"	:	Hong Kong dollars, the lawful currency of Hong Kong
"US$"	:	United States dollars, the lawful currency of the U.S.A.
"%"	:	per cent

All amounts in US$ have been translated in HK$ at a rate of US$1 = HK$7.8 in this circular for illustration purpose only.

UNITED ENERGY GROUP LIMITED
聯合能源集團有限公司

(incorporated in Cayman Islands and continued in Bermuda with limited liability)

(Stock Code: 467)

Executive Directors:
ZHANG, Hongwei *(Chairman)*
Zhu, Jun
Zhang, Meiying

Independent Non-Executive Directors:
Chau, Siu Wai
San, Fung
Zhu, Chengwu

Registered Office:
Clarendon House
2 Church Street
Hamilton HM11 Bermuda

Principal place of business in Hong Kong:
Unit 2112, 21 Floor
Two Pacific Place
88 Queensway
Hong Kong

30 September 2008

To the shareholders

Dear Sir or Madam,

VERY SUBSTANTIAL ACQUISITION
INVESTMENT IN TRANSMERIDIAN
AND
GENERAL MANDATE
ISSUE OF CONVERTIBLE BONDS

1. INTRODUCTION

On 22 June 2008 and subsequently on 26 September 2008, the Company announced that it has agreed to make an investment in Transmeridian with a value of approximately US$212 million, including a cash injection of US$75 million in Transmeridian to fund Transmeridian's ongoing capital expenditure program and working capital requirements.

The aggregate consideration payable by the Company under the Transactions (excluding the Exchange Offer, the Change of Control Offer and the New Notes Redemption) is approximately US$183.9 million, which will take the form of Convertible Bonds of up to approximately US$16.9 million and the balance in cash.

In addition, pursuant to the Investment Agreement, the Company will be issued Newly Issued Common Stock in exchange for Senior Notes and New Notes held by the Company or any of its affiliates and in return for funding to be provided by the Company or another party of the Exchange Offer, Change of Control Offer and New Notes Redemption, together for an aggregate consideration of approximately US$102.8 million.

The Consideration was determined after arm's length negotiation between the Company on one hand and Transmeridian (for itself and on behalf of the holders of the Senior Notes), the Key Senior Preferred Stockholders, the Key Junior Preferred Stockholders and the holders of Senior Notes on the other hand with reference to publicly available information concerning the Company and Transmeridian respectively, including the trading price of shares over the last twenty-four months and published financial statements, such as the annual and quarterly financial reports of Transmeridian. Reference was also made to other comparable transactions that have taken place between companies operating in the energy sector.

In view of the above, the Directors (including the independent non-executive Directors) consider the terms and conditions of the Transactions and the Transaction Agreements, in particular, the Transaction Value, to be fair and reasonable and are in the interest of the Company and the Shareholders as a whole.

The Transactions constitute a very substantial acquisition for the Company under Chapter 14 of the Listing Rules. Accordingly, the Transactions are subject to the approval of the Shareholders at the SGM.

Citigroup Global Markets Inc. is the financial adviser to the Company in respect of the Transactions.

The main purposes of this circular are to provide you with (i) details of the Transactions; (ii) a letter from the Board of the Company; (iii) financial information of the Company; (iv) financial information on Transmeridian; (v) unaudited pro forma financial information on the Enlarged Group; and (vi) a notice to shareholders of the Company convening an SGM to approve the terms of the Transactions.

To the best of the Directors' knowledge, information and belief, having made all reasonable enquiries, no shareholder of the Company will be required to abstain from voting on the ordinary resolution for approving the Transactions at the SGM.

2. THE TRANSACTIONS

2.1 Introduction

Under the terms of the Transaction Agreements, the Company will be making an investment in Transmeridian with a value of approximately US$212 million, which includes a cash injection of US$75 million in Transmeridian to fund Transmeridian's ongoing capital expenditure program and working capital requirements. This will take place by way of the purchase by the Company of at least 90% of the outstanding shares of each of Transmeridian's Senior Preferred Stock and Transmeridian's Junior Preferred Stock for cash, together with, in the case of one Key Senior Preferred Stockholder, Convertible Bonds. Additionally, Key Junior Preferred Stockholders may receive common stock in Transmeridian. Such securities in Transmeridian acquired by the Company plus US$75 million of cash consideration will be exchanged for new preferred stock (having full voting rights and powers equal to that of Transmeridian's Common Stock) convertible, and warrants carrying rights of subscription, into Transmeridian's Common Stock. Pursuant to the Transaction Agreements, after the Closing Date and prior to the issuance of any Newly Issued Common Stock or exercise of the Warrants, the Company will be able to control 54.8% of the voting rights of Transmeridian.

Pursuant to and subject to the terms and conditions of the Investment Agreement, the Company will exchange Senior Notes and New Notes held by it and fund the Exchange Offer, the Change of Control Offer and the New Notes Redemption for an aggregate amount of cash and principal amount of Senior Notes and New Notes totalling approximately US$117.3 million and receive 260,666,667 Newly Issued Common Stock. Such number of Newly Issued Common Stock when taken together with First Tranche Preferrred Shares and the Second Tranche Preferred Shares will represent in aggregate approximately 77.5% of Transmeridian's enlarged issued Common Stock on a fully diluted basis.

On Swap Closing, the Company will be issued with Additional Warrants, the exercise of which and of the Warrants would result in the Company holding in aggregate approximately 85% of Transmeridian's enlarged issued Common Stock on a fully diluted basis.

2.2 Investment Agreement

Date

11 June 2008 and amended and restated as of 22 September 2008

Parties to the Investment Agreement

(i) the Company

(ii) Transmeridian

Subject matters under the Investment Agreement

Pursuant to the Investment Agreement and subject to the terms and conditions thereof:

1. pursuant to the Stock Purchase Agreements, the Company has agreed to:

   (i) issue Convertible Bonds to a Key Senior Preferred Stockholder, in exchange for which the Company will acquire from the Key Senior Preferred Stockholder all of the Senior Preferred Stock owned by it; and

   (ii) purchase Senior Preferred Stock in cash from certain other Key Senior Preferred Stockholders, one of which had the option to elect to be paid in Convertible Bonds, but chose not to make such election.

   Together these represent approximately 83% of the issued and outstanding Senior Preferred Stock of Transmeridian **(“Roll-Over and Stock Purchase Transactions”**). The aggregate consideration for the Senior Preferred Stock owned by the Key Senior Preferred Stockholders is approximately US$34.6 million (out of which up to approximately US$16.9 million may be paid by way of issue of Convertible Bonds to be issued by the Company) and the aggregate consideration for 100% of the Senior Preferred Stock is approximately US$40.8 million.

2. the Company has agreed to acquire from the Key Junior Preferred Stockholders all of the Junior Preferred Stock owned by them, which represents approximately 74% of the issued and outstanding Junior Preferred Stock of Transmeridian under the terms and conditions of the Junior Preferred Stock Purchase Agreement at the acquisition price of US$76 per share of Junior Preferred Stock or, at the option of Key Junior Preferred Stockholders, a combination of cash and new shares of Common Stock of Transmeridian to be acquired for this purpose by the Company from Transmeridian. The aggregate consideration for 100% of the Junior Preferred Stock is approximately US$68.1 million (which includes the Additional Returns) (“**Sale and Purchase Transactions**”).

The number of new shares of Common Stock to be received by a Key Junior Preferred Stockholder from the Company as consideration shall not exceed 16% of the aggregate consideration to be paid by the Company to the Key Junior Preferred Stockholders.

3. the Company has agreed, subject to the terms and conditions of the Investment Agreement, to make a tender offer ("**Tender Offer**") to acquire (a) all outstanding shares of the Senior Preferred Stock that are not owned by the Key Senior Preferred Stockholders ("**Remaining Shares of the Senior Preferred Stock**") for US$76 per share, in cash and (b) all outstanding shares of the Junior Preferred Stock that are not owned by the Key Junior Preferred Stockholders ("**Remaining Shares of the Junior Preferred Stock**") for US$76 per share in cash (constituting a 24% discount to the face value of the shares), (the Remaining Shares of the Senior Preferred Stock and the Remaining Shares of the Junior Preferred Stock are collectively referred to as the "**Remaining Shares of the Preferred Stock**"). The obligations of the Company under the Tender Offer will be subject to a minimum 90% acceptance threshold, which includes the shares purchased from the Key Senior Preferred Stockholders and the Key Junior Preferred Stockholders.

   The Tender Offer, which had an original expiration date of 12:00 midnight, New York City time, on 29 August 2008 and was previously extended until 22 September 2008, has been extended until 5:00 p.m., New York City time, on 7 October 2008, unless further extended.

4. Subject to the terms and conditions of the Investment Agreement, the Company had the right to request Transmeridian to conduct an Exchange Offer (the "**Exchange Offer**") for Senior Notes in order to effect the Transactions.

   On July 23, 2008, at the Company's request, Transmeridian and the Senior Notes Issuer commenced the Exchange Offer, pursuant to which the Senior Notes Issuer has offered to exchange the Senior Notes for the New Notes and cash. The Exchange Offer, which is subject to a minimum 90% acceptance threshold (excluding the Senior Notes held by the Company), will expire at 12:00 a.m. midnight, New York City time, on 7 October 2008, unless further extended.

   The obligations of the Company under the Investment Agreement and the Stock Purchase Agreements are subject to the completion of the Tender Offer and the Exchange Offer and it is contemplated that the Tender Offer and the Exchange Offer will close simultaneously.

5. Swap Closing under the Amended and Restated investment Agreement

(A) First Tranche Preferred Shares

Under the terms of the Investment Agreement, upon the closing of the transactions described above and the other conditions to closing discussed below, the Company will:

(1) pay into an escrow account the First Tranche Price, which amount will equal: (i) US$151,215,804 minus (ii) (A) the number of shares of Senior Preferred Stock and Junior Preferred Stock acquired by the Company in the transaction times (B) US$100 minus (iii) the Additional Returns to be paid to the holders of Junior Preferred Stock pursuant to the Investment Agreement and the Junior Purchase Agreement;

(2) surrender to Transmeridian all of the shares of Senior Preferred Stock and Junior Preferred Stock acquired by it;

(3) pay the Additional Returns to the holders of Junior Preferred Stock; and

(4) receive 1,512,158 shares of Transmeridian's series B-1 redeemable convertible preferred stock, par value US$0.0006 per share and with face value of US$100 per share (the "**First Tranche Preferred Shares**"), at a conversion price of US$1.40 per share.

(B) Second Tranche Preferred Shares and the Warrants

Pursuant to the Investment Agreement, at the Swap Closing, the Company will:

(1) pay into the escrow account the Second Tranche Price, an amount equal to: (i) US$62,289,696 minus (ii) if the Company elects and the aggregate of the First Tranche Price and US$62,289,696 exceeds US$75,000,000 (any such excess, the "**Capital Excess**"), the amount of the Capital Excess;

(2) receive 622,897 shares of Transmeridian's series B-2 redeemable convertible preferred stock, par value US$0.0006 per share (the "**Second Tranche Preferred Shares**"), at a conversion price of US$1.84 per share, such total

number of shares of Second Tranche Preferred Shares to be proportionately reduced by the Capital Excess the Company elects not to pay;

(3) receive warrants to purchase 33,653,960 shares of Common Stock at US$1.20 per share (the "**Mandatory Warrants**") beginning on the one year anniversary of the date of the Swap Closing (the "**Original Issue Date**") and ending no later than on the ten year anniversary of the Original Issue Date (the "**Exercise Period**"); and

(4) subject to certain events not having occurred, receive warrants to purchase 5,000,000 shares of Common Stock at the subscription price of US$1.00 per share during the Exercise Period (the "**Optional Warrants**" and, together with the Mandatory Warrants, the "**Warrants**").

(C) Common Stock and the Additional Warrants

At Swap Closing, the Company will be required to exchange any Senior Notes and New Notes held by it, or any of its affiliates for (i) a number of shares of Common Stock to be determined based on the aggregate principal amount of the Senior Notes and the New Notes being surrendered, divided by US$0.45, subject to a cap as set out under section 7 below (Change of Control Offer), (ii) warrants to purchase up to 150,000,000 shares of Common Stock at the subscription price of US$0.60 per share during the Exercise Period; and (iii) warrants to purchase up to 75,000,000 shares during the Exercise Period, at the subscription price of US$1.20 per share (the warrants described in (ii) and (iii) of this paragraph, together, the "**Additional Warrants**").

6. Immediately following the completion of the transactions above, Transmeridian intends to redeem any shares of Senior Preferred Stock and Junior Preferred Stock not purchased from the Key Senior Preferred Stockholders and Key Junior Preferred Stockholders or tendered into the Tender Offer, using funds provided by, or at the direction of, the Company and other customary consents and approvals in a transaction of this size and nature.

7. Change of Control Offer

After completion of the Exchange Offer, subject to achievement a 90% acceptance threshold and after Closing, Transmeridian will cause the Senior Notes Issuer to offer to repurchase any Senior Notes not exchanged in the Exchange Offer in accordance with their terms (the "**Change of Control Offer**"). The cash to be paid under the Exchange offer and the Change of Control Offer are to be paid for using funds provided by or at the direction of the Company.

Pursuant to the Investment Agreement, if less than all of the outstanding Senior Notes are so repurchased in the Change of Control Offer, the Senior Notes Issuer and the Company will apply the amount of cash provided for the purposes of the Exchange Offer and the Change of Control Offer and not used to fully repurchase the outstanding Senior Notes (the "**Redemption Payment**") to redeem New Notes on a pro rata basis at par plus accrued but unpaid interest as at the redemption date in an amount equal to the Redemption Payment ("**New Notes Redemption**"). The Senior Notes Issuer will not be required to redeem any outstanding New Notes unless the aggregate principal amount of the New Notes to be redeemed is at least US$2,000,000.

The Investment Agreement provides that Transmeridian shall issue to the Company a number of shares of Common Stock equal to any funding or guarantee provided by the Company or by another party at the direction of the Company of (i) the Exchange Offer, (ii) the Change of Control Offer and (iii) the New Notes Redemption, divided by US$0.45; provided, that the number of shares of Common Stock to be issued to the Company under item (C) in paragraph 5 above (based on the aggregate principal amount of the Senior Notes and the New Notes being surrendered), together with any Common Stock issued to the Company pursuant to the funding of the Exchange Offer, Change of Control Offer and/or the subsequent redemption of any outstanding New Notes (collectively, the "**Newly Issued Common Stock**"), will be capped at 260,666,667 shares. The issue to the Company of the Newly Issued Common Stock contemplates that the Company (or its affiliates) will exchange Senior Notes and New Notes held by the Company or its affiliates and fund the Exchange Offer, the Change of Control Offer and the New Notes Redemption for an aggregate amount of cash and principal amount of Senior Notes and New Notes totalling approximately US$117.3 million.

8. The Company would, on Closing, be entitled to appoint up to six directors of Transmeridian on a seven person board.

The Tender Offer

Under and subject to the terms and conditions of the Amended and Restated Investment Agreement, the Company shall commence the Tender Offer at a time satisfactory to it after the date of the Investment Agreement. The obligation of the Company to accept for payment the Remaining Shares of the Preferred Stock tendered pursuant to the Tender Offer shall be subject to (i) the condition that at least 90% of each of the Senior Preferred Stock and the Junior Preferred Stock, which includes the shares purchased from the Key Senior Preferred Stockholders and the Key Junior Preferred Stockholders, having been validly tendered and not withdrawn prior to the expiration of the Tender Offer and (ii) the satisfaction of each of the other conditions in relation to the Tender Offer as set forth in the Investment Agreement. The Company expressly reserved the right under the Investment Agreement to waive any such condition, to increase the price payable in the Tender Offer, and to make any other changes in the terms and conditions of the Tender Offer subject to the terms and conditions of the Investment Agreement.

The Tender Offer, which had an original expiration date of 12:00 midnight, New York City time, on 29 August 2008 and was previously extended until 22 September 2008, has been extended until 5:00 p.m., New York City time, on 7 October 2008, unless further extended.

The Exchange Offer

Subject to the terms and conditions of the Investment Agreement, the Company had the right to request Transmeridian to conduct an Exchange Offer (the "**Exchange Offer**") for Senior Notes in order to effect the Transactions.

On July 23, 2008, at the Company's request, Transmeridian and the Senior Notes Issuer commenced the Exchange Offer, pursuant to which the Senior Notes Issuer has offered to exchange the Senior Notes for the New Notes and cash. The Exchange Offer, which is subject to a minimum 90% acceptance threshold (excluding the Senior Notes held by the Company), will expire at 12:00 a.m. midnight, New York City time, on 7 October 2008, unless further extended.

The obligations of the Company under the Investment Agreement and the Stock Purchase Agreements are subject to the completion of the Tender Offer and the Exchange Offer and it is contemplated that the Tender Offer and the Exchange Offer will close simultaneously.

First Tranche Preferred Shares, Second Tranche Preferred Shares and their terms and conditions

The terms and conditions attached to the First Tranche Preferred Shares and the Second Tranche Preferred Shares are substantially identical, save for their respective conversion rights. Their brief terms are set out below:

Interest Rate	:	15% per annum.
Dividends	:	payable quarterly, in arrears at the rate per annum of 15% per share.
Transferability	:	freely transferable, subject to applicable securities laws and regulations.
Conversion Rights	:	convertible to Common Stock at any time at the option of the holder of the First Tranche Preferred Shares or the Second Tranche Preferred Shares (as the case may be) at the conversion price of US$1.40 and US$1.84 per First Tranche Share and Second Tranche Share respectively.
Voting Rights	:	except for the election of directors of Transmeridian, holders of the First Tranche Preferred Shares and the Second Tranche Preferred Shares will vote together with Common Stock as a single class on all matters as to which the approval of the stockholders of Transmeridian may be required, on an as-converted basis with full voting rights and powers equal to the voting rights and powers of the holders of Common Stock.

Warrants and Additional Warrants

As a result of the Investment Agreement, the Mandatory Warrants and the Optional Warrants to be issued to the Company will give the Company the right to acquire, during the Exercise Period, approximately 33.7 million shares of Common Stock at the subscription price of US$1.20 per share and 5.0 million shares of Common Stock at the subscription price of US$1.00 per share, respectively.

The Additional Warrants to be issued to the Company will give the Company the right to acquire, during the Exercise Period, 150.0 million shares of Common Stock at the subscription price of US$0.60 per share and 75.0 million shares of Common Stock at a subscription price of $1.20 per share.

The terms and conditions of the Warrants and Additional Warrants are substantially identical, except for the exercise price. Their brief terms are set out below:

Mechanism of Exercise	:	the Warrants and Additional Warrants may be exercised, in whole or in part, at any time and from time to time on or after issue date at the election of the holder of the Warrants and Additional Warrants, upon payment to Transmeridian of the Exercise Price (defined below).
Exercise Price	:	(i) Mandatory Warrants: US$1.20 per share, (subject to adjustment), payable in cash or shares of Common Stock at the warrant holder's election; (ii) Optional Warrants: US$1 per share (subject to adjustment); and (iii) Additional Warrants: (a) warrants to purchase up to 150,000,000 shares of Common Stock at a subscription price of US$0.60 per share during the Exercise Period and (b) warrants to purchase up to 75,000,000 shares during the Exercise Period, at a subscription price of US$1.20 per share.
Transferability	:	Each of the Warrants and the Additional Warrants are not transferable until the commencement of the Exercise Period, may be exercised by cashless exercise during the Exercise Period, and the exercise price is subject to anti-dilution adjustments for dividends, subdivisions, combinations and reclassifications of Common Stock and for other distributions, as well as for issuances of Common Stock for less than the then-current exercise price on a weighted-average basis.

Status of the Common Stock to be issued upon exercise of the Warrants and Additional Warrants	:	the Common Stock, when issued pursuant to the exercise of any Warrant or Additional Warrants, will be duly and validly issued, fully paid and non-assessable and free from all taxes, liens, charges and security interests, and other encumbrances or restrictions on sale, and free of all preemptive rights.

Conditions precedent to completion of the Investment Agreement

Closing of the Investment Agreement is subject to the customary consents and approvals expected in a transaction of this size and nature and the satisfaction of the following conditions precedent:

1. the Company or its permitted assignee shall have purchased a number of the Remaining Shares of the Senior Preferred Stock and the Remaining Shares of the Junior Preferred Stock, which, together with the shares of the Senior Preferred Stock and the shares of the Junior Preferred Stock then owned by Purchaser, represents at least 90% of the outstanding shares of each of the Senior Preferred Stock and the Junior Preferred Stock, respectively;

2. the closing of the Rollover and Stock Purchase Transactions shall have occurred pursuant to the Senior Preferred Stock Purchase Agreements;

3. the closings of the Sale and Purchase Transactions shall have occurred pursuant to the Junior Preferred Stock Purchase Agreement;

4. After the closing of the Tender Offer, to the extent that that and only if the Company does not "beneficially" own at least $66^2/_3$% of the outstanding shares of Senior Preferred Stock or the Junior Preferred Stock, Transmeridian shall have obtained from the holders of the Junior Preferred Stock and the Senior Preferred Stock, written consent to amend certain provisions of the Junior Preferred Stock and the Senior Preferred Stock, approve the issuance of the New Preferred Stock and approve any other matters, if any, required by applicable law or reasonably requested by the Company consummate the Transactions;

5. receipt of the Requisite Noteholder Consent and the Company on the other hand; and

6. the Company having obtained 90% acceptance of the Exchange Offer.

Closing of the Investment Agreement shall take place immediately following the satisfaction or waiver of each of the conditions to the obligations of the parties set forth above.

Termination of the Investment Agreement

The Investment Agreement may be terminated and the transactions contemplated thereunder may be abandoned at any time prior to Closing:

1. by mutual written consent of each of the Company and Transmeridian;

2. by either the Company or Transmeridian, if Closing shall not have occurred on or before 31 December 2008;

3. by the Company, (i) if the Senior Preferred Stock Purchase Agreements or the Junior Preferred Stock Purchase Agreement is terminated without any material breach by the Company; (ii) if due to an occurrence or circumstance that would result in a failure to satisfy any condition in relation to the Tender Offer, the Company shall have failed to commence or terminated the Tender Offer or failed to accept the Senior Preferred Stock for payment as required or specified under the Investment Agreement; or (iii) the board of directors of Transmeridian ("**Transmeridian Board**") shall withdraw or modify any approval or recommendation by the Transmeridian Board of any of the Transactions in a manner adverse to the Company or shall have recommended or approved any transaction which involves the merger, liquidation or other similar transactions of the Transmeridian Group or sale or dispose of 15% or more of assets, securities of the Transmeridian Group or other transactions which would impede or materially delay any of the Transactions; or

4. by Transmeridian upon the approval of its board of directors, if due to a material breach by the Company of its representations or warranties or covenants contained in the Investment Agreement that would result in a failure to satisfy any condition to the Tender Offer, the Company shall have failed to commence the Tender Offer or terminated the Tender Offer or failed to accept any Senior Preferred Stock or the Senior Notes for payment pursuant to the Tender Offer as required or specified under the Investment Agreement.

In the event of termination of the Investment Agreement pursuant to the above terms, the Investment Agreement shall become void (other than regarding various provisions in relation to confidentiality) and there shall be no liability on the part of any party thereto, except as set forth in the Investment Agreement and save for any antecedent breaches of the Investment Agreement prior to the date of such termination.

Other material information in relation to the Investment Agreement and transactions contemplated thereunder

Listing of Common Stock

Transmeridian shall promptly prepare and submit to the American Stock Exchange a listing application covering the shares ("**Transmeridian Conversion Shares**") of Common Stock issuable upon the conversion of the New Preferred Stock and upon exercise of rights attached to the Warrants and Additional Warrants, and shall use its reasonable best efforts to obtain, prior to the Closing, approval for the listing of such Transmeridian Conversion Shares.

Retirement of preferred shares

Transmeridian shall take all necessary actions to retire all shares of Senior Preferred Stock and Junior Preferred Stock repurchased from the Company pursuant to the terms of the Investment Agreement immediately following the Closing.

Redemption of remaining shares

Immediately following the Closing, Transmeridian intends to redeem, at the same price per share paid in the Tender Offer, all of the then outstanding shares of Senior Preferred Stock and Junior Preferred Stock which have not been purchased by the Company and surrendered to Transmeridian (the "**Remaining Shares**"). Transmeridian shall take all necessary actions to cancel all of the Remaining Shares immediately following such redemption.

Conduct of Business

Between the signing of the Investment Agreement and the Closing, Transmeridian will, unless the Company otherwise agrees in writing, conduct the businesses of Transmeridian and its subsidiaries only in, the ordinary course of business and in a manner consistent with past practice, and pursuant to the terms of the Investment Agreement.

2.3 The Senior Preferred Stock Purchase Agreements

Date

11 June 2008

Parties to the Senior Preferred Stock Purchase Agreement

(i) the Company

(ii) Key Senior Preferred Stockholders

Subject matters under the Senior Preferred Stock Purchase Agreements

Pursuant to the three Senior Preferred Stock Purchase Agreements and subject to the terms and conditions of each of the agreements, the Company has agreed to:

(i) issue Convertible Bonds to a Key Senior Preferred Stockholder, in exchange for which the Company will acquire from the Key Senior Preferred Stockholder all of the Senior Preferred Stock owned by it; and

(ii) purchase Senior Preferred Stock in cash from certain other Key Senior Preferred Stockholders, one of which had the option to elect to be paid in Convertible Bond, but chose not to make such election.

Together these represent approximately 83% of the issued and outstanding Senior Preferred Stock of Transmeridian.

Conditions precedent to completion of the Senior Preferred Stock Purchase Agreements

Completion of the Senior Preferred Stock Purchase Agreements is subject to the satisfaction of the following conditions precedent:

1. the fulfilment or waiver by the Company (to the extent permitted under the Investment Agreement) of the conditions set forth in conditions (1), (3), (4) and (5) of the Investment Agreement, and in the case of one Senior Preferred Stock Purchase Agreement, condition (2) of the Investment Agreement, as set out in the section headed "Conditions precedent to completion of the Investment Agreement" in this circular above;

2. if applicable, the Listing Committee of the Stock Exchange having granted or having agreed to grant the listing of, and permission to deal in, the Conversion Shares and authority to issue such shares being granted by the shareholders of the Company;

3. if applicable, the shareholders of the Company having approved the issue of the Convertible Bonds;

4. the Investment Agreement having become and remaining unconditional under its own terms; and

5. that the respective representations, warranties, covenants or agreements of each of the Company and the Key Senior Preferred Stockholders contained in the Senior Preferred Stock Agreement shall be true and correct or complied with by the relevant parties in all material respects as of the Closing Date (or as of another date as specified), as the case may be.

The Senior Preferred Stock Purchase Agreements shall be terminated and the transactions contemplated thereby shall be abandoned solely in the event that the Investment Agreement is terminated pursuant to the terms thereof or if the purchase of the Senior Preferred Stock or, if applicable, the exchange of the Senior Preferred Stock for Convertible Bonds shall not have closed on or before 31 December 2008.

2.4 The Junior Preferred Stock Purchase Agreement

Date

11 June 2008

Parties to the Junior Preferred Stock Purchase Agreement

(i) the Company

(ii) Key Junior Preferred Stockholders

Subject matters under the Junior Preferred Stock Purchase Agreement

Pursuant to the Junior Preferred Stock Purchase Agreement and subject to the terms and conditions thereof, the Company agreed to acquire from the Key Junior Preferred Stockholders all of the Junior Preferred Stock owned by them, which represent approximately 74% of the issued Junior Preferred Stock of

Transmeridian at the acquisition price of US$76 per share of Junior Preferred Stock or, at the option of Key Junior Preferred Stockholders, a combination of cash and new shares of Common Stock of Transmeridian to be acquired for this purpose by the Company from Transmeridian. The aggregate cash value of 100% of the Junior Preferred Stock is approximately US$68.1 million.

The number of new shares of Common Stock to be received by a Key Junior Preferred Stockholder from the Company as consideration shall not exceed 16% of the aggregate consideration to be paid by the Company to the Key Junior Preferred Stockholders.

Conditions precedent to completion of the Junior Preferred Stock Purchase Agreement

Completion of the Junior Preferred Stock Purchase Agreement is subject to the satisfaction of the following conditions precedent:

1. the fulfilment or waiver by the Company (to the extent permitted under the Investment Agreement) of the conditions set forth in conditions (1), (2), (4) and (5) of the Investment Agreement as set out in the section headed "Conditions precedent to completion of the Investment Agreement" in this circular above; and

2. that the respective representations, warranties, covenants or agreements of each of the Company and the Key Junior Preferred Stockholders contained in the Junior Preferred Stock Agreement shall be true and correct or complied with by the relevant parties in all material respects as of the Closing Date (or as of another date as specified), as the case may be.

The Junior Preferred Stock Purchase Agreement shall be terminated and the transactions contemplated thereby shall be abandoned (i) in the event that the Investment Agreement is terminated pursuant to the terms thereof and (ii) in the event of the failure by Transmeridian to pay any interest payment under the Senior Notes by June 30 or September 30.

2.5 The Investor Rights Agreement

Date

11 June 2008 and amended and restated as of 22 September 2008

Parties to the Investor Rights Agreement

(i) the Company

(ii) Transmeridian

Subject matters under the Investor Rights Agreement

Pursuant to the Investor Rights Agreement and subject to the terms and conditions thereof, Transmeridian agreed with respect to the First Tranche Preferred Shares and Second Tranche Preferred Shares to be issued to the Company pursuant to the relevant Transaction Agreements, to grant the Company certain registration rights and other rights attached to or in relation to the First Tranche Preferred Shares and Second Tranche Preferred Shares.

Effectiveness of the Investor Rights Agreement

The Investor Rights Agreement will become effective as of the Closing.

Termination of the Investor Rights Agreement

The Investor Rights Agreement will only terminate:

1. by mutual written consent of each of the Company and Transmeridian; or

2. upon the expiration of (a) all rights created under the Investor Rights Agreement and (b) all statutes of limitations applicable to the enforcement of any claims under the Investor Rights Agreement.

2.6 Irrevocable Proxy

In connection with the transactions contemplated by the Amended and Restated Investment Agreement, on 22 September 2008, Lorrie T. Olivier ("**Mr. Olivier**"), the Chief Executive Officer of Transmeridian, and the Company entered into a Stockholder Support and Irrevocable Proxy Agreement (the "**Irrevocable Proxy**") pursuant to which Mr. Olivier, solely in his capacity as a stockholder of Transmeridian, granted the Company an irrevocable proxy to vote his Common Stock in favor of all matters required to consummate the transactions contemplated by the Amended and Restated Investment Agreement. Other than in his capacity as a stockholder and director of Transmeridian, a party to the Transaction Agreements, and as a party to the abovementioned Irrevocable Proxy, there is no other relationship between the Company and Mr. Oliver and Mr. Oliver is not a stockholder of the Company.

2.7 Other Information about the Transactions

Independence of parties to the Transaction Agreements

To the best of the Directors' knowledge, information and belief, having made all reasonable enquiry, each of Transmeridian, the Key Senior Preferred Stockholders and Key Junior Preferred Stockholders and the ultimate beneficial owners of each of Transmeridian, the Key Senior Preferred Stockholders and Key Junior Preferred Stockholders are third parties independent of the Company and connected persons of the Company.

Asset to be acquired

Subject to the terms and conditions of the Investment Agreement, the Senior Preferred Stock Purchase Agreements and the Junior Preferred Stock Purchase Agreement, the Company agreed to acquire New Preferred Stock, the Warrants and the Additional Warrants. Under the terms of the Transaction Agreements, the Company will be making an investment in Transmeridian for the value of approximately US$212 million (the "**Transaction Value**"). Based on the published US audited financial statements of Transmeridian for the year ended 31 December 2007, its net liabilities were approximately US$14,819,000.

On the assumption that Transmeridian will not issue or repurchase any Common Stock, shares, securities or stock other than pursuant to the terms of the Transaction Agreements, after receiving Newly Issued Common Stock at the Closing Date and prior to the date of exercise of the Warrants and the Additional Warrants, the Company will be able to control approximately 77.5% of the voting rights of Transmeridian. Upon exercise of the Warrants and the Additional Warrants, the Company will obtain a further approximately 7.6% of Transmeridian's enlarged issued Common Stock, constituting a total aggregated acquisition of approximately 85% of the shares of Transmeridian on a fully diluted basis. As a consequence of the Transactions, upon Closing, the financial statements of the Transmeridian Group will be consolidated into the Group's financial statements.

Consideration

The aggregate consideration payable by the Company under the Transactions (excluding the Exchange Offer, the Change of Control Offer and the New Notes Redemption) is approximately US$183.9 million (the "**Consideration**"), which will take the form of Convertible Bonds of up to approximately US$16.9 million and the balance in cash.

In addition, pursuant to the Investment Agreement, the Company will be issued Newly Issued Common Stock in exchange for Senior Notes and New Notes held by the Company or any of its affiliates and in return for funding to be provided by the Company or another party of the Exchange Offer, Change of Control Offer and New Notes Redemption, together for an aggregate consideration of approximately US$102.8 million, bringing the total aggregate consideration to approximately US$286.7 million.

In the event that the Company elects to exercise in full the Mandatory Warrants and the Optional Warrants granted to it under the Transactions (at the respective exercise price of US$1.20 and US$1 per share of Common Stock), the aggregate exercise price payable to Transmeridian could amount to approximately US$40.4 million and US$5 million respectively.

In the event that the Company elects to exercise in full the Additional Warrants to be issued to the Company under the Amended and Restated Investment Agreement, the aggregate exercise price payable to Transmeridian could amount to approximately US$90 million in relation to the US$0.60 warrants and US$90 million in relation to the US$1.20 warrants.

The above total cash payment under the First Tranche Price and the Second Tranche Price, in the aggregate amount of US$75 million, to Transmeridian is intended to fund Transmeridian's ongoing capital expenditure program and working capital requirements.

The First Tranche Price and the Second Tranche Price shall be paid to an escrow account to be maintained by an escrow agent ("**Escrow Agent**") jointly appointed by the Company and Transmeridian pursuant to the terms of an escrow agreement to be entered into between the Company, Transmeridian and the Escrow Agent prior to Closing. In accordance with the terms of the said escrow agreement, the Company shall deposit the First Tranche Price and Second Tranche Price to be managed and paid out by the Escrow Agent in accordance with the terms of the said escrow agreement. The proceeds ("**Proceeds**") to be received by Transmeridian from the Transactions, including the First Tranche Price and the Second Tranche Price, shall be allocated and used in accordance with the terms of the Investor Rights Agreement. The Proceeds shall be paid to Transmeridian by the Escrow Agent in accordance with the terms of the said escrow agreement and the Investor Rights Agreement.

It is expected that payment of the Transactions will be financed by the current cash reserves available within the Group.

The Consideration was determined after arm's length negotiation between the Company on one hand and Transmeridian (for itself and on behalf of the holders of the Senior Notes), the Key Senior Preferred Stockholders, the Key Junior Preferred Stockholders and the holders of Senior Notes on the other hand with reference to publicly available information concerning the Company and Transmeridian respectively, including the trading price of shares over the last twenty-four months and published financial statements, such as the annual and quarterly financial reports of Transmeridian. Reference was also made to other comparable transactions that have taken place between companies operating in the energy sector.

In view of the above, the Directors (including the independent non-executive Directors) consider the terms and conditions of the Transactions and the Transaction Agreements, in particular, the Transaction Value, to be fair and reasonable and are in the interest of the Company and the Shareholders as a whole.

3. THE CONVERTIBLE BONDS

The following are the principal indicative terms of the Convertible Bonds to be issued to a Key Senior Preferred Stockholder, which terms may be subject to amendment by agreement between the Company and the Key Senior Preferred Stockholder. The Convertible Bonds being issued to Senior Preferred Stockholder up to an aggregate principal amount of approximately US$16.9 million (under the Roll-Over and Stock Purchase Transactions) are agreed to be so issued as part of a private placement of Convertible Bonds of at least US$150,000,000 by the Company to institutional investors which will be Independent Third Parties. The Company has not yet entered into any placing agreement with any institutional investors in relation to the Convertible Bonds. The Convertible Bonds may be issued regardless of the completion of the Transactions. A further announcement will be made by the Company once it has entered into the placing agreement in relation to the Convertible Bonds and on settling the final terms of the Convertible Bonds.

Indicative terms and conditions:

Issuer	:	The Company
Maturity	:	5 years from the date of issue of the Convertible Bonds (**"Issue Date"**), with a one-time investor put at end of year 3 at the Early Redemption Price (as defined below)

Interest rate	:	Payable semi-annually, in arrears at a rate, subject to a coupon step down after Conversion Price Fixing Date to a lower rate, that are customary to this type of transaction and to be finalised
Ranking and Status	:	Senior secured debt obligation of the Company upon completion of the Transactions. The Notes will rank pari passu with all senior unsecured debt obligations of the Company following the "Secured Fall-away" subject to conditions under "Security" (detailed below)
Security	:	Initially: (1) the first priority charge on all cash and cash equivalent in an interest reserve account of the Company (2) the first priority charge on share capital of all the Company's subsidiaries (except subsidiaries domiciled in the PRC) Security Fall-away: The security package will "fall-away" around 3 months following Conversion Price Fixing Date
Conversion Price Fixing Date	:	Around 3 months following the Transactions
Reference Price	:	Reference Price will be determined based on around 3 month volume weighted average price of each trading day with trading volume exceeding around US$2 million or such other conventional reference price setting mechanism which will achieve substantially the same effect
Conversion Price	:	Around 20-30% premium to Reference Price

Redemption rights of the Company	:	The Company shall have right, on the date falling two (2) years from Conversion Price Fixing Date to redeem the outstanding Bonds held by the holders of the Convertible Bonds at the early redemption amount which is at 130% of the principal amount of the outstanding Bonds together with interest accrued thereon
Mandatory Repayment	:	Around 12 months from Issue Date if Closing shall not have taken place or completed pursuant to the terms and conditions of the Investment Agreement. Mandatory Repayment Amount would be calculated based on a premium over the principal amount of the outstanding Convertible Bonds less interest at a rate that is customary to this type of transaction and to be finalised paid before Mandatory Repayment Date
Covenants	:	Standard Euromarket provisions including negative pledge, delisting put, change of control put, anti-dilution protection and cross default Certain Restrictive Covenants not customary to Convertible Bonds will fall-away after Conversion Price Fixing Date
Redemption Price at Investor Put	:	At the end of the third anniversary of the Issued Date, the holders of the Convertible Bonds may request the Company to redeem the outstanding Convertible Bonds held by the holders of the Convertible Bonds at the early redemption amount which is a premium over the principal amount of the outstanding Convertible Bonds together with interest accrued thereon at a rate that is customary to this type of transaction and to be finalised ("**Early Redemption Price**")
Redemption Price at Maturity	:	Unless previously redeemed or converted or purchased and cancelled as provided herein, the Company shall redeem each outstanding Convertible Bond on the Maturity Date at the redemption amount which is a premium over the principal amount of the outstanding Convertible Bonds together with interest accrued thereon at a rate that is customary to this type of transaction and to be finalised

Dividend Protection	:	Adjustment to conversion price upon cash and stock dividend payment
Minimum Price	:	The minimum Conversion Price of the Conversion Shares will be a discount of no more than 20% to the higher of: (a) the closing price on the date of the relevant placing agreement or other agreement involving the proposed issue of securities under the general mandate; and (b) the average closing price in the 5 trading days immediately prior to the earlier of: (i) the date of announcement of the placing or the proposed transaction or arrangement involving the proposed issue of securities under the general mandate; (ii) the date of the placing agreement or other agreement involving the proposed issue of securities under the general mandate; and (iii) the date on which the placing or subscription price is fixed.
Maximum Issue	:	The maximum number of Conversion Shares upon conversion of the approximately US$16.9 million of Convertible Bonds to be issued to a Key Senior Preferred Stockholder will be 324,467,090 shares, such figure calculated on the basis that if the maximum number of Conversion Shares to be issued on conversion of the US$133.1 million of Convertible Bonds issued to Institutional Investors under the general mandate granted at a meeting of the Company held on 21 August 2008 is limited to the size of that general mandate (being 2,555,411,326 shares) then the corresponding number of Conversion Shares to be issued on conversion of the approximately US$16.9 million of Convertible Bonds issued to Key Senior Preferred Stockholders under the general mandate granted at a meeting of the Company held on 3 December 2007 will be 324,467,090 shares. In the event that the Conversion Shares to be issued upon conversion of the Convertible Bonds would exceed the Maximum Issue, the Company will be obliged to pay the bondholder in cash in lieu of those Conversion Shares

Conditions Precedent : Including but not limiting to completion of the Transactions

Governing Law : English Law

Conversion Shares

The Shares will, upon exercise (if so exercised) of the conversion rights attached to the Convertible Bonds, be allotted and issued as follows:

(i) since the Senior Preferred Stock Purchase Agreement was entered into on 11 June 2008, up to 324,467,090 Conversion Shares, being the maximum number of Conversion Shares to be issued to one Key Senior Preferred Stockholder on conversion of approximately US$16.9 million Convertible Bonds will be issued pursuant to the general mandate granted on 3 December 2007 by the shareholders of the Company to the Directors to issue shares, this general mandate being relied on for the issue of Conversion Shares to be issued pursuant to that agreement; and

(ii) the remaining Conversion Shares to be issued on conversion of the remaining approximately US$133.1 million Convertible Bonds will be issued pursuant to the general mandate granted on 21 August 2008 by the shareholders of the Company to the Directors to issue shares, assuming that the remaining Convertible Bonds will be issued by the Company during the term of such general mandate.

Since the grant of the general mandate on 3 December 2007, no new Shares have been issued. At the annual general meeting of the Company held on 21 August 2008, a new general mandate was granted by the shareholders of the Company to the Directors to issue 2,555,418,326 shares (being 20% of the total number of shares in issue of 12,777,091,632 at 21 August 2008). As such, the Company still has authority to issue 2,555,418,326 Shares under the current general mandate. Any such mandate will remain valid until the next AGM of the Company unless otherwise refreshed.

There is no restriction on the subsequent sale of the Conversion Shares issued on conversion of the Convertible Bonds. As part of the terms of the Convertible Bonds, in the event that any conversion of the Convertible Bonds into Common Stock would result in a breach of the requirement that at least 25% of the Company's total issued share capital must at all times be held by the public (the "**Public Float Requirement**"), the Company will have the option to pay an amount, in cash, to the relevant holder of the Convertible Bonds equivalent to the value of those shares, which on conversion, would have caused the Company to be in breach of the Public Float Requirement. The Company will exercise the above option in such a way as will enable it to comply with the Public Float Requirement.

As at the Latest Practicable Date, there were 12,777,091,632 Shares in issue. The conversion price will be determined based on the volume weighted average price of the shares of the Company of each trading day with trading volume exceeding US$2 million over a three month period after Closing plus a premium of around 20 to 30% or such other conventional reference price setting mechanism which will achieve substantially the same effect. For illustrative purposes only, on the basis of a Conversion Price as of the Latest Practicable Date (being HK$0.365 plus 20% premium of HK$0.438 per Conversion Share) the Convertible Bonds to be issued to one Key Senior Preferred Stockholder may be convertible into a maximum number of approximately 300,958,904 Conversion Shares which represent approximately 2.36% of the existing issued share capital of the Company and approximately 2.30% of the issued share capital of the Company as enlarged by the Conversion Shares. Investors should note that the actual number of Conversion Shares that may be issued on full conversion of the Convertible Bonds to be issued to one Key Senior Preferred Stockholder may be higher or lower than this number, although, if higher, up to the Maximum Issue under the terms of the Convertible Bonds to be issued to one Key Senior Preferred Stockholder, being 324,467,090 Conversion Shares. If the Maximum Issue under the terms of the Convertible Bonds to be issued to one Key Senior Preferred Stockholder takes place, such issue would represent approximately 2.54% of the existing issued share capital of the Company and approximately 2.48% of the issued share capital of the Company as enlarged by the Conversion Shares. The full conversion of the Convertible Bonds to be issued to Key Senior Preferred Stockholders will not lead to any change of control in the Company.

A further announcement will be made by the Company once it has entered into the placing agreement in relation to the Convertible Bonds and on settling the final terms of the Convertible Bonds.

Use of proceeds

The net proceeds of the issue of the Convertible Bonds are, after issue of approximately US$16.9 million in principal amount of the Convertible Bonds to a certain Key Senior Preferred Stockholder, intended by the Company to be used for future investment opportunities, if identified, with the balance of the net proceeds to be used for the general corporate and working capital requirements of the Group.

Application for listing

The Company currently has no plans to apply for listing of the Convertible Bonds on any stock exchanges.

Application will be made by the Company to the Listing Committee of the Stock Exchange for the listing of, and the permission to deal in, the Conversion Shares.

View of Directors

The terms and conditions of the Convertible Bonds were determined after arm's length negotiation between the Company and the Key Senior Preferred Stockholders, which in the opinion of the Directors (including the independent non-executive Directors) are fair and reasonable and the issue of the Convertible Bonds is in the interest of the Company and the Shareholders as a whole.

4. INFORMATION ON THE TRANSMERIDIAN GROUP

Transmeridian is a corporation incorporated in the State of Delaware, the U.S.A. in April 2000, whose Common Stock began trading on the American Stock Exchange in March 2005. Transmeridian is an energy company engaged in the business of acquiring, developing and producing crude oil and natural gas.

According to Transmeridian's most recent annual report for the fiscal year ended 31 December 2007, Transmeridian's activities are primarily focused on the Caspian Sea region of the former Soviet Union and it currently has projects in Kazakhstan and southern Russia. Transmeridian's primary oil and gas property is the South Alibek Field (the **"Field"**) in the Republic of Kazakhstan, of which it has a 100% interest in, covered by a subsoil use license and related exploration and production contracts.

Transmeridian conducts its operations in Kazakhstan through its indirect wholly owned subsidiary, JSC Caspi Neft TME, a joint stock company organized under the laws of Kazakhstan ("**Caspi Neft**"). Transmeridian holds, through Caspi Neft, an exclusive exploration contract governing the exploration activities in the Field, for the period from March 2000 to April 2009, and an exclusive 25-year production contract, commencing on 29 June 2005, that governs crude oil and gas production, both of which were entered into with the Kazakhstan Ministry of Energy and Mineral Resources.

Transmeridian also has a 50% interest in DNK LLC, a limited liability company incorporated under the laws of Russia ("**DNK**"). According to the information provided by Transmeridian and other publicly available information, DNK holds (i) a 20-year license that expires in May 2025, for developing the subsurface resources in the Gasha Field, which is located onshore in the Republic of Dagestan, Russia (the "**Gasha Field**"); and (ii) a 5-year license that expires in August 2009, for exploration of crude oil and gas in the Russian Federation. According to information given by the Transmeridian Group and other publicly available information, the Gasha Field, which is not currently producing, was active during the Soviet era and is located close to an existing oil and gas pipeline infrastructure and transportation networks.

On 2 July 2008, Transmeridian announced that it had signed a joint operating agreement with DNK in relation to the Selli Field and the Ullu Chai anticline (collectively the "**Selli Field**"), adjacent to the Gasha Field. DNK, holds a 125 sq km 20-year license for developing the subsurface resources in the Selli Field.

According to Transmeridian's most recent annual report for the fiscal year ended 31 December 2007, the Transmeridian Group has a history of losses, incurring net losses of approximately $20.5 million, $53.2 million and $57.7 million for the years ended December 31, 2005, 2006 and 2007, respectively.

5. REASONS FOR AND BENEFITS OF THE TRANSACTIONS

The Company is an investment holding company and the principal activities of its subsidiaries include investment holding, property development and investment and an oil resources business.

Following the entering into of acquisition agreements on 8 August 2007 with United Energy Holdings Limited, United Petroleum & Natural Gas Holdings Limited and Kowin Limited for the acquiring of the entire issued share capital of and shareholder's loan owing by United Petroleum & Natural Gas Investments Limited ("**United Petroleum**"), the Company's strategy has been to focus on the development of the oil resources business, primarily targeting investments in oil and gas fields globally with proved or probable reserves and significant upside reserve potential.

As a result of the acquisition of United Petroleum by the Company, the Company's main oil and gas asset comprises its participating interests in an oilfield project in Bohai Bay Basin in the People's Republic of China. These participating interests relate to the enhancing of oil recovery from the existing oilfield projects of China National Petroleum Corporation, China's largest oil and gas company, with United Energy acting as the operator for the asset.

The Company's acquisition of a majority interest in Transmeridian compliments the Company's strategy in the development of its oil resources business. The Company believes that Transmeridian will be an attractive investment due to Transmeridian's 100% interest in and operation of the Field, located in the highly prolific hydrocarbon area of Kazakhstan under a stable fiscal regime. The Company expects that Transmeridian's 25-year production contract related to the Field offers the

Company the opportunity to maximize further production growth and reserve upside potential of the Field. The Field also enjoys competitive operating costs and well-established infrastructure, allowing ready access to regional export pipeline system for hydrocarbon sales. In addition, Transmeridian's ownership in the Gasha Field and the adjacent Selli Field with a subsurface exploration license expiring in April 2009 and development license expiring 2025 provides the Company with an entry position into the Republic of Dagestan, Russia and further reserve upside opportunities. The Company's acquisition of a majority interest in Transmeridian will provide the Company with geographical diversification from which it can form a portfolio of oil and gas resources in the PRC., Kazakhstan and Russia.

In view of the above, the Directors (including the independent non-executive Directors) have considered the Transactions and the terms and conditions of the Transaction Agreements are fair and reasonable and are in the interest of the Company and the Shareholders as a whole.

6. FUND-RAISING ACTIVITIES OF THE GROUP DURING THE PAST TWELVE MONTHS

Apart from the following fund raising activity, the Company did not conduct any fund-raising activities during the past twelve months before the date of this circular.

Completion Date	Description	Net proceeds raised	Use of proceeds
16 October 2007	Placing of 1,374,000,000 Shares	Approximately HK$2.146 billion	(i) approximately HK$2.1 billion to finance the development of oil project; (ii) the remaining balance for working capital of the Company

The proceeds raised from the above fund raising activity have been and will continue to be applied as set out under the heading "Use of proceeds" in the circular made by the Company on 15 August 2007.

7. LISTING RULES IMPLICATIONS

Since certain of the relevant percentage ratios (as defined under the Listing Rules) are greater than 100%, the Transactions constitute a very substantial acquisition for the Company under Chapter 14 of the Listing Rules and, accordingly, the Transactions contemplated under the Transaction Agreements are subject to the approval of the Shareholders at the SGM.

The Shares will, upon exercise (if so exercised) of the conversion rights attached to the Convertible Bonds, be allotted and issued as follows:

(i) up to 324,467,090 Conversion shares, being the maximum number of Conversion Shares to be issued to one Key Senior Preferred Stockholder on conversion of approximately US$16.9 million Convertible Bonds will be issued pursuant to the general mandate granted on 3 December 2007 by the shareholders of the Company to the Directors to issue shares; and

(ii) the remaining Conversion Shares to be issued on conversion of the remaining approximately US$133.1 million Convertible Bonds will be issued pursuant to the general mandate granted on 21 August 2008 by the shareholders of the Company to the Directors to issue shares.

Rule 14.75 of the Listing Rules applies to the Warrants and the Additional Warrants and if and on any exercise such warrants, the Company will comply with all applicable requirements under the Listing Rules.

8. CHANGE IN THE SHAREHOLDING STRUCTURE OF THE COMPANY

As at the Latest Practicable Date, there were a total of 12,777,091,632 Shares in issue. There were no outstanding options nor convertible securities of the Company as at the Latest Practicable Date save for options granted under the Company's Share Option Scheme involving approximately 4.74% of the current issued share capital of the Company.

The following table summarises the Company's existing shareholding structure and the shareholding structure assuming and immediately after the issue of the Conversion Shares upon conversion of the approximately US$16.9 million Convertible Bonds to be issued to one Key Senior Preferred Stockholder and that none of the substantial Shareholders and other persons will acquire or dispose of their Shares and the Company will not issue or repurchase any, convertible securities or Shares other than pursuant to the terms of the Transaction Agreements prior to such conversion.

Shareholder	**As at the date of this circular**	**Immediately after the issue of the Conversion Shares assuming the Maximum Issue upon the exercise of the conversion right attached to the Convertible Bonds to be issued to one Key Senior Preferred Stockholder** *(Note 3)*
He Fu International Limited ("**He Fu**") *(Note 1)*	5,128,169,125 40.14%	5,128,169,125 39.14%
United Petroleum & Natural Gas Holdings Limited ("**UPNG**") *(Note 1)*	2,223,726,708 17.40%	2,223,726,708 16.97%
United Energy Holdings Limited ("**UEH**") *(Note 1)*	1,649,344,282 12.91%	1,649,344,282 12.59%
Mr. Zhu Jun *(Note 2)*	1,443,000 0.01%	1,443,000 0.01%
Sub-total:	**9,002,683,115** **70.46%**	**9,002,683,115** **68.71%**
Public:		
— Public Shareholders	3,774,408,517 29.54%	3,774,408,517 28.81%
— Senior Preferred Stockholder to be issued with Convertible Bonds *(Note 4)*	— —	324,467,090 2.48%
Sub-total:	**3,774,408,517** **29.54%**	**4,098,875,607** **31.29%**
Total:	**12,777,091,632** **100.00%**	**13,101,558,722** **100.00%**

Notes:

1. The entire issued share capital of each of He Fu, UPNG and UEH is solely and beneficially owned by Mr Zhang Hongwei, the controlling Shareholder of the Company, the chairman and an executive Director of the Company.

2. Mr. Zhu Jun is a Director.

3. The maximum number of Conversion Shares upon conversion of the Convertible Bonds to be issued to one Key Senior Preferred Stockholder will be 324,467,090 shares. In the event that the Conversion Shares to be issued upon conversion of the Convertible Bonds to the Key Senior Preferred Stockholder would exceed the Maximum Issue, the Company will be obliged to pay the bondholder in cash in lieu of those Conversion Shares exceeding the maximum allowed under the general mandate. These figures illustrate the shareholding structure immediately after the issue of the Conversion Shares in the event that the Conversion Price were to fall to a level where the maximum number of Conversion Shares upon conversion of the Convertible Bonds to be issued to the Key Senior Preferred Stockholder were to be issued.

4. Those figures relating to the Key Senior Preferred Stockholder are calculated on the basis that up to approximately US$16.9 million (out of the total issue of Convertible Bonds of at least US$150,000,000 by the Company) in aggregate principal amount of Convertible Bonds will be issued to one Key Senior Preferred Stockholder as consideration for the exchange for the Senior Preferred Stock owned by it under the Roll-Over and Stock Purchase Transactions.

9. RISK FACTORS

Transmeridian has a history of losses

Transmeridian has a history of losses. It incurred net losses of approximately $20.5 million, $53.2 million and $57.7 million for the years ended December 31, 2005, 2006 and 2007, respectively. The history of losses results in a stockholders' deficit of approximately $14.8 million. Transmeridian's failure to achieve profitability in the future could adversely affect its ability to meet its obligations as they mature and its ability to raise additional capital and, accordingly, its ability to continue its exploitation and development program and grow its business.

Transmeridian has a severe cash flow shortage

Transmeridian currently have an immediate and severe cash flow shortage, which, if not remedied, may cause it to cease operations. As part of the Investment Agreement, the Company will invest approximately $75 million in Transmeridian. However, even with this capital infusion, there is a significant possibility Transmeridian will not become cash flow positive within the near-term or ever.

Significant capital expenditures are required to execute Transmeridian's development program

Transmeridian's development and production activities, including its exploration and production contracts with the government of Kazakhstan, require Transmeridian to make substantial capital expenditures. If Transmeridian is unable to generate sufficient operating cash flows, or if its access to capital becomes limited, it may not be able to meet its capital expenditure requirements, which could, in turn, materially and adversely affect Transmeridian's business, financial condition and results of operations.

Transmeridian's exploitation and development activities may not result in economic quantities of oil and gas

The business of Transmeridian is dependent on finding, developing and producing economic quantities of oil and gas. The seismic data and other technologies Transmeridian uses do not allow Transmeridian to know conclusively prior to drilling a well that oil or gas is present or may be produced economically. The cost of drilling, completing and operating a well is often uncertain, and cost factors can adversely affect the economics of a project. In addition, technological difficulties encountered in well completion or following the establishment of production may result in reduced or ceased production from a well.

Further, its drilling operations may be curtailed, delayed or cancelled, or subject to higher costs as a result of a variety of factors, including:

- unexpected drilling conditions;
- high pressure or irregularities in geological formations;
- equipment failures or accidents;
- adverse weather conditions, such as winter snowstorms; and
- increases in the cost of, or shortages or delays in the availability of, drilling rigs, equipment and qualified personnel.

In addition, Transmeridian utilized much of its excess liquidity during the period in 2007 when the South Alibek Field was shut-in to fund operating costs, overhead, scheduled interest payments and necessary capital expenditures. As a result, Transmeridian do not currently have the necessary resources to allow for continued drilling of exploration and development wells.

Furthermore, even if Transmeridian had the necessary resources, its drilling operations may not be successful in finding, developing and producing economic quantities of oil and gas, or be able to sustain production from wells that initially produce.

The actual quantities of Transmeridian's oil and gas reserves may prove to be lower than it has estimated

The estimates of Transmeridian's oil and gas reserves is based upon various assumptions, including assumptions relating to oil and gas prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. The process of estimating oil and gas reserves is complex. The process involves significant decisions and assumptions in the evaluation of available geological, geophysical, engineering and economic data for each reservoir. Therefore, these estimates are inherently imprecise.

If oil and gas prices decrease or Transmeridian's exploitation efforts are unsuccessful, it may be required to write down the capitalized cost of individual oil and gas properties

Transmeridian uses the successful efforts accounting method. All property acquisition costs and costs of exploratory and development wells are capitalized when incurred, pending the determination of whether proved reserves are discovered. If proved reserves are not discovered with an exploratory well, the costs of drilling the well are expensed. All geological and geophysical costs on exploratory prospects are expensed as incurred.

A write-down of the capitalized cost of individual oil and gas properties could occur when oil and gas prices are low or if Transmeridian has substantial downward adjustments to its estimated proved oil and gas reserves, increases in its estimates of development costs or non-productive exploratory drilling results. A write-down could adversely affect the trading price of its common stock.

All of Transmeridian's operations are conducted in areas with inherent international and governmental risks

Transmeridian is subject to risks inherent in international operations, including adverse governmental actions, political risks, expropriation of assets and the risk of civil unrest or war. Its oil and gas properties are located in Kazakhstan, which until 1990 was part of the Soviet Union, and in Dagestan, which is an autonomous region within the Russian Federation. Kazakhstan and Russia retain many of the laws and customs from the former Soviet Union, but have developed and are continuing to develop their own legal, regulatory and financial systems.

As the political and regulatory environment changes, Transmeridian may face uncertainty about the interpretation of the agreements to which it is party and, in the event of dispute, it may have limited recourse within the legal and political system.

Oil prices are volatile. A decline in internal oil prices could adversely affect Transmeridian's financial position, results of operations, cash flows, access to capital and ability to grow

Transmeridian's revenues, results of operations and future growth depend primarily upon the prices it receives for the oil Transmeridian sells.

Historically, the markets for oil have been volatile and they are likely to continue to be volatile due to factors that are beyond its control, including:

- worldwide supplies of oil and gas;
- weather conditions;
- the level of consumer demand;
- the price and availability of alternative fuels;
- governmental regulations and taxes;
- the ability of the members of the Organization of Petroleum Exporting Countries to agree to, and maintain, oil price and production controls;
- political instability or armed conflict in oil-producing regions; and
- the overall economic environment.

These factors and the volatility of the energy markets make it extremely difficult to predict future oil price movements with any degree of certainty. Declines in oil prices would not only reduce Transmeridian's revenues, but could reduce the amount of oil that it can produce economically and, as a result, could have a material adverse effect on Transmeridian's business, financial condition and results of operations.

Transmeridian's substantial indebtedness could adversely affect its financial condition, its access to capital and its ability to grow

Transmeridian has substantial Senior Notes outstanding and, in turn, substantial debt service requirements, which could limit its ability to execute its development program. In addition, Transmeridian's ability to make payments on its Senior Notes and any future indebtedness it may incur depends on its ability to generate sufficient cash flow. There is no certainty that Transmeridian, in the future, will be able to:

- generate sufficient cash flow from operations to service its indebtedness;
- raise future borrowings or proceeds from equity issuances will be available in an amount sufficient to enable it to pay its indebtedness on or before the maturity date of such indebtedness; or
- refinance any of its indebtedness on commercially reasonable terms, if at all.

If, in the future, Transmeridian cannot generate sufficient cash flow from its operations to meet its debt service obligations, it may need to refinance its debt, obtain additional financing, issue equity or sell assets, which it may not be able to do on commercially reasonable terms, if at all, and which it may be prohibited from doing under the terms of its indebtedness. Transmeridian's inability to generate cash flow or obtain funding sufficient to satisfy its debt service obligations could materially and adversely affect its financial condition.

10. SGM

An SGM will be held on 16 October 2008 at 10:00 a.m. at Room 1501-02, 15/F., Hong Kong Club Building, 3A Chater Road, Central, Hong Kong, during which an ordinary resolution shall be proposed to the shareholders of the Company to approve the Transaction Agreements and the Transactions contemplated thereunder. Any vote of the shareholders at the SGM shall be taken by poll.

Under the articles of association of the Company, a poll can be demanded by:

(a) the chairman of the meeting; or

(b) by at least three members present in person (or in the case of a member being a corporation by its duly authorised representative) or by proxy for the time being entitled to vote at the meeting; or

(c) by a member or members present in person (or in the case of a member being a corporation by its duly authorised representative) or by proxy and representing not less than one tenth of the total voting rights of all members having the right to vote at the meeting; or

(d) by a member or members present in person (or in the case of a member being a corporation by its duly authorised representative) or by proxy and holding Shares in the Company conferring a right to vote at the meeting being Shares on which an aggregate sum has been paid up equal to not less than one tenth of the total sum paid up on all Shares conferring that right;

and a demand by a person as proxy for a member (or in the case of a member being a corporation by its duly authorised representative) shall be deemed to be the same as a demand by a member.

The Company is not aware of any Shareholders or the associates of any Shareholders who have a material interest in the Transactions and would therefore be required to abstain from voting at the SGM. Mr. Zhang Hongwei, the controlling Shareholder of the Company, has undertaken to Transmeridian to vote in favour of the resolutions proposed to approve the Transactions at the SGM.

11. GENERAL

Following Closing there will be no change to the composition of the Directors of the Company as a result of the Transactions.

12. RECOMMENDATION

The Directors consider that the terms of the Transactions are fair and reasonable, on normal commercial terms and are in the interests of the Company and the shareholders as a whole. Accordingly, the Directors recommend the shareholders of the Company to vote in favour of the resolution to be proposed at the SGM to approve the Transactions.

By Order of the Board
UNITED ENERGY GROUP LIMITED
Zhang Meiying
Director

INTRODUCTION

Pursuant to the Investment Agreement dated 11 June 2008 entered into between the Company and Transmeridian, the Company agreed to make an investment in Transmeridian with a value of approximately US$212 million. The Transaction constitutes a very substantial acquisition of the Company and an accountants' report in respect of Transmeridian is therefore required by the Listing Rules to be included in the circular to its shareholders.

For the purposes of this Appendix all references to "$" are to US$ unless stated otherwise.

Transmeridian is an independent energy company incorporated in Delaware with its primary listing on the American Stock Exchange and has engaged in the business of acquiring, developing and producing oil and natural gas in the Caspian Sea region of the former Soviet Union.

The audited combined financial statements of Transmeridian for the three years ended 31 December 2007, which have been prepared in accordance with US GAAP and audited by the Independent Registered Public Accounting Firm of Transmeridian in accordance with PCAOB Standards and the unaudited combined financial statements of Transmeridian for the three months ended 31 March 2007 and 2008 prepared in accordance with US GAAP (the "**US GAAP Combined Financial Information**"), form part of this circular and are presented in lieu of an accountants' report of Transmeridian. Due to the following reasons, the Company has applied to the Stock Exchange for a waiver from strict compliance with Rule 14.69(4)(a)(i) of the Listing Rules governing the presentation and preparation of the accountants' report as further described below.

REASON FOR NOT INCLUDING AN ACCOUNTANTS' REPORT ON TRANSMERIDIAN

In accordance with Rule 14.69(4)(a)(i) of the Listing Rules, the reporting accountants of the Company are required to prepare an accountants' report on Transmeridian using accounting policies materially consistent with those of the Company and in accordance with the requirements of the Auditing Guideline 3.340 "Prospectuses and the Reporting Accountant" ("**AG 3.340**") issued by the HKICPA.

The Exchange has granted to the Company a waiver from strict compliance with the requirements of Rule 14.69(4)(a)(i) of the Listing Rules to include an accountants' report on Transmeridian in accordance with Chapter 4 of the Listing Rules in this circular.

Such waiver was granted on the basis that:

(i) For the reasons given in (ii) and (iii) below, Transmeridian has refused to cooperate for the purpose of having its financial statements being reaudited and restated under HKFRS or IFRS (to comply with Chapter 4 of the Listing Rules), as it is averse to the potential additional liability of such restated financial statements. Without the agreement of Transmeridian, it is practically impossible for the Company to produce audited financial statements of Transmeridian under HKFRS or IFRS to comply with Chapter 4 of the Listing Rules.

(ii) Transmeridian, being a company listed on the American Stock Exchange, has already prepared and published its results for the three financial years ended 31 December 2007 and the three months ended 31 March 2008, which were prepared in accordance with US GAAP, in compliance with the relevant United States laws and regulations. Should any new or additional financial statements be prepared in accordance with HKFRS or IFRS and published in Hong Kong in compliance with the requirements applicable to very substantial acquisitions under the Listing Rules, such new set of financial statements (a) would be very unusual; and (b) may cause confusion to public investors in the United States and cause uncertainty in the market in relation to the Transmeridian stock. Members of the investing public in the U.S. would have relied upon the recent and historical published financial information of Transmeridian (prepared in accordance with US GAAP) before investing in the securities of Transmeridian. If there were to be a restatement of such financial information on the basis of HKFRS, public investors in the U.S. may be confused by the differences from the financial information upon which they had relied prior to investing in the Transmeridian securities, as they are unlikely to be familiar with HKFRS to appraise such differences. This could cause confusion in the market in respect of Transmeridian's financial position.

(iii) According to the U.S. legal advisers to the Company, under U.S. securities laws, Transmeridian is subject to ongoing disclosure obligations including requirements to file annual and quarterly reports. The annual report is required to include audited financial statements prepared under US GAAP, and, as a U.S. listed issuer, Transmeridian is not permitted under applicable rules of the U.S. Securities and Exchange Commission (the "SEC") to substitute audited financial statements under HKFRS or IFRS in lieu of the US GAAP audited financial statements. If Transmeridian prepares additional or new financial statements under the accounting standards of a foreign jurisdiction such as HKFRS, this would expose Transmeridian to unduly burdensome additional potential liability under U.S. securities laws. Liability of issuers under U.S. securities laws is premised upon misstatements or omissions in a U.S. issuer's public disclosure. Public disclosure of financial information is the most important type of disclosure made by listed issuers and is therefore the most

heavily scrutinised and relied upon by investors. Under applicable U.S. securities laws, Transmeridian is required under Regulation FD to file any HKFRS or IFRS financial statements mentioned above with the SEC or otherwise disclose them publicly in the U.S. if such financial statements are deemed to contain material information about Transmeridian that has not been previously disclosed to U.S. investors. We understand the HKFRS or IFRS financial statements would be considered material information and would therefore need to be disclosed publicly. If disclosed in the U.S. the HKFRS or IFRS financial statements would expose Transmeridian to possible regulatory or private enforcement actions under U.S. securities laws to the extent that an investor or the SEC asserts, based upon their review of the HKFRS audited financial statements, that Transmeridian's original U.S. GAAP audited financial statements contained a material misstatement or omission and were therefore misleading to investors. In such a case, investors may file lawsuits against Transmeridian claiming violations of Rule 10b-5 under the Securities Exchange Act of 1934 (the "Exchange Act") and the SEC may initiate official inquiries or enforcement actions against Transmeridian. The consequences of such actions may result in an award of damages against Transmeridian under section 18 of the Exchange Act or criminal liability under section 21 of the Exchange Act punishable by fines and/or imprisonment. Irrespective of whether Transmeridian's US GAAP financial statements contain any material misstatements or omissions or were misleading to investors, and irrespective of whether the claims brought against Transmeridian are without merit, Transmeridian would still be subject to the costs of defending itself against such claims, which may be substantial.

Additional potential liability arises from Transmeridian having published financial statements for a historical period under US GAAP being required to publish an additional set of financial statements under HKFRS for the same historical period. As Transmeridian is legally liable for all information that it discloses to U.S. investors, the publishing of an additional set of financial statements would mean that Transmeridian would be liable under U.S. securities laws for two sets of financial statements at the same time.

(iv) The Company believes that in lieu of an accountants' report the following financial information presented in this circular provides sufficient information for the Company's shareholders to make an informed decision regarding the Transactions:

(a) the published audited financial statements of Transmeridian for the three years ended 31 December 2007, prepared under US GAAP (Appendix I-3 to I-118);

(b) the published unaudited financial statements of Transmeridian for the three months ended 31 March 2008 and the three months ended 31 March 2007 prepared under US GAAP (Appendix I-119 to I-144);

(c) the line-by-line reconciliation statement of such financial statements of Transmeridian, which will substantially follow the presentation of the consolidated income statements and consolidated balance sheets set out in Transmeridian's audited and unaudited financial statements, from US GAAP to HKFRS for each of the financial periods covered by the financial statements as mentioned in paragraphs (a) and (b) above (the "**Reconciliation Statement**") (Appendix II-2 to II-4);

(d) the separate notes providing a qualitative explanation (on an individual basis) of the adjustments made in the Reconciliation Statement (Appendix II-5); and

(e) the review report on the Reconciliation Statement provided by the Company's auditors (Appendix II-6 to II-8).

(v) The Company should issue this circular within six months after the latest balance sheet date of the financial information of Transmeridian as mentioned in paragraph (iv)(b) above. On the basis that unaudited financial statements of Transmeridian up to 31 March 2008 are reproduced in this circular, the Company should issue this circular on or before 30 September 2008.

(A) FINANCIAL SUMMARY

The following is a summary of the audited consolidated statement of operations of Transmeridian for the three years ended 31 December 2007 and the consolidated balance sheets of Transmeridian as at 31 December 2005, 2006, 2007.

Consolidated Statement of Operations
(In thousands, except per share amounts)

	Year ended December 31,		
	2007	2006	2005
	US$	*US$*	*US$*
Revenue from oil sales, net	34,024	24,672	8,443
Operating costs and expenses:			
Exploration expense	522	256	9
Depreciation, depletion and amortization	19,729	14,921	3,385
Transportation expense	3,876	1,596	321
Impairment loss on drilling rig	—	—	4,022
Operating and administrative expense — Kazakhstan	16,681	15,652	3,897
General and administrative expense — Houston	13,750	9,972	6,632
Total operating costs and expenses	54,558	42,397	18,266
Operating loss	(20,534)	(17,725)	(9,823)
Other income (expense):			
Interest income	494	1,413	338
Interest expense, net of capitalized interest	(37,708)	(36,935)	(10,344)
Total other income (expense)	(37,214)	(35,522)	(10,006)
Loss before minority interest	(57,748)	(53,247)	(19,829)
Minority interest income (expense)	—	—	(712)
Net loss	(57,748)	(53,247)	(20,541)
Preferred dividends	(13,948)	(1,066)	(1,081)
Accretion of preferred stock discount	(2,424)	(49)	—
Net loss attributable to common stockholders	(74,120)	(54,362)	(21,622)
Basic and diluted loss per common share	(0.67)	(0.58)	(0.26)
Weighted average common shares outstanding, basic and diluted	110,024	93,284	82,004

Consolidated Balance Sheet

(In thousands, except preferred shares and par value information)

	December 31,		
	2007	**2006**	**2005**
	US$	*US$*	*US$*
ASSETS			
Current Assets:			
Cash and cash equivalents	939	12,193	34,444
Restricted cash	—	—	31,961
Accounts receivable	4,428	7,816	3,623
Crude oil inventory	1,057	837	1,626
Other current assets	261	20	51
Asset held for sale	—	3,000	3,000
Total current assets	6,685	23,866	74,705
Property and Equipment:			
Property and equipment	428,741	339,605	230,719
Accumulated depreciation, depletion and amortization	(38,497)	(18,799)	(3,904)
Property and equipment, net	390,244	320,806	226,815
Other assets, net	9,347	11,964	12,473
	406,276	356,636	313,993

	December 31,		
	2007	**2006**	**2005**
	US$	*US$*	*US$*
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)			
Current Liabilities:			
Accounts payable	23,728	12,279	2,245
Accrued liabilities	33,770	5,785	31,451
Total current liabilities	57,498	18,064	33,696
Long-term debt, net of discount of $16,648 and $22,276	273,352	267,724	223,407
Other long term liabilities	4,208	3,898	186
Senior redeemable convertible preferred stock, net of discount of $2,157 and $3,047	42,076	40,953	—
Junior redeemable convertible stock, net of discount of $20,104	43,961	—	—
Stockholders' Equity (Deficit):			
Preferred stock, $0.0006 par value per share, 5,000 shares authorized, 0 and 594.804 issued and outstanding	—	—	—
Common stock, $0.0006 par value per share, 200,000 shares authorized 116,860, and 101,246 issued and outstanding	70	61	52
Additional paid-in capital	151,278	117,983	94,337
Accumulated deficit	(166,167)	(92,047)	(37,685)
Total stockholders' equity (deficit)	(14,819)	25,997	56,704
	406,276	356,636	313,993

(B) SUMMARY OF AUDITED FINANCIAL STATEMENTS

Set out below are the audited financial statements together with the relevant notes to the financial statements of Transmeridian as extracted from the annual report of Transmeridian for the years ended 31 December 2005, 2006 and 2007.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Stockholders of Transmeridian Exploration Incorporated:

We have audited the accompanying consolidated balance sheets of Transmeridian Exploration Incorporated and subsidiaries (the "Company"), as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Transmeridian Exploration Incorporated and subsidiaries at December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company had a net working capital deficit of approximately $50.8 million and a total stockholders' deficit of approximately $14.8 million at December 31, 2007, and has incurred operating losses since its inception.

These conditions raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Transmeridian Exploration Incorporated and subsidiaries' internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 28, 2008, expressed an unqualified opinion on the effective operation of internal control over financial reporting.

/s/ UHY LLP

Houston, Texas
March 28, 2008

Consolidated Balance Sheet

(In thousands, except preferred shares and par value information)

	December 31,	
	2007	**2006**
	$	*$*
ASSETS		
Current Assets:		
Cash and cash equivalents	939	12,193
Accounts receivable	4,428	7,816
Crude oil inventory	1,057	837
Other current assets	261	20
Asset held for sale	—	3,000
Total current assets	6,685	23,866
Property and Equipment:		
Property and equipment	428,741	339,605
Accumulated depreciation, depletion and amortization	(38,497)	(18,799)
Property and equipment, net	390,244	320,806
Other assets, net	9,347	11,964
	406,276	356,636

	December 31, 2007	2006
	$	$
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current Liabilities:		
Accounts payable	23,728	12,279
Accrued liabilities	33,770	5,785
Total current liabilities	57,498	18,064
Long-term debt, net of discount of $16,648 and $22,276	273,352	267,724
Other long term liabilities	4,208	3,898
Senior redeemable convertible preferred stock, net of discount of $2,157 and $3,047	42,076	40,953
Junior redeemable convertible stock, net of discount of $20,104	43,961	—
Stockholders' Equity (Deficit):		
Preferred stock, $0.0006 par value per share, 5,000 shares authorized, 0 and 594.804 issued and outstanding	—	—
Common stock, $0.0006 par value per share, 200,000 shares authorized 116,860, and 101,246 issued and outstanding	70	61
Additional paid-in capital	151,278	117,983
Accumulated deficit	(166,167)	(92,047)
Total stockholders' equity (deficit)	(14,819)	25,997
	406,276	356,636

The accompanying notes are an integral part of these financial statements.

Consolidated Statement of Operations
(In thousands, except per share amounts)

	Year ended December 31,		
	2007	2006	2005
	$	$	$
Revenue from oil sales, net	34,024	24,672	8,443
Operating costs and expenses:			
Exploration expense	522	256	9
Depreciation, depletion and amortization	19,729	14,921	3,385
Transportation expense	3,876	1,596	321
Impairment loss on drilling rig	—	—	4,022
Operating and administrative expense — Kazakhstan	16,681	15,652	3,897
General and administrative expense — Houston	13,750	9,972	6,632
Total operating costs and expenses	54,558	42,397	18,266
Operating loss	(20,534)	(17,725)	(9,823)
Other income (expense):			
Interest income	494	1,413	338
Interest expense, net of capitalized interest	(37,708)	(36,935)	(10,344)
Total other income (expense)	(37,214)	(35,522)	(10,006)
Loss before minority interest	(57,748)	(53,247)	(19,829)
Minority interest income (expense)	—	—	(712)
Net loss	(57,748)	(53,247)	(20,541)
Preferred dividends	(13,948)	(1,066)	(1,081)
Accretion of preferred stock discount	(2,424)	(49)	—
Net loss attributable to common stockholders	(74,120)	(54,362)	(21,622)
Basic and diluted loss per common share	(0.67)	(0.58)	(0.26)
Weighted average common shares outstanding, basic and diluted	110,024	93,284	82,004

The accompanying notes are an integral part of these financial statements.

Consolidated Statement Of Stockholders' Equity (Deficit)
(In thousands, except preferred shares)

	Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount			
		$		$	$	$	$
Balance December 31, 2004	1,786	1	79,829	48	58,361	(16,063)	42,346
Exercise of warrants	—	—	1,757	1	2,762	—	2,763
Proceeds from the sale of common stock	—	—	882	1	1,790	—	1,791
Conversion of preferred stock	(238)	—	2,380	1	(1)	—	—
Issuance of warrants in connection with debt offerings	—	—	—	—	31,520	—	31,520
Stock-based compensation	—	—	1,609	1	2,089	—	2,090
Preferred stock registration costs	—	—	—	—	(2,312)	—	(2,312)
Exercise of stock options	—	—	671	—	128	—	128
Convertible preferred stock dividends	—	—	—	—	—	(1,081)	(1,081)
Net loss	—	—	—	—	—	(20,541)	(20,541)
Balance December 31, 2005	1,548	1	87,128	52	94,337	(37,685)	56,704
Exercise of warrants	—	—	413	—	649	—	649
Proceeds from the sale of common stock	—	—	1,998	1	10,631	—	10,632
Conversion of preferred stock	(953)	(1)	9,529	6	(6)	—	—
Issuance of warrants in connection with preferred stock offerings	—	—	—	—	304	—	304
Stock-based compensation	—	—	645	1	5,239	—	5,240
Issuance of common stock for acquisition of carried working interest	—	—	1,000	1	4,999	—	5,000
Issuance of common stock for settlement of liabilities	—	—	312	—	1,601	—	1,601
Exercise of stock options	—	—	221	—	229	—	229
Accretion of preferred stock discount	—	—	—	—	—	(49)	(49)
Convertible preferred stock dividends	—	—	—	—	—	(1,066)	(1,066)
Net loss	—	—	—	—	—	(53,247)	(53,247)

	Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount			
		$		$	$	$	$
Balance December 31, 2006	595	—	101,246	61	117,983	(92,047)	25,997
Exercise of warrants	—	—	6,667	4	13,390	—	13,394
Proceeds from the sale of common stock	—	—	1,655	1	4,467	—	4,468
Conversion of preferred stock	(595)	—	5,948	4	(4)	—	—
Issuance of warrants in connection with debt offerings	—	—	—	—	412	—	412
Stock-based compensation	—	—	739	—	5,838	—	5,838
Proceeds from the sale of warrants	—	—	—	—	8,000	—	8,000
Issuance of common stock for settlement of liabilities	—	—	298	—	819	—	819
Exercise of stock options	—	—	305	—	368	—	368
Accretion of preferred stock discount	—	—	—	—	—	(2,424)	(2,424)
Convertible preferred stock dividends	—	—	2	—	5	(13,948)	(13,943)
Net loss	—	—	—	—	—	(57,748)	(57,748)
Balance December 31, 2007	—	—	116,860	70	151,278	(166,167)	(14,819)

The accompanying notes are an integral part of these financial statements.

Consolidated Statement of Cash Flows
(In thousands)

	Year ended December 31,		
	2007	2006	2005
	$	*$*	*$*
Operating Activities:			
Net loss	(57,748)	(53,247)	(20,541)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation, depletion and amortization	19,729	14,921	3,385
Amortization of debt financing costs	2,892	2,744	1,115
Debt discount amortization	5,628	5,517	4,633
Stock-based compensation expense	5,838	5,240	2,090
Impairment charge	—	—	4,022
Accretion of asset retirement obligation	60	—	—
Loss on disposal of assets	340	—	—
Minority interest expense	—	—	712
(Increase) decrease in receivables	3,388	(4,192)	(1,979)
(Increase) decrease in crude oil inventory	(220)	789	(1,626)
(Increase) decrease in other current assets	(241)	31	25
Increase in other assets	(275)	(500)	—
Increase in accounts payable	11,449	10,033	1,361
Increase (decrease) in accrued liabilities	6,411	(17,336)	(4,549)
Decrease in other long-term liabilities	(11)	—	—
Net cash used in operating activities	(2,760)	(36,000)	(11,352)
Investing Activities:			
Capital expenditures	(86,247)	(107,283)	(20,703)
Proceeds from disposal of assets	—	48	—
Acquisitions	—	—	(124,000)
Net cash used in investing activities	(86,247)	(107,235)	(144,703)

	Year ended December 31,		
	2007	2006	2005
	$	$	$
Financing Activities:			
Proceeds from sale of common stock, net	4,468	10,632	1,791
Proceeds from sale of preferred stock, net	51,523	41,208	—
Proceeds from long-term debt, net	—	37,065	250,000
Repayments of long-term debt	—	—	(35,350)
Proceeds from short-term borrowings	—	—	25,740
Repayments of short-term borrowings	—	—	(25,740)
Decrease in notes payable to related parties	—	—	(50)
Payment of deferred financing costs	—	—	(12,578)
Payment of dividends on preferred stock	—	(760)	(991)
Proceeds from exercise of stock options	368	229	128
Proceeds from exercise or sale of warrants	21,394	649	2,763
(Increase) decrease in restricted cash	—	31,961	(31,961)
Net cash provided by financing activities	77,753	120,984	173,752
Net increase (decrease) in cash and cash equivalents	(11,254)	(22,251)	17,697
Cash and cash equivalents, beginning of year	12,193	34,444	16,747
Cash and cash equivalents, end of year	939	12,193	34,444

The accompanying notes are an integral part of these financial statements.

Consolidated Statement Of Cash Flows — Supplemental Information
(In thousands)

	Year ended December 31,		
	2007	2006	2005
	$	$	$
Cash paid for:			
Interest	34,800	32,903	11,643
Interest capitalized (non-cash)	(5,612)	(4,096)	(2,498)
Income taxes	—	—	—
Non-cash investing and financing transactions:			
Issuance of common stock for acquisition of carried working interest	—	5,000	—
Issuance of common stock for settlement of liabilities	819	1,601	—
Issuance of stock for preferred dividend	9,304	—	—
Issuance of warrants in connection with debt	—	—	31,250
Accrual for acquisition of carried working interest	—	—	20,250
Accrued and unpaid dividends on convertible preferred stock	5,194	550	244
Asset retirement obligation	261	370	—
Recovery of historical capital expenditures	—	1,493	—
Exchange of convertible preferred stock for common stock	—	1	1
Discount on issuance of preferred stock	18,163	—	—
Accretion of preferred stock discount	2,424	49	—
Issuance of warrants in connection with services	—	304	—
Other long term liabilities	—	186	—
Reclassification of asset held for sale	3,000	—	—

The accompanying notes are an integral part of these financial statements.

Notes to Consolidated Financial Statements

Note 1. Going Concern

The accompanying consolidated financial statements of Transmeridian Exploration Incorporated ("we", "our", "us" or the "Company") have been prepared on the basis of accounting principles applicable to a going concern, which contemplate the realization of assets and satisfaction of liabilities in the normal course of business. As shown in the accompanying consolidated financial statements, we had a net working capital deficit of approximately $50.8 million and a stockholders' deficit of approximately $14.8 million at December 31, 2007. These matters raise substantial doubt about our ability to continue as a going concern. Included in our current liabilities is approximately $17.8 million in returns obligations incurred in connection with the issuance of our 20% Junior Redeemable Convertible Preferred Stock ("Junior Preferred Stock"). However, the returns are not payable until the earlier of (i) the occurrence of a change of control of the Company (as defined in the certificate of designations, as amended, governing the Junior Preferred Stock) or (ii) June 18, 2008; provided, however, that if the returns become due and payable on June 18, 2008 in the absence of a change of control transaction, we may elect to satisfy our payment obligations by delivery of shares of our common stock valued at 97% of the common stock's market value at such time. Additionally, there is approximately $5.2 million in preferred stock dividends that can be satisfied by the issuance of additional preferred shares or common shares subject to certain restrictions. We have incurred operating losses since our inception. To date, we have funded our development operations and working capital requirements through a combination of debt and equity proceeds and cash flow from operations.

As announced on December 31, 2007, we entered into a definitive agreement to be acquired by Trans Meridian International, Inc. ("TMI"), a company formed by our Chairman and Chief Executive Officer. Pursuant to the agreement, TMI will commence a tender offer to purchase all of our outstanding shares of common stock for $3.00 per share, payable net to the seller in cash. The transaction is subject to satisfaction of various conditions precedent. As a result, no prediction can be made as to the timing of the commencement or completion of a tender offer. There can be no assurance that the transaction will be completed. As TMI has not met the financing condition in the definitive agreement within the prescribed time period, which we extended from January 31, 2008 to February 15, 2008, we may terminate the agreement at any time until the condition is satisfied. Our board of directors requested certain detailed information regarding TMI's financing be provided by March 21, 2008 and, if our board of directors is not satisfied with such information, then we intend to terminate the agreement if the financing condition is not satisfied by March 31, 2008. To date, our board of directors is not satisfied with the information that has been provided.

We will continue to seek proposals from other parties with respect to a potential acquisition of our company. There can be no assurance, however, that these efforts will result in any agreement or transaction. Further, if we do enter into an agreement to be acquired by a party other than TMI, the value to be received by our common stockholders may be substantially less than the $3.00 per share contained in the current agreement with TMI. We are also in preliminary discussions with interested parties regarding an investment of capital into our company. Again, there can be no assurance that such discussions will result in any agreement or transaction, which may be substantially dilutive to our stockholders. Furthermore, any potential transaction would be subject to the negotiation and execution of a definitive agreement and other related agreements, as well as to regulatory and other customary approvals and conditions, which may include stockholder approval and other factors including financing, and there can be no assurance that we would be successful in consummating any such transaction.

As of July 1, 2007, we temporarily curtailed production in the Field pending resolution of issues relating to the flaring of associated natural gas produced from the Field and to allow for the initial commissioning of the central production facility and crude export pipeline. We resumed production on September 29, 2007 after receiving an additional gas flaring permit until November 1, 2007. Subsequently, we received government approval from the Working Committee of the Ministry of Energy and Mineral Resources for our modified gas utilization program to supply gas to a proprietary brick manufacturing facility currently under construction, and approval for additional gas flaring volumes of 7.074 million cubic meters for November and December 2007 and 23 million cubic meters until the end of 2008. This protocol allows us to flare gas within these cumulative volumes without penalty until December 31, 2008, by which time our amended gas utilization program must be implemented. We signed a turnkey contract with a third party to construct and operate the brick manufacturing facility and construction is expected to be completed by June 2008.

Operating cash flow is dependent upon many factors, including production levels, sales volumes, oil prices and other factors that may be beyond our control. World oil prices increased to record levels in 2007, but we have not historically been able to consistently benefit from such prices due primarily to factors related to the lack of consistent access to the regional pipeline system, including the inability to process our own crude oil to remove mercaptans and other contaminants and the lack of our own connection to the regional pipeline system. From time to time we have utilized third-party processing facilities and pipeline connections, but access has been inconsistent and often unavailable. Prior to 2007, we exported our crude oil by rail, but due to transportation and storage costs as well as quality discounts, realized net revenues well below those from pipeline export. In mid-2007, we commissioned our permanent central production facility, including a demercaptan unit, and proprietary connection to the regional export pipeline system. As a result, we are now able to produce and export pipeline quality crude oil on a consistent basis, and receive substantially better prices for the crude oil we export.

Total production increased only marginally from 2006 to 2007, primarily due to the shut-in of the Field for substantially all of the third quarter of 2007. Average daily production during 2007, prior to the shut-in, increased approximately 33% over production levels in 2006. We utilized much of our excess liquidity during the shut-in period to fund operating costs, overhead, scheduled interest payments and necessary capital expenditures. As a result, we do not currently have the necessary resources to allow for continued drilling of exploration and development wells and to meet other working capital obligations. We suspended drilling operations and have instituted cost cutting measures in both Kazakhstan and the U.S., primarily personnel reductions, which are expected to result in cost savings of approximately $2.6 million annually. We have also recently completed four wells that were drilled in 2007. The new wells are currently producing an aggregate of approximately 300 bopd, and are expected to produce substantially more once they have been acid stimulated, currently planned for the second quarter of 2008. While all wells in the Field that have been acid stimulated have shown improved flow rates, results have been inconsistent and we are not able to accurately predict the future performance of these new wells. At current production levels of approximately 2,200 bopd, and at the prices we currently receive, management believes we are able to generate sufficient cash flow to cover our operating costs, overhead and scheduled interest payments on our debt. However, as discussed above, we had a working capital deficit of $50.8 million at December 31, 2007, and do not have sufficient liquidity to carry out the full development program set forth above. Furthermore, no assurance can be given that production from the new wells and the cost cutting measures that have been instituted will result in sufficient additional cash flow to cover the working capital deficit and to fund continued Field development. If we are unable to either complete the pending sale of the Company discussed above or another strategic transaction, or if we are unable to increase production to a sufficient level, we will have to seek additional capital to fund interest payments, operating expenses and continued Field development. If we are unable to secure adequate additional capital, we may not be able to carry out the entire development plan set forth above, in which case our business, financial condition, results of operations and possibly our reported proved reserves would be materially and adversely affected. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should we be unable to continue as a going concern.

Note 2. Organization and Summary of Significant Accounting Policies

We were incorporated in the State of Delaware in April 2000. We are engaged in the business of acquiring, developing and producing oil and gas, with our activities primarily focused on the Caspian Sea region of the former Soviet Union. Our primary oil and gas property is the South Alibek Field ("South Alibek" or the "Field") in the Republic of Kazakhstan covered by License 1557 (the "License") and the related exploration and production contracts with the government of Kazakhstan.

Principles of Consolidation and Reporting

The consolidated financial statements include the accounts of us and our majority-owned and controlled subsidiaries and are prepared in accordance with generally accepted accounting principles in the United States. All significant intercompany transactions and balances have been eliminated in consolidation.

We conduct our operations in Kazakhstan through a wholly-owned subsidiary, JSC Caspi Neft TME ("Caspi Neft"), a joint stock company organized under the laws of Kazakhstan. Caspi Neft holds the license, exploration and production contracts covering the Field in Kazakhstan. Prior to February 2004, we owned 100% of Caspi Neft. From February 2004 to December 2005, 50% of Caspi Neft was owned by Bramex Management, Inc. ("Bramex"). We continued to exercise significant control over Caspi Neft after Bramex acquired 50% of Caspi Neft in February 2004 and, accordingly, believe the most meaningful accounting treatment was to fully consolidate Caspi Neft with the 50% share owned by Bramex reflected as a minority interest. In December 2005, we reacquired 100% of Caspi Neft. The results of operations of Caspi Neft represent substantially all of the operations of the Company.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates and judgments on historical experience and on other information and assumptions that are believed to be reasonable under the circumstances. Estimates and judgments about future events and their effects cannot be perceived with certainty; accordingly, these estimates may change as additional information is obtained, as more experience is acquired, as our operating environment changes and as new events occur. While it is believed that such estimates are reasonable, actual results could differ materially from those estimates. Estimates are used for, but not limited to, determining the following: inventory valuation, recoverability of long-lived assets, useful lives and oil and gas reserves used in depreciation, depletion, and amortization, income taxes and related valuation allowances and insurance, environmental and legal accruals.

Revenue Recognition

We sell our production both in the export and domestic market on a contract basis. Revenue is recorded when the purchaser takes delivery of the oil and is presented in our consolidated financial statements net of royalties. At the end of the period, oil that has been produced but not sold is recorded as inventory at the lower of cost or market. Cost is determined on a weighted average basis based on production costs.

Cash and Cash Equivalents

We consider all highly liquid instruments with an original maturity of three months or less to be cash equivalents. Certain of our cash balances are maintained in foreign banks which are not covered by deposit insurance. The cash balances in our U.S. accounts may exceed federally insured limits.

Property and Equipment

We follow the "successful efforts" method of accounting for the costs of acquisition, exploration and development of oil and gas properties.

Oil and gas lease acquisition costs are capitalized when incurred. Unproved properties with significant acquisition costs are assessed quarterly on a property-by-property basis, and any impairment in value is recognized. Unproved properties with acquisition costs which are not individually significant are aggregated, and the portion of such costs estimated to be nonproductive, based on historical experience, is amortized over the average holding period. If the unproved properties are determined to be productive, the appropriate related costs are transferred to proved oil and gas properties. Lease rentals are expensed as incurred.

Oil and gas exploration costs, other than the costs of drilling exploratory wells, are charged to expense as incurred. Such costs include seismic expenditures and other geological and geophysical costs. The costs of drilling exploratory wells are capitalized pending determination of whether they have discovered proved commercial reserves. If proved commercial reserves are not discovered, exploratory drilling costs are expensed. Costs to develop proved reserves are capitalized, including the costs of all development wells and related equipment used in the production of crude oil and natural gas.

Depreciation, depletion and amortization of the costs of proved oil and gas properties is computed using the unit-of-production method based upon estimated proved reserves.

We review our oil and gas properties for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The determination of recoverability is based on comparing the estimated undiscounted future net cash flows at a producing field level to the unamortized capitalized cost of the asset. If the future undiscounted cash flows, based on our estimates of anticipated production from proved reserves and crude oil and natural gas prices and operating costs, are lower than the unamortized capitalized cost, the capitalized cost is reduced to fair value. Fair value is calculated by discounting the future cash flows at an appropriate risk-adjusted discount rate.

In December 2001, we purchased a drilling rig that, beginning in October 2002, was used in the development of the Field. The rig was depreciated on the straight-line method and while being used for development drilling, the depreciation of the rig and related support equipment was capitalized under the successful efforts method as part of the cost of the wells. Subsequent depreciation was expensed when the rig was stacked. In the first quarter of 2006, the Company reached an agreement to dispose of the rig. In accordance with generally accepted accounting principles, an impairment charge writing the value of the rig down to the estimated net proceeds and reclassifying the net book value of the rig to current asset held for sale was recorded. The carrying value of the drilling rig and related equipment was reclassified in June 2007 when the agreement to dispose of the rig was not consummated and is being depreciated over its estimated remaining useful life.

Our central production facility, pipeline and related oil processing equipment, transportation equipment and office and technology equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, which range from three to twenty four years.

Maintenance and repairs are charged to expense as incurred. Replacements and expenditures which improve or extend the life of assets are capitalized. When assets are sold, retired or otherwise disposed of, the applicable costs and accumulated depreciation and amortization are removed from the accounts, and the resulting gain or loss is recognized.

Capitalized Interest Costs

Certain interest costs have been capitalized as part of the cost of oil and gas properties under development, including property acquisition costs, wells in progress and related facilities. Additionally, interest was capitalized on the drilling rig while it was being readied for its intended use. Total interest costs capitalized during the years ended December 31, 2007, 2006 and 2005 totaled $5.6 million, $4.1 million and $2.5 million, respectively.

Income Taxes

We account for income taxes using the asset and liability method. The asset and liability method requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of (i) temporary differences between financial statement carrying amounts of assets and liabilities and the basis of these assets and liabilities for tax purposes and (ii) operating loss and tax credit carry-forwards for tax purposes. Deferred tax assets are reduced by a valuation allowance when management concludes that it is more likely than not that a portion of the deferred tax assets will not be realized in a future period.

Debt Financing Costs

Costs incurred with debt financings are capitalized and amortized over the term of the related financing facility.

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. Net loss attributable to common stockholders is calculated as the net loss after deductions for cumulative preferred stock dividends, whether paid or accrued, and accretion of preferred stock discount. Diluted net loss per common share has been computed based on the weighted average number of shares of common stock and common stock equivalents outstanding during the applicable period, as if all potentially dilutive securities were converted into common stock. Diluted net loss per share equals basic net loss per share for the periods presented because the effects of potentially dilutive securities are anti-dilutive. The calculation of diluted weighted average shares outstanding for the years ended December 31, 2007, 2006 and 2005 excludes 2,199,268, 10,872,553, and 3,926,973 common shares, respectively, issuable pursuant to convertible preferred stock and outstanding stock options and warrants because their effect is anti-dilutive.

Foreign Exchange Transactions

Our functional currency is the U.S. dollar because we primarily contract with customers, finance capital and purchase equipment and services using the U.S. dollar. Certain assets and liabilities are translated at historical exchange rates, revenues and expenses in foreign currency are translated at the average rate of exchange for the period and all translation gains or losses are reflected in the period's results of operations.

Concentration of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. We deposit our cash and cash equivalents in high credit quality financial institutions, however amounts on deposit do exceed the maximum amount insured by the Federal Deposit Insurance Corporation. Although our current crude oil sales are to a limited number of purchasers, all of our customers are involved in the energy industry.

Stock-Based Compensation

We account for employee stock-based compensation using the fair value method as prescribed in Statement of Financial Accounting Standards ("SFAS") No. 123(R). Under this method, we record the fair value attributable to stock options or stock grants, based on the Black-Scholes model, and amortize that amount to expense over the service period required to vest the options.

Financial Instruments

Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and long-term debt. The carrying values of cash and cash equivalents, receivables and accounts payable approximate fair value due to their short-term nature. The carrying value of long-term debt approximates its fair value based on the market interest rate of the debt instrument.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP") and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted, provided the company has not yet issued financial statements, including for interim periods, for that year. Consistent with its requirements, we adopted SFAS No. 157 as of January 1, 2008 and it did not have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We adopted SFAS No. 159 on January 1, 2008, and we do not expect this standard to have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* ("SFAS No. 160"), which amends Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to improve the relevance, comparability and transparency of the financial information that a reporting entity provides in its consolidated financial statements. SFAS No. 160 requires (i) that noncontrolling (minority) interests be reported as a component of shareholders' equity, (ii) that net income attributable to the parent and to the noncontrolling interest be separately identified in the consolidated statement of operations, (iii) that changes in a parent's ownership interest while the parent retains its controlling interest be accounted for as equity transactions, (iv) that any retained noncontrolling equity investment upon the deconsolidation of a subsidiary be initially measured at fair value, and (v) that sufficient disclosures are provided that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for annual periods beginning after December 15, 2008 and should be applied prospectively. However, the presentation and disclosure requirements of the statement shall be applied retrospectively for all periods presented. We do not expect this standard to have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* ("SFAS No. 141(R)"), which replaces SFAS No. 141, Business Combinations. SFAS No. 141(R) changes the requirements for an acquirer's recognition and measurement of the assets acquired and the liabilities assumed in a business combination. SFAS No. 141(R) is effective for annual periods beginning on or after December 15, 2008 and should be applied prospectively for all business combinations entered into after the date of adoption.

Note 3. Property and Equipment

Property and Equipment

Property and equipment consisted of the following:

	December 31,	
	2007	**2006**
	$	*$*
	(In thousands)	
Oil and gas properties, successful efforts method	424,628	338,548
Drilling rig and related equipment	3,000	—
Transportation equipment	479	510
Office and technology equipment	634	547
	428,741	339,605
Accumulated depreciation, depletion and amortization	(38,497)	(18,799)
Property and equipment, net	390,244	320,806

We capitalize interest costs on oil and gas projects under development, including the costs of unproved leasehold and property acquisition costs, wells in progress and related facilities. During the years ended December 31, 2007 and 2006, we capitalized approximately $5.6 million and $4.1 million, respectively, of interest costs.

Oil and Gas Properties

The License covering the Field was granted by the Republic of Kazakhstan on April 29, 1999 and originally covered 3,396 acres. In March 2000, we acquired the License from an unrelated third-party for $4.0 million. During 2001, based on its technical review and analysis of the probable productive area of the Field, we applied to the Kazakhstan Ministry of Energy and Mineral Resources to expand the area covered by the License. In November 2001, our application was approved and the License was expanded to cover an area of 14,111 acres.

The exploration contract associated with the License had an original six-year term which expired in April 2005 and has been extended through April 2009. The exploration contract required capital expenditures during the initial period of approximately $18.0 million, which was satisfied and $30.5 million during the first two-year extension, which has also been satisfied. The latest two-year extension, expiring April 2009, requires an additional commitment of $19.7 million for development of the Field, which has been satisfied. During the primary and extended terms of the exploration contract, we can produce from wells under a test program and pay a 2% royalty to the government.

In December 2006, the 25-year production contract for the Field was signed and officially registered by the governmental authorities in Kazakhstan. The production contract initially covers the approved 3,500 acre commercial area within the 14,111 acre License area. Under our exploration contract, we have the right to continue exploration activities within the License area and increase the size of the commercial area subject to the long-term production contract. The production contract provides, among other things, a minimum seven-year work program commitment of $59.6 million for the continued development of the Field, the recovery by the government of approximately $4.7 million of exploration costs that were incurred prior to privatization, a signature bonus, future commercial discovery bonuses if additional recoverable reserves are found, royalty rates determined using a sliding scale based on annual production levels of crude oil and annual funding of agreed social projects, training programs and an abandonment fund.

Pursuant to the terms of the production contract we may be required to dismantle and remove any facilities and equipment and return the area under the contract to a condition that permits the use of such area for purposes similar to those existing prior to the commencement of operations under the exploration contract. We have an asset retirement obligation of approximately $691,000 as of December 31, 2007 for the assets that have been placed into service as of that date. We will account for future asset retirement obligations as assets are placed into service and changes in existing retirement obligations pursuant to the requirements of SFAS No. 143, Accounting for Asset Retirement Obligations .

Note 4. Debt

Long-Term Debt

Long-term debt consists of the following:

	December 31, 2007	2006
	$	*$*
	(In thousands)	
Senior Secured Notes due 2010, net of discount of $16,648 and $22,276	273,352	267,724
Total long-term debt	273,352	267,724
Less current maturities	—	—
Long-term portion	273,352	267,724

Senior Secured Notes

In December 2005, we and Transmeridian Exploration Inc., our wholly owned subsidiary ("TEI"), issued in a private placement 250,000 Units, consisting of in the aggregate (i) $250 million principal amount of senior secured notes due 2010 of the Issuer (the "Existing Notes") and (ii) warrants to purchase approximately 17.3 million shares of our common stock. The Units were issued and sold for a purchase price of $1,000 per Unit. Each Unit consists of $1,000 principal amount of Notes and 69.054 Warrants to purchase an equal number of shares of our common stock. The Existing Notes, which will mature on December 15, 2010, bear interest at the rate of 12% per annum. Interest on the Existing Notes is payable quarterly on March 15, June 15, September 15 and December 15 of each year and at maturity. The fair value of the warrants of approximately $26,816,000 was recorded as a discount to the face amount of the Existing Notes and will be amortized to interest expense over the life of the Existing Notes. We used the proceeds from the offering of the Units of $237.4 million, after expenses, to fund the acquisition of Bramex and to retire the existing bank credit facility indebtedness of Caspi Neft, to repay $22.5 million of convertible promissory notes and to pre-fund the first year of interest payments on the Existing Notes of $30 million.

In May 2006, we and TEI issued in a private placement $40 million principal amount of additional senior secured notes due 2010 (the "Additional Notes") and (ii) 1,818,182 shares (approximately $10 million) of our common stock (the "Shares"). The Additional Notes were issued and sold for an issue price of 97% of the principal amount thereof plus accrued interest from March 15, 2006, and the Shares were issued and sold at an issue price of $5.50 per share. The discount was recorded as a reduction of the face amount of the Additional Notes and will be amortized to interest expense over the life of the Additional Notes.

The Additional Notes have terms and conditions identical to, and are fungible for trading and other purposes with, the Existing Notes. The Additional Notes, like the Existing Notes, are fully and unconditionally guaranteed by us and all of our material subsidiaries and are governed by the terms of the Indenture, dated as of December 12, 2005, as supplemented by the First Supplemental Indenture, dated as of December 22, 2005, and the Second Supplemental Indenture, dated as of May 24, 2006, by and among TEI, us, the subsidiary guarantors of the Existing Notes and the Additional Notes and the trustee. The Indenture contains provisions that limit the our ability to enter into transactions with affiliates; pay dividends or make other restricted payments; incur debt; create, incur or assume liens; sell assets; and consolidate, merge or transfer all or substantially all of our assets. We are required to offer to repurchase the Notes in connection with certain specified change of control events. The Notes are subject to redemption, in whole or in part, at our option at any time on or after December 15, 2008 at redemption prices starting at 106% of the principal amount redeemed and declining to 100% by June 15, 2010. Prior to December 15, 2008, we may redeem up to 35% of the Notes with proceeds of certain equity offerings at a specified redemption price.

In July 2006, pursuant to the registration rights agreements entered into in connection with the issuance of the Existing Notes and the Additional Notes, we completed an exchange offer of $290 million aggregate principal amount of TEI's senior secured notes due 2010 registered under the Securities Act of 1933 for all of the outstanding Existing Notes and Additional Notes.

Future maturities of long-term debt, exclusive of discount, at December 31, 2007, are as follows:

	Amount *$* *(In thousands)*
2008	—
2009	—
2010	290,000
2011	—
2012	—
Total long-term debt	290,000

Management believes the fair value of debt at December 31, 2007 approximates its carrying value based on the market interest rate of the debt instrument.

Note 5. Redeemable Convertible Preferred Stock

Senior Redeemable Convertible Preferred Stock

In December 2006, we sold (i) 370,000 shares of our 15% Senior Redeemable Convertible Preferred Stock (the "Senior Preferred Stock") in a private offering and (ii) 70,000 shares of Senior Preferred Stock in a concurrent private placement. Purchasers of the Senior Preferred Stock in the private placement included our Chairman and Chief Executive Officer and our Vice President and Chief Financial Officer, who purchased 41,000 and 5,000 shares, respectively.

The Senior Preferred Stock, which has a liquidation preference of $100 per share, pays cumulative quarterly dividends at an initial rate of 15% per annum, subject to adjustment, payable at our option in additional shares of the Senior Preferred Stock, shares of our common stock (subject to the satisfaction of certain conditions) or cash (if allowed by the terms of our then-existing debt instruments). Dividends are payable on January 1, April 1, July 1 and October 1 of each year, commencing April 1, 2007. Additionally, we issued to the initial purchaser in the offering 110,000 warrants to purchase shares of our common stock as part of the total fees of the offering. The fair value of the warrants of approximately $304,000 was recorded as a discount to the face amount of the Senior Preferred Stock and is being amortized over the life of the Senior Preferred Stock.

Our Senior Preferred Stock was originally convertible into approximately 9.8 million shares of common stock based on an initial conversion price of $4.50 per share of common stock. Effective July 1, 2007, there was a one-time test for adjustment of the conversion price and the dividend rate based upon the achievement of a specified average production rate prior to June 30, 2007 or a specified average trading price threshold of our common stock during the 15 trading days immediately following June 30, 2007. Neither of these thresholds was met and the conversion price and the dividend rate of the Senior Preferred Stock were adjusted to $3.90 per share and 18%, respectively, effective July 1, 2007. Additionally, the conversion price of the Senior Preferred Stock is subject to adjustment pursuant to customary anti-dilution provisions. As a result of the issuance of the 20% Junior Redeemable Convertible Preferred Stock ("Junior Preferred Stock"), our March 2007 private placement of warrants to purchase shares of our common stock referenced in Note 7 below and our April 2007 private placement of shares of our common stock also referenced in Note 7 below, the conversion price of the Senior Preferred Stock was further adjusted to $3.76 per share . Additionally, the conversion price of the Senior Preferred Stock may also be adjusted upon the occurrence of a change of control meeting certain conditions. However, in no event will the conversion price of the Preferred Stock be reduced to less than $3.23 per share (subject to adjustment), which was the closing price of our common stock on the American Stock Exchange on the pricing date of the private offering and the concurrent private placement. As of December 31, 2007, there were 442,334 shares of Senior Preferred Stock outstanding that were convertible into approximately 11.8 million shares of common stock.

The Senior Preferred Stock ranks senior to our common stock with respect to dividend rights and rights upon the Company's liquidation, winding-up or dissolution. There are also restrictive covenants related to our ability to incur indebtedness, make certain payments or investments and create restrictions on us and our subsidiaries' ability to pay dividends, and further provides for preemptive rights in favor of the holders of the Preferred Stock with respect to certain securities offerings that we may make in the future.

Junior Redeemable Convertible Preferred Stock

In June 2007, we sold 550,000 shares of our Junior Preferred Stock. The Junior Preferred Stock, which has a liquidation preference of $100 per share, will pay cumulative quarterly dividends at a rate of 20% per annum, payable at our option in additional shares of the Junior Preferred Stock, shares of our common stock (subject to the satisfaction of certain conditions) or cash (if allowed by the terms of our then-existing debt instruments or the Senior Preferred Stock).

The Junior Preferred Stock was originally convertible into approximately 24.4 million shares of common stock, based on an initial conversion price of $2.25 per share. The conversion price was adjusted on November 1, 2007 to $1.90 per share because a change of control had not occurred, or a definitive agreement that would lead to a change of control had not been signed as of October 31, 2007. As of December 31, 2007, there were 640,656 shares of Junior Preferred Stock outstanding that were convertible into approximately 33.7 million shares of common stock.

In connection with the issuance of our Junior Preferred Stock, each purchaser of Junior Preferred Stock that was also a beneficial owner of our Senior Preferred Stock had the right to exchange shares of Senior Preferred Stock, on a one-for-one basis, for Junior Preferred Stock, up to the number equal to 40% of the aggregate number of shares of Junior Preferred Stock purchased by such holder (the "Investment Rollover"). Purchasers of Junior Preferred Stock elected to convert 56,000 shares of Senior Preferred Stock into Junior Preferred Stock in August 2007 and the carrying value of the shares of Senior Preferred Stock was transferred to the Junior Preferred Stock.

The Junior Preferred Stock will be redeemable, at the option of the holder, on March 15, 2012 at the liquidation preference plus all accumulated and unpaid dividends, or upon a change of control at an amount equal to the sum of 125% of the liquidation preference plus all accumulated and unpaid dividends.

We will have the option, upon a change of control, to redeem the Junior Preferred Stock at an amount equal to the sum of 125% of the then-effective conversion price multiplied by the number of shares of common stock into which such shares of Junior Preferred Stock are then convertible plus all accrued and unpaid dividends. After June 15, 2008, the Junior Preferred Stock is redeemable, at our option, at a premium to the liquidation preference, provided the closing price of our common stock equals or exceeds 125% of the then-effective conversion price for at least 20 trading days in any 30 consecutive trading day period.

Of the 550,000 shares of the Junior Preferred Stock issued in the private placement, 100,000 shares of the Junior Preferred Stock were issued, and the net proceeds of approximately $9.5 million were paid to us, in connection with the first closing on June 18, 2007. In connection with the second closing on June 26, 2007, the remaining 450,000 shares of the Junior Preferred Stock were issued and net proceeds of approximately $11.0 million from the sale of 120,000 of the shares were paid to us. The remaining 330,000 shares of the Junior Preferred Stock and the gross proceeds of $33.0 million therefrom were originally placed in escrow pending stockholder approval of the issuance or potential issuance of shares of our common stock under the terms of the Junior Preferred Stock that, in the aggregate, equal or exceed 20% of the currently outstanding shares of our common stock. The escrow proceeds, net of transaction fees, were released to us in July 2007 upon our receipt of the requisite proxies evidencing such stockholder approval.

The private placement generated total net proceeds of approximately $51.5 million, after transaction fees and expenses. We used the net proceeds from the first closing to satisfy our interest payment obligation with respect to our senior secured notes due 2010 and for working capital and general corporate purposes. The net proceeds from the second closing, including the escrowed proceeds were used for working capital and general corporate purposes, including funding ongoing development costs. Additionally, we issued 550,000 warrants to the underwriter to purchase shares of our common stock at $2.25 per share as part of the total fees of the offering. We also agreed to pay a transaction preferred return, in cash, equal to 10% of an investors' commitment and a preferred return, in cash, equal to 25% of the aggregate liquidation preference of the shares of Junior Preferred Stock purchased. However, the returns are not payable until the earlier of (i) the occurrence of a change of control of the Company (as defined in the certificate of designations, as amended, governing the Junior Preferred Stock) or (ii) June 18, 2008; provided, however, that if the returns become due and payable on June 18, 2008 in the absence of a change of control transaction, we may elect to satisfy our payment obligations by delivery of shares of our common stock valued at 97% of the common stock's market value at such time. Additionally, if a change of control has not occurred by December 31, 2007, the return balances are increased, until paid, at the rate of 10% per annum. The fair value of the warrants of approximately $412,500, along with other offering expenses, and the value of the returns of approximately $17.8 million, were recorded as a discount to the face value of the Junior Preferred Stock and will be accreted over the life of the Junior Preferred Stock. The returns obligations have been recognized as current liabilities as of December 31, 2007.

In addition, holders of the Junior Preferred Stock have the right, upon written request of the holders of two-thirds of the outstanding shares of the Junior Preferred Stock, to designate individuals to constitute one-half of the membership of our board of directors and to require us to take the necessary action to effect such change in our board composition. In addition, we will be obligated to cause the directors designated by the holders of two-thirds of the outstanding shares of the Junior Preferred Stock to constitute a majority of the directors then serving on the special committee of the board of directors overseeing the ongoing process with respect to a possible sale of the Company or the Field. If a change of control of the Company has not occurred, or a definitive agreement that would lead to a change of control of the Company has not been signed, by June 15, 2008, we may be obligated to further alter the composition of the board of directors such that individuals designated by the holders of two-thirds of the outstanding shares of the Junior Preferred Stock would then constitute a majority of the members of the board of directors.

The holders of the Junior Preferred Stock are also entitled to certain registration rights with respect to the Junior Preferred Stock, pursuant to which we are obligated to file and cause to become effective a shelf registration statement covering the resale of the Junior Preferred Stock, the shares of our common stock into which the Junior Preferred Stock is convertible, and the shares of the Junior Preferred Stock and shares of our common stock issued in payment of the quarterly dividends. Pursuant to, and in timely compliance with, our filing obligation, we filed such shelf registration statement on July 18, 2007. On October 16, 2007, a registration default occurred because our Registration Statement on Form S-3 was not declared effective by the SEC within 120 days after the execution date of the Amended and Restated Commitment Letter by and among us and the purchasers of the Junior Preferred Stock. This default is continuing; as a result, while such registration default continues, the holders of the Junior Preferred Stock are entitled to receive additional dividends at a rate of 1.00% per annum for the first 30 days of such registration default and at a rate of 1.50% per annum thereafter, in addition to the dividends otherwise accruing until the default is cured.

Note 6. Stockholders' Equity

Series A Convertible Preferred Stock

During 2007, the remaining 594.804 shares of Series A Cumulative Convertible Preferred Stock (the "Series A Preferred") were converted into 5,948,039 shares of our common stock. No Series A Preferred shares were outstanding as of December 31, 2007.

Common Stock Reserved for Issuance

There are 200,000,000 common shares authorized by the Company's Amended and Restated Certificate of Incorporation and 116,859,838 and 101,245,877 common shares were issued and outstanding as of December 31, 2007 and 2006, respectively. Shares of common stock reserved for issuance are summarized as follows:

	December 31,	
	2007	2006
	(In thousands)	
2006 Incentive Plan (f/k/a 2001 Incentive Stock Option Plan)	8,097	5,107
2003 Stock Compensation Plan	285	1,337
Convertible preferred stock	45,483	15,726
Warrants to purchase common stock	28,645	26,262
Total	82,510	48,432

Warrants

On March 15, 2007, we issued in a private placement warrants to purchase an aggregate 8,500,000 shares of our common stock. The warrants were issued for total cash consideration of $8 million. Each warrant, when exercised, will entitle the holder to receive one share of our common stock at an exercise price of $2.00 per share. The warrant agreement governing the warrants provides for customary anti-dilution adjustments with respect to the exercise price and the number of shares of our common stock issuable upon exercise of the warrants. The warrants are exercisable at any time, at the holder's option, and will expire on March 15, 2012.

Also in March 2007, the holders of warrants to purchase an aggregate of 4,773,214 shares of our common stock notified us of their intention to exercise such warrants upon the expiration of the specified notice period for waiver of beneficial ownership limitations under the warrants. In connection with such notification, the holders paid in advance the exercise price of the warrants, resulting in proceeds to us of approximately $10,373,000. The common shares underlying these warrants were issued in May 2007.

Similarly, in April 2007, the holders of warrants to purchase an aggregate of 1,700,000 shares of our common stock notified us of their intention to exercise such warrants upon the expiration of the specified notice period for waiver of beneficial ownership limitations under the warrants. In connection with such notification, the holders paid in advance the exercise price of the warrants, resulting in proceeds to us of $2,635,000. The common shares underlying these warrants were issued in June 2007. Also in April 2007, the holders of warrants to purchase an aggregate of 193,750 shares of our common stock exercised their warrants resulting in proceeds to us of approximately $400,000.

In April 2007, we sold to various investors an aggregate of 1,655,000 shares of our common stock for cash in a private placement exempt from registration under the Securities Act of 1933 (as amended, the "Securities Act"). In connection therewith, we granted to the purchasers certain registration rights with respect to the resale or other disposition of such shares of common stock. The sales price of the shares sold was $2.70 per share, and the aggregate gross proceeds to us from the sale were approximately $4.5 million.

In May 2007, the holders of warrants to purchase an aggregate of 2,000,0000 shares of our common stock notified us of their intention to exercise such warrants upon the expiration of the specified notice period for waiver of beneficial ownership limitations under the warrants. In connection with such notification, the holders paid in advance $1.99 of the $2.00 exercise price of the warrants, resulting in proceeds to us of $3,980,000. As of December 31, 2007, the remainder of the exercise price of the warrants had not been paid and the shares of common stock issuable in connection with the pending warrant exercises had not been issued. Accordingly, a liability in the amount of $3,980,000 has been reflected in accrued liabilities at December 31, 2007, representing our obligation to issue the related shares of common stock upon the expiration of the notice period in July 2007 and receipt of the remaining exercise price.

2006 Incentive Plan

Our 2006 Incentive Plan (the "Plan"), which was approved by our stockholders at our 2006 annual meeting of stockholders in May 2006, is an amendment and restatement of our 2001 Incentive Stock Option Plan. Under the Plan, we may grant to officers, board members, key employees and consultants of the company, through May 30, 2016, options to purchase up to an aggregate of 10% of the total shares of our common stock outstanding from time to time, less the number of shares underlying unexercised options as of the date the Plan was approved by our stockholders at our 2006 annual meeting of stockholders (i.e., May 30, 2006); as of December 31, 2007, options to purchase up to an aggregate 3,645,000 shares of our common stock could be granted under the Plan. The exercise price of each option under the Plan shall generally be no less than the fair market value of our common stock on the date of grant, and all options granted under the Plan shall generally have a term of no greater than 10 years. The vesting period of options granted under the Plan is determined by the Board of Directors on the date of grant.

The following table summarizes activity under the Plan for the last three years.

	Number of Shares *(In thousands)*	Weighted Average Exercise Price Per Share *$*
Outstanding at December 31, 2004	1,395	0.78
Granted	1,740	1.61
Exercised	(705)	0.31
Forfeited	(150)	0.12
Outstanding at December 31, 2005	2,280	1.53
Granted	1,390	5.98
Exercised	(243)	1.49
Forfeited	(132)	4.70
Outstanding at December 31, 2006	3,295	3.28
Granted	1,800	3.49
Exercised	(305)	0.99
Forfeited	(339)	3.86
Outstanding at December 31, 2007	4,451	3.46
Shares exercisable at December 31		
2007	3,145	3.17
2006	1,802	2.65
2005	833	1.41

The aggregate fair value of options granted during 2007, 2006 and 2005 was $5,526,000, $4,365,000 and $970,000, respectively, which is being amortized to expense over the vesting period of the options. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rates of 5%; expected lives between 2.5 and 10 years; and volatility of the price of the underlying common stock of 45-90%. Compensation expense of $3,967,000, $2,070,000 and $401,000 for stock options was recognized during the years ended December 31, 2007, 2006 and 2005, respectively.

The following table summarizes additional information about the Company's outstanding and exercisable stock options at December 31, 2007:

	Outstanding			Exercisable	
Exercise Price	Number Outstanding *(In thousands)*	Weighted Average Remaining Life (In Years)	Weighted Average Exercise Price *$*	Number Outstanding *(In thousands)*	Weighted Average Exercise Price *$*
$1.50	373	1.88	1.50	373	1.50
$1.61	1,237	2.38	1.61	1,237	1.61
$3.49	1,658	9.11	3.49	708	3.49
$5.98	1,183	3.07	5.98	827	5.98
Total at December 31, 2007	4,451	5.03	3.46	3,145	3.17

2003 Stock Compensation Plan

In May 2003, we established the 2003 Stock Compensation Plan with the registration of 2.5 million shares under the plan. The plan was amended in May 2005 to increase the number of shares authorized for issuance to a total of 5,000,000 shares. Under the terms of the plan, such stock may be issued for restricted stock awards, payments of bonuses in stock, payments for services to consultants in the form of stock, employer contributions to a 401(k) plan, stock appreciation rights and warrants. Any shares issued in lieu of cash are recognized as expense based on the fair value of the shares on the date of grant. The fair value of restricted stock awards on the date of grant is amortized ratably over the vesting period. The following table summarizes the shares issued during the years ended December 31:

	2007	2006	2005
		(In thousands)	
Number of shares issued	1,250	826	1,357
Fair value at date of grant	3,024	4,737	2,871

Compensation expense of $1,871,000, $3,170,000 and $1,689,000 for shares issued or granted was recognized during the years ended December 31, 2007, 2006 and 2005, respectively.

Note 7. Income Taxes

We provide for deferred taxes on temporary differences between the financial statements and tax basis of assets using the enacted tax rates that are expected to apply to taxable income when the temporary differences are expected to reverse. We have not recorded any deferred tax assets or income tax benefits from the net deferred tax assets for the years ended December 31, 2007, 2006 and 2005. We have placed a 100% valuation allowance against the net deferred tax asset because future realization of these assets is not assured.

Income before income taxes is composed of the following:

	Year ended December 31,		
	2007	**2006**	**2005**
	$	*$*	*$*
		(In thousands)	
United States	(13,242)	(9,586)	(16,508)
International	(44,506)	(43,661)	(4,033)
	(57,748)	(53,247)	(20,541)

A reconciliation of the federal statutory income tax (34%) amounts to the effective amounts is shown below:

	Year ended December 31,		
	2007	**2006**	**2005**
	$	*$*	*$*
		(In thousands)	
Income tax benefit computed at statutory rates	(19,634)	(18,104)	(6,983)
Effect of foreign tax rate differential	15,367	14,155	885
Return to provision adjustments	1,190	6,590	(5,510)
US GAAP and local country accounting differences	1,050	1,360	294
Adjustment to valuation allowance	2,027	(4,001)	11,314
	—	—	—

At December 31, 2007, 2006 and 2005 the components of our deferred tax assets and liabilities were as follows:

		December 31,	
	2007	**2006**	**2005**
	$	*$*	*$*
		(In thousands)	
Current deferred tax assets			
Cost basis of assets held for sale	1,370	1,370	1,367
Accrual to cash adjustments in foreign subsidiary	—	—	1,239
Total current deferred tax assets	1,370	1,370	2,606
Noncurrent deferred tax assets			
Domestic net operating loss carryforwards	8,490	9,827	7,999
Foreign oil and gas exploration and development cost	—	510	6,542
Stock options	4,331	—	—
Property, plant and equipment	80	—	—
Other	196	1,131	128
Total noncurrent deferred tax assets	13,097	11,468	14,669
Total deferred tax assets	14,467	12,838	17,275
Noncurrent deferred tax liabilities			
Property, plant and equipment	—	(398)	(458)
Foreign capitalized interest	—	—	—
Other	—	—	(95)
Total noncurrent deferred tax liabilities	—	(398)	(553)
Net deferred tax assets	14,467	12,440	16,722
Valuation allowance	(14,467)	(12,440)	(16,722)
	—	—	—

As of December 31, 2007, we had estimated domestic net operating loss ("NOL") carryforwards of $25.0 million which will expire between 2020 and 2027. The 2006 and 2007 NOL for financial reporting purposes has been reduced by $828,000 and $163,000 respectively for the effect of SFAS No. 123(R), as more fully described below.

In December 2004, the FASB issued the revised SFAS No. 123(R), *Share-Based Payment*. SFAS 123(R) is a revision of SFAS No. 123 and supersedes APB No. 25. We had previously adopted SFAS No. 123, and, the revised provisions of SFAS No. 123(R) were effective January 1, 2006. For companies that have NOL carryforwards, SFAS No. 123(R) affects the manner in which stock-based compensation tax deductions are treated for financial reporting purposes. We may claim stock-based compensation deductions in our federal corporate income tax returns in an amount equal to the related income that is included in our employees' reported federal taxable income subject to any other applicable limitations. Under SFAS No. 123(R), tax benefits generated in 2006 and subsequent reporting periods related to the excess of tax deductible stock-

based compensation over the amount recognized for financial accounting purposes, may not be recorded to additional paid-in-capital for financial reporting purposes until the stock-based compensation deductions actually reduce our cash income tax liability. Any tax benefits attributable to these deductions will not be recorded to additional paid-in-capital for financial reporting purposes until such time as all existing and future NOL carryforwards have been fully utilized. As a result of the provisions of SFAS No. 123(R), at December 31, 2007, we have excluded $991,000 of stock-based compensation deductions from our NOL carryforwards for financial reporting purposes. The tax effect of the stock based compensation is approximately $337,000 at the 34% rate.

Prior to the effective date of SFAS No. 123(R), we were permitted to record the tax benefit associated with the excess of tax deductible stock-based compensation over the amount recognized for financial accounting purposes in our financial statement NOL, subject to SFAS No. 109's realization criteria. Accordingly, the tax return reporting and financial statement NOL carryforward amounts described above include excess tax benefits recognized in 2005 and prior years related to the exercise of non-qualified employee stock options and vested stock awards. The full amount of the related tax benefits have been offset through our deferred tax asset valuation allowance. The associated excess tax benefits will be charged to equity upon the reversal of the associated valuation allowances in future periods.

The change in valuation allowance is as follows:

	Year Ended December 31,		
	2007	**2006**	**2005**
	$	*$*	*$*
		(In thousands)	
Balance at the beginning of the period	12,440	16,722	5,407
Current year addition	2,027	2,308	5,805
Return to provision adjustments	—	(6,590)	5,510
Balance at the end of the period	14,467	12,440	16,722

Section 382 of the Internal Revenue Code ("Section 382") imposes limitations on a corporation's ability to utilize NOLs if it experiences an "ownership change." In general terms, an ownership change may result from transactions increasing the ownership percentage of certain stockholders in the stock of the corporation by more than 50 percentage points over a three year period. In the event of an ownership change, utilization of our NOLs would be subject to an annual limitation under Section 382 determined by multiplying the value of our stock at the time of the ownership change by the applicable long-term tax-exempt rate (which is 4.49% for December 2007). Any unused annual limitation may be carried over to later years. The amount of the limitation may, under certain circumstances, be increased by built-in gains held by us at the time of the ownership change that are recognized in the five year period after the change. We are currently assessing ownership changes and the impact, if any, that a potential ownership change may have on limiting the ability of the Company to fully utilize the US NOL carryforward.

We are subject to taxation in the United States and Kazakhstan. Our federal income tax returns in the United States are subject to examination for the tax years ended December 31, 2002 through December 31, 2006. Our subsidiary's tax return in Kazakhstan is subject to examination for the tax year ended December 31, 2007.

Note 8. Commitments and Contingencies

International Commitments

Through our subsidiary Caspi Neft, we are subject to the terms of License 1557 and the related exploration and production contracts covering 14,111 acres in the Field in Kazakhstan. In connection with the exploration contract, and the extensions of it, we have committed to spend approximately $76.6 million on development of the Field through April 2009. As of December 31, 2006, the cumulative capital expenditures which are creditable to our obligation under the contract have exceeded the minimum contract commitment. The production contract provides, among other things, a minimum seven-year work program commitment of $59.6 million for the continued development of the Field.

Purchase commitments are made in the ordinary course of business in connection with ongoing operations in the Field.

Our operations are subject to various levels of government controls and regulations in the United States, the Republic of Kazakhstan and the Russian Federation. It is not possible for us to separately calculate the costs of compliance with environmental and other governmental regulations as such costs are an integral part of our operations.

In Kazakhstan and the Russian Federation, legislation affecting the oil and gas industry is under constant review for amendment or expansion. Pursuant to such legislation, various governmental departments and agencies have issued extensive rules and regulations which affect the oil and gas industry, some of which carry substantial penalties for failure to comply. These laws and regulations can have a significant impact on the industry by increasing the cost of doing business and, consequentially, can adversely affect our profitability. Inasmuch as new legislation affecting the industry is commonplace and existing laws and regulations are frequently amended or reinterpreted, we are unable to predict the future cost or impact of complying with such laws and regulations.

Environmental

We as an owner and operator of oil and gas properties, are subject to various federal, state, local and foreign country laws and regulations relating to discharge of materials into, and protection of, the environment. These laws and regulations may impose liability on the lessee under an oil and gas lease or concession for the cost of pollution clean-up resulting from operations and also may subject the lessee to liability for pollution damages.

Legal

On July 18, 2007, Canam Services, Inc. (“Canam”), a supplier of tubing products, filed suit in the 151st Judicial District Court of Harris County, Texas asserting a cause of action against us based upon alleged breach of a guaranty agreement covering certain accounts payable of Caspi Neft. Canam seeks recovery from us in the amount of $1,986,633 plus fees and costs. We denied all of Canam’s material allegations and on September 5, 2007, filed an answer denying each and every material allegation contained in the Canam complaint. Subsequently, Canam reduced the recovery amount to $756,727 plus interest, fees and costs. We plan to vigorously defend this claim and have not recorded any reserve above our recorded accounts payable as of December 31, 2007.

Lease Commitments

We have operating leases for office facilities and certain equipment. Net rental expense under all operating leases and rental agreements was $2,030,000, $2,192,000, and $570,000 in 2007, 2006 and 2005, respectively. We lease office facilities in Houston and Kazakhstan. Future minimum lease commitments under operating leases are as follows:

Year Ending December 31	**Amount**
	$
	(In thousands)
2008	481
2009	215
2010	223
2011	231
2012	240
Thereafter	504
	1,894

Note 9. Business Segment Information

Our business activities relate solely to oil and gas exploration, development and production. Our primary emphasis since our formation in 2000 has been the development of the Field and substantially all of our assets are located in Kazakhstan. For each of the three years ended December 31, 2007 substantially all of our results of operations consisted of revenues, operating, general and administrative, and other costs associated with our operations in Kazakhstan.

For the year ended December 31, 2007, four customers accounted for approximately 24%, 16%, 14% and 11%, respectively, of consolidated revenue. For the year ended December 31, 2006, three customers accounted for approximately 30%, 28% and 17%, respectively, of consolidated revenue. For the year ended December 31, 2005, two customers accounted for approximately 38% and 37%, respectively, of consolidated revenue.

Note 10. Supplemental Financial Information

Other Assets

Other assets at December 31, 2007, consisted of deferred financing costs of $8,572,000, net of amortization, a note receivable of $500,000 from an unrelated third party and a $275,000 deposit. Other assets at December 31, 2006, consisted of debt financing costs of $11,464,000, net of amortization, and a note receivable of $500,000 from an unrelated third party.

Accrued Liabilities

Accrued liabilities consisted of the following:

	December 31, 2007	2006
	$	*$*
	(In thousands)	
Interest	1,450	1,450
Dividends	5,194	550
Production contract signature bonus	—	600
Royalties	345	333
Rig rentals	2,738	2,738
Junior preferred stock return agreements	17,750	—
Common stock registration costs	600	—
Proceeds received for common stock to be issued from exercise of warrants	3,980	—
Other	1,713	114
Total accrued liabilities	33,770	5,785

Note 11. Subsidiary Guarantors

In December 2005, TEI issued an aggregate of 250,000 Units, consisting of (i) an aggregate $250 million principal amount of senior its secured notes due 2010 and (ii) warrants to purchase approximately 17.3 million shares of the our common stock. We and all of our material subsidiaries fully and unconditionally guaranteed the senior secured notes. Prior to the Units offering, we financed our operations primarily through borrowings from banks in Kazakhstan or other private sources. As previously disclosed in 2005 and prior years, substantially all of our assets are located in Kazakhstan and substantially all of our revenue, operating expenses, general and administrative expenses and other costs were and currently are associated with the operations of our principal subsidiary, Caspi Neft, in Kazakhstan. Accordingly, there was no requirement for condensed consolidating financial information and the results for 2004 are not presented herein due to lack of comparability, because the information is not material for evaluation of the sufficiency of the guarantee and the omission of the information does not cause the financials to be inaccurate in reasonable detail.

The following is condensed consolidating financial information for the company, the Issuer, the subsidiary guarantors and the subsidiary non-guarantors of the senior secured notes for the three years ending December 31, 2007:

Condensed Consolidating Balance Sheet (in thousands)

	As of December 31, 2007					
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Eliminations	Consolidated
	$	$	$	$	$	$
Cash and cash equivalents	904	5	11	19	—	939
Other current assets	3,157	—	2,581	8	—	5,746
Total current assets	4,061	5	2,592	27	—	6,685
Property and equipment, net	69	—	386,759	3,416	—	390,244
Investment in and advances to subsidiaries	179,770	177,010	(320,587)	(3,981)	(32,212)	—
Other assets	275	8,572	—	500	—	9,347
	184,175	185,587	68,764	(38)	(32,212)	406,276
Total current liabilities	28,488	1,762	27,248	—	—	57,498
Debt	—	273,352	31,000	—	(31,000)	273,352
Other long-term liabilities	2,035	—	2,173	—	—	4,208
Senior preferred stock	42,076	—	—	—	—	42,076
Junior preferred stock	43,961	—	—	—	—	43,961
Stockholder's equity (deficit)	67,615	(89,527)	8,343	(38)	(1,212)	(14,819)
	184,175	185,587	68,764	(38)	(32,212)	406,276

Condensed Consolidating Statements of Operations (in thousands)

	Year Ended December 31, 2007				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
			(In thousands)		
Revenue, net	—	(1,095)	35,119	—	34,024
Operating costs and expenses	13,690	1,071	39,775	22	54,558
Operating income (loss)	(13,690)	(2,166)	(4,656)	(22)	(20,534)
Other income (expense)	448	(43,294)	5,627	5	(37,214)
Net loss	(13,242)	(45,460)	971	(17)	(57,748)
Preferred dividends	(13,948)	—	—	—	(13,948)
Accretion of preferred stock discount	(2,424)	—	—	—	(2,424)
Net loss attributable to common stockholders	(29,614)	(45,460)	971	(17)	(74,120)

Condensed Consolidating Statements of Cash Flow (in thousands)

	Year Ended December 31, 2007				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
			(In thousands)		
Net cash used in operating activities	(1,347)	(35,929)	34,644	(128)	(2,760)
Net cash used in investing activities	(36)	—	(86,157)	(54)	(86,247)
Net cash provided by financing activities	(8,017)	35,366	50,350	54	77,753
Net increase (decrease) in cash	(9,400)	(563)	(1,163)	(128)	(11,254)
Cash and cash equivalents, beginning of the year	10,304	568	1,174	147	12,193
Cash and cash equivalents, end of the year	904	5	11	19	939

Condensed Consolidating Balance Sheet (in thousands)

	As of December 31, 2006					
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Eliminations	Consolidated
	$	$	$	$	$	$
Cash and cash equivalents	10,304	569	1,173	147	—	12,193
Other current assets	2,621	—	9,049	3	—	11,673
Total current assets	12,925	569	10,222	150	—	23,866
Property and equipment, net	404	—	317,040	3,362	—	320,806
Investment in and advances to subsidiaries	94,618	213,377	(271,857)	(3,926)	(32,212)	—
Other assets	—	11,464	—	500	—	11,964
	107,947	225,410	55,405	86	(32,212)	356,636
Total current liabilities	1,035	1,752	15,171	106	—	18,064
Debt	—	267,724	31,000	—	(31,000)	267,724
Other long-term liabilities	2,035	—	1,863	—	—	3,898
Senior preferred stock	40,953	—	—	—	—	40,953
Stockholder’s equity (deficit)	63,924	(44,066)	7,371	(20)	(1,212)	25,997
	107,947	225,410	55,405	86	(32,212)	356,636

Condensed Consolidating Statements of Operations (in thousands)

	Year Ended December 31, 2006				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
			(In thousands)		
Revenue, net	—	(837)	25,509	—	24,672
Operating costs and expenses	9,837	633	31,903	24	42,397
Operating income (loss)	(9,837)	(1,470)	(6,394)	(24)	(17,725)
Other income (expense)	251	(39,890)	4,115	2	(35,522)
Net loss	(9,586)	(41,360)	(2,279)	(22)	(53,247)
Preferred dividends	(1,066)	—	—	—	(1,066)
Accretion of preferred stock discount	(49)	—	—	—	(49)
Net loss attributable to common stockholders	(10,701)	(41,360)	(2,279)	(22)	(54,362)

Condensed Consolidating Statements of Cash Flow (in thousands)

	Year Ended December 31, 2006				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
			(In thousands)		
Net cash used in operating activities	(6,927)	(48,011)	19,355	(417)	(36,000)
Net cash used in investing activities	(114)	(252)	(103,506)	(3,363)	(107,235)
Net cash provided by financing activities	(1,842)	33,581	85,318	3,927	120,984
Net increase (decrease) in cash	(8,883)	(14,682)	1,167	147	(22,251)
Cash and cash equivalents, beginning of the year	19,187	15,250	7	—	34,444
Cash and cash equivalents, end of the year	10,304	568	1,174	147	12,193

Condensed Consolidating Statements of Operations (in thousands)

	Year Ended December 31, 2005			
	Parent	Issuer	Subsidiary Guarantors	Consolidated
	$	$	$	$
Revenue, net	—	—	8,443	8,443
Operating costs and expenses	11,099	—	7,167	18,266
Operating income (loss)	(11,099)	—	1,276	(9,823)
Other expense	(5,409)	(2,411)	(2,186)	(10,006)
Minority interest expense	—	—	(712)	(712)
Net loss	(16,508)	(2,411)	(1,622)	(20,541)
Preferred dividends	(1,081)	—	—	(1,081)
Net loss attributable to common stockholders	(17,589)	(2,411)	(1,622)	(21,622)

Condensed Consolidating Statements of Cash Flow (in thousands)

	Year Ended December 31, 2005			
	Parent	Issuer	Subsidiary Guarantors	Consolidated
	$	$	$	$
Net cash used in operating activities	(4,372)	1,456	(8,436)	(11,352)
Net cash used in investing activities	(17)	—	(144,686)	(144,703)
Net cash provided by financing activities	12,917	13,794	147,041	173,752
Net increase (decrease) in cash	8,528	15,250	(6,081)	17,697
Cash and cash equivalents, beginning of the year	10,659	—	6,088	16,747
Cash and cash equivalents, end of the year	19,187	15,250	7	34,444

Note 12. Supplemental Oil and Gas Disclosures *(Unaudited)*

Costs Incurred

Costs incurred in oil and gas property acquisition, exploration and development activities, whether expensed or capitalized, are reflected in the table below. This schedule does not include the costs of acquiring the minority interest in Caspi Neft and the carried working interest of approximately $138,314,000.

	Kazakhstan	Other	Total
	$	*$*	*$*
		(In thousands)	
Year ended December 31, 2007			
Acquisition costs of properties:			
Proved	—	—	—
Unproved	—	—	—
Exploration costs	522	—	522
Development costs	86,247	—	86,247
Total	86,769	—	86,769
Year ended December 31, 2006			
Acquisition costs of properties:			
Proved	2,345	—	2,345
Unproved	—	3,423	3,423
Exploration costs	256	—	256
Development costs	102,685	—	102,685
Total	105,286	3,423	108,709
Year ended December 31, 2005			
Acquisition costs of properties:			
Proved	—	—	—
Unproved	—	—	—
Exploration costs	9	—	9
Development costs	27,098	—	27,098
Total	27,107	—	27,107

Capitalized Costs

The aggregate amount of capitalized costs related to oil and gas producing activities and the aggregate amount of the related accumulated depreciation, depletion and amortization ("DD&A"), including any accumulated valuation allowances, are reflected in the table below.

	Kazakhstan	**Other**	**Total**
	$	*$*	*$*
		(In thousands)	
As of December 31, 2007			
Proved properties	421,212	—	421,212
Unproved properties	—	3,416	3,416
Total oil and gas properties	421,212	3,416	424,628
Accumulated DD&A	(37,499)	—	(37,499)
Net oil and gas properties	383,713	3,416	387,129
As of December 31, 2006			
Proved properties	334,845	—	334,845
Unproved properties	—	3,703	3,703
Total oil and gas properties	334,845	3,703	338,548
Accumulated DD&A	(18,258)	—	(18,258)
Net oil and gas properties	316,587	3,703	320,290
As of December 31, 2005			
Proved properties	230,139	—	230,139
Unproved properties	—	—	—
Total oil and gas properties	230,139	—	230,139
Accumulated DD&A	(3,471)	—	(3,471)
Net oil and gas properties	226,668	—	226,668

Oil and Gas Reserve Information

Basis of Presentation

Proved oil and gas reserve quantities are based on estimates prepared by Ryder Scott Company, independent petroleum engineers. There are numerous uncertainties in estimating quantities of proved reserves and projecting future rates of production and the timing of development expenditures. These uncertainties are greater for properties which are undeveloped or have a limited production history, such as the Field. The following reserve data represents estimates only and actual reserves may vary substantially from these estimates. All of our proved reserves were in Kazakhstan as of December 31, 2006, 2005 and 2004. Our net quantities of proved developed and undeveloped reserves of crude oil and changes therein are reflected in the table below.

As of December 31, 2007, we owned a 100% working interest in the Field, subject to government royalties and an additional 3.5% net revenue interest retained by a third party in connection with our buyout of our former partners to be deducted from the remaining revenue interest. The effect of this overriding revenue interest is reflected in the calculation of the Company's net proved reserves and future net cash flows.

As of December 31, 2007, we operated under both a production contract and an exploration contract. The exploration contract associated with the License had an original six-year term which expired in April 2005 and has been extended through April 2009, The production contract for the Field was signed by the Kazakhstan government on December 29, 2006 with a term of 25 years, ending on December 29, 2031. The net revenue interests used in this report are calculated from a sliding-scale royalty payment based on gross annual production and made to the Kazakhstan government during the period of the production contract of this license, and an additional 3.5% net revenue interest retained by a third party. Based on the forecast annual production, the government royalty rate is between 2.0% to 2.2% and is capped at 6%.

As of December 31, 2007, we had 12 wells producing, five wells shut-in awaiting work over and three new wells, the K-2H, K-3 and SA-32, which began producing in the first quarter of 2008. Additionally, we were injecting water into SA-4 under a pilot injection program.

The proved reserves as of December 31, 2007 represent the reserves that were estimated to be recovered from 21 wells (South Alibek 1, 2, 3, 4, 5, 11, 12, 13, 14, 15, 16, 17, 21, 23, 27 and in-fill wells 31, 32, 35, K-1, K-2 and K-3), and a total of 45 offset locations not yet drilled. Reserves have been allocated to in-fill wells which may have been previously allocated to existing wells. The redrilling of two wells and the deepening of three wells are also included for the full recovery of the estimated reserves. The redrills include SA-4, which is considered to have reservoir damage that prevented placing the well on production, and SA-5 to capture reserves remaining below the horizontal sidetrack. All direct offset well locations in this report are proved undeveloped and are based on 80 acre drainage patterns unless current developed completions are estimated to drain an area larger than their volumetric assignment. In this case, the reserves of certain offset locations have been reduced. All locations have a scheduled KT1 and a KT2 reservoir completion and each of these reservoir completions includes the cost of drilling a separate wellbore. All reserves included in this report were estimated using either historical performance or volumetric methods. Our future drilling plans may include infill drilling on tighter spacing and horizontal wells; however, the effect of these future plans have not been considered in this SEC report.

The cost of 15 wells has been included in this report for water injection into the KT1 reservoir and the cost of 13 wells has been included for water injection into the KT2 reservoir. The first pilot water injection well started injection in October 2007 using well SA-4. The specific location of the remaining injection wells has not been identified; therefore, the reservoir response to the water injection has not been assigned to specific wells, but a total estimated waterflood recovery from each reservoir is included in the reserve forecasts to represent a waterflood type curve performance and recovery estimate of each reservoir.

A 15% primary recovery factor was assigned to each developed and undeveloped well in the KT1 and KT2 reservoirs. A secondary recovery factor of 15% was assigned to the KT1 waterflood and to the KT2 waterflood. The total primary and secondary recovery of 30% was based on analogy data from other fields.

An estimated annual decline rate (ADR) of 25% was assigned to the primary forecasts of the undeveloped wells. The final decline assigned to the KT1 and KT2 waterflood type curve forecasts were also based on an approximate 25% ADR.

Estimated Quantities of Net Proved Crude Oil Reserves
(Quantities in thousands of barrels)

	December 31,		
	2007	**2006**	**2005**
Net proved crude oil reserves:			
Beginning of year	67,189	72,937	26,814
Revisions of previous estimates	(7,886)	(9,270)	(970)
Extensions, discoveries and other additions	—	4,230	6,097
Revision of net interest	—	—	41,194
Production	(732)	(708)	(198)
End of year	58,571	67,189	72,937
Net proved developed reserves:			
Beginning of year	5,138	3,332	4,476
End of year	4,826	5,138	3,332

The downward revision of previous reserves estimates was primarily due to a reduction of the KT2 reserves as a result of a revised correlation of the KT2 zonation and a reassessment of reservoir mapping based on additional log analysis from infill drilling.

Standardized Measure of Discounted Future Net Cash Flows (Unaudited)

Basis of Presentation

The standardized measure data includes estimates of oil and gas reserve volumes and forecasts of future production rates over the reserve lives. Estimates of future production expenditures, including taxes and future development costs, are based on management's best estimate of such costs assuming a continuation of current economic and operating conditions. No provision is included for depletion, depreciation and amortization of property acquisition costs or indirect costs. Income tax expense has been computed using expected future tax rates and giving effect to tax deductions and credits available, under current laws, and which relate to oil and gas producing activities. The sales prices used in the calculation are the year-end prices of crude oil, including condensate and natural gas liquids, which as of December 31, 2007, 2006 and 2005 were $73.58, $35.59 and $42.45 per barrel, respectively. The sales prices were based on the last sales price received for December 2007, 2006 and 2005, respectively. No value was assigned to natural gas reserves, as there is not currently an established market or pipeline facilities for gas sales. Changes in prices and cost levels, as well as the timing of future development costs, may cause actual results to vary significantly from the data presented. This information is not intended to represent a forecast or fair market value of the Company's oil and gas assets, but does present a standardized disclosure of

discounted future net cash flows that would result under the assumptions used. The standardized measure of discounted future net cash flows relating to proved oil and gas reserves for 2007, 2006 and 2005 were as follows:

Standardized Measure of Discounted Future Net Cash Flows
(In thousands)

	$
December 31, 2007:	
Future cash inflows	4,309,676
Future production costs	(913,843)
Future development costs	(444,293)
Future income tax expense	(838,295)
10% discount for estimated timing of cash flows	(1,441,019)
Standardized measure of discounted future net cash flows	672,226
December 31, 2006:	
Future cash inflows	2,391,263
Future production costs	(518,871)
Future development costs	(452,768)
Future income tax expense	(352,370)
10% discount for estimated timing of cash flows	(588,572)
Standardized measure of discounted future net cash flows	478,682
December 31, 2005:	
Future cash inflows	3,096,160
Future production costs	(406,539)
Future development costs	(397,879)
Future income tax expense	(709,534)
10% discount for estimated timing of cash flows	(829,605)
Standardized measure of discounted future net cash flows	752,603

The following table presents a reconciliation of changes in the standardized measure of discounted future net cash flows:

Changes in the Standardized Measure of Discounted Future Net Cash Flows
(In thousands)

	Year ended December 31,		
	2007	**2006**	**2005**
	$	$	$
Standardized Measure, beginning of year	478,682	752,603	176,854
Sales of oil produced, net of production costs	(24,060)	(14,835)	(8,738)
Net changes in prices, development and production costs	675,226	(299,636)	320,930
Extensions, discoveries and improved recovery, less related costs	—	23,185	596,505
Development costs incurred and changes during the period	(112,507)	(39,297)	(193,753)
Revisions of previous quantity estimates	(154,375)	(113,377)	(6,948)
Accretion of discount	58,060	101,543	21,999
Net changes in production rates and other	40,145	(158,881)	(373,928)
Net change in income taxes	(288,945)	227,377	219,682
Standardized Measure, end of year	672,226	478,682	752,603

Note 13. Supplemental Quarterly Information (Unaudited)

The following table reflects a summary of the unaudited interim results of operations for the quarterly periods in the years ended December 31, 2007 and 2006.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	$	*$*	*$*	*$*
	(In thousands, except per share amounts)			
2007				
Revenue from oil sales, net	7,138	11,237	4,170	11,479
Operating loss	(6,563)	(4,089)	(6,409)	(3,473)
Net loss	(15,455)	(12,898)	(15,590)	(13,805)
Preferred dividends	(1,650)	(1,733)	(5,373)	(5,192)
Accretion of preferred stock discount	(147)	(153)	(1,077)	(1,047)
Net loss attributable to common stockholders	(17,252)	(14,784)	(22,040)	(20,044)
Basic and diluted loss per share	(0.17)	(0.14)	(0.19)	(0.17)
Weighted average common shares outstanding	101,246	107,930	115,795	116,210
2006				
Revenue from oil sales, net	2,842	5,151	7,755	8,924
Operating loss	(4,208)	(4,267)	(4,948)	(4,302)
Net loss	(12,747)	(13,075)	(14,235)	(13,190)
Preferred dividends	(243)	(226)	(47)	(550)
Accretion of preferred stock discount	—	—	—	(49)
Net loss attributable to common stockholders	(12,990)	(13,301)	(14,282)	(13,789)
Basic and diluted loss per share	(0.15)	(0.15)	(0.15)	(0.14)
Weighted average common shares outstanding	88,208	90,978	94,509	99,307

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Stockholders of Transmeridian Exploration Incorporated:

We have audited the accompanying consolidated balance sheets of Transmeridian Exploration Incorporated and subsidiaries ("the Company") as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Transmeridian Exploration Incorporated and subsidiaries at December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Transmeridian Exploration Incorporated and subsidiaries' internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 15, 2007, expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/UHY LLP

Houston, Texas
March 15, 2007

Consolidated Balance Sheet

(In thousands, except preferred shares and par value information)

	December 31,	
	2006	**2005**
	$	*$*
ASSETS		
Current Assets:		
Cash and cash equivalents	12,193	34,444
Restricted cash	—	31,961
Accounts receivable	7,816	3,623
Crude oil inventory	837	1,626
Other current assets	20	51
Asset held for sale	3,000	3,000
Total current assets	23,866	74,705
Property and Equipment:		
Property and equipment	339,605	230,719
Accumulated depreciation, depletion and amortization	(18,799)	(3,904)
Property and equipment, net	320,806	226,815
Other assets, net	11,964	12,473
	356,636	313,993

	December 31,	
	2006	2005
	$	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	12,279	2,245
Accrued liabilities	5,785	31,451
Total current liabilities	18,064	33,696
Long-term debt, net of discount of $22,276 and $26,593	267,724	223,407
Other long term liabilities	3,898	186
Senior redeemable convertible preferred stock, net of discount of $3,047	40,953	—
Stockholders' Equity:		
Preferred stock, $0.0006 par value per share, 5,000 shares authorized, 594.804 and 1,547.714 issued and outstanding	—	—
Common stock, $0.0006 par value per share, 200,000 shares authorized 101,246 and 87,128 issued and outstanding	61	52
Additional paid-in capital	117,983	94,337
Accumulated deficit	(92,047)	(37,685)
Total stockholders' equity	25,997	56,704
	356,636	313,993

The accompanying notes are an integral part of these financial statements.

Consolidated Statement of Operations
(In thousands, except per share amounts)

	Year ended December 31,		
	2006	2005	2004
	$	$	$
Revenue from oil sales, net	24,672	8,443	3,923
Operating costs and expenses:			
Exploration expense	256	9	131
Depreciation, depletion and amortization	14,921	3,385	789
Transportation expense	1,596	321	155
Impairment loss on drilling rig	—	4,022	—
Operating and administrative expense — Kazakhstan	15,652	3,897	3,591
General and administrative expense — Houston	9,972	6,632	2,562
Total operating costs and expenses	42,397	18,266	7,228
Operating loss	(17,725)	(9,823)	(3,305)
Other income (expense):			
Interest income	1,413	338	34
Interest expense, net of capitalized interest	(36,935)	(10,344)	(1,400)
Total other income (expense)	(35,522)	(10,006)	(1,366)
Loss before minority interest	(53,247)	(19,829)	(4,671)
Minority interest income (expense)	—	(712)	823
Net loss	(53,247)	(20,541)	(3,848)
Preferred dividends	(1,066)	(1,081)	(154)
Net loss attributable to common stockholders	(54,313)	(21,622)	(4,002)
Basic and diluted loss per common share	(0.58)	(0.26)	(0.05)
Weighted average common shares outstanding, basic and diluted	93,284	82,004	78,615

The accompanying notes are an integral part of these financial statements.

Consolidated Statement of Stockholders' Equity
(In thousands, except preferred shares)

	Preferred Stock		Common Stock		Additional Paid-In	Accumulated	
	Shares	Amount	Shares	Amount	Capital	Deficit	Total
		$		$	$	$	$
Balance December 31, 2003	—	—	70,673	42	12,525	(12,061)	506
Exercise of warrants	—	—	358	—	—	—	—
Issuance of common stock to retire debt	—	—	800	1	703	—	704
Proceeds from the sale of common stock, net of offering costs	—	—	7,268	4	4,378	—	4,382
Proceeds from the sale of preferred stock, net of offering costs	1,786	1	—	—	20,762	—	20,762
Issuance of warrants in connection with sale of preferred stock sale	—	—	—	—	2,679	—	2,679
Stock-based compensation	—	—	730	1	395	—	396
Private placement termination fee	—	—	—	—	200	—	200
Elimination of minority interest	—	—	—	—	16,719	—	16,719
Convertible preferred stock dividends	—	—	—	—	—	(154)	(154)
Net loss	—	—	—	—	—	(3,848)	(3,848)
Balance December 31, 2004	1,786	1	79,829	48	58,361	(16,063)	42,346
Exercise of warrants	—	—	1,757	1	2,762	—	2,763
Proceeds from the sale of common stock	—	—	882	1	1,790	—	1,791
Conversion of preferred stock	(238)	—	2,380	1	(1)	—	—
Issuance of warrants in connection with debt offerings	—	—	—	—	31,520	—	31,520
Stock-based compensation	—	—	1,609	1	2,089	—	2,090
Preferred stock registration costs	—	—	—	—	(2,312)	—	(2,312)
Exercise of stock options	—	—	671	—	128	—	128
Convertible preferred stock dividends	—	—	—	—	—	(1,081)	(1,081)
Net loss	—	—	—	—	—	(20,541)	(20,541)

	Preferred Stock		Common Stock		Additional Paid-In	Accumulated	
	Shares	Amount	Shares	Amount	Capital	Deficit	Total
		$		$	$	$	$
Balance December 31, 2005	1,548	1	87,128	52	94,337	(37,685)	56,704
Exercise of warrants	—	—	413	—	649	—	649
Proceeds from the sale of common stock	—	—	1,998	1	10,631	—	10,632
Conversion of preferred stock	(953)	(1)	9,529	6	(6)	—	—
Issuance of warrants in connection with preferred stock offerings	—	—	—	—	304	—	304
Stock-based compensation	—	—	645	1	5,239	—	5,240
Issuance of common stock for acquisition of carried working interest	—	—	1,000	1	4,999	—	5,000
Issuance of common stock for settlement of liabilities	—	—	312	—	1,601	—	1,601
Exercise of stock options	—	—	221	—	229	—	229
Accretion of preferred stock discount	—	—	—	—	—	(49)	(49)
Convertible preferred stock dividends	—	—	—	—	—	(1,066)	(1,066)
Net loss	—	—	—	—	—	(53,247)	(53,247)
Balance December 31, 2006	595	—	101,246	61	117,983	(92,047)	25,997

The accompanying notes are an integral part of these financial statements.

Consolidated Statement of Cash Flows
(In thousands)

	Year ended December 31,		
	2006	2005	2004
	$	$	$
Operating Activities:			
Net loss	(53,247)	(20,541)	(3,848)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation, depletion and amortization	14,921	3,385	789
Amortization of debt financing costs	2,744	1,115	193
Debt discount amortization	5,517	4,633	—
Stock-based compensation expense	5,240	2,090	396
Impairment charge	—	4,022	—
Amortization of prepaid contracts	—	—	61
Exploration expense	—	—	131
Stock issued for services	—	—	—
Minority interest (income) expense	—	712	(823)
Increase in receivables	(4,192)	(1,979)	(3,502)
(Increase) decrease in crude oil inventory	789	(1,626)	—
Decrease in other current assets	31	25	18
Increase in other assets	(500)	—	—
Increase in accounts payable	10,033	1,361	733
Increase (decrease) in accrued liabilities	(17,336)	(4,549)	(4,253)
Net cash used in operating activities	(36,000)	(11,352)	(10,105)
Investing Activities:			
Capital expenditures	(107,283)	(20,703)	(17,647)
Proceeds from disposal of assets	48	—	—
Acquisitions	—	(124,000)	—
Net cash used in investing activities	(107,235)	(144,703)	(17,647)

	Year ended December 31,		
	2006	2005	2004
	$	$	$
Financing Activities:			
Proceeds from sale of common stock, net	10,632	1,791	4,582
Proceeds from sale of preferred stock, net	41,208	—	23,441
Proceeds from long-term debt, net	37,065	250,000	16,892
Repayments of long-term debt	—	(35,350)	(16,540)
Proceeds from short-term borrowings	—	25,740	—
Repayments of short-term borrowings	—	(25,740)	—
Decrease in notes payable to related parties	—	(50)	(198)
Payment of deferred financing costs	—	(12,578)	—
Payment of dividends on preferred stock	(760)	(991)	—
Proceeds from sale of stock by Caspi Neft	—	—	15,000
Proceeds from exercise of stock options	229	128	—
Proceeds from exercise of warrants	649	2,763	—
(Increase) decrease in restricted cash	31,961	(31,961)	—
Net cash provided by financing activities	120,984	173,752	43,177
Net increase (decrease) in cash and cash equivalents	(22,251)	17,697	15,425
Cash and cash equivalents, beginning of year	34,444	16,747	1,322
Cash and cash equivalents, end of year	12,193	34,444	16,747

The accompanying notes are an integral part of these financial statements.

Consolidated Statement of Cash Flows — Supplemental Information
(In thousands)

	Year ended December 31,		
	2006	2005	2004
	$	$	$
Cash paid for:			
Interest	32,903	11,643	4,865
Interest capitalized (non-cash)	(4,096)	(2,498)	(4,520)
Income taxes	—	—	—
Non-cash investing and financing transactions:			
Issuance of common stock for acquisition of carried working interest	5,000	—	—
Issuance of common stock for settlement of liabilities	1,601	—	—
Issuance of warrants in connection with debt	—	31,250	—
Accrual for acquisition of carried working interest	—	20,250	—
Accrued and unpaid dividends on convertible preferred stock	550	244	154
Asset retirement obligation	370	—	—
Recovery of historical capital expenditures	1,493	—	—
Exchange of convertible preferred stock for common stock	1	1	—
Issuance of common stock to retire debt	—	—	704
Settlement of drilling rig dispute	—	—	(2,345)
Assumption of note payable on drilling rig	—	—	3,393
Issuance of warrants in connection with services	304	—	1,004
Other long term liabilities	186	—	—

The accompanying notes are an integral part of these financial statements.

Notes to Consolidated Financial Statements

Note 1 — Organization and Summary of Significant Accounting Policies

Transmeridian Exploration Incorporated ("we", "our" or "us") was incorporated in the State of Delaware in April 2000. We are engaged in the business of acquiring, developing and producing oil and gas, with our activities primarily focused on the Caspian Sea region of the former Soviet Union. Our primary oil and gas property is the South Alibek Field ("South Alibek" or the "Field") in the Republic of Kazakhstan covered by License 1557 (the "License") and the related exploration and production contracts with the government of Kazakhstan.

Principles of Consolidation and Reporting

The consolidated financial statements include the accounts of us and our majority-owned and controlled subsidiaries and are prepared in accordance with generally accepted accounting principles in the United States. All significant intercompany transactions and balances have been eliminated in consolidation.

We conduct our operations in Kazakhstan through a wholly-owned subsidiary, JSC Caspi Neft TME ("Caspi Neft"), a joint stock company organized under the laws of Kazakhstan. Caspi Neft holds the license, exploration and production contracts covering the Field in Kazakhstan. Prior to February 2004, we owned 100% of Caspi Neft. From February 2004 to December 2005, 50% of Caspi Neft was owned by Bramex Management, Inc. ("Bramex"). We continued to exercise significant control over Caspi Neft after Bramex acquired 50% of Caspi Neft in February 2004 and, accordingly, believe the most meaningful accounting treatment was to fully consolidate Caspi Neft with the 50% share owned by Bramex reflected as a minority interest. In December 2005, we reacquired 100% of Caspi Neft. The results of operations of Caspi Neft represent substantially all of the operations of the Company.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates and judgments on historical experience and on other information and assumptions that are believed to be reasonable under the circumstances. Estimates and judgments about future events and their effects cannot be perceived with certainty; accordingly, these estimates may change as additional information is obtained, as more experience is acquired, as our operating environment changes and as new events occur. While it is believed that such estimates are reasonable, actual results could differ materially from those estimates. Estimates are used for, but not limited to, determining the following: inventory valuation, recoverability of long-lived assets, useful lives and oil and gas reserves used in depreciation, depletion, and amortization, income taxes and related valuation allowances and insurance, environmental and legal accruals.

Revenue Recognition

We sell our production both in the export and domestic market on a contract basis. Revenue is recorded when the purchaser takes delivery of the oil. At the end of the period, oil that has been produced but not sold is recorded as inventory at the lower of cost or market. Cost is determined on a weighted average basis based on production costs.

Cash and Cash Equivalents

We consider all highly liquid instruments with an original maturity of three months or less to be cash equivalents. Certain of our cash balances are maintained in foreign banks which are not covered by deposit insurance. The cash balances in our U.S. accounts may exceed federally insured limits. Cash that was escrowed for specific purposes such as interest payments is shown as restricted cash in the accompanying consolidated balance sheet.

Property and Equipment

We follow the "successful efforts" method of accounting for the costs of acquisition, exploration and development of oil and gas properties.

Oil and gas lease acquisition costs are capitalized when incurred. Unproved properties with significant acquisition costs are assessed quarterly on a property-by-property basis, and any impairment in value is recognized. Unproved properties with acquisition costs which are not individually significant are aggregated, and the portion of such costs estimated to be nonproductive, based on historical experience, is amortized over the average holding period. If the unproved properties are determined to be productive, the appropriate related costs are transferred to proved oil and gas properties. Lease rentals are expensed as incurred.

Oil and gas exploration costs, other than the costs of drilling exploratory wells, are charged to expense as incurred. Such costs include seismic expenditures and other geological and geophysical costs. The costs of drilling exploratory wells are capitalized pending determination of whether they have discovered proved commercial reserves. If proved commercial reserves are not discovered, exploratory drilling costs are expensed. Costs to develop proved reserves are capitalized, including the costs of all development wells and related equipment used in the production of crude oil and natural gas.

Depreciation, depletion and amortization of the costs of proved oil and gas properties is computed using the unit-of-production method based upon estimated proved reserves.

We review our oil and gas properties for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The determination of recoverability is based on comparing the estimated undiscounted future net cash flows at a producing field level to the unamortized capitalized cost of the asset. If the future undiscounted cash flows, based on our estimates of anticipated production from proved reserves and future crude oil and natural gas prices and operating costs, are lower than the unamortized capitalized cost, the capitalized cost is reduced to fair value. Fair value is calculated by discounting the future cash flows at an appropriate risk-adjusted discount rate.

In December 2001, we purchased a drilling rig that, beginning in October 2002, was used in the development of the South Alibek Field. The rig was depreciated on the straight-line method and while being used for development drilling, the depreciation of the rig and related support equipment was capitalized under the successful efforts method as part of the cost of the wells. Subsequent depreciation was expensed when the rig was stacked. In the first quarter of 2006, the Company reached an agreement to dispose of the rig. In accordance with generally accepted accounting principles, an impairment charge writing the value of the rig down to the estimated net proceeds and reclassifying the net book value of the rig to current asset held for sale was recorded in the accompanying consolidated financial statements.

Transportation equipment and office and technology equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, which range from three to five years.

Maintenance and repairs are charged to expense as incurred. Replacements and expenditures which improve or extend the life of assets are capitalized. When assets are sold, retired or otherwise disposed of, the applicable costs and accumulated depreciation and amortization are removed from the accounts, and the resulting gain or loss is recognized.

Capitalized Interest Costs

Certain interest costs have been capitalized as part of the cost of oil and gas properties under development, including property acquisition costs, wells in progress and related facilities. Additionally, interest was capitalized on the drilling rig while it was being readied for its intended use. Total interest costs capitalized during the years ended December 31, 2006, 2005 and 2004 totaled $4.1 million, $2.5 million and $4.5 million, respectively.

Income Taxes

We account for income taxes using the asset and liability method. The asset and liability method requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of (i) temporary differences between financial statement carrying amounts of assets and liabilities and the basis of these assets and liabilities for tax purposes and (ii) operating loss and tax credit carry-forwards for tax purposes. Deferred tax assets are reduced by a valuation allowance when management concludes that it is more likely than not that a portion of the deferred tax assets will not be realized in a future period.

Debt Financing Costs

Debt financing costs are amortized over the term of the related financing facility.

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. Net loss attributable to common stockholders is calculated as the net loss after deductions for cumulative preferred stock dividends, whether paid or accrued. Diluted net loss per common share has been computed based on the weighted average number of shares of common stock and common stock equivalents outstanding during the applicable period, as if all potentially dilutive securities were converted into common stock. Diluted net loss per share equals basic net loss per share for the periods presented because the effects of potentially dilutive securities are anti-dilutive. The calculation of diluted weighted average shares outstanding for the years ended December 31, 2006, 2005 and 2004 excludes 10,872,553, 3,926,973 and 671,538 common shares, respectively, issuable pursuant to convertible preferred stock and outstanding stock options and warrants because their effect is anti-dilutive.

Foreign Exchange Transactions

Our functional currency is the U.S. dollar because we primarily contract with customers, finance capital and purchase equipment and services using the U.S. dollar. Certain assets and liabilities are translated at historical exchange rates, revenues and expenses in foreign currency are translated at the average rate of exchange for the period and all translation gains or losses are reflected in the period's results of operations.

Concentration of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. We deposit our cash and cash equivalents in high credit quality financial institutions, however amounts on deposit do exceed the maximum amount insured by the Federal Deposit Insurance Corporation. Although our current crude oil sales are to a limited number of purchasers, all of our customers are involved in the energy industry.

Stock-Based Compensation

We account for employee stock-based compensation using the fair value method as prescribed in Statement of Financial Accounting Standards ("SFAS") No. 123(R). Under this method, we record the fair value attributable to stock options or stock grants, based on the Black-Scholes model, and amortizes that amount to expense over the service period required to vest the options.

Financial Instruments

Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and long-term debt. The carrying values of cash and cash equivalents, receivables and accounts payable approximate fair value due to their short-term nature. The carrying value of long-term debt approximates its fair value based on the market interest rate of the debt instrument.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes . It prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. Consistent with its requirements, we will adopt FIN 48 effective January 1, 2007. We are currently evaluating the provisions of FIN 48 and have not yet determined the impact, if any, on our consolidated condensed financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP") and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted, provided the company has not yet issued financial statements, including for interim periods, for that year. Consistent with its requirements, we will adopt SFAS No. 157 as of January 1, 2008. We do not expect this standard to have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106 and 132(R)* ("SFAS No. 158"). SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. Additionally, SFAS No. 158 requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. The effective date of SFAS No. 158 differs for an employer that is an issuer of publicly traded equity securities (as defined) and an employer that is not. An employer with publicly traded equity securities is required to initially recognize the funded status of defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. This standard will have no impact on our consolidated financial statements as we have no defined benefit pension or other postretirement plans.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ("SAB 108"). SAB 108 provides interpretative guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for fiscal years ending on or after November 15, 2006. We adopted SAB 108 as of December 31, 2006 and it has not had, to date, a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We will evaluate the provisions of SFAS No. 159 to determine the impact, if any, on our consolidated financial statements.

Note 2 — Acquisitions

In October 2005, a wholly-owned subsidiary of ours entered into a share sale and purchase agreement with Seeria Alliance Ltd. to purchase 100% of the authorized and issued shares of Bramex, the owner of 50% of Caspi Neft. In December 2005, the transaction was completed and the subsidiary now owns, directly or indirectly, 100% of Caspi Neft. The total consideration of $168 million, of which approximately $44 million was to pay the outstanding indebtedness of Caspi Neft, was funded from the net proceeds of the private placement of units as described in Note 5.

In December 2005, we entered into a purchase agreement with Kornerstone Investment Group Ltd. ("Kornerstone") pursuant to which we acquired the 10% carried working interest in the South Alibek Field held by Kornerstone. Pursuant to the purchase agreement, we paid Kornerstone a purchase price consisting of $15.25 million in cash and one million shares of our common stock. The cash portion of the purchase price obligation was funded from the net proceeds of the private placement of units.

In September 2006, we paid $2.5 million to a private Russian investor group to acquire 50% of the share capital of a privately held Russian company, DNK LLC ("DNK"), that owns the license to the Gasha field. The Gasha field is located onshore in the Republic of Dagestan, an autonomous region within Russia along the northwestern shoreline of the Caspian Sea. We will be negotiating a joint operating agreement with

the other shareholder of DNK for future petroleum operations within Dagestan. In connection with the proposed joint operating agreement, we anticipate funding 100 percent of the costs, up to $4 million, of drilling an extended-reach well and conducting a 3-D seismic survey. These advances would be recovered on a preferential basis from the cash surpluses generated by operations. Remaining cash needs would be funded on a joint basis. The Gasha field, which is not currently producing, was active during the Soviet era and is located close to existing oil and gas pipeline infrastructure and transportation networks.

Note 3 — Property and Equipment

Property and Equipment

Property and equipment consisted of the following:

	December 31, 2006	2005
	$	$
	(In thousands)	
Oil and gas properties, successful efforts method	338,548	230,139
Transportation equipment	510	240
Office and technology equipment	547	340
	339,605	230,719
Accumulated depreciation, depletion and amortization	(18,799)	(3,904)
Property and equipment, net	320,806	226,815

We capitalize interest costs on oil and gas projects under development, including the costs of unproved leasehold and property acquisition costs, wells in progress and related facilities. During the years ended December 31, 2006 and 2005, we capitalized approximately $4.1 million and $2.5 million, respectively, of interest costs.

Oil and Gas Properties

The License covering the South Alibek Field was granted by the Republic of Kazakhstan on April 29, 1999 and originally covered 3,396 acres. In March 2000, we acquired the License from an unrelated third-party for $4.0 million. During 2001, based on its technical review and analysis of the probable productive area of the Field, we applied to the Kazakhstan Ministry of Energy and Mineral Resources to expand the area covered by the License. In November 2001, our application was approved and the License was expanded to cover an area of 14,111 acres.

The exploration contract associated with the License had an original six-year term which expired in April 2005 and has been extended through April 2009. The exploration contract required capital expenditures during the initial period of approximately $18.0 million, which was satisfied and $30.5 million during the first two-year extension, which has also been satisfied. The latest two-year extension, expiring April 2009, requires an additional commitment of $28.1 million for development of the Field. During the primary and extended terms of the exploration contract, we can produce from wells under a test program and pay a 2% royalty to the government.

In December 2006, the 25-year production contract for the Field was signed and officially registered by the governmental authorities in Kazakhstan. The production contract initially covers the approved 3,500 acre commercial area within the 14,111 acre License area. Under our exploration contract, we have the right to continue exploration activities within the License area and increase the size of the commercial area subject to the long-term production contract. The production contract provides, among other things, a work program commitment of $59.6 million for the continued development of the Field, the recovery by the government of approximately $4.7 million of exploration costs that were incurred prior to privatization, a signature bonus, future commercial discovery bonuses if additional recoverable reserves are found, royalty rates determined using a sliding scale based on annual production levels of crude oil and annual funding of agreed social projects, training programs and an abandonment fund. For additional information on commitments and contingencies related to the production contract, see Note 9.

Pursuant to the terms of the production contract we may be required to dismantle and remove any facilities and equipment and return the area under the contract to a condition that permits the use of such area for purposes similar to those existing prior to the commencement of operations under the exploration contract. As a result, we established an asset retirement obligation of approximately $370,000 as of December 31, 2006 for the assets that have been placed into service as of that date. We will account for future asset retirement obligations as assets are placed into service and changes in existing retirement obligations pursuant to the requirements of SFAS No. 143, Accounting for Asset Retirement Obligations .

Drilling Rig and Equipment

In the first quarter of 2006, we reached an agreement to sell a stacked drilling rig. An impairment charge writing the value of the rig down to the estimated net proceeds and reclassifying the net book value of the rig to current asset held for sale was recorded as of December 31, 2005. We expect the sale of the rig to be consummated in the second quarter of 2007.

Note 4 — Related Parties

In a series of notes issued between June 2002 and November 2002, certain stockholders and related parties, including the Chief Executive Officer of the Company, loaned us $248,025. These notes had interest rates of 17% and were paid in full in September 2005.

In connection with the private offering of redeemable convertible preferred stock as described in Note 6, our Chief Executive Officer and Chief Financial Officer were two of the purchasers of shares in the concurrent private placement.

Note 5 — Debt

Long-Term Debt

Long-term debt consists of the following:

	December 31, 2006	2005
	$	$
	(In thousands)	
Senior Secured Notes due 2010, net of discount of $22,276 and $26,593	267,724	223,407
Total long-term debt	267,724	223,407
Less current maturities	—	—
Long-term portion	267,724	223,407

Senior Secured Notes

In December 2005, we and Transmeridian Exploration Inc., our wholly owned subsidiary ("TEI"), issued in a private placement 250,000 Units, consisting of in the aggregate (i) $250 million principal amount of senior secured notes due 2010 of the Issuer (the "Existing Notes") and (ii) warrants to purchase approximately 17.3 million shares of our common stock. The Units were issued and sold for a purchase price of $1,000 per Unit. Each Unit consists of $1,000 principal amount of Notes and 69.054 Warrants to purchase an equal number of shares of our common stock. The Existing Notes, which will mature on December 15, 2010, bear interest at the rate of 12% per annum. Interest on the Existing Notes is payable quarterly on March 15, June 15, September 15 and December 15 of each year and at maturity. The fair value of the warrants of approximately $26,816,000 was recorded as a discount to the face amount of the Existing Notes and will be amortized to interest expense over the life of the Existing Notes. We used the proceeds from the offering of the Units of $237.4 million, after expenses, to fund the acquisition of Bramex and to retire the existing bank credit facility indebtedness of Caspi Neft, to repay $22.5 million of convertible promissory notes and to pre-fund the first year of interest payments on the Existing Notes of $30 million.

In May 2006, we and TEI issued in a private placement $40 million principal amount of additional senior secured notes due 2010 (the "Additional Notes") and (ii) 1,818,182 shares (approximately $10 million) of our common stock (the "Shares"). The Additional Notes were issued and sold for an issue price of 97% of the principal amount thereof plus accrued interest from March 15, 2006, and the Shares were issued and sold at an issue price of $5.50 per share. The discount was recorded as a reduction of the face amount of the Additional Notes and will be amortized to interest expense over the life of the Additional Notes.

The Additional Notes have terms and conditions identical to, and are fungible for trading and other purposes with, the Existing Notes. The Additional Notes, like the Existing Notes, are fully and unconditionally guaranteed by us and all of our material subsidiaries and are governed by the terms of the Indenture, dated as of December 12, 2005, as supplemented by the First Supplemental Indenture, dated as of December 22, 2005, and the Second Supplemental Indenture, dated as of May 24, 2006, by and among TEI, us, the subsidiary guarantors of the Existing Notes and the Additional Notes and the trustee. The Indenture contains provisions that limit the our ability to enter into transactions with affiliates; pay dividends or make other restricted payments; incur debt; create, incur or assume liens; sell assets; and consolidate, merge or transfer all or substantially all of our assets. We are required to offer to

repurchase the Notes in connection with certain specified change of control events. The Notes are subject to redemption, in whole or in part, at our option at any time on or after December 15, 2008 at redemption prices starting at 106% of the principal amount redeemed and declining to 100% by June 15, 2010. Prior to December 15, 2008, we may redeem up to 35% of the Notes with proceeds of certain equity offerings at a specified redemption price.

In July 2006, pursuant to the registration rights agreements entered into in connection with the issuance of the Existing Notes and the Additional Notes, we completed an exchange offer of $290 million aggregate principal amount of TEI's senior secured notes due 2010 registered under the Securities Act of 1933 for all of the outstanding Existing Notes and Additional Notes.

Future maturities of long-term debt, exclusive of discount, at December 31, 2006, are as follows:

	Amount
	$
	(In thousands)
2007	—
2008	—
2009	—
2010	290,000
2011	—
Total long-term debt	290,000

Management believes the fair value of debt at December 31, 2006 approximates its carrying value based on the market interest rate of the debt instrument.

Note 6 — Redeemable Convertible Preferred Stock

In December 2006, we sold (i) 370,000 shares of our 15% Senior Redeemable Convertible Preferred Stock (the "Preferred Stock") in a private offering and (ii) 70,000 shares of Preferred Stock in a concurrent private placement. Purchasers of the Preferred Stock in the private placement included our Chairman of the Board, President and Chief Executive Officer and our Vice President and Chief Financial Officer.

The Preferred Stock, which has a liquidation preference of $100 per share, will pay cumulative quarterly dividends at an initial rate of 15% per annum, payable at our option in additional shares of the Preferred Stock, shares of our common stock (subject to the satisfaction of certain conditions) or cash (if allowed by the terms of our then-existing debt instruments). Dividends are payable on January 1, April 1, July 1 and October 1 of each year, commencing April 1, 2007.

The Preferred Stock is initially convertible into approximately 9.8 million shares of common stock, based on an initial conversion price of $4.50 per share of common stock. There is a one-time test for adjustment of the conversion price and the dividend rate, effective July 1, 2007, based upon the achievement of a specified average production rate prior to June 30, 2007 or a specified average trading price threshold of our common stock during the 15 days trading days immediately following June 30, 2007. If we meet or exceed either of these thresholds, there will be no adjustment in the conversion price or the dividend rate. Otherwise, the conversion price and the dividend rate of the Preferred Stock will be adjusted to $3.90 per share and 18%, respectively. In addition, the conversion price of the Preferred Stock will be subject to adjustment pursuant to customary anti-dilution provisions and may also be adjusted upon the occurrence of a change of control meeting certain conditions. However, in no event will the conversion price of the Preferred Stock be reduced to less than $3.23 per share (subject to adjustment), which was the closing price of our common stock on the American Stock Exchange on the pricing date of the private offering and the concurrent private placement.

The sale of the Preferred Stock generated total net proceeds to us of approximately $41.2 million, net of commissions of approximately $2.4 million and other offering expenses totaling approximately $0.4 million. Additionally, we issued to the initial purchaser in the offering 110,000 warrants to purchase shares of our common stock as part of the total fees of the offering. The fair value of the warrants of approximately $304,000 was recorded as a discount to the face amount of the Preferred Stock and will be amortized over the life of the Preferred Stock.

On or after July 1, 2007, an automatic conversion mechanism will become effective, providing for conversion in tranches of one-third (1/3) of the shares of Preferred Stock for each period of 20 out of 30 consecutive trading for which the closing price of our common stock exceeds 150% of the then-effective conversion price of the Preferred Stock.

We will have the option, at any time on or after October 1, 2007 through December 31, 2007, to redeem all or a portion of the Preferred Stock for cash at specified redemption prices if the market price of our common stock exceeds a specified level, and after December 31, 2007 without regard to the market price of our common stock. In addition, the Preferred Stock is redeemable at the option of the holder on December 1, 2011 or upon a change of control of the Company, at the liquidation preference plus all accumulated and unpaid dividends on the Preferred Stock.

The Preferred Stock ranks senior to our common stock and Series A Cumulative Convertible Preferred Stock with respect to dividend rights and rights upon the Company's liquidation, winding-up or dissolution. There are also restrictive covenants related to our ability to incur indebtedness, make certain payments or investments and create restrictions on us and our subsidiaries' ability to pay dividends, and further provides for preemptive rights in favor of the holders of the Preferred Stock with respect to certain securities offerings that we may make in the future.

Note 7 — Stockholders' Equity

Series A Convertible Preferred Stock

In November 2004, we sold 1,785.714 shares of Series A Cumulative Convertible Preferred Stock (the "Series A Preferred") in a private placement at a purchase price of $14,000 per share, and issued warrants to purchase up to 4,464,286 shares of our common stock at an exercise price equal to $1.55 per share. The aggregate purchase price, net of offering costs, for the Series A Preferred and the related warrants was $22.5 million, which included the value of warrants attributable to offering cost. The proceeds from the private placement of Series A Preferred and warrants were used for general corporate purposes, including funding our development drilling program in the South Alibek Field, and to pursue growth opportunities.

The Series A Preferred is convertible at the holders' option into common stock at a conversion price of $1.40 per share, subject to adjustments in certain circumstances. The holders of the Series A Preferred have full voting rights and powers (subject to a beneficial ownership limitation as described below) equal to the voting rights and powers of the holders of our common stock, and vote together with the holders of common stock as one class. A holder of the Series A Preferred may not, unless it elects in advance not to be governed by this limitation, convert the Series A Preferred into common stock such that the total number of shares of common stock beneficially owned by such holder would exceed 4.999% of our then-issued and outstanding shares of common stock. In July 2006, the conditions for the automatic conversion of the Series A Preferred were satisfied and 229.881 shares of the Series A Preferred were converted into shares of our common stock; the then-remaining 1,189.286 shares of the Series A Preferred were not converted into shares of our common stock due to the 4.999% beneficial ownership limitation specified in the certificate of designations governing the Series A Preferred. In connection with the November 2006 sale by the holders of the then-remaining 1,189.286 shares of the Series A Preferred, an additional 594.482 shares of the Series A Preferred were converted into shares of our common stock in accordance

with the automatic conversion and beneficial ownership limitation provisions specified in the certificate of designations governing the Series A Preferred. The 594.804 shares of the Series A Preferred remaining outstanding will convert into shares of our common stock when permitted by the beneficial ownership limitation provisions. All Series A Preferred that remain outstanding ceased to have a preference in liquidation, accrue dividends and enjoy veto participation and certain other preferential rights as of the July 2006 effective date of the automatic conversion. During the years ended December 31, 2006 and 2005, 952.91 shares and 238 shares of Series A Preferred were converted into 9,529,100 and 2,380,000 shares of our common stock, respectively.

Additionally, during 2006 we issued 1,000,000 common shares for the acquisition of a carried working interest in the Field and 234,565 shares of common stock for the settlement of acquisition costs incurred in connection with the acquisition of 50% of Caspi Neft. Also, we issued 721,843 shares of common stock in connection with stock-based compensation, 634,163 shares of common stock pursuant to the exercise of outstanding stock options and warrants and 180,000 common shares in a private placement; the proceeds of which were used for general corporate purposes.

Common Stock Reserved for Issuance

There are 200,000,000 common shares authorized by the Company's Amended and Restated Certificate of Incorporation and 101,245,877 and 87,128,021 common shares were issued and outstanding as of December 31, 2006 and 2005, respectively. Shares of common stock reserved for issuance are summarized as follows:

	December 31,	
	2006	**2005**
	$	*$*
	(In thousands)	
2006 Incentive Plan (f/k/a 2001 Incentive Stock Option Plan)	5,107	1,365
2003 Stock Compensation Plan	1,337	1,813
Convertible preferred stock	15,726	15,477
Warrants to purchase common stock	26,262	26,565
Total	48,432	45,220

Warrants

In connection with certain 2005 short-term borrowings from individuals, we issued detachable warrants to purchase 420,000 shares of common stock at exercise prices ranging from $2.00 to $2.12 per share. The warrants have a three-year term.

In connection with the convertible notes issued in August 2005, we issued detachable warrants to purchase 4,500,000 shares of common stock at an exercise price equal to $2.40 per share. The warrants have a five-year term, and beginning six months after the closing of the issuance of the convertible notes, the exercise price of the warrants is subject to adjustment for issuances of common stock at a purchase price of less than the then-effective exercise price of the warrants.

The warrants issued in December 2005 as part of the Units entitle the holder to purchase one share of the Company's common stock at the current exercise price of $3.68 per share. The warrant agreement contains anti-dilution provisions for the exercise price of the warrants to be adjusted upon the conversion of any shares of the Company's outstanding Series A Preferred and upon the occurrence of certain other events. After conversion of the Series A Preferred discussed above, the exercise price was adjusted to $3.68 per share. The warrants will expire on December 15, 2010.

In connection with the offering of the Preferred Stock described in Note 6, we issued 110,000 warrants to purchase shares of our common stock. The warrants entitle the holder to purchase shares of our common stock at $3.08 per share, the fair value of our common stock as of the issue date, and will expire on December 1, 2013. The warrant agreement contains customary anti-dilution provisions providing for the adjustment of the number of warrants and exercise price upon the occurrence of specified events.

2006 Incentive Plan

Our 2006 Incentive Plan (the "Plan"), which was approved by our stockholders at our 2006 annual meeting of stockholders in May 2006, is an amendment and restatement of our 2001 Incentive Stock Option Plan. Under the Plan, we may grant to officers, board members, key employees and consultants of the company, through May 30, 2016, options to purchase up to an aggregate of 10% of the total shares of our common stock outstanding from time to time, less the number of shares underlying unexercised options as of the date the Plan was approved by our stockholders at our 2006 annual meeting of stockholders (i.e., May 30, 2006); as of December 31, 2006, options to purchase up to an aggregate 6,647,921 shares of our common stock could be granted under the Plan. The exercise price of each option under the Plan shall generally be no less than the fair market value of our common stock on the date of grant, and all options granted under the Plan shall generally have a term of no greater than 10 years. The vesting period of options granted under the Plan is determined by the Board of Directors on the date of grant.

The following table summarizes activity under the Plan for the last three years.

	Number of Shares *(In thousands)*	**Weighted Average Exercise Price Per Share** *$*
Outstanding at December 31, 2003	1,740	0.25
Granted	555	1.50
Exercised	(650)	0.23
Forfeited	(250)	0.22
Outstanding at December 31, 2004	1,395	0.78
Granted	1,740	1.61
Exercised	(705)	0.31
Forfeited	(150)	0.12
Outstanding at December 31, 2005	2,280	1.53
Granted	1,390	5.98
Exercised	(243)	1.49
Forfeited	(132)	4.70
Outstanding at December 31, 2006	3,295	3.28
Shares exercisable at December 31		
2006	1,802	2.65
2005	833	1.41
2004	790	0.27

The aggregate fair value of options granted during 2006, 2005 and 2004 was $4,365,000, $970,000 and $355,000, respectively, which is being amortized to expense over the vesting period of the options. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rates of 5%; expected lives between 2.5 and 4.0 years; and volatility of the price of the underlying common stock of 45-75%. Compensation expense of $2,070,000, $401,000 and $106,000 for stock options was recognized during the years ended December 31, 2006, 2005 and 2004, respectively.

The following table summarizes additional information about the Company's outstanding and exercisable stock options at December 31, 2006:

	Outstanding			Exercisable	
Exercise Price	**Number Outstanding** *(In thousands)*	**Weighted Average Remaining Life (In Years)**	**Weighted Average Exercise Price** *$*	**Number Outstanding** *(In thousands)*	**Weighted Average Exercise Price** *$*
$0.24	90	1.36	0.24	90	0.24
$1.50	373	2.88	1.50	240	1.50
$1.61	1,535	3.38	1.61	1,009	1.61
$5.98	1,297	4.07	5.98	463	5.98
Total at December 31, 2006	3,295	3.54	3.28	1,802	2.65

2003 Stock Compensation Plan

In May 2003, we established the 2003 Stock Compensation Plan with the registration of 2.5 million shares under the plan. The plan was amended in May 2005 to increase the number of shares authorized for issuance to a total of 5,000,000 shares. Under the terms of the plan, such stock may be issued for restricted stock awards; payments of bonuses in stock; payments for services to consultants in the form of stock; employer contributions to a 401(k) plan; stock appreciation rights and warrants. Any shares issued in lieu of cash are recognized as expense based on the fair value of the shares on the date of grant. The fair value of restricted stock awards on the date of grant is amortized ratably over the vesting period. The following table summarizes the shares issued during the years ended December 31:

	2006	**2005** *(In thousands)*	**2004**
Number of shares issued	826	1,357	600
Fair value at date of grant	4,737	2,801	750

Note 8 — Income Taxes

We provide for deferred taxes on temporary differences between the financial statements and tax basis of assets using the enacted tax rates that are expected to apply to taxable income when the temporary differences are expected to reverse. We have not recorded any deferred tax assets or income tax benefits from the net deferred tax assets for the years ended December 31, 2006, 2005 and 2004. We have placed a 100% valuation allowance against the net deferred tax asset because future realization of these assets is not assured.

Loss before income taxes is composed of the following:

	Year ended December 31,		
	2006	**2005**	**2004**
	$	*$*	*$*
		(In thousands)	
United States	(9,586)	(16,508)	(3,031)
International	(43,660)	(4,033)	(817)
	(53,246)	(20,541)	(3,848)

A reconciliation of the federal statutory income tax (34%) amounts to the effective amounts is shown below:

	Year ended December 31,		
	2006	**2005**	**2004**
	$	*$*	*$*
		(In thousands)	
Income tax benefit computed at statutory rates	(18,104)	(6,983)	(1,361)
Effect of foreign tax rate differential	14,155	885	—
Return to provision adjustments	6,590	(5,510)	—
U.S. GAAP and local country accounting differences	1,360	294	—
Adjustment to valuation allowance	(4,001)	11,314	1,361
	—	—	—

At December 31, 2006, 2005 and 2004 the components of our deferred tax assets and liabilities were as follows:

		December 31,	
	2006	2005	2004
	$	*$*	*$*
		(In thousands)	
Current deferred tax assets			
Cost basis of assets held for sale	1,370	1,367	—
Accrual to cash adjustments in foreign subsidiary	—	1,239	—
Total current deferred tax assets	1,370	2,606	—
Noncurrent deferred tax assets			
Domestic net operating loss carryforwards	9,827	7,999	5,614
Foreign net operating loss carryforwards	—	—	3,183
Foreign oil and gas exploration and development cost	510	6,542	—
Stock option expense	1,131	128	—
Total noncurrent deferred tax assets	11,468	14,669	8,797
Total deferred tax assets	12,838	17,275	8,797
Noncurrent deferred tax liabilities			
Domestic property, plant and equipment	(398)	(458)	—
Foreign capitalized interest	—	—	(3,390)
Other	—	(95)	—
Total noncurrent deferred tax liabilities	(398)	(553)	(3,390)
Net deferred tax assets	12,440	16,722	5,407
Valuation allowance	(12,440)	(16,722)	(5,407)
	—	—	—

As of December 31, 2006, we had estimated domestic net operating loss ("NOL") carryforwards of $29.7 million which will expire between 2021 and 2026.

In December 2004, the FASB issued the revised SFAS No. 123(R), *Share-Based Payment*. SFAS No. 123(R) is a revision of SFAS No. 123 and supersedes APB No. 25. We had previously adopted SFAS No. 123, and the revised provisions of SFAS No. 123(R) were effective January 1, 2006. For companies that have NOL carryforwards, SFAS No. 123(R) affects the manner in which stock-based compensation tax deductions are treated for financial reporting purposes. We may claim stock-based compensation deductions in our federal corporate income tax returns in an amount equal to the related income that is included in our employees' reported federal taxable income subject to any other applicable limitations. Under SFAS No. 123(R), tax benefits generated in 2006 and subsequent reporting periods related to the excess of tax deductible stock-based compensation over the amount recognized for financial accounting

purposes may not be recorded to additional paid-in capital for financial reporting purposes until the stock-based compensation deductions actually reduce our cash income tax liability. Any tax benefits attributable to these deductions will not be recorded to additional paid-in capital for financial reporting purposes until such time as all existing and future NOL carryforwards have been fully utilized. As a result of the provisions of SFAS No. 123(R), at December 31, 2006, we have excluded $828,000 of stock-based compensation deductions from our NOL carryforwards for financial reporting purposes.

Prior to the effective date of SFAS No. 123(R), we were permitted to record the tax benefit associated with the excess of tax deductible stock-based compensation over the amount recognized for financial accounting purposes in our financial statement NOL, subject to SFAS No. 109's realization criteria. Accordingly, the tax return reporting and financial statement NOL carryforward amounts described above include excess tax benefits recognized in 2005 and prior years related to the exercise of non-qualified employee stock options and vested stock awards. The full amount of the related tax benefits have been offset through our deferred tax asset valuation allowance. The associated excess tax benefits will be charged to equity upon the reversal of the associated valuation allowances in future periods.

The change in valuation allowance is as follows:

	Year ended December 31,		
	2006	**2005**	**2004**
	$	*$*	*$*
		(In thousands)	
Balance at the beginning of the period	16,722	5,407	4,013
Current year addition	2,308	5,805	1,394
Return to provision adjustments	(6,590)	5,510	—
Balance at the end of the period	12,440	16,722	5,407

Section 382 of the Internal Revenue Code ("Section 382") imposes limitations on a corporation's ability to utilize NOLs if it experiences an "ownership change." In general terms, an ownership change may result from transactions increasing the ownership percentage of certain stockholders in the stock of the corporation by more than 50 percentage points over a three-year period. In the event of an ownership change, utilization of our NOLs would be subject to an annual limitation under Section 382 determined by multiplying the value of our stock at the time of the ownership change by the applicable long-term tax-exempt rate (which is 4.22% for December 2006). Any unused annual limitation may be carried over to later years. The amount of the limitation may, under certain circumstances, be increased by built-in gains held by us at the time of the ownership change that are recognized in the five-year period after the change. We are currently assessing ownership changes and the impact, if any, that a potential ownership change may have on limiting our ability to fully utilize the domestic NOL carryforward.

Note 9 — Commitments and Contingencies

International Commitments

Through our subsidiary Caspi Neft, we are subject to the terms of License 1557 and the related exploration and production contracts covering 14,111 acres in the South Alibek Field in Kazakhstan. In connection with the exploration contract, and the extensions of it, we have committed to spend approximately $76.6 million on development of the Field through April 2009. As of December 31, 2006, the cumulative capital expenditures which are creditable to our obligation under the contract have exceeded the minimum contract commitment. The production contract provides, among other things, a work program commitment of $59.6 million for the continued development of the Field.

Purchase commitments are made in the ordinary course of business in connection with ongoing operations in the South Alibek Field.

Our operations are subject to various levels of government controls and regulations in the United States, the Republic of Kazakhstan and the Russian Federation. It is not possible for us to separately calculate the costs of compliance with environmental and other governmental regulations as such costs are an integral part of our operations.

In Kazakhstan and the Russian Federation, legislation affecting the oil and gas industry is under constant review for amendment or expansion. Pursuant to such legislation, various governmental departments and agencies have issued extensive rules and regulations which affect the oil and gas industry, some of which carry substantial penalties for failure to comply. These laws and regulations can have a significant impact on the industry by increasing the cost of doing business and, consequentially, can adversely affect our profitability. Inasmuch as new legislation affecting the industry is commonplace and existing laws and regulations are frequently amended or reinterpreted, we are unable to predict the future cost or impact of complying with such laws and regulations.

Environmental

We as an owner and operator of oil and gas properties, are subject to various federal, state, local and foreign country laws and regulations relating to discharge of materials into, and protection of, the environment. These laws and regulations may impose liability on the lessee under an oil and gas lease or concession for the cost of pollution clean-up resulting from operations and also may subject the lessee to liability for pollution damages.

Lease Commitments

We have operating leases for office facilities and certain equipment. Net rental expense under all operating leases and rental agreements was $2,192,000, $570,000 and $547,000 in 2006, 2005 and 2004, respectively. We lease office facilities in Houston and Kazakhstan under leases that are less than one year. Future minimum lease commitments under operating leases are as follows:

	Amount
	$
	(In thousands)
2007	285
2008	—
2009	—
2010	—
2011	—
Thereafter	—
	285

Note 10 — Business Segment Information

Our business activities relate solely to oil and gas exploration, development and production. Our primary emphasis since our formation in 2000 has been the development of the South Alibek Field and substantially all of our assets are located in Kazakhstan. For each of the three years ended December 31, 2006 substantially all of our results of operations consisted of revenues, operating, general and administrative, and other costs associated with our operations in Kazakhstan.

For the year ended December 31, 2006, three customers accounted for approximately 30%, 28% and 17%, respectively, of consolidated revenue. For the year ended December 31, 2005, two customers accounted for approximately 38% and 37%, respectively, of consolidated revenue. For the year ended December 31, 2004, two customers accounted for approximately 57% and 28%, respectively, of consolidated revenue.

Note 11 — Supplemental Financial Information

Other Assets

Other assets at December 31, 2006, consisted of debt financing costs of $11,464,000, net of amortization, and a note receivable of $500,000 from an unrelated third party. At December 31, 2005, other assets consisted of debt financing costs of $12,473,000, net of amortization.

Accrued Liabilities

Accrued liabilities consisted of the following:

	December 31,	
	2006	**2005**
	$	*$*
	(In thousands)	
Interest	1,450	1,583
Dividends	550	244
Production contract signature bonus	600	—
Royalties	333	307
Rig rentals	2,738	2,738
Bonus	—	1,032
Preferred stock registration costs	—	2,035
Acquisition costs	—	21,450
Rig lawsuit settlement	—	1,961
Other	114	101
Total accrued liabilities	5,785	31,451

Note 12 — Subsidiary Guarantors

In December 2005, TEI issued an aggregate of 250,000 Units, consisting of (i) an aggregate $250 million principal amount of senior its secured notes due 2010 and (ii) warrants to purchase approximately 17.3 million shares of the our common stock. We and all of our material subsidiaries fully and unconditionally guaranteed the senior secured notes. Prior to the Units offering, we financed our operations primarily through borrowings from banks in Kazakhstan or other private sources. As previously disclosed in 2005 and prior years, substantially all of our assets are located in Kazakhstan and substantially all of our revenue, operating expenses, general and administrative expenses and other costs were and currently are associated with the operations of our principal subsidiary, Caspi Neft, in Kazakhstan. Accordingly, there was no requirement for condensed consolidating financial information and the results for 2004 are not presented herein due to lack of comparability, because the information is not material for evaluation of the sufficiency of the guarantee and the omission of the information does not cause the financials to be inaccurate in reasonable detail.

The following is condensed consolidating financial information for the company, the Issuer, the subsidiary guarantors and the subsidiary non-guarantors of the senior secured notes for the two years ending December 31, 2006:

Condensed Consolidating Balance Sheet (in thousands)

	As of December 31, 2006					
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Eliminations	Consolidated
	$	$	$	$	$	$
Cash and cash equivalents	10,304	569	1,173	147	—	12,193
Other current assets	2,621	—	9,049	3	—	11,673
Total current assets	12,925	569	10,222	150	—	23,866
Property and equipment, net	404	—	317,040	3,362	—	320,806
Investment in and advances to subsidiaries	94,618	213,377	(271,857)	(3,926)	(32,212)	—
Other assets	—	11,464	—	500	—	11,964
	107,947	225,410	55,405	86	(32,212)	356,636
Total current liabilities	1,035	1,752	15,171	106	—	18,064
Debt	—	267,724	31,000	—	(31,000)	267,724
Other long-term liabilities	2,035	—	1,863	—	—	3,898
Senior redeemable convertible preferred stock	40,953	—	—	—	—	40,953
Stockholder's equity	63,924	(44,066)	7,371	(20)	(1,212)	25,997
	107,947	225,410	55,405	86	(32,212)	356,636

Condensed Consolidating Statements of Operations (in thousands)

	Year ended December 31, 2006				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
			(In thousands)		
Revenue, net	—	(837)	25,509	—	24,672
Operating costs and expenses	9,837	633	31,903	24	42,397
Operating income (loss)	(9,837)	(1,470)	(6,394)	(24)	(17,725)
Other income (expense)	251	(39,890)	4,115	2	(35,522)
Net loss	(9,586)	(41,360)	(2,279)	(22)	(53,247)
Preferred dividends	(1,066)	—	—	—	(1,066)
Net loss attributable to common stockholders	(10,652)	(41,360)	(2,279)	(22)	(54,313)

Condensed Consolidating Statements of Cash Flow (in thousands)

	Year ended December 31, 2006				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
			(In thousands)		
Net cash used in operating activities	(6,927)	(48,011)	19,355	(417)	(36,000)
Net cash used in investing activities	(114)	(252)	(103,506)	(3,363)	(107,235)
Net cash provided by financing activities	(1,842)	33,581	85,318	3,927	120,984
Net increase (decrease) in cash	(8,883)	(14,682)	1,167	147	(22,251)
Cash and cash equivalents, beginning of the year	19,187	15,250	7	—	34,444
Cash and cash equivalents, end of the year	10,304	568	1,174	147	12,193

Condensed Consolidating Balance Sheet (in thousands)

	December 31, 2005				
	Parent	Issuer	Subsidiary Guarantors	Eliminations	Consolidated
	$	$	$	$	$
Cash and cash equivalents	21,148	45,250	7	—	66,405
Other current assets	2,765	—	5,535	—	8,300
Total current assets	23,913	45,250	5,542	—	74,705
Property and equipment, net	305	—	226,510	—	226,815
Investment in and advances to subsidiaries	—	9,083	—	(9,083)	—
Other assets	—	32,973	—	(20,500)	12,473
	24,218	87,306	232,052	(29,583)	313,993
Total current liabilities	5,759	23,328	4,609	—	33,696
Debt	—	223,407	31,000	(31,000)	223,407
Other long-term liabilities	—	—	186	—	186
Stockholder's equity	18,459	(159,429)	196,257	1,417	56,704
	24,218	87,306	232,052	(29,583)	313,993

Condensed Consolidating Statements of Operations (in thousands)

	Year ended December 31, 2005			
	Parent	Issuer	Subsidiary Guarantors	Consolidated
	$	$	$	$
Revenue, net	—	—	8,443	8,443
Operating costs and expenses	11,099	—	7,167	18,266
Operating income (loss)	(11,099)	—	1,276	(9,823)
Other expense	(5,409)	(2,411)	(2,186)	(10,006)
Minority interest expense	—	—	(712)	(712)
Net loss	(16,508)	(2,411)	(1,622)	(20,541)
Preferred dividends	(1,081)	—	—	(1,081)
Net loss attributable to common stockholders	(17,589)	(2,411)	(1,622)	(21,622)

Condensed Consolidating Statements of Cash Flow (in thousands)

	Year ended December 31, 2005			
	Parent	Issuer	Subsidiary Guarantors	Consolidated
	$	$	$	$
Net cash used in operating activities	(4,372)	1,456	(8,436)	(11,352)
Net cash used in investing activities	(17)	—	(144,686)	(144,703)
Net cash provided by financing activities	12,917	13,794	147,041	173,752
Net increase (decrease) in cash	8,528	15,250	(6,081)	17,697
Cash and cash equivalents, beginning of the year	10,659	—	6,088	16,747
Cash and cash equivalents, end of the year	19,187	15,250	7	34,444

Note 13 — Supplemental Oil and Gas Disclosures (Unaudited)

Costs Incurred

Costs incurred in oil and gas property acquisition, exploration and development activities, whether expensed or capitalized, are reflected in the table below. This schedule does not include the costs of acquiring the minority interest in Caspi Neft and the carried working interest of approximately $138,314,000.

	Kazakhstan	**Other**	**Total**
	$	*$*	*$*
		(In thousands)	
Year ended December 31, 2006			
Acquisition costs of properties:			
Proved	2,345	—	2,345
Unproved	—	3,423	3,423
Exploration costs	256	—	256
Development costs	98,589	—	98,589
Capitalized interest	4,096	—	4,096
Total	105,286	3,423	108,709
Year ended December 31, 2005			
Acquisition costs of properties:			
Proved	—	—	—
Unproved	—	—	—
Exploration costs	9	—	9
Development costs	24,600	—	24,600
Capitalized interest	2,498	—	2,498
Total	27,107	—	27,107
Year ended December 31, 2004			
Acquisition costs of properties:			
Proved	—	—	—
Unproved	—	—	—
Exploration costs	3,477	—	3,477
Development costs	18,651	—	18,651
Capitalized interest	4,520	—	4,520
Total	26,648	—	26,648

Capitalized Costs

The aggregate amount of capitalized costs related to oil and gas producing activities and the aggregate amount of the related accumulated depreciation, depletion and amortization ("DD&A"), including any accumulated valuation allowances, are reflected in the table below. These capitalized costs do not include the drilling rig which was purchased and modified for use in our development activities in Kazakhstan. Capitalized costs for the drilling rig were $3.0 million, $3.0 million and $8.5 million at December 31, 2006, 2005 and 2004, respectively.

	Kazakhstan	**Other**	**Total**
	$	*$*	*$*
		(In thousands)	
As of December 31, 2006			
Proved properties	334,845	—	334,845
Unproved properties	—	3,703	3,703
Total oil and gas properties	334,845	3,703	338,548
Accumulated DD&A	(18,258)	—	(18,258)
Net oil and gas properties	316,587	3,703	320,290
As of December 31, 2005			
Proved properties	230,139	—	230,139
Unproved properties	—	—	—
Total oil and gas properties	230,139	—	230,139
Accumulated DD&A	(3,471)	—	(3,471)
Net oil and gas properties	226,668	—	226,668
As of December 31, 2004			
Proved properties	71,048	—	71,048
Unproved properties	—	—	—
Total oil and gas properties	71,048	—	71,048
Accumulated DD&A	(899)	—	(899)
Net oil and gas properties	70,149	—	70,149

Oil and Gas Reserve Information

Basis of Presentation

Proved oil and gas reserve quantities are based on estimates prepared by Ryder Scott Company, independent petroleum engineers. There are numerous uncertainties in estimating quantities of proved reserves and projecting future rates of production and the timing of development expenditures. These uncertainties are greater for properties which are undeveloped or have a limited production history, such as the South Alibek Field. The following reserve data represents estimates only and actual reserves may vary substantially from these estimates. All of our proved reserves were in Kazakhstan as of December 31, 2006, 2005 and 2004. Our net quantities of proved developed and undeveloped reserves of crude oil and changes therein are reflected in the table below.

As of December 31, 2006, we owned a 100% working interest in the South Alibek Field, subject to government royalties and an additional 3.5% net revenue interest retained by a third party in connection with our buyout of our former partners to be deducted from the remaining revenue interest. The effect of this overriding revenue interest is reflected in the calculation of the Company's net proved reserves and future net cash flows.

As of December 31, 2006, we operated under both a production contract and an exploration contract. The exploration contract associated with the License had an original six-year term which expired in April 2005 and has been extended through April 2009, The Production Contract for South Alibek was signed by the Kazakhstan government on December 29, 2006 with a concession for 25 years, ending on December 29, 2031. The net revenue interests used in this report are calculated from a sliding-scale royalty payment based on gross annual production and made to the Kazakhstan government during the period of the production contract of this license, and an additional 3.5% net revenue interest retained by a third party. Based on the forecast annual production, the government royalty rate is between 2.0% to 2.2% and is capped at 6%.

The proved reserves as of December 31, 2006 represent the reserves that were estimated to be recovered from 14 wells (South Alibek 1, 2, 3, 4, 5, 11, 12, 13, 14, 15, 16, 17, K1, and 21), and a total of 17 development offsets not yet drilled. All direct offset well locations in this report are proved undeveloped and are based on 80 acre drainage patterns unless current developed completions are estimated to drain an area larger than their volumetric assignment. In this case, the reserves of certain offset locations have been reduced. All locations have a scheduled KT1 and a KT2 reservoir completion and each of these reservoir completions includes the cost of drilling a separate wellbore. All reserves included in this report were estimated using either historical performance or volumetric methods. Our future drilling plans may include infill drilling on tighter spacing and horizontal wells; however, the effect of these future plans have not been considered in this SEC report.

The cost of 15 wells has been included in this report for water injection into the KT1 reservoir and the cost of 14 wells has been included for water injection into the KT2 reservoir. The first water injection well is expected to start in the first quarter of year 2007. The specific location of the remaining injection wells has not been identified; therefore, the reservoir response to the water injection has not been assigned to specific wells, but a total estimated waterflood recovery from each reservoir is included in the reserve forecasts to represent a waterflood typecurve performance and recovery estimate of each reservoir.

A 15% primary recovery factor was assigned to each developed and undeveloped well in the KT1 and KT2 reservoirs. A secondary recovery factor of 15% was assigned to the KT1 waterflood and to the KT2 waterflood. The total primary and secondary recovery of 30% was based on analogy data from other fields.

An estimated annual decline rate (ADR) of 30% was assigned to the primary forecasts of the undeveloped wells. The final decline assigned to the KT1 and KT2 waterflood typecurve forecasts were also based on an approximate 30% ADR.

As of December 31, 2006, we had four new wells, the SA-12, SA-13, SA-21, and SA-K1, which are scheduled to start producing in the first quarter of 2007. The drilling of SA-5H had commenced by December 31, 2006 and due to this work its associated reserves were reclassified to proved undeveloped, and is forecast to start producing in the first quarter of 2007 from the KT2 reservoir. An undeveloped redrill has been included in the estimates to capture the volumetric reserves assigned to the SA-4 well, which has reservoir damage that prevented placing the well on production during 2006.

Estimated Quantities of Net Proved Crude Oil Reserves
(Quantities in thousands of barrels)

	December 31,		
	2006	2005	2004
	$	$	$
Net proved crude oil reserves:			
Beginning of year	72,937	26,814	45,745
Revisions of previous estimates	(9,270)	(970)	(521)
Extensions, discoveries and other additions	4,230	6,097	6,828
Revision of net interest	—	41,194	(25,086)
Production	(708)	(198)	(152)
End of year	67,189	72,937	26,814
Net proved developed reserves:			
Beginning of year	3,332	4,476	7,816
End of year	5,138	3,332	4,476

Standardized Measure of Discounted Future Net Cash Flows (Unaudited)

Basis of Presentation

The standardized measure data includes estimates of oil and gas reserve volumes and forecasts of future production rates over the reserve lives. Estimates of future production expenditures, including taxes and future development costs, are based on management's best estimate of such costs assuming a continuation of current economic and operating conditions. No provision is included for depletion, depreciation and amortization of property acquisition costs or indirect costs. Income tax expense has been computed using expected future tax rates and giving effect to tax deductions and credits available, under current laws, and which relate to oil and gas producing activities. The sales prices used in the calculation are the year-end prices of crude oil, including condensate and natural gas liquids, which as of December 31, 2006, 2005 and 2004 were $35.59, $40.21 and $20.09 per barrel, respectively. The sales prices were based on the last sales price received for December 2006, 2005 and 2004, respectively. No value was assigned to natural gas reserves, as there is not currently an established market or pipeline facilities for gas sales. Changes in prices and cost levels, as well as the timing of future development costs, may cause actual results to vary significantly from the data presented. This information is not intended to represent a forecast or fair market value of the Company's oil and gas assets, but does present a standardized disclosure of discounted future net cash flows that would result under the assumptions used. The standardized measure of discounted future net cash flows relating to proved oil and gas reserves for 2006, 2005 and 2004 were as follows:

Standardized Measure of Discounted Future Net Cash Flows
(In thousands)

	$
December 31, 2006:	
Future cash inflows	2,391,263
Future production costs	(518,871)
Future development costs	(452,768)
Undiscounted future net cash flows before income tax	1,419,624
10% discount for estimated timing of cash flows	(905,495)
Present value of future net cash flows before income tax	514,129
Future income tax expense, discounted at 10%	(35,447)
Standardized measure of discounted future net cash flows	478,682
December 31, 2005:	
Future cash inflows	3,096,160
Future production costs	(406,539)
Future development costs	(397,879)
Undiscounted future net cash flows before income tax	2,291,742
10% discount for estimated timing of cash flows	(1,276,314)
Present value of future net cash flows before income tax	1,015,428
Future income tax expense, discounted at 10%	(262,825)
Standardized measure of discounted future net cash flows	752,603
December 31, 2004:	
Future cash inflows	538,688
Future production costs	(74,001)
Future development costs	(65,260)
Undiscounted future net cash flows before income tax	399,427
10% discount for estimated timing of cash flows	(179,431)
Present value of future net cash flows before income tax	219,996
Future income tax expense, discounted at 10%	(43,142)
Standardized measure of discounted future net cash flows	176,854

The following table presents a reconciliation of changes in the standardized measure of discounted future net cash flows:

Changes in the Standardized Measure of Discounted Future Net Cash Flows
(In thousands)

	Year ended December 31,		
	2006	**2005**	**2004**
	$	$	$
Standardized Measure, beginning of year	752,603	176,854	180,443
Sales and transfers of oil and gas produced, net of production costs	(14,835)	(8,738)	(152)
Net changes in prices, development and production costs	(299,636)	320,930	151,644
Extensions, discoveries and improved recovery, less related costs	69,509	596,505	65,492
Purchase of minerals in place	—	—	—
Development costs incurred and changes during the period	(85,621)	(193,753)	17,754
Revisions of previous quantity estimates	(113,377)	(6,948)	(4,458)
Increase in present value due to passage of one year	101,543	21,999	24,135
Exercise of Option by Bramex	—	—	(203,699)
Net changes in production rates and other	(158,881)	(373,928)	(36,563)
Net change in income taxes	227,377	219,682	(17,742)
Standardized Measure, end of year	478,682	752,603	176,854

Note 14 — Supplemental Quarterly Information (Unaudited)

The following table reflects a summary of the unaudited interim results of operations for the quarterly periods in the years ended December 31, 2006 and 2005.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	$	*$*	*$*	*$*
		(In thousands)		
2006				
Revenue, net	2,842	5,151	7,755	8,924
Operating loss	(4,208)	(4,267)	(4,948)	(4,302)
Net loss	(12,747)	(13,075)	(14,235)	(13,190)
Preferred dividends	243	226	47	550
Net loss attributable to common shareholders	(12,990)	(13,301)	(14,282)	(13,740)
Basic and diluted loss per share	(0.15)	(0.15)	(0.15)	(0.14)
Weighted average common shares outstanding	88,208	90,978	94,509	99,307
2005				
Revenue, net	1,154	2,032	3,852	1,405
Operating income (loss)	(1,705)	(254)	581	(8,445)
Net loss	(1,852)	(1,649)	(2,523)	(14,517)
Preferred dividends	278	281	279	244
Net loss attributable to common shareholders	(2,130)	(1,930)	(2,802)	(14,760)
Basic and diluted loss per share	(0.03)	(0.02)	(0.03)	(0.17)
Weighted average common shares outstanding	79,994	80,213	81,562	86,179

Note 15 — Subsequent Event

On March 15, 2007, we issued in a private placement warrants to purchase an aggregate 8,500,000 shares of our common stock and, in connection therewith, granted to the purchasers certain registration rights with respect to the resale or other disposition of the shares of our common stock issuable upon exercise of the warrants. The warrants were issued for total cash consideration of $8 million. Each warrant, when exercised, will entitle the holder to receive one share of our common stock at an exercise price of $2.00 per share. The warrant agreement governing the warrants provides for customary anti-dilution adjustments with respect to the exercise price and the number of shares of our common stock issuable upon exercise of the warrants. The warrants are exercisable at any time, at the holder's option, and will expire on March 15, 2012. The private placement of the warrants was effected pursuant to the exemption from registration provided by Section 4(2) of the Securities Act of 1933.

Reports of Independent Registered Public Accounting Firms

To the Board of Directors and Stockholders
Transmeridian Exploration Incorporated and Subsidiaries
Houston, Texas

We have audited the accompanying consolidated balance sheet of Transmeridian Exploration Incorporated and subsidiaries ("the Company") as of December 31, 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Transmeridian Exploration Incorporated and subsidiaries as of December 31, 2005, and the consolidated results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO criteria") and our report dated March 16, 2006 expressed an unqualified opinion on management's assessment that the Company did not maintain effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria, and because of the effects of the material weakness described therein, Transmeridian Exploration Incorporated has not maintained effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

/s/ UHY MANN FRANKFORT STEIN & LIPP CPAs, LLP

Houston, Texas
March 16, 2006

Report of Independent Certified Public Accountants

Board of Directors
Transmeridian Exploration, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Transmeridian Exploration, Inc. and Subsidiaries as of December 31, 2004, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the years in the two year period ended December 31, 2004. 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 in accordance with standards of Public Company Accounting Oversight Board (United States of America). 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Transmeridian Exploration Inc. and Subsidiaries at December 31, 2004 and 2003 and the consolidated results of their operations and cash flows for each of the years in the three year period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

By: /s/ JOHN A. BRADEN & COMPANY, P.C.
John A. Braden & Co., P.C.

Houston, Texas
March 14, 2005

Transmeridian Exploration Incorporated and Subsidiaries
Consolidated Balance Sheet

	December 31, 2005	2004
	$	$
ASSETS		
Current Assets:		
Cash and cash equivalents	34,443,457	16,746,137
Restricted cash	31,960,491	—
Accounts receivable	3,623,399	3,644,891
Crude oil inventory	1,625,934	192,465
Other current assets	51,264	75,850
Asset held for sale	3,000,000	8,545,897
Total current assets	74,704,545	29,205,240
Property and Equipment:		
Oil and gas properties, successful efforts method	230,139,394	71,048,574
Transportation equipment	239,821	239,821
Office and technology equipment	339,580	291,305
Total property and equipment	230,718,795	71,579,700
Less accumulated depreciation, depletion and amortization	3,903,446	1,190,791
Property and equipment, net	226,815,349	70,388,909
Other assets, net	12,473,536	216,111
	313,993,430	99,810,260

	December 31, 2005	December 31, 2004
	$	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable and accrued liabilities	31,869,443	7,137,016
Current maturities of long-term debt	—	12,005,208
Accrued interest payable	1,583,333	6,132,477
Deferred revenue	—	192,465
Preferred dividends payable	244,003	154,110
Notes payable to related parties	—	50,000
Total current liabilities	33,696,779	25,671,276
Long-term debt, net of discount of $26,592,924 at December 31, 2005	223,407,076	23,682,999
Other long term liabilities	186,000	186,000
Minority interest	—	7,924,558
Stockholders' Equity:		
Preferred stock, $0.0006 par value per share, 5,000,000 shares authorized, 1,547.714 and 1,785.714 issued and outstanding	1	1
Common stock, $0.0006 par value per share, 200,000,000 shares authorized 87,128,021 and 79,829,062 issued and outstanding	52,277	47,897
Additional paid-in capital	94,336,744	58,361,256
Accumulated deficit	(37,685,447)	(16,063,727)
Total stockholders' equity	56,703,575	42,345,427
	313,993,430	99,810,260

The accompanying notes are an integral part of these financial statements.

Transmeridian Exploration Incorporated and Subsidiaries
Consolidated Statement of Operations

	Year ended December 31,		
	2005	**2004**	**2003**
	$	$	$
Revenue from oil sales	8,442,787	3,922,990	797,411
Operating costs and expenses:			
Exploration expense	9,470	130,926	592,553
Depreciation, depletion and amortization	3,384,893	788,758	245,712
Transportation expense	321,313	154,993	235,264
Impairment loss on drilling rig	4,022,015	—	—
Operating and administrative expense — Kazakhstan	3,896,332	3,591,529	2,503,674
General and administrative expense — Houston	6,631,490	2,562,033	2,135,237
Total operating costs and expenses	18,265,513	7,228,239	5,712,440
Operating loss	(9,822,726)	(3,305,249)	(4,915,029)
Other income (expense):			
Interest income	337,815	34,242	870
Interest expense, net of capitalized interest	(10,344,217)	(1,400,227)	(772,409)
Total other income (expense)	(10,006,402)	(1,365,985)	(771,539)
Loss before minority interest	(19,829,128)	(4,671,234)	(5,686,568)
Minority interest income (expense)	(711,558)	823,053	—
Net loss	(20,540,686)	(3,848,181)	(5,686,568)
Preferred dividends	(1,081,034)	(154,110)	(19,736)
Net loss attributable to common stockholders	(21,621,720)	(4,002,291)	(5,706,304)
Basic and diluted loss per share	(0.26)	(0.05)	(0.09)
Weighted average common shares outstanding, basic and diluted	82,004,175	78,615,433	64,573,627

The accompanying notes are an integral part of these financial statements.

Transmeridian Exploration Incorporated and Subsidiaries
Consolidated Statement of Stockholders' Equity

	Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount			
		$	(000's)	$	$	$	$
Balance December 31, 2002	3,000	2	59,147	35,488	10,201,625	(6,355,132)	3,881,983
Conversion of preferred stock	(3,000)	(2)	1,546	928	56,329	—	57,255
Common stock issued for services	—	—	5,320	3,192	830,075	—	833,267
Proceeds from the sale of common stock, net of offering costs	—	—	3,333	2,000	998,000	—	1,000,000
Common stock used to retire debt	—	—	1,327	796	295,421	—	296,217
Stock-based compensation	—	—	—	—	122,800	—	122,800
Issuance of warrants in connection with services	—	—	—	—	21,000	—	21,000
Convertible preferred stock dividends	—	—	—	—	—	(19,736)	(19,736)
Net loss	—	—	—	—	—	(5,686,568)	(5,686,568)
Balance December 31, 2003	—	—	70,673	42,404	12,525,250	(12,061,436)	506,218
Exercise of warrants	—	—	358	214	(214)	—	—
Issuance of common stock to retire debt	—	—	800	480	703,520	—	704,000
Proceeds from the sale of common stock, net of offering costs	—	—	7,268	4,361	4,377,689	—	4,382,050
Proceeds from the sale of preferred stock, net of offering costs	1,786	1	—	—	20,762,056	—	20,762,057
Issuance of warrants in connection with sale of preferred stock sale	—	—	—	—	2,678,570	—	2,678,570
Stock-based compensation	—	—	730	438	395,851	—	396,289
Private placement termination fee	—	—	—	—	200,000	—	200,000
Elimination of minority interest	—	—	—	—	16,718,534	—	16,718,534
Convertible preferred stock dividends	—	—	—	—	—	(154,110)	(154,110)
Net loss	—	—	—	—	—	(3,848,181)	(4,002,291)
Balance December 31, 2004	1,786	1	79,829	47,897	58,361,256	(16,063,727)	42,345,427
Exercise of warrants	—	—	1,757	1,054	2,762,112	—	2,763,166
Proceeds from the sale of common stock	—	—	882	529	1,790,252	—	1,790,781
Conversion of preferred stock	(238)	—	2,380	1,428	(1,428)	—	—
Issuance of warrants in connection with debt offerings	—	—	—	—	31,520,394	—	31,520,394
Stock-based compensation	—	—	1,609	966	2,089,363	—	2,090,329
Preferred stock registration costs	—	—	—	—	(2,312,500)	—	(2,312,500)
Exercise of stock options	—	—	671	403	127,295	—	127,698
Convertible preferred stock dividends	—	—	—	—	—	(1,081,034)	(1,081,034)
Net loss	—	—	—	—	—	(20,540,686)	(20,540,686)
Balance December 31, 2005	1,548	1	87,128	52,277	94,336,744	(37,685,447)	56,703,575

The accompanying notes are an integral part of these financial statements.

Transmeridian Exploration Incorporated and Subsidiaries
Consolidated Statement of Cash Flows

	Year ended December 31,		
	2005	**2004**	**2003**
	$	*$*	*$*
Operating Activities:			
Net loss	(20,540,686)	(3,848,181)	(5,686,568)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation, depletion and amortization	3,384,893	788,758	245,712
Amortization of debt financing costs	1,114,930	193,332	184,166
Debt discount amortization	4,633,470	—	—
Impairment charge	4,022,015	—	—
Amortization of prepaid contracts	—	61,250	411,355
Stock-based compensation expense	2,090,329	396,289	122,800
Exploration expense	—	130,926	277,012
Stock issued for services	—	—	285,299
Minority interest (income) expense	711,558	(823,053)	—
Increase in receivables	(1,978,508)	(3,501,756)	(49,465)
Decrease in prepaid expenses	24,586	18,149	89,392
Increase in crude oil inventory	(1,625,934)	—	—
Increase in accounts payable and accrued liabilities	1,361,311	732,738	40,687
Increase (decrease) in interest payable	(4,549,144)	(4,253,422)	424,920
Net cash used in operating activities	(11,351,180)	(10,104,970)	(3,654,690)
Investing Activities:			
Capital expenditures	(20,703,352)	(17,647,162)	(23,574,311)
Acquisitions	(123,999,769)	—	—
Increase in other assets.	—	—	(65,997)
Net cash used in investing activities	(144,703,121)	(17,647,162)	(23,640,308)

	Year ended December 31,		
	2005	2004	2003
	$	$	$
Financing Activities:			
Proceeds from long-term debt	250,000,000	16,891,972	28,807,214
Repayments of long-term debt	(35,350,037)	(16,539,868)	(1,515,509)
Proceeds from short-term borrowings	25,740,000	—	—
Repayments of short-term borrowings	(25,740,000)	—	—
Decrease in notes payable to related parties	(50,000)	(198,025)	—
Payment of deferred financing costs	(12,578,355)	—	(300,000)
Payment of dividends on preferred stock	(991,142)	—	—
Proceeds from sale of stock by Caspi Neft	—	15,000,000	—
Proceeds from sale of common stock, net	1,790,781	4,582,050	1,000,000
Proceeds from sale of preferred stock	—	23,440,626	—
Proceeds from exercise of stock options	127,700	—	—
Proceeds from exercise of warrants	2,763,165	—	—
Increase in restricted cash	(31,960,491)	—	—
Net cash provided by financing activities	173,751,621	43,176,755	27,991,705
Net increase in cash and cash equivalents	17,697,320	15,424,623	696,707
Cash and cash equivalents, beginning of year	16,746,137	1,321,514	624,807
Cash and cash equivalents, end of year	34,443,457	16,746,137	1,321,514

The accompanying notes are an integral part of these financial statements.

Transmeridian Exploration Incorporated and Subsidiaries
Consolidated Statement of Cash Flows-supplemental Information

	Year ended December 31,		
	2005	**2004**	**2003**
	$	*$*	*$*
Cash paid for:			
Interest	11,642,884	4,864,749	187,613
Interest capitalized (non-cash)	(2,497,923)	(4,519,759)	(4,164,694)
Income taxes	—	—	—
Non-cash investing and financing transactions:			
Issuance of warrants in connection with debt	31,250,394	—	—
Accrual for acquisition of carried working interest	20,250,000	—	—
Accrued and unpaid dividends on convertible preferred stock	244,003	154,110	19,736
Exchange of convertible preferred stock for common stock	1,428	—	2
Issuance of common stock for services	—	—	833,267
Issuance of common stock to retire debt	—	704,000	296,217
Settlement of drilling rig dispute	—	(2,345,188)	—
Assumption of note payable on drilling rig	—	3,393,158	—
Issuance of warrants in connection with services	—	1,004,464	21,000
Other long term liabilities	—	—	186,000

The accompanying notes are an integral part of these financial statements.

Transmeridian Exploration Incorporated and Subsidiaries
Notes to Consolidated Financial Statements

Note 1 — Organization and Summary of Significant Accounting Policies

Transmeridian Exploration Incorporated (the "Company") was incorporated in the State of Delaware in April 2000. The Company is engaged in the business of acquiring, developing and producing oil and gas with its activities primarily focused on the Caspian Sea region of the former Soviet Union. The Company's primary oil and gas property is the South Alibek Field ("South Alibek" or the "Field") in the Republic of Kazakhstan covered by License 1557 (the "License") and the related exploration contract with the government of Kazakhstan.

The Company's operations in Kazakhstan are conducted through the now wholly-owned subsidiary, JSC Caspi Neft TME ("Caspi Neft"), an open joint stock company organized under the laws of Kazakhstan. In February 2004, Bramex Management, Inc. ("Bramex") exercised its option to acquire 50% of the issued and outstanding shares of Caspi Neft. In December 2005, the Company acquired all of the issued and outstanding shares of Bramex and, thus, the Company owns 100% of Caspi Neft.

Principles of Consolidation and Reporting

The consolidated financial statements include the accounts of the Company and its majority-owned and controlled subsidiaries and are prepared in accordance with generally accepted accounting principles in the United States. All significant intercompany transactions and balances have been eliminated in consolidation. The assets and results of operations of Caspi Neft represent substantially all of the consolidated assets and operations of the Company.

The Company continued to exercise significant control over Caspi Neft after Bramex exercised its option to acquire 50% of Caspi Neft in February 2004 and accordingly, believed the most meaningful accounting treatment was to fully consolidate Caspi Neft with the 50% share owned by Bramex reflected as a minority interest. To exercise its option, Bramex contributed $15.0 million in cash to Caspi Neft, the proceeds of which were used by Caspi Neft to retire debt. The difference between the $15.0 million of capital contributed to Caspi Neft and 50% of the book equity of Caspi Neft after such capital contribution represents an excess purchase price paid by Bramex of $6.0 million. This amount was included in additional paid-in capital on the accompanying 2004 consolidated balance sheet.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates and judgments on historical experience and on other information and assumptions that are believed to be reasonable under the circumstances. Estimates and judgments about future events and their effects cannot be perceived with certainty; accordingly, these estimates may change as additional information is obtained, as more experience is acquired, as the Company's operating environment changes and as new events occur. While it is believed that such estimates are reasonable, actual results could differ materially from those estimates. Estimates are used for, but not limited to, determining the following: inventory valuation, recoverability of long-lived assets, useful lives and oil and gas reserves used in depreciation, depletion, and amortization, income taxes and related valuation allowances and insurance, environmental and legal accruals.

Revenue Recognition

The Company sells its production both in the export and domestic market on a contract basis. Revenue is recorded when the purchaser takes delivery of the oil. At the end of the period, oil that has been produced but not sold is recorded as inventory at the lower of cost or market. Cost is determined on a weighted average basis based on production costs.

Cash and Cash Equivalents

The Company considers all highly liquid instruments with an original maturity of three months or less to be cash equivalents. Certain of the Company's cash balances are maintained in foreign banks which are not covered by deposit insurance. The cash balances in the Company's U.S. accounts may exceed federally insured limits. Cash that is escrowed for specific purposes such as interest payments is shown as restricted cash in the accompanying consolidated balance sheet.

Property and Equipment

The Company follows the "successful efforts" method of accounting for its costs of acquisition, exploration and development of oil and gas properties.

Oil and gas lease acquisition costs are capitalized when incurred. Unproved properties with significant acquisition costs are assessed quarterly on a property-by-property basis, and any impairment in value is recognized. Unproved properties with acquisition costs which are not individually significant are aggregated, and the portion of such costs estimated to be nonproductive, based on historical experience, is amortized over the average holding period. If the unproved properties are determined to be productive, the appropriate related costs are transferred to proved oil and gas properties. Lease rentals are expensed as incurred.

Oil and gas exploration costs, other than the costs of drilling exploratory wells, are charged to expense as incurred. Such costs include seismic expenditures and other geological and geophysical costs. The costs of drilling exploratory wells are capitalized pending determination of whether they have discovered proved commercial reserves. If proved commercial reserves are not discovered, exploratory drilling costs are expensed. Costs to develop proved reserves are capitalized, including the costs of all development wells and related equipment used in the production of crude oil and natural gas.

Depreciation, depletion and amortization of the costs of proved oil and gas properties is computed using the unit-of-production method based upon estimated proved reserves. Estimated future restoration and abandonment costs, if any, will be recognized as incurred as the Company does not have an ownership interest in the South Alibek Field and all property reverts to the government of Kazakhstan at the end of the License period. The Company does not have any legal obligations associated with the retirement of long-lived assets.

The Company reviews its oil and gas properties for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The determination of recoverability is based on comparing the estimated undiscounted future net cash flows at a producing field level to the unamortized capitalized cost of the asset. If the future undiscounted cash flows, based on the Company's estimates of anticipated production from proved reserves and future crude oil and natural gas prices and operating costs, are lower than the unamortized capitalized cost, the capitalized cost is reduced to fair value. Fair value is calculated by discounting the future cash flows at an appropriate risk-adjusted discount rate.

In December 2001, the Company purchased a drilling rig that, beginning in October 2002, was used in the development of the South Alibek Field. The rig was depreciated on the straight-line method over an estimated useful life of ten years and while being used for development drilling, the depreciation of the rig

and related support equipment was capitalized under the successful efforts method as part of the cost of the wells. Subsequent depreciation was expensed when the rig was stacked. In the first quarter of 2006, the Company reached an agreement to dispose of the rig. In accordance with generally accepted accounting principles, an impairment charge writing the value of the rig down to the estimated net proceeds and reclassifying the net book value of the rig to current asset held for sale was recorded in the accompanying consolidated financial statements.

Transportation equipment and office and technology equipment are depreciated on a straight-line basis over the estimated useful lives of the assets, which range from three to five years.

Maintenance and repairs are charged to expense as incurred. Replacements and expenditures which improve or extend the life of assets are capitalized. When assets are sold, retired or otherwise disposed of, the applicable costs and accumulated depreciation and amortization are removed from the accounts, and the resulting gain or loss is recognized.

Capitalized Interest Costs

Certain interest costs have been capitalized as part of the cost of oil and gas properties, including property acquisition costs, wells in progress and related facilities. Additionally, interest was capitalized on the drilling rig while it was being readied for its intended use. Total interest costs capitalized during the years ended December 31, 2005, 2004 and 2003 totaled $2.5 million, $4.5 million and $4.2 million, respectively.

Income Taxes

The Company accounts for income taxes using the asset and liability method. The asset and liability method requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of (i) temporary differences between financial statement carrying amounts of assets and liabilities and the basis of these assets and liabilities for tax purposes and (ii) operating loss and tax credit carry-forwards for tax purposes. Deferred tax assets are reduced by a valuation allowance when management concludes that it is more likely than not that a portion of the deferred tax assets will not be realized in a future period.

Debt Financing Costs

Debt financing costs are amortized over the term of the related financing facility.

Loss per Common Share

Basic net loss per common share is calculated by dividing the net loss attributable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net loss per common share is computed based upon the weighted average number of common shares outstanding plus the common shares which would be issuable upon the conversion or exercise of all potentially dilutive securities. Diluted net loss per share equals basic net loss per share for all periods presented because the effects of potentially dilutive securities are anti-dilutive.

Net loss attributable to common stockholders is calculated as the net loss after deductions for cumulative preferred stock dividends, whether paid or accrued.

Foreign Exchange Transactions

The Company's functional currency is the U.S. dollar because it primarily contracts with customers, finances capital and purchases equipment and services using the U.S. dollar. Certain assets and liabilities are translated at historical exchange rates, revenues and expenses in foreign currency are translated at the average rate of exchange for the period and all translation gains or losses are reflected in the period's results of operations.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company deposits its cash and cash equivalents in high credit quality financial institutions, however amounts on deposit do exceed the maximum amount insured by the Federal Deposit Insurance Corporation.

Stock-Based Compensation

The Company accounts for employee stock-based compensation using the fair value method as prescribed in Statement of Financial Accounting Standards ("SFAS") No. 123. Under this method, the Company records the fair value attributable to stock options or stock grants, based on the Black-Scholes model, and amortizes that amount to expense over the service period required to vest the options.

Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and long-term debt. The carrying values of cash and cash equivalents, receivables and accounts payable approximate fair value due to their short-term nature. The carrying value of long-term debt approximates its fair value based on the market interest rate of the debt instrument.

Reclassifications

Prior period amounts primarily related to the Company's drilling rig have been reclassified to conform to the current period presentation.

New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") issued the revised SFAS No. 123, Share-Based Payment ("SFAS No. 123(R)"). SFAS 123(R) is a revision of SFAS No. 123 and supersedes APB No. 25. SFAS 123(R) requires compensation costs related to share-based payment transactions to be recognized in the financial statements. With limited exceptions, the amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. In addition, liability awards will be remeasured at each reporting date through the settlement date. Compensation cost will be recognized over the period that an employee provides services in exchange for the award. The Company had previously adopted SFAS No. 123, and, the adoption of SFAS 123(R) on January 1, 2006 is not expected to have a material effect on the Company's consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections. SFAS No. 154 replaces Accounting Principles Board Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Internal Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application of changes in accounting principle to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company adopted SFAS No. 154 on January 1, 2006. Any impact on the Company's consolidated results of operations and earnings per share will be dependent on the amount of any accounting changes or corrections of errors whenever recognized.

Note 2 — Acquisitions

In October 2005, a wholly-owned subsidiary of the Company entered into a share sale and purchase agreement with Seeria Alliance Ltd. to purchase 100% of the authorized and issued shares of Bramex, the owner of 50% of Caspi Neft. In December 2005, the transaction was completed and the subsidiary now owns, directly or indirectly, 100% of Caspi Neft. The total consideration of $168 million, of which approximately $44 million was to pay the outstanding indebtedness of Caspi Neft, was funded from the net proceeds of the private placement of units as described in note 5.

In December 2005, the Company entered into a purchase agreement with Kornerstone Investment Group Ltd. ("Kornerstone") pursuant to which the Company acquired the 10% carried working interest in the South Alibek Field held by Kornerstone. Pursuant to the purchase agreement, the Company paid Kornerstone a purchase price consisting of $15.25 million in cash and one million shares of the Company's common stock. The cash portion of the purchase price obligation was funded from the net proceeds of the private placement of units.

Note 3 — Property and Equipment

Oil and Gas Properties

The License covering the South Alibek Field, was granted by the Republic of Kazakhstan on April 29, 1999 and originally covered 3,396 acres. In March 2000, the Company acquired the License from an unrelated third-party for $4.0 million. During 2001, based on its technical review and analysis of the probable productive area of the Field, the Company applied to the Kazakhstan Ministry of Energy and Mineral Resources to expand the area covered by the License. In November 2001, the Company's application was approved and the License was expanded to cover an area of 14,111 acres.

The exploration contract associated with the License had a six-year term which expired in April 2005 and has been extended through April 2007, and may be extended by mutual agreement for an additional two years. The exploration contract required capital expenditures during the initial period of approximately $18.0 million, which has been satisfied. In connection with the recent two-year extension, the Company has committed to an additional work program of $30.5 million. During the primary and extended terms, the Company can produce from wells under a test program and pay a royalty of 2% to the government. The exploration contract also contains a provision which will allow the government to recover, from future revenues, approximately $4.9 million of exploration costs which were incurred prior to privatization. The final terms for the recovery of these costs will be contained in the production contract when executed, The Company has received approval from the government of Kazakhstan for a production contract covering a portion of the License area, and is currently awaiting final signature of the production contract from the Kazakhstan government.

Drilling Rig and Equipment

In December 2001, the Company purchased a drilling rig that was used in the development of the South Alibek Field beginning in October 2002. The rig was depreciated on the straight-line method over an estimated useful life of ten years and while being used for development drilling, the depreciation of the rig and related support equipment was capitalized under the successful efforts method as part of the cost of the wells. Subsequent depreciation was expensed when the rig was stacked. In the first quarter of 2006, the Company reached an agreement to dispose of the rig. An impairment charge writing the value of the rig down to the estimated net proceeds and reclassifying the net book value of the rig to current asset held for sale was recorded as of December 31, 2005. As more fully discussed in note 8, there was a legal dispute between the Company and the holder of an apparent first lien on the drilling rig that was settled in December 2005.

Note 4 — Notes Payable to Related Parties

In a series of notes issued between June 2002 and November 2002, certain stockholders and related parties, including the Chief Executive Officer of the Company, loaned the Company $248,025. These notes had interest rates of 17% and were paid in full in September 2005.

Note 5 — Debt

Short-Term Debt

In May 2005, the Company borrowed an aggregate of $2,240,000 from a group of individuals pursuant to unsecured, short-term notes. The notes bore interest at 15% per annum and were repaid along with accrued interest in July and September 2005. In July 2005, the Company borrowed $1,000,000 from an individual pursuant to an unsecured short-term note, which bore interest at 15% per annum and was repaid with accrued interest in December 2005. In connection with these borrowings, the Company issued detachable warrants to purchase 420,000 shares of common stock at exercise prices ranging from $2.00 to $2.12 per share. The warrants have a three-year term.

In August 2005, the Company issued convertible promissory notes (the "Convertible Notes") in the original aggregate principal amount of $22,500,000. The Convertible Notes bore interest at 10% per annum and matured on the earlier of December 15, 2005 or the closing of certain equity financings. The Convertible Notes were repaid in full, including accrued interest, in December 2005 utilizing a portion of the proceeds from the private placement of units.

Long-Term Debt

Long-term debt consists of the following:

	December 31,	
	2005	**2004**
	$	*$*
Senior Secured Notes due 2010, net of discount of $26,592,924	223,407,076	—
$20 million credit facility with a Kazakhstan bank	—	3,583,863
$30 million credit facility with a Kazakhstan bank	—	29,399,585
Note payable secured by drilling rig	—	2,704,759
Total long-term debt	223,407,076	35,688,207
Less current maturities	—	12,005,208
Long-term portion	223,407,076	23,682,999

Senior Secured Notes

In December 2005, a wholly-owned subsidiary of the Company issued in a private placement an aggregate of 250,000 units (the "Units") consisting of (1) an aggregate $250 million principal amount of the subsidiary's senior secured notes due 2010 (the "Notes") and (2) warrants to purchase in the aggregate approximately 17.3 million shares of the Company's common stock (the "Warrants"). The Units were issued and sold for a purchase price of $1,000 per Unit. Each Unit consists of $1,000 principal amount of Notes and 69.054 Warrants to purchase an equal number of shares of the Company's common stock. The Notes, which will mature on December 15, 2010, bear interest at the rate of 12% per annum. Interest on the Notes is payable quarterly on March 15, June 15, September 15 and December 15 of each year,

beginning on March 15, 2006, and at maturity. The first year of interest payments have been escrowed and are recorded as restricted cash on the Company's consolidated balance sheet as of December 31, 2005. The fair value of the warrants of approximately $26,816,000 was recorded as a discount to the face amount of the Notes and will be amortized to interest expense over the life of the Notes.

The Notes are secured by first priority pledges of all the capital stock of Transmeridian Exploration Inc., the issuing wholly-owned subsidiary, and of all of the Company's other material subsidiaries. In addition, the Notes are fully and unconditionally guaranteed by the Company and all of the Company's other material subsidiaries. The Notes contain provisions that limit the ability of the Company and its subsidiaries to enter into transactions with affiliates; pay dividends or make other restricted payments; incur debt; create, incur or assume liens; sell assets; and consolidate, merge or transfer all or substantially all of the Company's assets. The Company is required to offer to repurchase the Notes in connection with certain specified change of control events. The Notes are subject to redemption, in whole or in part, at the option of the Company at any time on or after December 15, 2008 at redemption prices starting at 106% of the principal amount redeemed and declining to 100% by June 15, 2010. Prior to December 15, 2008, the Company may redeem up to 35% of the Notes with proceeds of certain equity offerings at a specified redemption price.

The Company used the proceeds from the offering of the Units of $237.4 million, after expenses, to fund the acquisition of Bramex and to retire the existing bank credit facility indebtedness of Caspi Neft, to repay $22.5 million of convertible promissory notes and to pre-fund the first year of interest payments on the Notes of $30 million.

$20 Million and $30 Million Credit Facilities

In February 2002, Caspi Neft entered into a credit facility with a Kazakhstan bank that provided for borrowings totaling $20.0 million with an interest rate of 15% and a fee of 0.5% per annum on the unutilized portion of the commitment. The original maturity date was February 2005; however, the terms were renegotiated to allow for deferral of all principal and interest payments until the earlier of (i) the closing date of the acquisition of Bramex or (ii) December 23, 2005.

In June 2003, Caspi Neft entered into a new $30.0 million credit facility with the same Kazakhstan bank. This facility provided for borrowings up to $30.0 million with an interest rate of 15% and a commitment fee of 0.5% per annum on the unutilized portion. Upon execution of the credit facility, Caspi Neft paid the bank an arrangement fee of $300,000, which was capitalized as a deferred financing cost and was being amortized over the five-year life of the facility. Originally, the amount outstanding as of May 31, 2005 was scheduled to be repaid over 36 equal monthly installments beginning June 2005 through the final maturity date of May 31, 2008; however, those terms were renegotiated to allow for deferral of all principal and interest payments until the earlier of (i) the closing date of the acquisition of Bramex or (ii) December 23, 2005.

Both credit facilities were repaid in full in December 2005 in connection with the acquisition of Bramex by a wholly-owned subsidiary of the Company and the Company's December 2005 private placement of Units discussed above.

Note Payable Secured by Drilling Rig

In December 2001, the Company purchased a drilling rig for $5.3 million by the issuance, to the seller, of a note payable for $3.3 million and 1.0 million shares of redeemable common stock having a value at that time of $2.0 million. In July 2003, the Company was notified by the holder of an apparent first lien on the rig that the seller was in default under its note payable obligation to the lienholder. The Company was not informed of the existence of the prior lienholder by the seller of the rig. The note payable was in dispute as a result of the seller's apparent default to the lienholder. The Company held discussions with the lienholder

with the intent to resolve the seller's default by making certain payments directly to the lienholder. The Company made installment payments to the lienholder totaling $688,400 during 2003. However, in December 2003, the Company ceased installment payments to the lienholder as it had not been able to reach a settlement agreement with both the seller and the lienholder. In August 2004, the Company settled its legal dispute with the seller. Pursuant to the terms of the settlement, the remaining balance due on the note of $1.6 million, plus accrued interest of $550,000, was cancelled, and the Company agreed to seek a settlement with the lienholder pursuant to which the Company would assume the obligation of the seller of the rig to the lienholder. Also under the terms of the settlement, the seller returned 200,000 shares to the Company, the remaining 800,000 shares were retained by the seller and such shares are no longer redeemable. In December 2005, the Company settled the remaining outstanding obligation to the lienholder for approximately $1.8 million, plus $120,000 for legal fees. This amount was held in escrow at December 31, 2005 and is recorded as restricted cash on the consolidated balance sheet as of December 31, 2005.

Future maturities of long-term debt, exclusive of discount, at December 31, 2005, are as follows:

	Amount
	$
2006	—
2007	—
2008	—
2009	—
2010	250,000,000
Total long-term debt	250,000,000

Management believes the fair value of debt at December 31, 2005 approximates its carrying value based on the market interest rate of the debt instrument.

Note 6 — Stockholders' Equity

Series A Convertible Preferred Stock

In November 2004, the Company sold 1,785.714 shares of its Series A Cumulative Convertible Preferred Stock (the "Series A Preferred") in a private placement at a purchase price of $14,000 per share, and issued warrants to purchase up to 4,464,286 shares of the Company's common stock at an exercise price equal to $1.55 per share. The aggregate purchase price, net of offering costs, for the Series A Preferred and the related warrants was $22.5 million, which includes the value of warrants attributable to offering cost. The proceeds from the private placement of Series A Preferred and warrants were used for general corporate purposes, including funding the Company's development drilling program in the South Alibek Field, and to pursue growth opportunities.

The Series A Preferred has a liquidation value of $14,000 per share and is convertible at the holders' option into common stock at a conversion price of $1.40 per share, subject to adjustments in certain circumstances. The holders of the Series A Preferred are entitled to a quarterly dividend payable at the rate of 4.5% per annum, payable in cash. The holders of the Series A Preferred have full voting rights and powers (subject to a beneficial ownership cap as described below) equal to the voting rights and powers of the holders of the Company's common stock, and vote together with the holders of common stock as one class. A holder of the Series A Preferred may not, unless it chooses in advance not to be governed by this limitation, convert the Series A Preferred or exercise the warrants into common stock such that the number of shares of common stock issued after the conversion would exceed, when aggregated with

all other shares of common stock owned by such holder at such time, 4.999% of the then issued and outstanding shares of the Company's common stock. So long as at least 20% of the Series A Preferred remains outstanding, the Company is not permitted to issue any new securities or financial instruments that rank pari passu or senior to the Series A Preferred without the approval of at least 75% of the Series A Preferred outstanding. In July 2006, the Series A Preferred automatically converts into the common stock of the Company at the conversion price of $1.40 per share (subject to adjustments), if the common stock trades at a price equal to or greater than $4.15 per share for twenty consecutive trading days and the average daily trading volume of the Company's common stock during such period exceeds 200,000 shares, subject to the applicable ownership limitations. In the event a holder is prohibited from converting into common stock due to the 4.999% ownership limitation, the excess portion of the Series A Preferred remains outstanding, but ceases to accrue a dividend. During 2005, 238 shares of Series A Preferred stock were converted into 2,380,000 shares of the Company's common stock. The Company has accrued $2.3 million for costs associated with the delayed effectiveness of the required registration statement for the conversion shares.

Common Stock Reserved for Issuance

There are 200,000,000 common shares authorized by the Company's Amended and Restated Certificate of Incorporation and 87,128,021, 79,829,062, and 70,673,207 common shares were issued and outstanding as of December 31, 2005, 2004 and 2003, respectively. Shares of common stock reserved for issuance are summarized as follows:

	December 31,	
	2005	2004
2001 Incentive Stock Option Plan	1,365,000	2,955,000
2003 Stock Compensation Plan	1,813,021	706,673
Convertible preferred stock	15,477,140	17,857,140
Warrants to purchase common stock	26,565,285	6,138,393
Total	45,220,446	27,657,206

Warrants

In connection with certain 2005 short-term borrowings from individuals, the Company issued detachable warrants to purchase 420,000 shares of common stock at exercise prices ranging from $2.00 to $2.12 per share. The warrants have a three-year term.

In connection with the Convertible Notes issued in August 2005, the Company issued detachable warrants to purchase 4,500,000 shares of the Company's common stock at an exercise price equal to $2.40 per share. The warrants have a five-year term, and beginning six months after the closing of the issuance of the Convertible Notes, the exercise price of the warrants is subject to adjustment for issuances of common stock at a purchase price of less than the then-effective exercise price of the warrants.

The warrants issued in December 2005 as part of the Units entitle the holder to purchase one share of the Company's common stock at an exercise price of $4.27 per share; pursuant to the warrant agreement, the exercise price of the warrants was adjusted from the initial exercise price of $4.31 per share to $4.27 per share as a result of the issuance of 1,000,000 shares of the Company's common stock to Kornerstone in connection with the acquisition of Kornerstone's carried working interest in the South Alibek Field discussed in Note 2. The warrant agreement contains anti-dilution provisions and the exercise price of the warrants will be adjusted upon the conversion of any shares of the Company's outstanding Series A Preferred. The warrants will be exercisable at any time on or after the earlier of (i) December 12, 2006

or (ii) the date a registration statement covering the issuance of the warrant shares upon exercise of the warrants and resales of the warrants and the warrant shares becomes effective, subject to the accelerated exercisability exceptions with respect to dividend declarations and certain corporate events described in the warrant agreement. The warrants will expire on December 15, 2010.

2001 Incentive Stock Option Plan

The Company has a 2001 Incentive Stock Option Plan (the "Plan") under which options to purchase 5.0 million shares of common stock may be granted to officers, board members, key employees and consultants through December 31, 2010. Under the Plan, the exercise price of each option is equal to the fair market value of the Company's common stock on the date of grant and all options granted have a term of five years. The vesting period is determined by the Board of Directors at the date of grant.

No stock options were granted under the Plan prior to 2003. The following table summarizes activity under the Plan for the last three years.

	Number of Shares (In thousands)	Weighted Average Exercise Price Per Share
Outstanding at December 31, 2002	—	—
Granted	1,740	0.25
Exercised	—	—
Forfeited	—	—
Outstanding at December 31, 2003	1,740	0.25
Granted	555	1.50
Exercised	(650)	0.23
Forfeited	(250)	0.22
Outstanding at December 31, 2004	1,395	0.78
Granted	1,740	1.61
Exercised	(705)	0.31
Forfeited	(150)	0.12
Outstanding at December 31, 2005	2,280	1.53
Shares exercisable at December 31		
2005	833	1.41
2004	790	0.27
2003	75	0.24

The aggregate fair value of options granted during 2005, 2004 and 2003 was $969,900, $355,200 and $212,700, respectively, which is being amortized to expense over the vesting period in accordance with SFAS No. 123. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rates of 5%; expected lives between 1.5 and 2.5 years; and volatility of the price of the underlying common stock of 45-75%. Compensation expense of $400,920, $105,997 and $117,383 was recognized during the years ended December 31, 2005, 2004 and 2003, respectively.

The following table summarizes additional information about the Company's stock options outstanding exercisable at December 31, 2005:

	Outstanding			Exercisable	
	Number Outstanding (In thousands)	Weighted Average Remaining Life (In Years)	Weighted Average Exercise Price $	Number Outstanding (In thousands)	Weighted Average Exercise Price $
Exercise Price					
$0.24	100	2.36	0.24	100	0.24
$0.57	10	2.96	0.57	10	0.57
$1.50	430	3.88	1.50	143	1.50
$1.61	1,740	4.38	1.61	580	1.61
Total at December 31, 2005	2,280	4.19	1.53	833	1.41

2003 Stock Compensation Plan

In May 2003, the Company established its 2003 Stock Compensation Plan with the registration of 2.5 million shares under the plan. The plan was amended in May 2005 to increase the number of shares authorized for issuance to a total of 5,000,000 shares. Under the terms of the plan, such stock may be issued for restricted stock awards; payments of bonuses in stock; payments for services to consultants in the form of stock; employer contributions to a 401(k) plan; stock appreciation rights and warrants. Any shares issued in lieu of cash are recognized as expense based on the fair value of the shares on the date of grant. The fair value of restricted stock awards on the date of grant is amortized ratably over the vesting period. The following table summarizes the shares issued during the years ended December 31:

	2005	2004	2003
Number of shares issued	1,357,216	600,000	1,234,047
Fair value at date of grant	2,800,549	750,000	283,625

Note 7 — Income Taxes

The Company provides for deferred taxes on temporary differences between the financial statements and tax basis of assets using the enacted tax rates that are expected to apply to taxable income when the temporary differences are expected to reverse. The Company has not recorded any deferred tax assets or income tax benefits from the net deferred tax assets for the years ended December 31, 2005, 2004 and 2003. The Company has placed a 100% valuation allowance against the net deferred tax asset because future realization of these assets is not assured. Income before income taxes is composed of the following:

	Year ended December 31,		
	2005	2004	2003
	$	$	$
United States	(16,508,000)	(3,185,000)	(2,940,000)
International	(4,033,000)	(817,000)	(2,767,000)
	(20,541,000)	(4,002,000)	(5,707,000)

A reconciliation of the federal statutory income tax (34%) amounts to the effective amounts is shown below:

	Year ended December 31,		
	2005	2004	2003
	$	$	$
Income tax benefit computed at statutory rates	(6,983,000)	(1,361,000)	(1,940,000)
Effect of foreign tax rate differential	885,000	—	—
Return to provision adjustments	(5,510,000)	—	—
Other	294,000	—	—
Adjustment to valuation allowance	11,314,000	1,361,000	1,940,000
	—	—	—

At December 31, 2005, 2004 and 2003 the components of the Company's deferred tax assets and liabilities were as follows:

	December 31,		
	2005	2004	2003
	$	$	$
Current deferred tax assets			
Cost basis of assets held for sale	1,367,000	—	—
Accrual to cash adjustments in foreign subsidiary	1,239,000	—	—
Total current deferred tax assets	2,606,000	—	—
Noncurrent deferred tax assets			
Domestic net operating loss carryforwards	7,999,000	5,614,000	2,100,000
Foreign net operating loss carryforwards	—	3,183,000	3,766,000
Foreign oil and gas exploration and development costs	6,542,000	—	—
Other	128,000	—	—
Total noncurrent deferred tax assets	14,669,000	8,797,000	5,866,000
Total deferred tax assets	17,275,000	8,797,000	5,866,000
Noncurrent deferred tax liabilities			
Domestic property, plant, and equipment	(458,000)	—	—
Foreign capitalized interest	—	(3,390,000)	(1,853,000)
Other	(95,000)	—	—
Total noncurrent deferred tax liabilities	(553,000)	(3,390,000)	(1,853,000)
Net deferred tax assets	16,722,000	5,407,000	4,013,000
Valuation allowance	(16,722,000)	(5,407,000)	(4,013,000)
	—	—	—

As of December 31, 2005, the Company has estimated domestic net operating loss carryforwards of $24.6 million which will expire between 2020 and 2025. There are no foreign net operating loss carryforwards.

The change in valuation allowance is as follows:

	Year ended December 31,		
	2005	2004	2003
	$	$	$
Balance at the beginning of the period	5,407,000	4,013,000	2,106,000
Current year addition	5,805,000	1,394,000	1,997,000
Return to provision adjustments	5,510,000	—	—
Balance at the end of the period	16,722,000	5,407,000	4,013,000

Note 8 — Commitments and Contingencies

Drilling Rig Dispute

In December 2001, the Company purchased a land drilling rig for total consideration of $5.3 million, including a note payable for $3.3 million and the issuance of $2.0 million in redeemable common stock. The Company was not informed that the rig was subject to a lien in favor of a prior owner of the rig. Beginning in December 2003, the seller, the Company and the lienholder engaged in litigation to determine the parties' rights and obligations with respect to the rig, the lien and payments due the seller and the lienholder. In August 2004, the Company and the seller of the rig entered into a settlement and release agreement, pursuant to which the remaining balance on the note of $1.6 million, plus accrued interest of $550,000 was cancelled, and the Company agreed to endeavor to negotiate a settlement with the lienholder pursuant to which the Company would assume the obligation of the seller of the rig to the lienholder. In December 2005, the parties engaged in a court-supervised mediation at which they agreed to settle all outstanding claims against one another. Pursuant to the settlement agreement, which was signed in February 2006, the Company paid approximately $1.8 million to the first lienholder to settle the remaining payment obligations to the lienholder, plus $120,000 for legal fees.

Former Chief Financial Officer

In May 2003, Jim W. Tucker, a former chief financial officer of the Company, filed suit in state district court in Texas against the Company in connection with his separation from service in January 2003. The suit alleged breach of an oral employment agreement. The Company took a default judgment in November 2003 in the amount of $0.9 million. In February 2005, the court granted our motion to vacate the default judgment. The plaintiff subsequently passed away in July 2005. The case may still be reinstated by the deceased's estate prior to April 2007, and would begin as if the Company had just been served notice. The Company believes it has meritorious defenses to the allegations against it and intends to vigorously contest this matter and pursue all available legal remedies; however, the Company believes the chances that plaintiff's estate will refile the suit to be remote.

International Commitments

The Company, through its subsidiary Caspi Neft, is subject to the terms of License 1557 and the related exploration contract covering 14,111 acres in the South Alibek Field in Kazakhstan. In connection with the exploration contract, the Company has committed to spend approximately $18.0 million on development of the Field through 2005. As of December 31, 2005, the cumulative capital expenditures which are creditable to our obligation under the Contract have exceeded the minimum contract commitment. In connection with the two-year extension granted on July 8, 2004, the Company committed to spend approximately $30.5 million from 2005 to 2007.

Purchase commitments are made in the ordinary course of business in connection with ongoing operations in the South Alibek Field.

Our operations are subject to various levels of government controls and regulations in the United States and in the Republic of Kazakhstan. It is not possible for us to separately calculate the costs of compliance with environmental and other governmental regulations as such costs are an integral part of our operations.

In the Republic of Kazakhstan, legislation affecting the oil and gas industry is under constant review for amendment or expansion. Pursuant to such legislation, various governmental departments and agencies have issued extensive rules and regulations which affect the oil and gas industry, some of which carry substantial penalties for failure to comply. These laws and regulations can have a significant impact

on the industry by increasing the cost of doing business and, consequentially, can adversely affect our profitability. Inasmuch as new legislation affecting the industry is commonplace and existing laws and regulations are frequently amended or reinterpreted, we are unable to predict the future cost or impact of complying with such laws and regulations.

Environmental

The Company, as an owner and operator of oil and gas properties, is subject to various federal, state, local and foreign country laws and regulations relating to discharge of materials into, and protection of, the environment. These laws and regulations may impose liability on the lessee under an oil and gas lease or concession for the cost of pollution clean-up resulting from operations and also may subject the lessee to liability for pollution damages.

Lease Commitments

The Company has operating leases for office facilities and certain equipment. Net rental expense under all operating leases and rental agreements was $570,086, $546,639 and $930,698 in 2005, 2004 and 2003, respectively. The Company leases office facilities in Houston and Kazakhstan under leases greater than one year. Future minimum lease commitments under operating leases are as follows:

	Amount
	$
2006	273,324
2007	76,216
2008	—
2009	—
Thereafter	—
	349,540

Note 9 — Business Segment Information

The Company's business activities relate solely to oil and gas exploration, development and production. The primary emphasis since its formation in 2000 has been the development of the South Alibek Field and substantially all of the Company's assets are located in Kazakhstan. For each of the three years ended December 31, 2005 substantially all of the Company's results of operations consisted of revenues, operating, general and administrative, and other costs associated with its operations in Kazakhstan.

For the year ended December 31, 2005, two customers accounted for approximately 38% and 37%, respectively, of consolidated revenues. For the year ended December 31, 2004, two customers accounted for approximately 57% and 28%, respectively, of consolidated revenues. One customer accounted for 100% of consolidated revenues for the year ended December 31, 2003.

Note 10 — Supplemental Financial Information

Other Assets

Other assets at December 31, 2005 and 2004, consisted of debt financing costs, net of amortization, of $12,473,536 and $216,111, respectively.

Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consisted of the following:

	December 31, 2005	2004
	$	$
Accounts payable	419,456	152,158
Salaries and bonus	1,032,357	12,458
Preferred stock registration costs	2,035,000	—
Acquisition costs	21,450,000	—
Rig lawsuit settlement	1,960,491	446,482
Rig rentals	2,737,722	1,446,587
Oil and gas properties costs	1,826,554	3,893,727
Other	407,863	1,185,604
Total accounts payable and accrued liabilities	31,869,443	7,137,016

Note 11 — Subsidiary Guarantors

In December 2005, Transmeridian Exploration Inc., a wholly-owned subsidiary of the Company (the "Issuer"), issued an aggregate of 250,000 Units, consisting of (i) an aggregate $250 million principal amount of senior its secured notes due 2010 and (ii) warrants to purchase approximately 17.3 million shares of the Company's common stock. The Company and all material subsidiaries of the Company fully and unconditionally guaranteed the senior secured notes. Prior to the Units offering, the Company financed its operations primarily through borrowings from banks in Kazakhstan or other private sources. As previously disclosed in 2005 and prior years, substantially all of the Company's assets are located in Kazakhstan. For each of the three years ended December 31, 2005, substantially all of the results of operations consisted of revenue, operating, general and administrative and other costs associated with the operations of its subsidiary, Caspi Neft, in Kazakhstan. Accordingly, there was no requirement for condensed consolidating financial information and the results for 2004 and 2003 are not presented herein due to lack of comparability and the information is not material for evaluation of the sufficiency of the guarantee and the omission of the information does not cause the financials to be inaccurate in reasonable detail.

The following is condensed consolidating financial information for the Company, the Issuer and the subsidiary guarantors of the senior secured notes:

Condensed Consolidating Balance Sheet

	December 31, 2005				
	Parent	Issuer	Subsidiary Guarantors	Eliminations	Consolidated
	$	$	$	$	$
Cash and cash equivalents	21,147,921	45,250,000	6,027	—	66,403,948
Other current assets	2,764,674	—	5,535,923	—	8,300,597
Total current assets	23,912,595	45,250,000	5,541,950	—	74,704,545
Property and equipment, net	305,657	—	226,509,692	—	226,815,349
Investment in and advances to subsidiaries	100	9,082,519	—	(9,082,619)	—
Other assets	—	32,973,536	—	(20,500,000)	12,473,536
Total Assets	24,218,352	87,306,055	232,051,642	(29,582,619)	313,993,430
Total current liabilities	5,759,807	23,328,142	4,608,830	—	33,696,779
Debt	—	223,407,076	31,000,000	(31,000,000)	223,407,076
Other long-term liabilities	—	—	186,000	—	186,000
Stockholder's equity	18,458,545	(159,429,163)	196,256,812	1,417,381	56,703,575
Total Liabilities	24,218,352	87,306,055	232,051,642	(29,582,619)	313,993,430

Condensed Consolidating Statements of Operations

	Year ended December 31, 2005			
	Parent	Issuer	Subsidiary Guarantors	Consolidated
	$	$	$	$
Revenue	—	—	8,442,787	8,442,787
Operating costs and expenses	11,099,038	—	7,166,475	18,265,513
Operating income (loss)	(11,099,038)	—	1,276,312	(9,822,726)
Other expense	(5,408,632)	(2,411,623)	(2,186,147)	(10,006,402)
Minority interest expense	—	—	(711,558)	(711,558)
Net loss	(16,507,670)	(2,411,623)	(1,621,393)	(20,540,686)
Preferred dividends	(1,081,034)	—	—	(1,081,034)
Net loss attributable to common stockholders	(17,588,704)	(2,411,623)	(1,621,393)	(21,621,720)

Condensed Consolidating Statements of Cash Flow

	Year ended December 31, 2005			
	Parent	Issuer	Subsidiary Guarantors	Consolidated
	$	$	$	$
Net cash used in operating activities	(4,371,558)	1,456,366	(8,435,988)	(11,351,180)
Net cash used in investing activities	(17,322)	—	(144,685,799)	(144,703,121)
Net cash provided by financing activities	12,916,826	13,793,634	147,041,161	173,751,621
Net increase (decrease) in cash	8,527,946	15,250,000	(6,080,626)	17,697,320
Cash and cash equivalents, beginning of the year	10,659,484	—	6,086,653	16,746,137
Cash and cash equivalents, end of the year	19,187,430	15,250,000	6,027	34,443,457

Note 12 — Supplemental Oil and Gas Disclosures

Costs Incurred

Costs incurred in oil and gas property acquisition, exploration and development activities, whether expensed or capitalized, are reflected in the table below. This schedule does not include the costs of acquiring the minority interest in Caspi Neft and the carried working interest of approximately $138,314,000 or the costs of the drilling rig which was purchased and modified for use in the Company's development activities in Kazakhstan. Costs incurred for the drilling rig were $444,000 in 2003.

	Kazakhstan	United States	Total
	$	$	$
Year ended December 31, 2005			
Acquisition costs of properties:			
Proved	—	—	—
Unproved	—	—	—
Exploration costs	9,470	—	9,470
Development costs	24,599,684	—	24,599,684
Capitalized interest	2,497,923	—	2,497,923
Total	27,107,077	—	27,107,077
Year ended December 31, 2004			
Acquisition costs of properties:			
Proved	—	—	—
Unproved	—	—	—
Exploration costs	3,477,336	—	3,477,336
Development costs	18,651,179	—	18,651,179
Capitalized interest	4,519,759	—	4,519,759
Total	26,648,274	—	26,648,274
Year ended December 31, 2003:			
Acquisition costs of properties:			
Proved	—	—	—
Unproved	—	—	—
Exploration costs	26,292,534	118,893	26,411,427
Development costs	56,255	—	56,256
Capitalized interest	4,164,694	—	4,164,693
Total	30,513,483	118,893	30,632,376

Capitalized Costs

The aggregate amount of capitalized costs related to oil and gas producing activities and the aggregate amount of the related accumulated depreciation, depletion and amortization ("DD&A"), including any accumulated valuation allowances, are reflected in the table below. These capitalized costs do not include the drilling rig which was purchased and modified for use in the Company's development activities in Kazakhstan. Capitalized costs for the drilling rig were $3.0 million, $8.5 million and $6.5 million at December 31, 2005, 2004 and 2003, respectively.

	Kazakhstan	**United States**	**Total**
	$	*$*	*$*
As of December 31, 2005			
Proved properties	62,876,028	—	62,876,028
Unproved properties	167,263,366	—	167,263,366
Total oil and gas properties	230,139,394	—	230,139,394
Accumulated DD&A	3,471,351	—	3,471,351
Net oil and gas properties	226,668,043	—	226,668,043
As of December 31, 2004			
Proved properties	39,487,758	—	39,487,758
Unproved properties	31,560,816	—	31,560,816
Total oil and gas properties	71,048,574	—	71,048,574
Accumulated DD&A	899,131	—	899,131
Net oil and gas properties	70,149,443	—	70,149,443
As of December 31, 2003			
Proved properties	16,300,263	—	16,300,263
Unproved properties	32,483,389	16,604	32,499,993
Total oil and gas properties	48,783,652	16,604	48,800,256
Accumulated DD&A	189,635	—	189,635
Net oil and gas properties	48,594,017	16,604	48,610,621

Oil and Gas Reserve Information (Unaudited)

Basis of Presentation

Proved oil and gas reserve quantities are based on estimates prepared by Ryder Scott Company, independent petroleum engineers. There are numerous uncertainties in estimating quantities of proved reserves and projecting future rates of production and the timing of development expenditures. These uncertainties are greater for properties which are undeveloped or have a limited production history, such as the South Alibek Field. The following reserve data represents estimates only and actual reserves may vary substantially from these estimates. All of the Company's proved reserves were in Kazakhstan as of December 31, 2005, 2004 and 2003. The Company's net quantities of proved developed and undeveloped reserves of crude oil and changes therein are reflected in the table below.

As of December 31, 2005, the Company owned a 100% working interest in the South Alibek Field, subject to government royalties and an additional 3.5% net revenue interest retained by a third party in connection with the Company's buyout of its former partners to be deducted from the remaining revenue interest. The effect of this overriding revenue interest is reflected in the calculation of the Company's net proved reserves and future net cash flows.

As of December 31, 2005, the Company is operating under an exploration contract, which was extended by the government of Kazakhstan in July 2004 for two years ending on April 2007. Final terms for the South Alibek production contract have been agreed to and the contract is waiting on final approval from the Kazakhstan government. The Company's oil and gas reserve data and future net cash flows have been prepared assuming a commercial production contract is obtained, beginning on January 1, 2006, which will allow production for the expected 25 year term of the production contract and utilizes all the terms and costs associated with the production contract. Net revenue interest used in the report are calculated from a sliding-scale royalty payment to the Kazakhstan government during the production contract life. Based on the forecast annual production, the government royalty rate is between 2.0% to 2.2%. Royalty rate is capped at 5%.

The proved reserves as of December 31, 2005 represent the reserves that were estimated to be recovered from eight wells (South Alibek 1, 2, 3, 4, 5, 14, 15 and 17), and a total of seventeen development offsets not yet drilled. All reserves were estimated using either historical performance or volumetric methods. All direct offset well locations in this report are proved undeveloped and are based on 80 acre drainage patterns, unless current developed completions are estimated to drain an area larger than their volumetric assignment, and in these cases the reserves of certain offset locations have been reduced. All locations have a scheduled KT1 and a KT2 reservoir completion and each of these reservoir completions includes the cost of drilling a separate wellbore. Based on the separate development program for the KT1 and KT2 reservoirs, reserves assigned to the KT1 reservoir are undeveloped whereas in previous year-end estimates these reserves were developed. The associated additional costs required for a separate KT1 reservoir development program has also been included in the reserves estimate. The total primary and secondary recovery of 30% was based on analogy data from other fields. A 15% primary recovery factor was assigned to each developed and undeveloped well in the KT1 and KT2 reservoirs. A secondary recovery factor of 15% was assigned to the KT1 reservoir and to the KT2 reservoir. Based on separate primary and secondary recoveries, reserves assigned to the secondary recoveries are undeveloped whereas in previous year-end estimates these reserves were developed. The associated additional capital and operating costs required for a separate KT1 and KT2 reservoir water flood program has also been included in the reserves estimate, requiring the drilling of 25 injector wells in the KT1 reservoir and 25 injector wells in the KT2 reservoir and related surface facilities to support these programs. As of December 31, 2005, the Company had three new wells, the SA-3, SA-14, and SA-15, which have reserves assigned as behind-pipe and are forecast to start producing in the first quarter of 2006 from the KT2 reservoir. The Ryder Scott reserve estimate as of December 31, 2005 included these three wells and SA-1, SA-2, SA-5 and SA-17 as proved developed in the KT2 reservoir. SA-1 was shut-in during a workover program. The completion in SA-5 may have been damaged during a previous work-over and an undeveloped redrill has been included in the estimates to capture the volumetric reserves assigned to this location. SA-4, which has reservoir damage that prevented placing the well on production during 2005 and sixteen additional offset locations are also proved undeveloped in the KT2 reservoir.

Estimated Quantities of Net Proved Crude Oil Reserves
(Quantities in Barrels)

	December 31,		
	2005	2004	2003
	$	$	$
Net proved crude oil reserves:			
Beginning of year	26,813,736	45,744,788	17,110,741
Revisions of previous estimates	(322,972)	(521,118)	(5,079,386)
Extensions, discoveries and other additions	6,096,959	6,827,529	33,830,809
Revision of net interest	41,194,007	(25,085,729)	
Production	(845,108)	(151,734)	(117,376)
End of year	72,936,622	26,813,736	45,744,788
Net proved developed reserves:			
Beginning of year	4,476,364	7,815,861	5,695,613
End of year	3,331,580	4,476,364	7,815,861

Standardized Measure of Discounted Future Net Cash Flows (Unaudited)

Basis of Presentation

The standardized measure data includes estimates of oil and gas reserve volumes and forecasts of future production rates over the reserve lives. Estimates of future production expenditures, including taxes and future development costs, are based on management's best estimate of such costs assuming a continuation of current economic and operating conditions. No provision is included for depletion, depreciation and amortization of property acquisition costs or indirect costs. Income tax expense has been computed using expected future tax rates and giving effect to tax deductions and credits available, under current laws, and which relate to oil and gas producing activities. The sales prices used in the calculation are the year-end prices of crude oil, including condensate and natural gas liquids, which as of December 31, 2005, 2004 and 2003 were $40.21, $20.09 and $12.44 per barrel, respectively. The sales prices were based on the last sales price received for December 2005, 2004 and 2003, respectively. No value was assigned to natural gas reserves, as there is not currently an established market or pipeline facilities for gas sales. Changes in prices and cost levels, as well as the timing of future development costs, may cause actual results to vary significantly from the data presented. This information is not intended to represent a forecast or fair market value of the Company's oil and gas assets, but does present a standardized disclosure of discounted future net cash flows that would result under the assumptions used. The standardized measure

of discounted future net cash flows relating to proved oil and gas reserves for 2005, 2004 and 2003 were as follows:

Standardized Measure of Discounted Future Net Cash Flows
(Amounts in Thousands)

	$
December 31, 2005:	
Future cash inflows	3,096,160
Future production costs	(406,539)
Future development costs	(397,879)
Undiscounted future net cash flows before income tax	2,291,742
10% discount for estimated timing of cash flows	(1,276,314)
Present value of future net cash flows before income tax	1,015,428
Future income tax expense, discounted at 10%	(268,447)
Standardized measure of discounted future net cash flows	746,981
December 31, 2004:	
Future cash inflows	538,688
Future production costs	(74,001)
Future development costs	(65,260)
Undiscounted future net cash flows before income tax	399,427
10% discount for estimated timing of cash flows	(179,431)
Present value of future net cash flows before income tax	219,996
Future income tax expense, discounted at 10%	(43,142)
Standardized measure of discounted future net cash flows	176,854
December 31, 2003:	
Future cash inflows	569,065
Future production costs	(74,723)
Future development costs	(76,373)
Undiscounted future net cash flows before income tax	417,969
10% discount for estimated timing of cash flows	(176,618)
Present value of future net cash flows before income tax	241,351
Future income tax expense, discounted at 10%	(60,908)
Standardized measure of discounted future net cash flows	180,443

The following table presents a reconciliation of changes in the standardized measure of discounted future net cash flows:

Changes in the Standardized Measure of Discounted Future Net Cash Flows
(Amounts in Thousands)

	Year ended December 31,		
	2005	2004	2003
	$	$	$
Standardized Measure, beginning of year	176,854	180,443	143,999
Sales and transfers of oil and gas produced, net of production costs	(324)	(152)	(397)
Net changes in prices, development and production costs	320,930	151,644	(107,366)
Extensions, discoveries and improved recovery, less related costs	596,505	65,492	171,513
Purchase of minerals in place	—	—	—
Development costs incurred and changes during the period	(213,411)	17,754	(2,887)
Revisions of previous quantity estimates	(6,948)	(4,458)	(30,436)
Increase in present value due to passage of one year	21,999	24,135	20,431
Exercise of Option by Bramex	—	(203,699)	—
Net changes in production rates and other	225,304	(36,563)	(13,824)
Net change in income taxes	(373,928)	(17,742)	(590)
Standardized Measure, end of year	746,981	176,854	180,443

Note 13 — Supplemental Quarterly Information (Unaudited)

The following table reflects a summary of the unaudited interim results of operations for the quarterly periods in the years ended December 31, 2005 and 2004.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2005				
Revenue	1,153,739	2,032,310	3,852,122	1,404,616
Operating expenses	2,858,923	2,286,599	3,270,940	9,849,051
Minority interest	507,818	(355,896)	(791,171)	(72,309)
Preferred dividends	277,397	280,479	279,155	244,003
Net loss attributable to common shareholders	(2,129,546)	(1,930,106)	(2,802,111)	(14,759,957)
Basic and diluted loss per share	(0.03)	(0.02)	(0.03)	(0.17)
Weighted average common shares outstanding	79,993,732	80,213,343	81,561,819	86,179,295
2004				
Revenue	642,927	1,562,656	843,348	874,059
Operating expenses	1,463,781	2,235,200	1,735,301	1,793,957
Minority interest	207,379	(117,481)	401,802	331,353
Preferred dividends	—	—	—	154,110
Net loss attributable to common shareholders	(1,028,233)	(555,063)	(1,293,755)	(1,125,240)
Basic and diluted loss per share	(0.01)	(0.01)	(0.02)	(0.01)
Weighted average common shares outstanding	77,382,894	78,208,663	79,153,647	79,685,312

(C) SUMMARY OF UNAUDITED FINANCIAL STATEMENTS

Set out below are the unaudited financial statements together with the relevant notes to the financial statements of Transmeridian as extracted from the quarterly report of Transmeridian for the three months ended 31 March 2007 and 2008.

Consolidated Balance Sheet
(In thousands, except par value information)

	March 31, 2008	December 31, 2007
	$	*$*
	(Unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	1,159	939
Accounts receivable	3,968	4,428
Crude oil inventory	539	1,057
Other current assets	337	261
Total current assets	6,003	6,685
Property and Equipment:		
Property and equipment	432,902	428,741
Accumulated depreciation, depletion and amortization	(45,318)	(38,497)
Property and equipment, net	387,584	390,244
Other assets, net	8,624	9,347
	402,211	406,276

	March 31, 2008 $ (Unaudited)	December 31, 2007 $
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	23,334	23,728
Accrued liabilities	38,896	33,770
Total current liabilities	62,230	57,498
Long-term debt, net of discount of $15,241 and $16,648	274,759	273,352
Other long term liabilities	4,225	4,208
Senior redeemable convertible preferred stock, net of discount of $2,026 and $2,157	44,196	42,076
Junior redeemable convertible preferred stock, net of discount of $19,132 and $20,104	48,315	43,961
Stockholders' Deficit:		
Preferred stock, $0.0006 par value per share, 5,000 shares authorized, 1,137 issued and outstanding	—	—
Common stock, $0.0006 par value per share, 200,000 shares authorized, 117,012 and 116,860 issued and outstanding	70	70
Additional paid-in capital	152,447	151,278
Accumulated deficit	(184,031)	(166,167)
Total stockholders' deficit	(31,514)	(14,819)
	402,211	406,276

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three months ended March 31,	
	2008	**2007**
	$	*$*
Revenue from oil sales, net	15,252	7,138
Operating costs and expenses:		
Exploration expense	—	157
Depreciation, depletion and amortization	6,821	6,267
Transportation expense	1,508	1,132
Operating and administrative expense — Kazakhstan	4,563	3,585
General and administrative expense — Houston	2,591	2,560
Total operating costs and expenses	15,483	13,701
Operating loss	(231)	(6,563)
Other income (expense):		
Interest income	8	116
Interest expense, net of capitalized interest	(10,649)	(9,008)
Total other income (expense)	(10,641)	(8,892)
Net loss	(10,872)	(15,455)
Preferred dividends	(5,887)	(1,650)
Accretion of preferred stock discount	(1,103)	(147)
Net loss attributable to common stockholders	(17,862)	(17,252)
Basic and diluted loss per common share	(0.15)	(0.17)
Weighted average common shares outstanding, basic and diluted	116,456	101,246

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows
(In thousands)
(Unaudited)

	Three months ended March 31,	
	2008	2007
	$	$
Operating Activities:		
Net loss	(10,872)	(15,455)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation, depletion and amortization	6,821	6,267
Amortization of debt financing costs	723	723
Debt discount amortization	1,407	1,407
Stock-based compensation expense	933	1,208
Accretion of asset retirement obligation	20	11
Decrease in receivables	460	3,956
(Increase) decrease in crude oil inventory	518	(544)
(Increase) in other current assets	(76)	(530)
Increase (decrease) in accounts payable	(394)	27,636
Increase (decrease) in accrued liabilities	4,612	(802)
Decrease in other long-term liabilities	(3)	(2)
Net cash provided by operating activities	4,149	23,875
Investing Activities:		
Capital expenditures	(4,161)	(44,823)
Net cash used in investing activities	(4,161)	(44,823)
Financing Activities:		
Proceeds from exercise of stock options	—	18,373
Proceeds from exercise or sale of warrants	232	—
Net cash provided by financing activities	232	18,373
Net increase (decrease) in cash and cash equivalents	220	(2,575)
Cash and cash equivalents, beginning of period	939	12,193
Cash and cash equivalents, end of period	1,159	9,618

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows — Supplemental Information

(In thousands)

(Unaudited)

	Three months ended March 31,	
	2008	**2007**
	$	*$*
Cash paid for:		
Interest	8,700	8,700
Interest capitalized (non-cash)	(181)	(1,822)
Non-cash investing and financing transactions:		
Issuance of stock for preferred stock dividend	5,370	—
Accrued and unpaid dividends on convertible preferred stock	5,708	1,650
Asset retirement obligation	—	56
Accretion of preferred stock discount	1,103	147

The accompanying notes are an integral part of these consolidated financial statements.

Notes to Unaudited Consolidated Financial Statements

Note 1. Going Concern

The accompanying consolidated financial statements of Transmeridian Exploration Incorporated and subsidiaries ("we", "our", "us" or the "Company") have been prepared on the basis of accounting principles applicable to a going concern, which contemplate the realization of assets and satisfaction of liabilities in the normal course of business. As shown in the accompanying consolidated financial statements, we had a net working capital deficit of approximately $56.2 million and a stockholders' deficit of approximately $31.5 million at March 31, 2008. Approximately 89% of our accounts payable at March 31, 2008 have been outstanding more than 120 days. These matters raise substantial doubt about our ability to continue as a going concern. Included in our current liabilities is approximately $17.8 million in returns obligations incurred in connection with the issuance of our 20% Junior Redeemable Convertible Preferred Stock ("Junior Preferred Stock"). However, the returns are not payable until the earlier of (i) the occurrence of a change of control of the Company (as defined in the certificate of designations, as amended, governing the Junior Preferred Stock) or (ii) June 18, 2008; provided, however, that if the returns become due and payable on June 18, 2008 in the absence of a change of control transaction, we may elect to satisfy our payment obligations by delivery of shares of our common stock valued at 97% of the common stock's market value at such time. Additionally, there is approximately $5.7 million in preferred stock dividends that can be satisfied by the issuance of additional preferred shares or common shares subject to certain restrictions. We have incurred operating losses since our inception. To date, we have funded our development operations and working capital requirements through a combination of debt and equity proceeds and cash flow from operations.

In March 2008 we terminated the Company's merger agreement with Trans Meridian International, Inc. ("TMI"), a British Virgin Islands company formed by the Company's Chairman and Chief Executive Officer, Lorrie T. Olivier. This action did not require the Company to pay any termination fee to TMI and is without any other liability to the company. Termination of the definitive agreement with TMI resulted in a downward adjustment to the conversion price of our Junior Preferred Stock from the previous conversion price of $1.90 per share (equivalent to a conversion rate of 52.63 shares of common stock for each share of Junior Preferred Stock) to $1.50 per share (equivalent to a conversion rate of 66.67 shares of common stock for each share of Junior Preferred Stock).

We will continue to seek proposals from other parties with respect to a potential acquisition of our Company. There can be no assurance, however, that these efforts will result in any agreement or transaction. Further, if we do enter into an agreement to be acquired, the value to be received by our common stockholders may be substantially less than the $3.00 per share contained in the terminated agreement with TMI. We are also in preliminary discussions with interested parties regarding an investment of capital into our company. Again, there can be no assurance that such discussions will result in any agreement or transaction, or that any agreement or transaction would not be substantially dilutive to our stockholders. Furthermore, any potential transaction would be subject to the negotiation and execution of a definitive agreement and other related agreements, as well as to regulatory and other customary approvals and conditions, which may include stockholder approval and other factors including financing, and there can be no assurance that we would be successful in consummating any such transaction.

Operating cash flow is dependent upon many factors, including production levels, sales volumes, oil prices and other factors that may be beyond our control. World oil prices hovered around $100 per bbl in the first quarter of 2008 and we have received substantially better prices for the crude oil we export as compared to the first quarter of 2007, when all of our export crude oil sales were via rail. With the commissioning of our central production facility, including a demercaptan unit, and proprietary connection to the regional pipeline system, we have been able to produce and export pipeline quality crude oil on a consistent basis.

We utilized much of our excess liquidity during the period in 2007 when the South Alibek Field (the "Field") was shut-in to fund operating costs, overhead, scheduled interest payments and necessary capital expenditures. As a result, we do not currently have the necessary resources to allow for continued drilling of exploration and development wells and to meet other working capital obligations. We are currently carrying out a limited workover program in the Field to clean out paraffin deposits in wells and install artificial lift equipment in selected wells. At current production levels of approximately 2,100 bopd, and at the prices we currently receive, management believes we are able to generate sufficient cash flow to cover our operating costs, overhead and scheduled interest payments on our debt. However, as discussed above, we had a working capital deficit of $56.2 million at March 31, 2008, and do not have sufficient liquidity to carry out a full development program of the Field. Furthermore, no assurance can be given that production from the new wells and the cost cutting measures that have been instituted will result in sufficient additional cash flow to cover the working capital deficit and to fund continued Field development. If we are unable to either complete a strategic transaction, or if we are unable to increase production to a sufficient level, we will have to seek additional capital to fund interest payments, operating expenses and continued Field development. If we are unable to secure adequate additional capital, we may not be able to carry out the development plan for the Field, in which case our business, financial condition, results of operations and possibly our reported proved reserves would be materially and adversely affected. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should we be unable to continue as a going concern.

Note 2. Basis of Presentation and Significant Accounting Policies

The consolidated financial statements of the Company included herein have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). They reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the interim periods, on a basis consistent with the annual audited financial statements. All such adjustments are of a normal recurring nature. Certain information and note disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. However, we believe that the disclosures contained herein are adequate to make the information presented not misleading. The consolidated balance sheet at December 31, 2007 is derived from the December 31, 2007 audited consolidated financial statements. These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007. The results of operations for interim periods are not necessarily indicative of the results to be expected for an entire year.

We conduct our operations in Kazakhstan through a wholly-owned subsidiary, JSC Caspi Neft TME ("Caspi Neft"), a joint stock company organized under the laws of Kazakhstan. Caspi Neft holds the license and exploration and production contracts covering the Field in Kazakhstan.

In September 2006, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP") and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 was originally effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In November 2007, the FASB placed a one year deferral for the implementation of SFAS No. 157 for nonfinancial assets and liabilities; however, SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities. Consistent with its requirements, we adopted SFAS No. 157 as of January 1, 2008, except as it relates to nonfinancial assets and liabilities, which will be adopted on January 1, 2009, as allowed under SFAS No. 157. The adoption did not have a material impact on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *"Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133"* ("SFAS No. 161"). SFAS No. 161 requires enhanced disclosure related to derivatives and hedging activities and thereby seeks to improve the transparency of financial reporting. Under SFAS No. 161, entities are required to provide enhanced disclosures relating to: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedge items are accounted for under SFAS No. 133, " Accounting for Derivative Instruments and Hedging Activities " ("SFAS No. 133"), and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under SFAS No. 133 for all financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. We do not expect the adoption of SFAS No. 161 to significantly impact our financial position, results of operations or cash flows.

Note 3. Redeemable Convertible Preferred Stock

In January 2008, we issued 19,885 shares of Senior Redeemable Convertible Preferred Stock ("Senior Preferred Stock") and 33,815 shares of Junior Preferred Stock for the payment of dividends on our Senior Preferred Stock and Junior Preferred Stock.

On March 31, 2008 we announced we had terminated the Company's merger agreement with TMI. This action did not require the Company to pay any termination fee to TMI and is without any other liability to the Company. Termination of the definitive agreement with TMI resulted in a downward adjustment to the conversion price of our Junior Preferred Stock from the previous conversion price of $1.90 per share (equivalent to a conversion rate of 52.63 shares of common stock for each share of Junior Preferred Stock) to $1.50 per share (equivalent to a conversion rate of 66.67 shares of common stock for each share of Junior Preferred Stock).

Note 4. Stockholders' Equity

In January 2008 a holder of warrants to purchase an aggregate of 150,000 shares of our common stock exercised such warrants. In connection with such exercise, the holder paid us $1.55, the exercise price of the warrants, resulting in proceeds of $232,500.

In January 2008, we issued 2,391 shares of common stock for fractional dividend shares for the dividends paid on our Senior Preferred Stock and Junior Preferred Stock.

Note 5. 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. Net loss attributable to common stockholders is calculated as the net loss after deductions for cumulative preferred stock dividends, whether paid or accrued, and accretion of preferred stock discount. Diluted net loss per common share has been computed based on the weighted average number of shares of common stock and common stock equivalents outstanding during the applicable period, as if all potentially dilutive securities were converted into common stock. Diluted net loss per share equals basic net loss per share for the periods presented because the effects of potentially dilutive securities are anti-dilutive. The calculation of diluted weighted average shares outstanding for the three months ended March 31, 2008 and 2007 excludes 32,917,094 and 39,857,392 common shares, respectively, issuable pursuant to outstanding stock options and warrants because their effect is anti-dilutive.

Note 6. Income Taxes

We account for income taxes pursuant to SFAS No. 109 "Accounting for Income Taxes," which requires recognition of deferred income tax liabilities and assets for the expected future tax consequences of events that have been recognized in our financial statements or tax returns. We provide for deferred taxes on temporary differences between the financial statements and tax basis of assets using the enacted tax rates that are expected to apply to taxable income when the temporary differences are expected to reverse. We have not recorded any deferred tax assets or income tax benefits from the net operating losses for the three months ended March 31, 2008 and 2007 because we do not believe the future realization of these assets is more likely than not to occur.

Note 7. Commitments and Contingencies

In July 2007, Canam Services, Inc. ("Canam"), a supplier of tubing products, filed suit in the 151st Judicial District Court of Harris County, Texas asserting a cause of action against us based upon alleged breach of a guaranty agreement covering certain accounts payable of Caspi Neft. The suit initially sought recovery from us in the amount of $1,986,633 plus fees and costs. We denied all of Canam's material allegations and on September 5, 2007, filed an answer denying each and every material allegation contained in the Canam complaint. Subsequently, Canam reduced the recovery amount to $756,727 plus interest, fees and costs. We plan to vigorously defend this claim and have not recorded any reserve above our recorded accounts payable as of March 31, 2008.

We are subject, through our subsidiary Caspi Neft, to the terms of License 1557 and the related exploration and production contracts covering 14,111 acres in the Field in Kazakhstan. The exploration and production contracts provide, among other things, certain minimum levels of capital expenditures for the continued development of the Field, which have been met as of March 31, 2008.

Purchase commitments are made from time to time in the ordinary course of business in connection with ongoing operations in the South Alibek Field.

Note 8. Supplemental Financial Information

Property and Equipment

Property and equipment consisted of the following:

	March 31, 2008	December 31, 2007
	$	*$*
	(Unaudited)	
	(In thousands)	
Oil and gas properties, successful efforts method	428,785	424,628
Drilling rig and related equipment	3,000	3,000
Transportation equipment	479	479
Office and technology equipment	638	634
	432,902	428,741
Accumulated depreciation, depletion and amortization	(45,318)	(38,497)
Property and equipment, net	387,584	390,244

We capitalize interest costs on oil and gas projects under development, including the costs of unproved leasehold and property acquisition costs, wells in progress and related facilities. During the three month periods ended March 31, 2008 and 2007, we capitalized approximately $181,000 and $1.8 million, respectively, of interest costs.

Other Assets

Other assets at March 31, 2008 consisted of debt financing costs of $7.8 million, net of amortization, a note receivable of $500,000 from an unrelated third party and a $275,000 deposit. At December 31, 2007, other assets consisted of debt financing costs of $8.6 million, net of amortization, a note receivable of $500,000 from an unrelated third party and a $275,000 deposit.

Accrued Liabilities

Accrued liabilities consisted of the following:

	March 31, 2008	December 31, 2007
	$	*$*
	(Unaudited)	
	(In thousands)	
Interest	1,450	1,450
Dividends	5,708	5,194
Royalties	628	345
Rig rentals	2,738	2,738
Junior preferred stock return agreements	17,750	17,750
Common stock registration costs	825	600
Proceeds received for common stock to be issued from exercise of warrants	3,980	3,980
Deferred revenue	5,665	1,541
Other	152	172
Total accrued liabilities	38,896	33,770

Note 9. Business Segment Information

Our business activities relate solely to oil and gas exploration, development and production. The primary emphasis since our formation in 2000 has been the development of the Field and substantially all of our assets are located in Kazakhstan. For each of the three months ended March 31, 2008 and 2007, substantially all of our results of operations consisted of revenues, operating, general and administrative expenses and other costs associated with our operations in Kazakhstan.

One customer accounted for approximately 91% of consolidated revenue for the three months ended March 31, 2008. For the three months ended March 31, 2007, three customers accounted for approximately 37%, 13%, and 12% of consolidated revenue.

Note 10. Subsidiary Guarantors (Unaudited)

In December 2005, we and our wholly owned subsidiary Transmeridian Exploration Inc. (the "Issuer") issued 250,000 Units, consisting of an aggregate of (i) $250 million principal amount of senior secured notes due 2010 of the Issuer (the "Senior Secured Notes") and (ii) warrants to purchase approximately 17.3 million shares of our common stock. We and all of our material subsidiaries fully and unconditionally guaranteed the Senior Secured Notes. Prior to the Units offering, we financed our operations primarily through borrowings from banks in Kazakhstan or other private sources. Substantially all of our assets are located in Kazakhstan and substantially all of our revenue, operating, general and administrative expenses and other costs were, and currently are, associated with the operations of our principal subsidiary in Kazakhstan.

Following is condensed consolidating financial information for the Company, the Issuer, the subsidiary guarantors and the subsidiary non-guarantors of the Senior Secured Notes for the three month periods ended March 31, 2008 and 2007:

Condensed Consolidating Balance Sheet (in thousands)

	As of March 31, 2008					
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Eliminations	Consolidated
	$	$	$	$	$	$
Cash and cash equivalents	209	10	920	20	—	1,159
Other current assets	3,174	—	1,660	10	—	4,844
Total current assets	3,383	10	2,580	30	—	6,003
Property and equipment, net	61	—	384,108	3,415	—	387,584
Investment in and advances to subsidiaries	179,590	167,911	(311,308)	(3,981)	(32,212)	—
Other assets	275	7,849	—	500	—	8,624
	183,309	175,770	75,380	(36)	(32,212)	402,211
Total current liabilities	29,566	2,145	30,519	—	—	62,230
Debt	—	274,759	31,000	—	(31,000)	274,759
Other long-term liabilities	2,035	—	2,190	—	—	4,225
Senior preferred stock	44,196	—	—	—	—	44,196
Junior preferred stock	48,315	—	—	—	—	48,315
Stockholder's equity (deficit)	59,197	(101,134)	11,671	(36)	(1,212)	(31,514)
	183,309	175,770	75,380	(36)	(32,212)	402,211

Condensed Consolidating Statement of Operations (in thousands)

	Three months ended March 31, 2008				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
Revenue from oil sales, net	—	(498)	15,750	—	15,252
Operating costs and expenses	2,600	283	12,600	—	15,483
Operating income (loss)	(2,600)	(781)	3,150	—	(231)
Other income (expense)	6	(10,829)	181	1	(10,641)
Net earnings (loss)	(2,594)	(11,610)	3,331	1	(10,872)

Condensed Consolidating Statement of Cash Flow (in thousands)

	Three months ended March 31, 2008				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
Net cash provided by (used in) operating activities	(1,106)	(8,814)	14,069	—	4,149
Net cash used in investing activities	(1)	—	(4,160)	—	(4,161)
Net cash provided by (used in) financing activities	412	8,820	(9,000)	—	232
Net increase (decrease) in cash	(695)	6	909	—	220
Cash and cash equivalents, beginning of the period	904	5	11	19	939
Cash and cash equivalents, end of the period	209	11	920	19	1,159

Condensed Consolidating Balance Sheet (in thousands)

	As of March 31, 2007					
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Eliminations	Consolidated
	$	$	$	$	$	$
Cash and cash equivalents	7,396	1	2,077	144	—	9,618
Other current assets	2,591	—	6,195	5	—	8,791
Total current assets	9,987	1	8,272	149	—	18,409
Property and equipment, net	395	—	355,647	3,376	—	359,418
Investment in and advances to subsidiaries	114,722	204,555	(283,124)	(3,941)	(32,212)	—
Other assets	—	10,741	—	500	—	11,241
	125,104	215,297	80,795	84	(32,212)	389,068
Total current liabilities	13,086	1,668	42,061	106	—	56,921
Debt	—	269,131	31,000	—	(31,000)	269,131
Other long-term liabilities	2,035	—	1,928	—	—	3,963
Senior redeemable convertible preferred stock	41,100	—	—	—	—	41,100
Stockholder's equity (deficit)	68,883	(55,502)	5,806	(22)	(1,212)	17,953
	125,104	215,297	80,795	84	(32,212)	389,068

Condensed Consolidating Statement of Operations (in thousands)

	Three months ended March 31, 2007				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
Revenue, net	—	(218)	7,356	—	7,138
Operating costs and expenses	2,545	409	10,744	3	13,701
Operating loss	(2,545)	(627)	(3,388)	(3)	(6,563)
Other income (expense)	93	(10,809)	1,822	2	(8,892)
Net loss	(2,452)	(11,436)	(1,566)	(1)	(15,455)

Condensed Consolidating Statement of Cash Flow (in thousands)

	Three months ended March 31, 2007				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
Net cash provided by (used in) operating activities	(1,178)	(9,001)	34,057	(3)	23,875
Net cash used in investing activities	—	—	(44,809)	(14)	(44,823)
Net cash provided by (used in) financing activities	(1,730)	8,434	11,655	14	18,373
Net increase (decrease) in cash	(2,908)	(567)	903	(3)	(2,575)
Cash and cash equivalents, beginning of the year	10,304	568	1,174	147	12,193
Cash and cash equivalents, end of the year	7,396	1	2,077	144	9,618

PART I — FINANCIAL INFORMATION
Item 1 — Financial Statements

Transmeridian Exploration Incorporated and Subsidiaries Consolidated Balance Sheet
(In thousands, except preferred shares and par value information)

	March 31, 2007 $ (Unaudited)	December 31, 2006 $
ASSETS		
Current Assets:		
Cash and cash equivalents	9,618	12,193
Accounts receivable	3,860	7,816
Crude oil inventory	1,381	837
Other current assets	550	20
Assets held for sale	3,000	3,000
Total current assets	18,409	23,866
Property and Equipment:		
Property and equipment	384,484	339,605
Accumulated depreciation, depletion and amortization	(25,066)	(18,799)
Property and equipment, net	359,418	320,806
Other assets, net	11,241	11,964
	389,068	356,636

	March 31, 2007	December 31, 2006
	$	*$*
	(Unaudited)	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	39,915	12,279
Accrued liabilities	17,006	5,785
Total current liabilities	56,921	18,064
Long-term debt, net of discount of $20,869 and $22,276	269,131	267,724
Other long term liabilities	3,963	3,898
Senior redeemable convertible preferred stock, net of discount $2,900 and $3,047	41,100	40,953
Stockholders' Equity:		
Preferred stock, $0.0006 par value per share, 5,000,000 shares authorized, 594.804 issued and outstanding	—	—
Common stock, $0.0006 par value per share, 200,000 shares authorized, 101,246 issued and outstanding	61	61
Additional paid-in capital	127,191	117,983
Accumulated deficit	(109,299)	(92,047)
Total stockholders' equity	17,953	25,997
	389,068	356,636

The accompanying notes are an integral part of these consolidated financial statements.

Transmeridian Exploration Incorporated and Subsidiaries Consolidated Statement of Operations

(In thousands, except per share amounts)

(Unaudited)

	Three months ended March 31,	
	2007	2006
	$	$
Revenue from oil sales, net	7,138	2,842
Operating costs and expenses:		
Exploration expense	157	256
Depreciation, depletion and amortization	6,267	2,522
Transportation expense	1,132	224
Operating and administrative expense — Kazakhstan	3,585	1,724
General and administrative expense — Houston	2,560	2,324
Total operating costs and expenses	13,701	7,050
Operating loss	(6,563)	(4,208)
Other income (expense):		
Interest income	116	459
Interest expense, net of capitalized interest	(9,008)	(8,998)
Total other income (expense)	(8,892)	(8,539)
Net loss	(15,455)	(12,747)
Basic and diluted loss per common share	(0.17)	(0.15)

The accompanying notes are an integral part of these consolidated financial statements.

Transmeridian Exploration Incorporated and Subsidiaries Consolidated Statement of Cash Flows
(In thousands)
(Unaudited)

	Three months ended March 31, 2007 $	2006 $
Operating Activities:		
Net loss	(15,455)	(12,747)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation, depletion and amortization	6,267	2,522
Amortization of debt financing costs	723	633
Debt discount amortization	1,407	1,341
Stock-based compensation expense	1,208	1,268
Accretion of asset retirement obligation	11	—
(Increase) decrease in accounts receivable	3,956	(964)
Increase in crude oil inventory	(544)	(193)
Increase in other current assets	(530)	(74)
Increase in other assets	—	(168)
Increase in accounts payable	27,636	7,666
Decrease in accrued liabilities	(802)	(18,764)
Decrease in other long-term liabilities	(2)	—
Net cash provided by (used in) operating activities	23,875	(19,480)
Investing Activities:		
Capital expenditures	(44,823)	(12,984)
Net cash used in investing activities	(44,823)	(12,984)
Financing Activities:		
Proceeds from exercise or sale of warrants	18,373	13
Proceeds from exercise of stock options	—	(8)
Decrease in restricted cash	—	9,471
Net cash provided by financing activities	18,373	9,476
Net decrease in cash and cash equivalents	(2,575)	(22,988)
Cash and cash equivalents, beginning of period	12,193	34,444
Cash and cash equivalents, end of period	9,618	11,456

The accompanying notes are an integral part of these consolidated financial statements.

Transmeridian Exploration Incorporated and Subsidiaries Consolidated Statement of Cash Flows — Supplemental Information
(In thousands)
(Unaudited)

	Three months ended March 31,	
	2007	**2006**
	$	*$*
Cash paid for:		
Interest	8,700	7,752
Interest capitalized (non-cash)	(1,822)	(478)
Income taxes	—	—
Non-cash investing and financing transactions:		
Issuance of common stock for acquisition of carried working interest	—	5,000
Accrued and unpaid dividends on convertible preferred stock	1,650	243
Asset retirement obligation	56	—

The accompanying notes are an integral part of these consolidated financial statements.

Transmeridian Exploration Incorporated and Subsidiaries Notes to Unaudited Consolidated Financial Statements

Note 1 — Basis of Presentation and Significant Accounting Policies

The consolidated financial statements of Transmeridian Exploration Incorporated and subsidiaries (“we”, “our” or “us”) included herein have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). They reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the interim periods, on a basis consistent with the annual audited financial statements. All such adjustments are of a normal recurring nature. Certain information and note disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. However, we believe that the disclosures contained herein are adequate to make the information presented not misleading. The consolidated balance sheet at December 31, 2006 is derived from the December 31, 2006 audited consolidated financial statements. These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006. The results of operations for interim periods are not necessarily indicative of the results to be expected for an entire year.

We conduct our operations in Kazakhstan through a wholly-owned subsidiary, JSC Caspi Neft TME (“Caspi Neft”), a joint stock company organized under the laws of Kazakhstan. Caspi Neft holds the license and exploration and production contracts covering the South Alibek Field (the “Field”) in Kazakhstan.

In February 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We will adopt SFAS No. 159 on January 1, 2008, and have not yet determined the impact, if any, on our consolidated financial statements.

Note 2 — Liquidity and Stockholders' Equity

As shown in the accompanying consolidated financial statements, we had a net working capital deficit of approximately $38.5 million at March 31, 2007. In addition, we have incurred operating losses since our inception. To date, we have funded our development operations and working capital requirements through a combination of debt and equity proceeds and cash flow from operations. Management believes that cash flows from operations will improve in 2007, which will provide a portion of the funds needed to continue our development plan for the South Alibek Field and make scheduled interest payments on our senior secured notes. Increased operating cash flow is dependent upon many factors, including achieving and sustaining adequate production and sales rates, oil prices and other factors that may be beyond our control. Because our production rates have not increased as rapidly as anticipated, and in fact have recently decreased, we are currently seeking to raise approximately $40 million of additional capital to allow for the continued development of the Field at the current accelerated pace. If we are unable to secure the additional funds or if current production does not increase, crude oil prices are not sustainable and our operating cash flows do not increase accordingly within the near term, we will not be able to continue our accelerated development of the Field. In such case, we will have to significantly reduce our capital program and significantly modify our operational structure in order to fund interest payments and operating expenses, each of which may materially and adversely affect our business, financial condition and results of operations.

On March 15, 2007, we issued in a private placement warrants to purchase an aggregate 8,500,000 shares of our common stock and, in connection therewith, granted to the purchasers certain registration rights with respect to the resale or other disposition of the shares of our common stock issuable upon exercise of the warrants. The warrants were issued for total cash consideration of $8 million. Each warrant, when exercised, will entitle the holder to receive one share of our common stock at an exercise price of $2.00 per share. The warrant agreement governing the warrants provides for customary anti-dilution adjustments with respect to the exercise price and the number of shares of our common stock issuable upon exercise of the warrants. The warrants are exercisable at any time, at the holder's option, and will expire on March 15, 2012. The private placement of the warrants was effected pursuant to the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act").

Also in March 2007, the holders of warrants to purchase an aggregate of 4,773,214 shares of our common stock notified us of their intention to exercise such warrants upon the expiration of the specified notice period for waiver of beneficial ownership limitations under the warrants. In connection with such notification, the holders paid in advance the exercise price of the warrants, resulting in proceeds to us of $10.4 million. As of March 31, 2007, the shares of common stock issuable in connection with the pending warrant exercises had not been issued. Accordingly, a liability in the amount of $10.4 million has been reflected in accrued liabilities at March 31, 2007, representing our obligation to issue the related shares of common stock upon the expiration of the notice period and exercise of the warrants in May 2007.

Note 3 — Loss per Common Share

Basic net loss per common share has been computed based on the weighted-average number of shares of common stock outstanding during the applicable period. Diluted net loss per common share has been computed based on the weighted-average number of shares of common stock and common stock equivalents outstanding during the applicable period, as if all potentially dilutive securities were converted into common stock. Diluted net loss per share equals basic net loss per share for the periods presented because the effects of potentially dilutive securities are anti-dilutive. The calculation of diluted weighted average shares outstanding for the three months ended March 31, 2007 and 2006 excludes 7,575,125 and 12,309,383 common shares respectively, issuable pursuant to convertible preferred stock and outstanding stock options and warrants because their effect is anti-dilutive. Net loss attributable to common stockholders is calculated as follows:

	Three months ended March 31,	
	2007	**2006**
	$	*$*
	(Unaudited)	
	(in thousands, except per share amounts)	
Net loss	(15,455)	(12,747)
Preferred dividends	(1,650)	(243)
Accretion of senior preferred stock discount	(147)	—
Net loss attributable to common stockholders	(17,252)	(12,990)
Basic and diluted loss per common share	(0.17)	(0.15)
Weighted average common shares outstanding; basic and diluted	101,246	88,208

Note 4 — Income Taxes

We adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109* ("FIN 48"), effective January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. It prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

In accordance with the requirements of FIN 48, we evaluated all tax years still subject to potential audit under the applicable state, federal and foreign income tax laws. As a result of the adoption, we recorded an unrecognized tax benefit of approximately $2.2 million as of January 1, 2007. The adoption of FIN 48 did not result in a reduction of retained earnings due to an offsetting valuation allowance against our net deferred tax asset. The entire amount of the unrecognized tax benefit will impact the effective tax rate in future periods if recognized. There was no change in the unrecognized tax benefit during the quarter ended March 31, 2007. We do not anticipate a significant change in the balance of unrecognized tax benefits within the next twelve months.

We did not recognize any interest and penalties in our financial statements as a result of the adoption of FIN 48. If any interest or penalties related to any income tax liabilities are imposed in future reporting periods, we expect to record both of these items as components of income tax expense.

We are subject to taxation in the United States and Kazakhstan. Our federal income tax returns in the United States are subject to examination for the tax years ended December 31, 2003 through December 31, 2005. Our subsidiary's tax returns in Kazakhstan are subject to examination for the tax years ended December 31, 2004 through December 31, 2006.

Note 5 — Commitments and Contingencies

We are subject, through our subsidiary Caspi Neft, to the terms of License 1557 and the related exploration and production contracts covering 14,111 acres in the Field in Kazakhstan. The exploration and production contracts provide, among other things, certain minimum levels of capital expenditures for the continued development of the Field.

Purchase commitments are made from time to time in the ordinary course of business in connection with ongoing operations in the South Alibek Field.

Note 6 — Supplemental Financial Information

Property and Equipment

Property and equipment consisted of the following:

	March 31, 2007	December 31, 2006
	$	$
	(Unaudited)	
	(In thousands)	
Oil and gas properties, successful efforts method	383,389	338,548
Transportation equipment	511	510
Office and technology equipment	584	547
	384,484	339,605
Accumulated depreciation, depletion and amortization	(25,066)	(18,799)
Property and equipment, net	359,418	320,806

We capitalize interest costs on oil and gas projects under development, including the costs of unproved leasehold and property acquisition costs, wells in progress and related facilities. During the three-month periods ended March 31, 2007 and 2006, we capitalized approximately $1,822,000 and $478,000, respectively, of interest costs.

Other Assets

Other assets at March 31, 2007 consisted of debt financing costs of $10.7 million, net of amortization, and a note receivable of $500,000 from an unrelated third party. At December 31, 2006, other assets consisted of debt financing costs of $11.5 million, net of amortization, and a note receivable of $500,000 from an unrelated third party.

Accrued Liabilities

Accrued liabilities consisted of the following:

	March 31, 2007	December 31, 2006
	$	*$*
	(Unaudited)	
	(In thousands)	
Interest	1,450	1,450
Dividends	2,200	550
Production contract	—	600
Royalties	201	333
Rig rentals	2,738	2,738
Proceeds received for common stock to be issued from exercise of warrants	10,373	—
Other	44	114
Total accrued liabilities	17,006	5,785

Note 7 — Business Segment Information

Our business activities relate solely to oil and gas exploration, development and production. The primary emphasis since our formation in 2000 has been the development of the Field and substantially all of our assets are located in Kazakhstan. For each of the three months ended March 31, 2007 and 2006, substantially all of our results of operations consisted of revenues, operating, general and administrative expenses and other costs associated with our operations in Kazakhstan.

For the three months ended March 31, 2007, three customers accounted for approximately 37%, 13%, and 12% of consolidated revenues. Three customers accounted for approximately 63%, 23% and 12%, of consolidated revenues for the three months ended March 31, 2006.

Note 8 — Subsidiary Guarantors (Unaudited)

In December 2005, we and our wholly owned subsidiary Transmeridian Exploration Inc. (the "Issuer") issued 250,000 Units, consisting of an aggregate of (i) $250 million principal amount of senior secured notes due 2010 of the Issuer and (ii) warrants to purchase approximately 17.3 million shares of our common stock. We and all of our material subsidiaries fully and unconditionally guaranteed the senior secured notes. Prior to the Units offering, we financed our operations primarily through borrowings from banks in Kazakhstan or other private sources. As previously disclosed in 2005 and prior years, substantially all of our assets are located in Kazakhstan and substantially all of our revenue, operating, general and administrative expenses and other costs were, and currently are, associated with the operations of our principal subsidiary in Kazakhstan.

Condensed Consolidating Balance Sheet (in thousands)

	As of March 31, 2007					
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Eliminations	Consolidated
	$	$	$	$	$	$
Cash and cash equivalents	7,396	1	2,077	144	—	9,618
Other current assets	2,591	—	6,195	5	—	8,791
Total current assets	9,987	1	8,272	149	—	18,409
Property and equipment, net	395	—	355,647	3,376	—	359,418
Investment in and advances to subsidiaries	114,722	204,555	(283,124)	(3,941)	(32,212)	—
Other assets	—	10,741	—	500	—	11,241
	125,104	215,297	80,795	84	(32,212)	389,068
Total current liabilities	13,086	1,668	42,061	106	—	56,921
Debt	—	269,131	31,000	—	(31,000)	269,131
Other long-term liabilities	2,035	—	1,928	—	—	3,963
Senior redeemable convertible preferred stock	41,100	—	—	—	—	41,100
Stockholder's equity	68,883	(55,502)	5,806	(22)	(1,212)	17,953
	125,104	215,297	80,795	84	(32,212)	389,068

Condensed Consolidating Statement of Operations (in thousands)

	Three months ended March 31, 2007				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
Revenue, net	—	(218)	7,356	—	7,138
Operating costs and expenses	2,545	409	10,744	3	13,701
Operating income (loss)	(2,545)	(627)	(3,388)	(3)	(6,563)
Other income (expense)	93	(10,809)	1,822	2	(8,892)
Net loss	(2,452)	(11,436)	(1,566)	(1)	(15,455)

Condensed Consolidating Statement of Cash Flow (in thousands)

	Three months ended March 31, 2007				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
Net cash used in operating activities	(1,178)	(9,001)	34,057	(3)	23,875
Net cash used in investing activities	—	—	(44,809)	(14)	(44,823)
Net cash provided by financing activities	(1,730)	8,434	11,655	14	18,373
Net increase (decrease) in cash	(2,908)	(567)	903	(3)	(2,575)
Cash and cash equivalents, beginning of the year	10,304	568	1,174	147	12,193
Cash and cash equivalents, end of the year	7,396	1	2,077	144	9,618

Condensed Consolidating Balance Sheet (in thousands)

	As of March 31, 2006					
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Eliminations	Consolidated
	$	$	$	$	$	$
Cash and cash equivalents	8,376	24,217	1,353	—	—	33,946
Other current assets	2,656	—	6,875	—	—	9,531
Total current assets	11,032	24,217	8,228	—	—	43,477
Property and equipment, net	343	—	236,935	—	—	237,278
Investment in and advances to subsidiaries	—	143,166	(134,083)	—	(9,083)	—
Other assets	46,432	47,958	—	—	(82,382)	12,008
	57,807	215,341	111,080	—	(91,465)	292,763
Total current liabilities	3,025	2,553	12,263	—	—	17,841
Debt	—	224,748	31,000	(31,000)	224,748	224,748
Other long-term liabilities	—	—	186	—	—	186
Stockholder's equity	54,782	(11,960)	67,631	—	(60,465)	49,988
	57,807	215,341	111,080	—	(91,465)	292,763

Condensed Consolidating Statement of Operations (in thousands)

	Three months ended March 31, 2006				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
Revenue from oil sales, net	—	(95)	2,937	—	2,842
Operating costs and expenses	2,332	16	4,702	—	7,050
Operating loss	(2,332)	(111)	(1,765)	—	(4,208)
Other income (expense)	111	(9,142)	492	—	(8,539)
Net loss	(2,221)	(9,253)	(1,273)	—	(12,747)

Condensed Consolidating Statement of Cash Flow (in thousands)

	Three months ended March 31, 2006				
	Parent	Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantor	Consolidated
	$	$	$	$	$
Net cash (used in) provided by operating activities	(4,000)	(23,205)	7,725	—	(19,480)
Net cash used in investing activities	(9)	—	(12,975)	—	(12,984)
Net cash (used in) provided by financing activities	(6,803)	9,682	6,597	—	9,476
Net increase (decrease) in cash	(10,812)	(13,523)	1,347	—	(22,988)
Cash and cash equivalents, beginning of the period	19,188	15,250	6	—	34,444
Cash and cash equivalents, end of the period	8,376	1,727	1,353	—	11,456

Note 9 — Subsequent Event

Between April 26, 2007 and April 30, 2007, we sold to various investors an aggregate of 1,655,000 shares of our common stock for cash in a private placement exempt from registration under the Securities Act. In connection therewith, we granted to the purchasers certain registration rights with respect to the resale or other disposition of such shares of common stock. Application has been made to list the shares on the American Stock Exchange. The per share price of the shares sold was $2.70. The aggregate gross proceeds from the sale were approximately $4.5 million. The private placement was effected pursuant to the exemptions from registration provided by Section 4(2) of the Securities Act and Regulation S thereunder.

The US GAAP Combined Financial Information of Transmeridian as contained in Appendix I of the circular has been prepared in accordance with Transmeridian's accounting policies which follow accounting principles generally accepted in the United States of America ("US GAAP") as detailed in Note B to the US GAAP Combined Financial Information, which differ in certain significant aspects from the accounting policies adopted by the Company which follow Hong Kong Financial Reporting Standards ("HKFRSs"). Differences, other than certain presentational differences, which have a significant effect on the US GAAP Combined Financial Information and the unaudited combined financial information under HKFRSs are set out below.

A. UNAUDITED COMBINED FINANCIAL INFORMATION UNDER HKFRSs

The following unaudited combined statements of operations and unaudited combined statements of cash flows for the three months ended 31 March 2008 and 2007, and the years ended 31 December 2007, 2006 and 2005 (the "Relevant Periods") and the unaudited combined balance sheets as at 31 March 2008 and 2007; and 31 December 2007, 2006 and 2005 of Transmeridian under HKFRSs (collectively the "Unaudited HKFRS Financial Information"), which are prepared by the Directors of the Company, are derived from the US GAAP Combined Financial Information included in Appendix I of the circular. Your attention is drawn to the basis of preparation of the US GAAP Combined Financial Information as stated in the notes to the US GAAP Combined Financial Information and the audit opinion of Transmeridian's Independent Registered Public Accounting Firm. Your attention is also drawn to the fact that the Unaudited HKFRS Financial Information has not been subject to an independent audit. Accordingly, it may not fairly present the operations during the Relevant Periods and the financial positions ended on the above dates under HKFRSs.

Unaudited Combined Statements of Operations under HKFRSs:

(in thousand of U.S. dollars)	Notes	For the three months ended 31 March						For the year ended 31 December								
		2008			2007			2007			2006			2005		
		Unadjusted US GAAP combined financial information	GAAP adjustments	HKFRS financial information	Unadjusted US GAAP combined financial information	GAAP adjustments	HKFRS financial information	Unadjusted US GAAP combined financial information	GAAP adjustments	HKFRS financial information	Unadjusted US GAAP combined financial information	GAAP adjustments	HKFRS financial information	Unadjusted US GAAP combined financial information	GAAP adjustments	HKFRS financial information
		Unaudited	*Unaudited*	*Unaudited*	*Unaudited*	*Unaudited*	*Unaudited*	*Audited*	*Unaudited*	*Unaudited*	*Audited*	*Unaudited*	*Unaudited*	*Audited*	*Unaudited*	*Unaudited*
Revenue from oil sales, net		15,252	—	15,252	7,138	—	7,138	34,024	—	34,024	24,672	—	24,672	8,443	—	8,443
Operating cost and expenses:																
Exploration expenses		—	—	—	157	—	157	522	—	522	256	—	256	9	—	9
Depreciation, depletion and amortization		6,821	—	6,821	6,267	—	6,267	19,729	—	19,729	14,921	—	14,921	3,385	—	3,385
Transportation expenses		1,508	—	1,508	1,132	—	1,132	3,876	—	3,876	1,596	—	1,596	321	—	321
Impairment loss on drilling rig		—	—	—	—	—	—	—	—	—	—	—	—	4,022	—	4,022
Operating and administrative expenses — Kazakhstan		4,563	—	4,563	3,585	—	3,585	16,681	—	16,681	15,652	—	15,652	3,897	—	3,897
General and administrative expenses — Houston		2,591	—	2,591	2,560	—	2,560	13,750	—	13,750	9,972	—	9,972	6,632	—	6,632
Total operating costs and expenses		15,483		15,483	13,701		13,701	54,558		54,558	42,397		42,397	18,266		18,266
Operating loss		(231)		(231)	(6,563)		(6,563)	(20,534)		(20,534)	(17,725)		(17,725)	(9,823)		(9,823)
Other income/(expenses):																
Interest income		8	—	8	116	—	116	494	—	494	1,413	—	1,413	338	—	338
Interest expense, net of capitalized interest		(10,649)	—	(10,649)	(9,008)	—	(9,008)	(37,708)	—	(37,708)	(36,935)	—	(36,935)	(10,344)	—	(10,344)
Total other income/(expenses)		(10,641)		(10,641)	(8,892)		(8,892)	(37,214)		(37,214)	(35,522)		(35,522)	(10,006)		(10,006)
Loss before minority interest		(10,872)			(15,455)			(57,748)			(53,247)			(19,829)		
Minority interest income/(expense)	*(iii)*	—	—	—	—	—	—	—	—	—	—	—	—	(712)	712	—
Net loss		(10,872)			(15,455)			(57,748)			(53,247)			(20,541)		
Fair value gain/(loss) on preferred stock	*(i)*	—	6,668	6,668	—	8,451	8,451	—	(29,636)	(29,636)	—	(16,109)	(16,109)	—	—	—
Preferred dividends	*(i), (iii)*	(5,887)	5,887	—	(1,650)	1,650	—	(13,948)	13,948	—	(1,066)	1,066	—	(1,081)	1,081	—
Accretion of preferred stock discount	*(i)*	(1,103)	1,103	—	(147)	147	—	(2,424)	2,424	—	(49)	49	—	—	—	—
Net gain/(loss) attributable to common stockholders		(17,862)			(17,252)			(74,120)			(54,362)			(21,622)		
Loss for the year				(4,204)			(7,004)			(87,384)			(69,356)			(19,829)
Attributable to:																
Common stockholders of the Company	*(iii)*			(4,204)			(7,004)			(87,384)			(69,872)			(21,622)
Preferred stockholders of the Company	*(iii)*			—			—			—			516			1,081
Minority interests	*(iii)*			—			—			—			—			712
				(4,204)			(7,004)			(87,384)			(69,356)			(19,829)

Unaudited Combined Balance Sheets under HKFRSs:

(in thousand of U.S. dollars)		As at 31 March						As at 31 December								
		2008			2007			2007			2006			2005		
	Notes	Unadjusted US GAAP combined financial information *Unaudited*	GAAP adjustments *Unaudited*	HKFRS financial information *Unaudited*	Unadjusted US GAAP combined financial information *Unaudited*	GAAP adjustments *Unaudited*	HKFRS financial information *Unaudited*	Unadjusted US GAAP combined financial information *Audited*	GAAP adjustments *Unaudited*	HKFRS financial information *Unaudited*	Unadjusted US GAAP combined financial information *Audited*	GAAP adjustments *Unaudited*	HKFRS financial information *Unaudited*	Unadjusted US GAAP combined financial information *Audited*	GAAP adjustments *Unaudited*	HKFRS financial information *Unaudited*
ASSETS																
Current assets:																
Cash and cash equivalents		1,159	—	1,159	9,618	—	9,618	939	—	939	12,193	—	12,193	34,444	—	34,444
Restricted cash		—	—	—	—	—	—	—	—	—	—	—	—	31,961	—	31,961
Accounts receivable		3,968	—	3,968	3,860	—	3,860	4,428	—	4,428	7,816	—	7,816	3,623	—	3,623
Crude oil inventory		539	—	539	1,381	—	1,381	1,057	—	1,057	837	—	837	1,626	—	1,626
Other current assets		337	—	337	550	—	550	261	—	261	20	—	20	51	—	51
Assets held for sale		—	—	—	3,000	—	3,000	—	—	—	3,000	—	3,000	3,000	—	3,000
Total current assets		6,003		6,003	18,409		18,409	6,685		6,685	23,866		23,866	74,705		74,705
Non-current assets:																
Property and Equipment:																
Property and equipment		432,902	—	432,902	384,484	—	384,484	428,741	—	428,741	339,605	—	339,605	230,719	—	230,719
Accumulated depreciation, depletion and amortization		(45,318)	—	(45,318)	(25,066)	—	(25,066)	(38,497)	—	(38,497)	(18,799)	—	(18,799)	(3,904)	—	(3,904)
Property and equipment, net		387,584		387,584	359,418		359,418	390,244		390,244	320,806		320,806	226,815		226,815
Other assets, net	*(ii)*	8,624	(7,849)	775	11,241	(10,741)	500	9,347	(8,572)	775	11,964	(11,464)	500	12,473	(12,473)	—
Total assets		402,211		394,362	389,068		378,327	406,276		397,704	356,636		345,172	313,993		301,520
LIABILITIES AND STOCKHOLDERS' EQUITY/(DEFICIT)																
Current Liabilities:																
Accounts payable		23,334	—	23,334	39,915	—	39,915	23,728	—	23,728	12,279	—	12,279	2,245	—	2,245
Accrued liabilities	*(i)*	38,896	(23,458)	15,438	17,006	(2,200)	14,806	33,770	(22,944)	10,826	5,785	(550)	5,235	31,451	—	31,451
Total current liabilities		62,230		38,772	56,921		54,721	57,498		34,554	18,064		17,514	33,696		33,696
Non-current liabilities:																
Long term debts	*(ii)*	274,759	(7,849)	266,910	269,131	(10,741)	258,390	273,352	(8,572)	264,780	267,724	(11,464)	256,260	223,407	(12,473)	210,934
Other long term liabilities		4,225	—	4,225	3,963	—	3,963	4,208	—	4,208	3,898	—	3,898	186	—	186
Senior redeemable convertible preferred stock	*(i)*	44,196	3,128	47,324	41,100	7,462	48,562	42,076	4,046	46,122	40,953	16,060	57,013	—	—	—
Junior redeemable convertible preferred stock	*(i)*	48,315	35,446	83,761	—	—	—	43,961	47,672	91,633	—	—	—	—	—	—
Stockholders' Equity/(Deficit):																
Preferred stock		—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Common stock		70	—	70	61	—	61	70	—	70	61	—	61	52	—	52
Additional paid-in capital		152,447	—	152,447	127,191	—	127,191	151,278	—	151,278	117,983	—	117,983	94,337	—	94,337
Accumulated deficit	*(i)*	(184,031)	(15,116)	(199,147)	(109,299)	(5,262)	(114,561)	(166,167)	(28,774)	(194,941)	(92,047)	(15,510)	(107,557)	(37,685)	—	(37,685)
Total stockholders' equity/(deficit)		(31,514)		(46,630)	17,953		12,691	(14,819)		(43,593)	25,997		10,487	56,704		56,704
Total equity and liabilities		402,211		394,362	389,068		378,327	406,276		397,704	356,636		345,172	313,993		301,520

Unaudited Combined Statements of Cash Flows under HKFRSs:

(in thousand of U.S. dollars)

		For the three months ended 31 March						For the year ended 31 December								
		2008			2007			2007			2006			2005		
	Notes	Unadjusted US GAAP combined financial information *Unaudited*	GAAP adjustments *Unaudited*	HKFRS financial information *Unaudited*	Unadjusted US GAAP combined financial information *Unaudited*	GAAP adjustments *Unaudited*	HKFRS financial information *Unaudited*	Unadjusted US GAAP combined financial information *Audited*	GAAP adjustments *Unaudited*	HKFRS financial information *Unaudited*	Unadjusted US GAAP combined financial information *Audited*	GAAP adjustments *Unaudited*	HKFRS financial information *Unaudited*	Unadjusted US GAAP combined financial information *Audited*	GAAP adjustments *Unaudited*	HKFRS financial information *Unaudited*
Operating Activities:																
Net gain /(loss)	*(iii)*	(10,872)	10,872	—	(15,455)	15,455	—	(57,748)	57,748	—	(53,247)	53,247	—	(20,541)	20,541	—
Loss for the year	*(i), (iii)*	—	(4,204)	(4,204)	—	(7,004)	(7,004)	—	(87,384)	(87,384)	—	(69,356)	(69,356)	—	(19,829)	(19,829)
Adjustment to reconcile net loss to net cash used in operating activities																
Depreciation, depletion and amortization		6,821	—	6,821	6,267	—	6,267	19,729	—	19,729	14,921	—	14,921	3,385	—	3,385
Amortization of debt financing costs		723	—	723	723	—	723	2,892	—	2,892	2,744	—	2,744	1,115	—	1,115
Debt discount amortization		1,407	—	1,407	1,407	—	1,407	5,628	—	5,628	5,517	—	5,517	4,633	—	4,633
Interest expenses— others	*(iii)*	—	8,519	8,519	—	6,878	6,878	—	29,188	29,188	—	28,674	28,674	—	4,596	4,596
Interest income	*(iii)*	—	(8)	(8)	—	(116)	(116)	—	(494)	(494)	—	(1,413)	(1,413)	—	(338)	(338)
Fair value (gain)/loss on preferred stocks	*(i)*	—	(6,668)	(6,668)	—	(8,451)	(8,451)	—	29,636	29,636	—	16,109	16,109	—	—	—
Stock-based compensation expenses		933	—	933	1,208	—	1,208	5,838	—	5,838	5,240	—	5,240	2,090	—	2,090
Impairment charges		—	—	—	—	—	—	—	—	—	—	—	—	4,022	—	4,022
Accretion of asset retirement obligation		20	—	20	11	—	11	60	—	60	—	—	—	—	—	—
Loss on disposal of assets		—	—	—	—	—	—	340	—	340	—	—	—	—	—	—
Minority interest expense		—	—	—	—	—	—	—	—	—	—	—	—	712	(712)	—
(Increase)/decrease in receivables		460	—	460	3,956	—	3,956	3,388	—	3,388	(4,192)	—	(4,192)	(1,979)	—	(1,979)
(Increase)/decrease in crude oil inventory		518	—	518	(544)	—	(544)	(220)	—	(220)	789	—	789	(1,626)	—	(1,626)
(Increase)/decrease in other current assets		(76)	—	(76)	(530)	—	(530)	(241)	—	(241)	31	—	31	25	—	25
Increase in other assets		—	—	—	—	—	—	(275)	—	(275)	(500)	—	(500)	—	—	—
Increase in accounts payable		(394)	—	(394)	27,636	—	27,636	11,449	—	11,449	10,033	—	10,033	1,361	—	1,361
Increase/(decrease) in accrued liabilities		4,612	—	4,612	(802)	—	(802)	6,411	—	6,411	(17,336)	133	(17,203)	(4,549)	4,549	—
Decrease in other long-term liabilities		(3)	—	(3)	(2)	—	(2)	(11)	—	(11)	—	—	—	—	—	—
Cash provided by/(used in) operations		4,149		12,660	23,875		30,637	(2,760)		25,934	(36,000)		(8,606)	(11,352)		(2,545)
Interest paid	*(iii)*	—	(8,700)	(8,700)	—	(8,700)	(8,700)	—	(34,800)	(34,800)	—	(32,903)	(32,903)	—	(11,643)	(11,643)
Net cash provided by/(used in) operating activities		4,149		3,960	23,875		21,937	(2,760)		(8,866)	(36,000)		(41,509)	(11,352)		(14,188)
Investing Activities:																
Capital expenditures	*(iii)*	(4,161)	181	(3,980)	(44,823)	1,822	(43,001)	(86,247)	5,612	(80,635)	(107,283)	4,096	(103,187)	(20,703)	2,498	(18,205)
Proceeds from disposal of assets		—	—	—	—	—	—	—	—	—	48	—	48	—	—	—
Interest received	*(iii)*	—	8	8	—	116	116	—	494	494	—	1,413	1,413	—	338	338
Acquisitions		—	—	—	—	—	—	—	—	—	—	—	—	(124,000)	—	(124,000)
Net cash used in investing activities		(4,161)		(3,972)	(44,823)		(42,885)	(86,247)		(80,141)	(107,235)		(101,726)	(144,703)		(141,867)
Financing Activities:																
Proceeds from sale of common stock, net		—	—	—	—	—	—	4,468	—	4,468	10,632	—	10,632	1,791	—	1,791
Proceeds from sale of preferred stock, net		—	—	—	—	—	—	51,523	—	51,523	41,208	—	41,208	—	—	—
Proceeds from long-term debts, net		—	—	—	—	—	—	—	—	—	37,065	—	37,065	250,000	—	250,000
Repayments of long-term debts		—	—	—	—	—	—	—	—	—	—	—	—	(35,350)	—	(35,350)
Proceeds from short-term borrowings		—	—	—	—	—	—	—	—	—	—	—	—	25,740	—	25,740
Repayments of short-term borrowings		—	—	—	—	—	—	—	—	—	—	—	—	(25,740)	—	(25,740)
Decrease in notes payable to related parties		—	—	—	—	—	—	—	—	—	—	—	—	(50)	—	(50)
Payment of deferred financing costs		—	—	—	—	—	—	—	—	—	—	—	—	(12,578)	—	(12,578)
Payment of dividends on preferred stock		—	—	—	—	—	—	—	—	—	(760)	—	(760)	(991)	—	(991)
Proceeds from exercise of stock options		—	—	—	18,373	—	18,373	368	—	368	229	—	229	128	—	128
Proceeds from exercise or sale of warrants		232	—	232	—	—	—	21,394	—	21,394	649	—	649	2,763	—	2,763
(Increase)/decrease in restricted cash		—	—	—	—	—	—	—	—	—	31,961	—	31,961	(31,961)	—	(31,961)
Net cash provided by financing activities		232		232	18,373		18,373	77,753		77,753	120,984		120,984	173,752		173,752
Net increase/(decrease) in cash and cash equivalents		220		220	(2,575)		(2,575)	(11,254)		(11,254)	(22,251)		(22,251)	17,697		17,697
Cash and cash equivalents, beginning of year		939	—	939	12,193	—	12,193	12,193	—	12,193	34,444	—	34,444	16,747	—	16,747
Cash and cash equivalents, end of year		1,159		1,159	9,618		9,618	939		939	12,193		12,193	34,444		34,444

Notes to the Unaudited Combined Statements of Operations, Unaudited Combined Balance Sheets and Unaudited Combined Statements of Cash Flows:

(i) Accounting for senior and junior redeemable convertible preferred stocks

Under US GAAP, Accounting Principles Board Opinion No. 14 "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants" the proceeds received from a convertible debt with a non-detachable conversion feature should all be credited to a liability account if the conversion price is above the market price as at the commitment date. The senior and junior redeemable convertible preferred stocks are accounted for in the US GAAP Combined Financial Information accordingly.

Under HKFRSs, financial instruments with cash settlement options and other derivative components need to be bifurcated into a debt component and a derivative component, or to designate the entire contract as a financial liability at fair value through profit or loss in accordance with Hong Kong Accounting Standard No. 39 "Financial Instruments: Recognition and Measurement" ("HKAS 39"). Accordingly, the senior and junior redeemable convertible preferred stock are designated as financial liabilities at fair value through profit or loss under HKFRSs.

Accretion of preferred stock discount of US$1,103,000, US$147,000, US$2,424,000 and US$49,000 for the three months ended 31 March 2008 and 2007; and the years ended 31 December 2007 and 2006 respectively and preferred dividends of US$5,887,000, US$1,650,000, US$13,948,000 and US$550,000 for the three months ended 31 March 2008 and 2007; and the years ended 31 December 2007 and 2006 respectively are reversed under the requirement of HKFRSs. Additionally, accrued liabilities (including accrued preferred dividends and liabilities under junior redeemable convertible preferred stock return agreements) of US$23,458,000, US$2,200,000, US$22,944,000 and US$550,000 as at 31 March 2008, 31 March 2007, 31 December 2007 and 31 December 2006 respectively are reclassified under the requirement of HKFRSs. Fair value gain/(loss) on financial liabilities at fair value through profit or loss of US$6,668,000, US$8,451,000, US$(29,636,000) and US$(16,109,000) for the three months ended 31 March 2008 and 2007; and the years ended 31 December 2007 and 2006 respectively are recorded to adjust the senior and junior redeemable convertible preferred stocks to their fair values as at each balance sheet dates in the Unaudited HKFRS Financial Information.

(ii) Accounting for issue costs of long term debts

Under US GAAP, Accounting Principles Board Opinion No. 21 "Interest on Receivables and Payables" debt issue costs should be reported in the balance sheet as deferred charges.

Under HKFRSs, HKAS 39 a financial liability should be recognised initially at its fair value plus, in the case of a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial liability. Accordingly, issue costs of US$7,849,000, US$10,741,000, US$8,572,000, US$11,464,000 and US$12,473,000 are set off with long term debts as at 31 March 2008, 31 March 2007, 31 December 2007, 31 December 2006 and 31 December 2005 respectively in the Unaudited HKFRS Financial Information.

(iii) Presentation of combined statements of operations and combined statements of cash flows

Certain balances are reclassified or presented to eliminate the presentational differences in combined statements of operations and combined statements of cash flows between US GAAP and HKFRSs.

B. REPORT ON HKFRSS RECONCILIATION

The following is the text of a report received from the Company's independent auditor, RSM Nelson Wheeler, Certified Public Accountants, Hong Kong, for inclusion in this circular.

RSM! Nelson Wheeler
中瑞岳華(香港)會計師事務所
Certified Public Accountants

30 September 2008

The Board of Directors
United Energy Group Limited

Dear Sirs,

We have examined the adjustments made in arriving at and the computation of the Unaudited HKFRS Financial Information of Transmeridian Exploration Incorporated ("Transmeridian") as at 31 December 2007, 2006 and 2005 and 31 March 2008 and 2007; and for each of the three years ended 31 December 2007 and the three months ended 31 March 2008 and 2007 (the "Unaudited HKFRS Financial Information") as set out in Appendix II of the circular of United Energy Group Limited (the "Company") dated 30 September 2008 in connection with the proposed investment in Transmeridian (the "Circular").

Respective responsibilities of management of Transmeridian and the directors of the Company and RSM Nelson Wheeler

The Unaudited HKFRS Financial Information is arrived at after making adjustments to the audited financial statements of Transmeridian for the three years ended 31 December 2007 and the unaudited financial statements of Transmeridian for the three months ended 31 March 2008 and 2007 as set out in Appendix I of the Circular, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") and are the responsibility of the Transmeridian's management. The audited financial statements of Transmeridian for each of the three years ended 31 December 2007 were audited by the Independent Registered Public Accounting Firm of Transmeridian in accordance with the standards of the Public Company Accounting Oversight Board of the United States of America.

The directors of the Company are responsible for the adjustments made in arriving at and the computation of the Unaudited HKFRS Financial Information to show the financial positions and the results of Transmeridian in accordance with the accounting policies of the Company which follow Hong Kong Financial Reporting Standards ("HKFRSs").

It is our responsibility to form an independent conclusion, based on our reasonable assurance engagement, on the Unaudited HKFRS Financial Information and to report our conclusion to you.

Basis of conclusion

We conducted our reasonable assurance engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements other than Audits or Reviews of Historical Financial Information" issued by the Hong Kong Institute of Certified Public Accountants.

We planned and performed our reasonable assurance engagement so as to obtain all the information and explanations we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Unaudited HKFRS Financial Information has been properly compiled by the directors of the Company. For the purposes of this assurance report, we have performed the following procedures:

(a) compare the Unadjusted US GAAP Combined Financial Information of Transmeridian as set out in Appendix I of the Circular (the "US GAAP Combined Financial Information") with the audited financial statements of Transmeridian for each of the three years ended 31 December 2007 and the unaudited financial statements of Transmeridian for the three months ended 31 March 2008 and 2007 prepared in accordance with US GAAP;

(b) consider the evidence supporting the adjustments made in arriving at the Unaudited HKFRS Financial Information which include reviewing the differences between the Transmeridian's accounting policies under US GAAP and the Company's accounting policies under HKFRSs; and

(c) check the arithmetic accuracy of the computation of the Unaudited HKFRS Financial Information.

Our reasonable assurance engagement did not involve independent examination of any of the underlying financial information.

We believe that our reasonable assurance engagement provides a reasonable basis for our conclusion.

Conclusion

Based on our work described in this report, in our opinion:

(a) the US GAAP Combined Financial Information has been properly extracted from the audited financial statements of Transmeridian for the three years ended 31 December 2007 and the unaudited financial statements of Transmeridian for the three months ended 31 March 2008 and 2007 as set out in Appendix I of the Circular;

(b) the adjustments made in arriving at the Unaudited HKFRS Financial Information reflect, in all material aspects, differences between Transmeridian's accounting policies under US GAAP and the Company's accounting policies under HKFRSs; and

(c) the computation of the Unaudited HKFRS Financial Information is arithmetically accurate.

Yours faithfully,

RSM Nelson Wheeler
Certified Public Accountants
Hong Kong

(A) FINANCIAL SUMMARY

The following is a summary of the consolidated income statements of the Company for the three years ended 31 March 2008 and the consolidated balance sheets of the Company as at 31 March 2006, 2007 and 2008.

Consolidated Income Statements

	Years ended 31 March		
	2008	**2007**	**2006**
	HK$'000	*HK$'000*	*HK$'000*
	(Audited)	(Restated)	(Unaudited and restated)
Turnover	4,893	15,933	236,468
Cost of sales and service rendered	(754)	(5,314)	(224,367)
Gross profit	4,139	10,619	12,101
Other income	55,573	40,868	20,917
Oil exploitation expenses	(76,875)	(723)	—
Administrative expenses	(97,776)	(28,254)	(13,025)
(Loss)/Profit from operations	(114,939)	22,510	19,993
Finance costs	—	(951)	(718)
Share of loss of an associate	(758)	—	—
Gain on deemed disposal of a subsidiary	7,395	—	—
(Loss)/Profit before tax	(108,302)	21,559	19,275
Income tax credit/(expense)	3,823	(2,571)	(7,879)
(Loss)/Profit for the year	(104,479)	18,988	11,396
Attributable to:			
Equity holders of the Company	(101,497)	16,820	6,419
Minority interests	(2,982)	2,168	4,977
	(104,479)	18,988	11,396
(Loss)/earnings per share			
Basic	(0.84 cents)	0.15 cents	0.12 cents
Diluted	N/A	N/A	N/A

Consolidated Balance Sheets

	At 31 March		
	2008	**2007**	**2006**
	HK$'000	*HK$'000*	*HK$'000*
	(Audited)	(Restated)	(Unaudited and restated)
Non-current assets			
Property, plant and equipment	36,703	150,323	137,147
Investment properties	177,600	161,616	172,523
Investment in an associate	86,403	—	—
	300,706	311,939	309,670
Current assets			
Properties under development	—	367,480	328,854
Trade and other receivables	716,350	77,263	760
Deposits paid for prepaid land lease payments	—	13,398	15,745
Due from a director	—	5	—
Due from a corporate shareholder	—	133,724	—
Due from a related company	—	69	—
Due from an associate	66,552	—	—
Financial assets at fair value through profit or loss	6,613	6,109	—
Pledged bank deposits	—	128,043	—
Bank and cash balances	2,113,460	361,014	242,212
	2,902,975	1,087,105	587,571
Current liabilities			
Trade and other payables	34,005	22,533	13,302
Current tax liabilities	4	573	584
Due to directors	5,534	3,930	12,454
Due to related companies	3,774	13,216	23,288
Due to a minority equity holder	—	31,402	—
Bank loans	—	303,030	1,473
	43,317	374,684	51,101

	At 31 March		
	2008	**2007**	**2006**
	HK$'000	*HK$'000*	*HK$'000*
	(Audited)	(Restated)	(Unaudited and restated)
Net current assets	2,859,658	712,421	536,470
Total assets less current liabilities	3,160,364	1,024,360	846,140
Non-current liabilities			
Bank loans	—	—	303,648
Deferred tax liabilities	27,209	29,020	26,572
	27,209	29,020	330,220
NET ASSETS	3,133,155	995,340	515,920
Capital and reserves			
Share capital	127,771	114,031	51,760
Reserves	2,813,966	674,609	268,234
Equity attributable to equity holders of the Company	2,941,737	788,640	319,994
Minority interests	191,418	206,700	195,926
TOTAL EQUITY	3,133,155	995,340	515,920

Notes:

(1) As stated in the Company's 2007 annual report and its circular dated 31 March 2006, the Company issued 5,080,000,000 shares at par value of HK$0.01 each as consideration to acquire Grand Hope Group Limited and its subsidiaries (the "Grand Hope Group") from He Fu International Limited ("He Fu") and the acquisition was completed on 6 June 2006 (the "First Acquisition"). As the Company and Grand Hope Group were both ultimately controlled by He Fu before and after the First Acquisition, the First Acquisition was accounted for as a combination of entities under common control. Therefore, figures for the two years ended 31 March 2007 were prepared based on the principles of merger accounting in accordance with the Accounting Guideline 5 "Merger Accounting for Common Control Combinations" ("AG 5") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA"), as if the First Acquisition had occurred from the date when the combining entities first came under the control of He Fu.

(2) As stated in the Company's 2008 annual report and its circular dated 17 September 2007, the Company issued 4,360,248,448 shares at par value of HK$0.01 each as consideration to acquire 51%, 34% and 15% equity interest in United Petroleum & Natural Gas Investments Limited ("United Petroleum") from United Energy Holdings Limited ("United Energy"), United Petroleum & Natural Gas Holdings Limited ("United Petroleum Holdings") and Kowin Limited respectively (the "Second Acquisition"). United Energy and United Petroleum Holdings were wholly owned by Mr. Zhang Hongwei. In addition, the Company issued 166,859,809 shares at par value of HK$0.01 each to United Energy for acquiring the loan of HK$268,644,000 due to United Energy by United Petroleum before the completion of the Second Acquisition. The Second Acquisition was completed on 16 October 2007. As the Company and United Petroleum were both ultimately controlled by Mr. Zhang Hongwei before and after the Second Acquisition, the Second Acquisition was accounted for as a business combination of entities under common control. Therefore, figures for the two years ended 31 March 2008 were prepared based on the principles of merger accounting in accordance with the AG5 issued by the HKICPA, as if the Second Acquisition had occurred from the date when the combining entities first came under the control of Mr. Zhang Hongwei. Comparative figures have been restated accordingly.

(3) Figures for 2008 and 2007 are extracted from the 2008 annual report of the Company. The 2007 and 2006 figures presented in the 2008 and 2007 financial statements had been restated for comparative purpose to reflect the acquisition of United Petroleum and Grand Hope Group respectively. The auditors of the Company had performed appropriate audit procedures for the 2007 and 2006 comparative figures and the opening balances of the financial statements for the year 2007 and 2008 in accordance with the relevant Hong Kong Standards on Auditing issued by the HKICPA. The Directors of the Company are of the view and auditors of the Company concurred that, the 2008 and 2007 financial statements which include the 2007 and 2006 comparative figures, provide a true and fair view of the state of affairs of the Group and of the results of its operations and its cash flows.

(B) SUMMARY OF AUDITED FINANCIAL STATEMENTS

Set out below is the audited financial statements together with the relevant notes to the financial statements of the Group as extracted from the annual report of the Company for the year ended 31 March 2008.

Consolidated Income Statement

For the year ended 31 March 2008

	Note	**2008** *HK$'000*	**2007** *HK$'000* (Restated)
Turnover	*6*	4,893	15,933
Cost of sales and service rendered		(754)	(5,314)
Gross profit		4,139	10,619
Other income	*7*	55,573	40,868
Oil exploitation expenses		(76,875)	(723)
Administrative expenses		(97,776)	(28,254)
(Loss)/profit from operations	*9*	(114,939)	22,510
Finance costs	*10*	—	(951)
Share of loss of an associate	*17*	(758)	—
Gain on deemed disposal of a subsidiary	*33*	7,395	—
(Loss)/profit before tax		(108,302)	21,559
Income tax credit/(expense)	*11*	3,823	(2,571)
(Loss)/profit for the year		(104,479)	18,988
Attributable to:			
Equity holders of the Company		(101,497)	16,820
Minority interests		(2,982)	2,168
		(104,479)	18,988
(Loss)/earnings per share			
Basic	*13*	(0.84 cents)	0.15 cents
Diluted	*13*	N/A	N/A

Consolidated Balance Sheet

At 31 March 2008

	Note	2008 *HK$'000*	2007 *HK$'000* (Restated)
Non-current assets			
Property, plant and equipment	*15*	36,703	150,323
Investment properties	*16*	177,600	161,616
Investment in an associate	*17*	86,403	—
		300,706	311,939
Current assets			
Properties under development	*18*	—	367,480
Trade and other receivables	*19*	716,350	77,263
Deposits paid for prepaid land lease payments	*20*	—	13,398
Due from a director	*21*	—	5
Due from a corporate shareholder	*22*	—	133,724
Due from a related company	*23*	—	69
Due from an associate	*17*	66,552	—
Financial assets at fair value through profit or loss	*24*	6,613	6,109
Pledged bank deposits	*25*	—	128,043
Bank and cash balances	*25*	2,113,460	361,014
		2,902,975	1,087,105
Current liabilities			
Trade and other payables	*26*	34,005	22,533
Current tax liabilities		4	573
Due to directors	*37(b)*	5,534	3,930
Due to related companies	*37(b)*	3,774	13,216
Due to a minority equity holder	*37(b)*	—	31,402
Bank loans	*27*	—	303,030
		43,317	374,684
Net current assets		2,859,658	712,421
Total assets less current liabilities		3,160,364	1,024,360

	Note	2008 HK$'000	2007 HK$'000 (Restated)
Non-current liabilities			
Deferred tax liabilities	*28*	27,209	29,020
NET ASSETS		3,133,155	995,340
Capital and reserves			
Share capital	*29*	127,771	114,031
Reserves	*31(a)*	2,813,966	674,609
Equity attributable to equity holders of the Company		2,941,737	788,640
Minority interests		191,418	206,700
TOTAL EQUITY		3,133,155	995,340

Consolidated Statement of Changes in Equity

For the year ended 31 March 2008

	Attributable to equity holders of the Company											
	Share capital *(note 29)* *HK$'000*	Share premium account *(note 31(c))* *HK$'000*	Merger reserve *(note 31(c))* *HK$'000*	Capital reserve *(note 31(c))* *HK$'000*	Property revaluation reserve *HK$'000*	Foreign currency translation reserve *HK$'000*	Statutory reserve *(note 31(c))* *HK$'000*	Share-based payments reserve *(note 31(c))* *HK$'000*	Accumulated losses *HK$'000*	Total *HK$'000*	Minority interests *HK$'000*	Total *HK$'000*
At 1 April 2006, as previously reported	51,760	2,420,885	(2,286,000)	287,545	2,672	5,921	522	–	(163,311)	319,994	195,926	515,920
Effect on merger of equity interests in subsidiary *(note 3(b)(ii))*	45,271	8,284,608	(8,060,845)	–	–	–	–	–	–	269,034	–	269,034
At 1 April 2006, as restated	97,031	10,705,493	(10,346,845)	287,545	2,672	5,921	522	–	(163,311)	589,028	195,926	784,954
Share issue expenses paid	–	(1,716)	–	–	–	–	–	–	–	(1,716)	–	(1,716)
Exchange differences arising on translation of foreign operations	–	–	–	–	–	14,508	–	–	–	14,508	8,606	23,114
Net income and expenses recognised directly in equity	–	(1,716)	–	–	–	14,508	–	–	–	12,792	8,606	21,398
Profit for the year	–	–	–	–	–	–	–	–	16,820	16,820	2,168	18,988
Total recognised income and expense for the year	–	(1,716)	–	–	–	14,508	–	–	16,820	29,612	10,774	40,386
Issue of shares on placement	17,000	153,000	–	–	–	–	–	–	–	170,000	–	170,000
Realised on disposal of property	–	–	–	–	(2,672)	–	–	–	2,672	–	–	–
Transfer	–	–	–	–	–	–	307	–	(307)	–	–	–
	17,000	153,000	–	–	(2,672)	–	307	–	2,365	170,000	–	170,000
At 31 March 2007, as restated	114,031	10,856,777	(10,346,845)	287,545	–	20,429	829	–	(144,126)	788,640	206,700	995,340
At 1 April 2007, as previously reported	68,760	2,572,169	(2,286,000)	287,545	–	20,429	829	–	(142,438)	521,294	206,700	727,994
Effect on merger of equity interests in subsidiary *(note 3(b)(ii))*	45,271	8,284,608	(8,060,845)	–	–	–	–	–	(1,688)	267,346	–	267,346
At 1 April 2007, as restated	114,031	10,856,777	(10,346,845)	287,545	–	20,429	829	–	(144,126)	788,640	206,700	995,340
Share issue expenses paid	–	(27,851)	–	–	–	–	–	–	–	(27,851)	–	(27,851)
Exchange differences arising on translation of foreign operations	–	–	–	–	–	35,111	–	–	–	35,111	19,649	54,760
Net income and expenses recognised directly in equity	–	(27,851)	–	–	–	35,111	–	–	–	7,260	19,649	26,909
Loss for the year	–	–	–	–	–	–	–	–	(101,497)	(101,497)	(2,982)	(104,479)
Total recognised income and expense for the year	–	(27,851)	–	–	–	35,111	–	–	(101,497)	(94,237)	16,667	(77,570)
Deemed disposal of a subsidiary	–	–	–	–	–	–	–	–	–	–	(31,949)	(31,949)
Issue of shares on placement	13,740	2,198,400	–	–	–	–	–	–	–	2,212,140	–	2,212,140
Recognition of share-based payments	–	–	–	–	–	–	–	35,194	–	35,194	–	35,194
Transfer	–	–	–	–	–	–	(327)	–	327	–	–	–
	13,740	2,198,400	–	–	–	–	(327)	35,194	327	2,247,334	(31,949)	2,215,385
At 31 March 2008	127,771	13,027,326	(10,346,845)	287,545	–	55,540	502	35,194	(245,296)	2,941,737	191,418	3,133,155

Consolidated Cash Flow Statement

For the year ended 31 March 2008

	Note	2008 HK$'000	2007 HK$'000 (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES			
(Loss)/profit before tax		(108,302)	21,559
Adjustments for:			
Depreciation		7,978	664
Share of loss of an associate		758	—
Interest income		(38,807)	(14,330)
Interest expenses		—	951
Equity-settled share-based payments		35,194	—
Fair value gain on investment properties		—	(2,020)
Gain on disposal of property, plant and equipment		(4)	—
Gain on deemed disposal of a subsidiary		(7,395)	—
Net gain on disposals of financial assets at fair value through profit or loss		(11,521)	(8,896)
Gain on disposals of property and investment properties		—	(12,788)
Operating loss before working capital changes		(122,099)	(14,860)
Additions to properties under development		(162,053)	(21,312)
Increase in trade and other receivables		(50,809)	(2,217)
Decrease/(increase) in amount due from a director		5	(5)
Decrease/(increase) in amount due from a related company		69	(69)
Increase in trade and other payables		80,738	8,804
Increase/(decrease) in amounts due to directors		1,604	(8,524)
Increase/(decrease) in amounts due to related companies		3,189	(10,603)
Increase in amount due to a minority equity holder		176,503	31,402
Cash used in operations		(72,853)	(17,384)
Interest paid		—	(951)
Income taxes paid		(1,898)	(1,314)
Net cash used in operating activities		(74,751)	(19,649)

	Note	2008 HK$'000	2007 HK$'000 (Restated)
CASH FLOWS FROM INVESTING ACTIVITIES			
Decrease/(increase) in pledged bank deposits		128,043	(128,043)
Loan receivables granted to unrelated companies		(650,000)	(73,000)
Repayments of loan receivables from unrelated companies		75,368	—
Deemed disposal of a subsidiary	33	(57,426)	—
Net proceeds from disposal of property and investment properties		—	32,771
Purchases of financial assets at fair value through profit or loss		(168,768)	(72,386)
Sales of financial assets at fair value through profit or loss		179,785	75,173
Purchases of property, plant and equipment		(46,395)	(8,314)
Proceeds from disposal of property, plant and equipment		24	—
Advance from a corporate shareholder		133,724	135,310
Interest received		22,412	13,050
Net cash used in investing activities		(383,233)	(25,439)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issue of shares		2,212,140	170,000
Share issue expenses paid		(27,851)	(1,716)
Repayments of bank loans		—	(14,706)
Net cash generated from financing activities		2,184,289	153,578
NET INCREASE IN CASH AND CASH EQUIVALENTS		1,726,305	108,490
Effect of foreign exchange rate changes		26,141	10,312
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		361,014	242,212
CASH AND CASH EQUIVALENTS AT END OF YEAR		2,113,460	361,014
ANALYSIS OF CASH AND CASH EQUIVALENTS			
Bank and cash balances		2,113,460	361,014

Notes to the Financial Statements

For the year ended 31 March 2008

1. General Information

The Company was incorporated in the Cayman Islands and redomiciled to Bermuda as an exempted company with limited liability under the Companies Act of Bermuda. The address of its registered office is Clarendon House, 2 Church Street, Hamilton HM11, Bermuda. The address of its principal place of business is Unit 2112, 21/F, Two Pacific Place, 88 Queensway, Hong Kong. The Company's shares are listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

During the year, the Company is primarily involved in investment holding. The principal activities of its subsidiaries are set out in note 38 to the financial statements.

In the opinion of the directors of the Company, as at 31 March 2008, He Fu International Limited ("He Fu"), a company incorporated in the British Virgin Islands, is the immediate and ultimate parent and Mr. Zhang Hongwei is the ultimate controlling party of the Company.

2. Adoption of New and Revised HKFRSs

In the current year, the Group has adopted all the new and revised Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") that are relevant to its operations and effective for its accounting year beginning on 1 April 2007. HKFRSs comprise Hong Kong Financial Reporting Standards; Hong Kong Accounting Standards; and Interpretations. The adoption of these new and revised HKFRSs did not result in substantial changes to the Group's accounting polices and amounts reported for the current year and prior years.

The Group has not applied the new HKFRSs that have been issued but are not yet effective. The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a material impact on its results of operations and financial position.

3. Significant Accounting Policies

These financial statements have been prepared in accordance with HKFRSs, accounting principles generally accepted in Hong Kong and the applicable disclosures required by the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules") and by the Hong Kong Companies Ordinance.

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of investment properties and financial assets at fair value through profit or loss which are carried at their fair values.

The preparation of financial statements in conformity with HKFRSs requires the use of certain key assumptions and estimates. It also requires the directors to exercise its judgements in the process of applying the accounting policies. The areas involving critical judgements and areas where assumptions and estimates are significant to these financial statements, are disclosed in note 4 to the financial statements.

The significant accounting policies applied in the preparation of these financial statements are set out below.

(a) Consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries made up to 31 March. Subsidiaries are entities over which the Group has control. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group has control.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date the control ceases.

The gain or loss on the disposal of a subsidiary represents the difference between the proceeds of the sale and the Group's share of its net assets together with any goodwill relating to the subsidiary which was not previously charged or recognised in the consolidated income statement and also any related accumulated foreign currency translation reserve.

Inter-company transactions, balances and unrealised profits on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Minority interests represent the interests of minority shareholders in the operating results and net assets of subsidiaries. Minority interests are presented in the consolidated balance sheet and consolidated statement of changes in equity within equity. Minority interests are presented in the consolidated income statement as an allocation of profit or loss for the year between minority and shareholders of the Company. Losses applicable to the minority in excess of the minority's interests in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses. If the subsidiary subsequently reports profits, such profits are allocated to the interests of the Group until the minority's share of losses previously absorbed by the Group has been recovered.

(b) Merger accounting for common control combinations

(i) Pursuant to the sale and purchase agreement dated 22 September 2005, the Company issued 5,080,000,000 shares at par value of HK$0.01 each as consideration to acquire Grand Hope Group Limited ("Grand Hope") and its subsidiaries ("Grand Hope Group") from He Fu (the "First Acquisition"). The First Acquisition was a very substantial acquisition pursuant to the Listing Rules. Details of the First Acquisition were set out in the Company's circular dated 31 March 2006. The First Acquisition was completed on 6 June 2006.

Grand Hope Group is principally engaged in the investment holding, property development and investment and wholesale of household building materials.

As the Company and Grand Hope Group were both ultimately controlled by He Fu before and after the First Acquisition, the First Acquisition was accounted for as a business combination of entities under common control. The financial statements of the Group for the year ended 31 March 2007 were prepared based on the principles of merger accounting in accordance with the Accounting Guideline 5 "Merger Accounting for Common Control Combinations" (the "AG 5") issued by the HKICPA, as if the First Acquisition had occurred from the date when the combining entities first came under the control of He Fu.

(ii) Pursuant to the sale and purchase agreement dated 8 August 2007, the Company issued 4,360,248,448 shares at par value of HK$0.01 each as consideration to acquire 51%, 34% and 15% equity interest in United Petroleum & Natural Gas Investments Limited ("United Petroleum") from United Energy Holdings Limited ("United Energy"), United Petroleum & Natural Gas Holdings Limited ("United Petroleum Holdings") and Kowin Limited respectively (the "Second Acquisition"). In addition, the Company issued 166,859,809 shares at par value of HK$0.01 each to United Energy for acquiring the loan of HK$268,644,000 due to United Energy by United Petroleum before the completion of the Second Acquisition. United Energy and United Petroleum Holdings were wholly owned by Mr. Zhang Hongwei. Details of the Second Acquisition were set out in the Company's circular dated 17 September 2007. The Second Acquisition was completed on 16 October 2007.

United Petroleum is principally engaged in production of crude oil in the People's Republic of China ("PRC").

As the Company and United Petroleum were both ultimately controlled by Mr. Zhang Hongwei before and after the Second Acquisition, the Second Acquisition was accounted for as a business combination of entities under common control. The financial statements of the Group for the year ended 31 March 2008 were prepared based on the principles of merger accounting in accordance with the AG 5, as if the Second Acquisition had occurred from the date when the combining entities first came under the control of Mr. Zhang Hongwei. Comparative figures have been restated accordingly.

(iii) The consolidated financial statements incorporate the financial statements of the combining entities as if they had been combined from the date when they first came under the control of the controlling party.

The consolidated income statement and consolidated cash flow statement include the results and cash flows of the combining entities from the earliest date presented or since the date when the combining entities first came under the common control, where this is a shorter period, regardless of the date of the common control combination.

The consolidated balance sheet has been prepared to present the assets and liabilities of the combining entities as if the Group structure as at 31 March 2008 had been in existence at each balance sheet date. The net assets of the combining entities are combined using the existing book values from the controlling party's perspective. No amount is recognised in respect of goodwill or excess of acquirers' interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over the cost at the time of common control combination, to the extent of the continuation of the controlling party's interest.

There was no adjustment made to the net assets nor the net profit or loss of any combining entities in order to achieve consistency of the Group's accounting policies.

(c) Associates

Associates are entities over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policies of an entity but is not control or joint control over those policies. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group has significant influence.

Investment in an associate is accounted for in the consolidated financial statements by the equity method of accounting and is initially recognised at cost. Identifiable assets, liabilities and contingent liabilities of the associate in an acquisition are measured at their fair values at the acquisition date. The excess of the cost of acquisition over the Group's share of the net fair value of the associate's identifiable assets, liabilities and contingent liabilities is recorded as goodwill. The goodwill is included within the carrying amount of the investment and is assessed for impairment as part of the investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition is recognised in the consolidated income statement.

The Group's share of an associate's post-acquisition profits or losses is recognised in the consolidated income statement, and its share of the post-acquisition movements in reserves is recognised in the consolidated reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the Group resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

The gain or loss on the disposal of an associate represents the difference between the proceeds of the sale and the Group's share of its net assets together with any goodwill relating to the associate which was not previously charged or recognised in the consolidated income statement and also any related accumulated foreign currency translation reserve.

Unrealised profits on transactions between the Group and its associates are eliminated to the extent of the Group's interests in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

(d) Joint venture

A joint venture is a contractual arrangement whereby the Group and other parties undertake an economic activity that is subject to joint control. Joint control is the contractually agreed sharing of control over the economic activity when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.

In respect of interests in jointly controlled operations, the Group recognises in its financial statements, the assets that it controls and the liabilities that it incurs; and the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture.

(e) Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Hong Kong dollars, which is the Company's functional and presentation currency.

(ii) Transactions and balances in each entity's financial statements

Transactions in foreign currencies are translated into the functional currency using the exchange rates prevailing on the transaction dates. Monetary assets and liabilities in foreign currencies are translated at the rates ruling on the balance sheet date. Profits and losses resulting from this translation policy are included in the consolidated income statement.

Translation differences on non-monetary items, such as equity instruments classified as financial assets at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equity instruments classified as available-for-sale financial assets, are included in the investment revaluation reserve in equity.

(iii) Translation on consolidation

The results and financial position of all the Group entities that have a functional currency different from the Company's presentation currency are translated into the Company's presentation currency as follows:

— Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

— Income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the exchange rates on the transaction dates); and

— All resulting exchange differences are recognised in the foreign currency translation reserve.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities and of borrowings are recognised in the foreign currency translation reserve. When a foreign operation is sold, such exchange differences are recognised in the consolidated income statement as part of the profit or loss on disposal.

(f) Investment properties

Investment properties are land and/or buildings held to earn rentals and/or for capital appreciation. An investment property is measured initially at its cost including all direct costs attributable to the property.

After initial recognition, the investment property is stated at its fair value based on valuation by an external independent valuer. Gains or losses arising from changes in fair value of the investment property are included in the consolidated income statement for the period in which they arise.

If an item of property, plant and equipment becomes an investment property because its use has changed, any difference resulting between the carrying amount and the fair value of this item at the date of transfer is recognised in equity as a revaluation of property, plant and equipment. However, if a fair value gain reverses a previous impairment loss, the gain is recognised in the consolidated income statement.

If an investment property becomes owner-occupied or a property held for sale, it is reclassified as property, plant and equipment or properties held for sale as appropriate, and its fair value at the date of reclassification becomes its cost for accounting purposes.

Property that is being constructed or developed for future use as investment property is classified as investment properties under construction in property, plant and equipment and stated at cost less impairment losses until construction or development is completed, at which time it is reclassified as an investment property at fair value. The difference between the fair value and the previous carrying amount is recognised in the consolidated income statement.

The gain or loss on disposal of an investment property is the difference between the net sales proceeds and the carrying amount of the property, and is recognised in the consolidated income statement.

(g) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the consolidated income statement during the period in which they are incurred.

Depreciation of property, plant and equipment is calculated at rates sufficient to write off their cost less their residual values over the estimated useful lives on a straight-line basis. The principal residual values and annual depreciation rates are as follows:

	Residual values	**Annual depreciation rate**
Land and buildings	—	5%
Leasehold improvements	—	5%-33.3%
Motor vehicles	0%-3%	12.5%-25%
Furniture, fixtures and equipment	3%-10%	20%
Plant and machinery	—	20%

The residual values, useful lives and depreciation method are reviewed and adjusted, if appropriate, at each balance sheet date.

Investment properties under construction represents properties being constructed or developed for future use as investment properties, and is stated at cost less impairment losses.

The gain or loss on disposal of property, plant and equipment is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the consolidated income statement.

(h) Properties for sale under development

Properties for sale under development are stated at the lower of cost and net realisable value. Costs include acquisition costs, prepaid land lease payments, construction costs, borrowing costs capitalised and other direct costs attributable to such properties. Net realisable value is determined by reference to sale proceeds received after the balance sheet date less selling expenses, or by estimates based on prevailing market condition. On completion, the properties are reclassified to properties held for sale at the then carrying amount.

(i) Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases.

(i) The Group as lessee

Lease payments (net of any incentives received from the lessor) are expensed in the consolidated income statement on a straight-line basis over the lease term.

(ii) The Group as lessor

Rental income from operating leases is recognised in the consolidated income statement on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised as an expense on a straight-line basis over the lease term.

(j) Recognition and derecognition of financial instruments

Financial assets and financial liabilities are recognised in the consolidated balance sheet when the Group becomes a party to the contractual provisions of the instruments.

Financial assets are derecognised when the contractual rights to receive cash flows from the assets expire; the Group transfers substantially all the risks and rewards of ownership of the assets; or the Group neither transfers nor retains substantially all the risks and rewards of ownership of the assets but has not retained control on the assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised directly in equity is recognised in the consolidated income statement.

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognised and the consideration paid is recognised in the consolidated income statement.

(k) Investments

Investments are recognised and derecognised on a trade date basis where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, plus directly attributable transaction costs except in the case of financial assets at fair value through profit or loss.

Financial assets at fair value through profit or loss are either investments held for trading or designated as at fair value through profit or loss upon initial recognition. These investments are subsequently measured at fair value. Gains or losses arising from changes in fair value of these investments are recognised in the consolidated income statement.

(l) Trade and other receivables

Trade and other receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less allowance for impairment. An allowance for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the allowance is the difference between the receivables' carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate computed at initial recognition. The amount of the allowance is recognised in the consolidated income statement.

Impairment losses are reversed in subsequent periods and recognised in the consolidated income statement when an increase in the receivables' recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to the restriction that the carrying amount of the receivables at the date the impairment is reversed shall not exceed what the amortised cost would have been had the impairment not been recognised.

(m) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents represent cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term highly liquid investments which are readily convertible into known amounts of cash and subject to an insignificant risk of change in value. Bank overdrafts which are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents.

(n) Financial liabilities and equity instruments

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument under HKFRSs. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. The accounting policies adopted for specific financial liabilities and equity instruments are set out below.

(o) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred, and subsequently measured at amortised cost using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

(p) Trade and other payables

Trade and other payables are stated initially at their fair value and subsequently measured at amortised cost using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost.

(q) Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

(r) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and is recognised when it is probable that the economic benefits will flow to the Group and the amount of revenue can be measured reliably.

Rental income is recognised on a straight-line basis over the lease term.

Property management service fee income is recognised when the services are rendered.

Revenues from the wholesale of household building materials are recognised on the transfer of significant risks and rewards of ownership, which generally coincides with the time when the goods are delivered and the title has passed to the customers.

Interest income is recognised on a time-proportion basis using the effective interest method.

(s) Employee benefits

(i) Employee leave entitlements

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long service leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are not recognised until the time of leave.

(ii) Pension obligations

The Group contributes to defined contribution retirement schemes which are available to all employees. Contributions to the schemes by the Group and employees are calculated as a percentage of employees' basic salaries. The retirement benefit scheme cost charged to the consolidated income statement represents contributions payable by the Group to the funds.

(iii) Termination benefits

Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

(t) Share-based payments

The Group issues equity-settled share-based payments to certain directors and employees. Equity-settled share-based payments are measured at fair value (excluding the effect of non market-based vesting conditions) of the equity instruments at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest and adjusted for the effect of non market-based vesting conditions.

(u) Research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

(v) Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sales, are capitalised as part of the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specified borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation is determined by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate is the weighted average of the borrowing costs applicable to the borrowings of the Group that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

All other borrowing costs are recognised in the consolidated income statement in the period in which they are incurred.

(w) Taxation

Income tax represents the sum of the current tax and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences, unused tax losses or unused tax credits can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based on tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited to the consolidated income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

(x) Related parties

A party is related to the Group if:

(i) directly or indirectly through one or more intermediaries, the party controls, is controlled by, or is under common control with, the Group; has an interest in the Group that gives it significant influence over the Group; or has joint control over the Group;

(ii) the party is an associate;

(iii) the party is a joint venture;

(iv) the party is a member of the key management personnel of the Company or its parent;

(v) the party is a close member of the family of any individual referred to in (i) or (iv);

(vi) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (iv) or (v); or

(vii) the party is a post-employment benefit plan for the benefit of employees of the Group, or of any entity that is a related party of the Group.

(y) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products and services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal financial reporting, the Group has determined that business segments be presented as the primary reporting format and geographical segments as the secondary reporting format.

Segment revenue, expenses, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to the segment. Unallocated costs mainly represent corporate expenses. Segment assets consist primarily of property, plant and equipment, investment properties, trade and other receivables and bank and cash balances. Segment liabilities comprise operating liabilities and exclude items such as tax liabilities and corporate borrowings.

Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between Group enterprises within a single segment. Inter-segment pricing is based on terms mutually agreed between the segments.

Segment capital expenditure is the total cost incurred during the period to acquire segment assets (both tangible and intangible) that are expected to be used for more than one period.

(z) Impairment of assets

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets except investment properties, receivables and investments to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the assets is estimated in order to determine the extent of the impairment loss. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset or cash-generating unit is estimated to be less than its carrying amount, the carrying amount of the asset or cash-generating unit is reduced to its recoverable amount. An impairment loss is recognised immediately in the consolidated income statement, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset or cash-generating unit is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset or cash-generating unit in prior years. A reversal of an impairment loss is recognised immediately in the consolidated income statement, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

(aa) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group has a present legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow is remote.

(bb) Events after the balance sheet date

Events after the balance sheet date that provide additional information about the Group's position at the balance sheet date or those that indicate the going concern assumption is not appropriate are adjusting events and are reflected in the financial statements. Events after the balance sheet date that are not adjusting events are disclosed in the notes to the financial statements when material.

4. Critical Judgement and Key Estimates

Critical judgements in applying accounting policies

In the process of applying the accounting policies, the directors have made the following judgements that have the most significant effect on the amounts recognised in the financial statements (apart from those involving estimation, which are dealt with below).

(a) Split of land and buildings elements

The Group determines that the lease payments cannot be allocated reliably between the land and buildings elements. Accordingly the entire lease of land and buildings is classified as a finance lease and included under property, plant and equipment.

(b) Legal titles of land and buildings and investment properties

As stated in notes 15 and 16 to the financial statements, the titles of land and buildings and investment properties were not transferred to the Group as at 31 March 2008. Despite the fact that the Group has not obtained the relevant legal titles, the directors determine to recognise those land and buildings as property, plant and equipment and investment properties respectively, on the grounds that they expect the transfer of legal titles in future should have no major difficulties and the Group is in substance controlling those land and buildings.

Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

(a) Fair values of investment properties

The Group appointed an independent professional valuer to assess the fair values of the investment properties. In determining the fair values, the valuer has utilised a method of valuation which involves certain estimates. The directors have exercised their judgement and are satisfied that the method of valuation is reflective of the current market conditions.

(b) Income tax

The Group is subject to income taxes in several jurisdictions. Significant estimates are required in determining the provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

(c) *Share-based payments expenses*

The fair value of the share options granted to the directors determined at the date of grant of the respective share options is expensed over the vesting period, with a corresponding adjustment to the Group's share-based payments reserve. In assessing the fair value of the share options, the Black-Scholes option pricing model (the "Black-Scholes Model") was used. The Black-Scholes Model is one of the generally accepted methodologies used to calculate the fair value of the share options. The Black-Scholes Model requires the input of subjective assumptions, including the expected volatility and expected life of options. Any changes in these assumptions can significantly affect the estimate of the fair value of the share options.

5. Financial Risk Management

The Group's activities expose it to a variety of financial risks: interest rate risk, liquidity risk, credit risk, price risk and foreign currency risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance.

(a) Interest rate risk

The Group's exposure to interest-rate risk arises from its bank deposits and loan receivables.

The Group's certain bank deposits mainly bear interest at variable rates varied with the then prevailing market condition.

At 31 March 2008, if interest rates at that date had been 50 basis points lower/higher with all other variables held constant, consolidated loss after tax for the year would have been HK$9,127,000 higher/lower, arising mainly as a result of lower/higher interest income on the bank deposits bearing interest at variable rates.

At 31 March 2007, if interests rates at that date had been 50 basis points lower/higher, with all other variables held constant, consolidated profit after tax for the year would have been HK$792,000 lower/higher, arising mainly as a result of lower/higher interest income on the bank deposits bearing interest at variable rates.

The Group's certain bank deposits and loan receivables bear interests at fixed interest rates, and therefore are subject to fair value interest rate risks.

(b) Liquidity risk

The Group's policy is to regularly monitor current and expected liquidity requirements to ensure that it maintains sufficient reserves of cash to meet its liquidity requirements in the short and long term.

The maturity of the Group's financial liabilities at the balance sheet date is less than one year.

(c) Credit risk

The carrying amount of the bank and cash balances, trade and other receivables, financial assets at fair value through profit or loss and amount due from an associate included in the consolidated balance sheet represents the Group's maximum exposure to credit risk in relation to the Group's financial assets.

The Group has no significant concentrations of credit risk.

The credit quality of the counterparties in respect of trade and other receivables is assessed by taking into account their financial position, credit history and other factors. Given the constant repayment history, the directors are of the opinion that the risk of default by these counterparties is low.

The credit risk on bank and cash balances is limited because the counterparties are banks with high credit-ratings assigned by international credit-rating agencies and PRC large state-controlled banks.

(d) Price risk

The Group's financial assets at fair value through profit or loss are measured at fair value at each balance sheet date. Therefore, the Group is exposed to equity security price risk. The directors manage this exposure by maintaining a portfolio of investments with difference risk profiles.

At 31 March 2008, if the share prices of the equity investments had increased/decreased by 10 per cent, consolidated loss after tax for the year would have been HK$690,000 lower/higher.

At 31 March 2007, if the share prices of the equity investments had increased/decreased by 10 per cent, consolidated profit after tax for the year would have been HK$611,000 higher/lower.

(e) Foreign currency risk

The Group has minimal exposure to foreign currency risk as most of its business transactions, assets and liabilities are principally denominated in Hong Kong dollars ("HK$"), United States dollars ("US$") and Renminbi ("RMB") and the functional currencies of the principal operating Group entities are HK$ and RMB. The Group currently does not have a foreign currency hedging policy in respect of foreign currency transactions, assets and liabilities. The Group will monitor its foreign currency exposure closely and will consider hedging significant foreign currency exposure should the need arise.

At 31 March 2008, if the US$ had weakened/strengthened 1 per cent against the HK$ with all other variables held constant, consolidated loss after tax for the year would have been HK$1,901,000 higher/lower, arising mainly as a result of the foreign exchange loss/gain on bank and cash balances denominated in US$.

At 31 March 2007, if the US$ had weakened/strengthened 1 per cent against the HK$ with all other variables held constant, consolidated profit after tax for the year would have been HK$1,284,000 lower/higher, arising mainly as a result of the foreign exchange loss/gain on bank and cash balances denominated in US$.

(f) Fair value

The carrying amounts of the Group's financial assets and financial liabilities as reflected in the consolidated balance sheet approximate their respective fair values.

6. Turnover

The Group's turnover which represents rental income, property management service fee income and wholesale of household building materials are as follows:

	2008	**2007**
	HK$'000	*HK$'000*
Rental income	3,114	9,491
Property management service fee income	1,779	3,359
Wholesale of household building materials	—	3,083
	4,893	15,933

7. Other Income

	2008	**2007**
	HK$'000	*HK$'000*
		(Restated)
Fair value gain on investment properties	—	2,020
Gain on disposals of property and investment properties	—	12,788
Net gain on disposals of financial assets at fair value through profit or loss	11,521	8,896
Interest income	38,807	14,330
Gain on disposal of property, plant and equipment	4	—
Net foreign exchange gains	3,777	—
Others	1,464	2,834
	55,573	40,868

8. Segment Information

(a) Primary reporting format — business segments

The Group is organised into four main business segments:

Property development	—	The property development segment engages in development of commercial properties for sales;
Property investment	—	The property investment segment invests in commercial properties for their rental income, property management service fee income and value appreciation potential;
Wholesale of household building materials	—	The wholesale of household building materials segment engages in trading of household building materials on indent basis;
Oil exploitation	—	The oil exploitation segment engages in activities relating to the production of crude oil.

(b) Secondary reporting format — geographical segments

More than 90% of the Group's turnover and operating profit is earned within the PRC and all major operating assets of the Group are located in the PRC. Therefore, no geographical segment is presented.

Primary reporting format — business segments:

	Property development	Property investment	Wholesale of household building materials	Oil exploitation	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Year ended 31 March 2008					
Total revenue	—	4,893	—	—	4,893
Segment results before fair value gain on investment properties and gain on disposals of property and investment properties	(16,201)	154	(125)	(95,502)	(111,674)
Gain on disposals of property and investment properties	—	—	—	—	—
Fair value gain on investment properties	—	—	—	—	—
Segment results	(16,201)	154	(125)	(95,502)	(111,674)
Other income					55,573
Unallocated expenses					(58,838)
Loss from operations					(114,939)
Finance costs					—
Gain on deemed disposal of a subsidiary	7,395				7,395
Share of loss of an associate	(758)				(758)
Loss before tax					(108,302)
At 31 March 2008					
Segment assets	66,551	203,841	270,256	244,086	784,734
Investment in an associate	86,403	—	—	—	86,403
Unallocated assets					2,332,544
Total assets					3,203,681
Segment liabilities	—	18,897	119	12,701	31,717
Unallocated liabilities					38,809
Total liabilities					70,526
Other segment information:					
Capital expenditure	5,184	—	—	41,211	46,395
Depreciation	166	31	3	7,778	7,978
Equity-settled share-based payments	—	—	—	—	35,194

	Property development	Property investment	Wholesale of household building materials	Oil exploitation	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
				(Restated)	(Restated)
Year ended 31 March 2007					
Total revenue	—	12,850	3,083	—	15,933
Segment results before fair value gain on investment properties and gain on disposals of property and investment properties	(5,568)	7,131	(365)	(9,219)	(8,021)
Gain on disposals of property and investment properties	—	12,788	—	—	12,788
Fair value gain on investment properties	—	2,020	—	—	2,020
Segment results	(5,568)	21,939	(365)	(9,219)	6,787
Other income					26,060
Unallocated expenses					(10,337)
Profit from operations					22,510
Finance costs					(951)
Profit before tax					21,559
At 31 March 2007					
Segment assets	544,537	189,744	245,916	134,925	1,115,122
Unallocated assets					283,922
Total assets					1,399,044
Segment liabilities	18,196	1,202	107	878	20,383
Unallocated liabilities					383,321
Total liabilities					403,704
Other segment information:					
Capital expenditure	5,755	1,943	—	616	8,314
Depreciation	76	582	3	3	664

9. (Loss)/Profit from Operations

(Loss)/profit from operations is arrived at after charging the following:

	2008 *HK$'000*	2007 *HK$'000* (Restated)
Auditor's remuneration		
— Current	753	915
— Under-provision in prior year	61	214
	814	1,129
Depreciation	7,978	664
Directors' emoluments *(note 12)*	16,448	2,934
Operating lease rentals paid in respect of rented premises *(note)*	3,159	1,786
Research and development expenditures	12,726	723
Staff costs including directors' emoluments		
Salaries, bonuses and allowances *(note)*	11,109	7,560
Retirement benefits scheme contributions	426	285
Equity-settled share-based payments	35,194	—
	46,729	7,845
Direct operating expenses of investment properties that generate rental income	3,987	2,264

Note: The amount includes the accommodation benefits provided to a director amounting to HK$228,000 (2007: HK$206,000) included in the directors' emoluments.

10. Finance Costs

	2008 *HK$'000*	2007 *HK$'000*
Interest on bank loans	17,105	19,147
Amount capitalised	(17,105)	(18,196)
	—	951

Borrowing costs on funds borrowed generally are capitalised at a rate of 5.3% per annum (2007: 6%).

11. Income Tax (credit)/Expense

	2008	2007
	HK$'000	*HK$'000*
Current tax — PRC enterprise income tax		
Provision for the year	680	1,306
Under/(over)-provision in prior years	10	(28)
	690	1,278
Deferred tax *(note 28)*	(4,513)	1,293
	(3,823)	2,571

No provision for profits tax in the Bermuda, the British Virgin Islands or Hong Kong is required as the Group has no assessable profit arising in or derived from these jurisdictions for the year ended 31 March 2008 (2007: Nil).

PRC enterprise income tax is calculated at the applicable rates based on estimated taxable income earned by the companies with certain tax preference, based on existing legislation, interpretation and practices in respect thereof.

The new PRC enterprise income tax law passed by the Tenth National People's Congress on 16 March 2007 introduces various changes which include the unification of the enterprise income tax rate for domestic and foreign enterprises at 25%. The new tax law became effective from 1 January 2008. As a result, the tax rate for the PRC subsidiaries had been reduced from 33% to 25%.

The reconciliation between the income tax (credit)/expense and the product of profit before tax multiplied by the PRC enterprise income tax rate is as follows:

	2008	2007
	HK$'000	*HK$'000*
		(Restated)
(Loss)/profit before tax (excluding share of loss of an associate)	(107,544)	21,559
Tax at the statutory PRC enterprise income tax rate of 25% (2007: 33%)	(26,886)	7,114
Tax effect of income that is not taxable	(5,093)	(6,068)
Tax effect of expenses that are not deductible	10,265	5,385
Tax effect of tax losses not recognised	24,851	631
Tax effect of utilisation of tax losses not previously recognised	(2,986)	(883)
Tax effect of temporary differences not recognised	1,449	—
Tax effect of change in tax rate in PRC	(1,607)	—
Tax effect on decrease in tax rate for opening deferred tax balances	(4,513)	—
Under/(over)-provision in prior years	10	(28)
Effect of different tax rates of subsidiaries	687	(3,391)
Tax effect of tax preferential period	—	(189)
Income tax (credit)/expense	(3,823)	2,571

12. Directors' and Employees' Emoluments

The emoluments of each director were as follows:

	Fees	Salaries and other benefits	Share-based payments	Retirement benefits scheme contributions	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Year ended 31 March 2008					
Executive directors:					
Mr. Zhang Hongwei	1,000	—	—	—	1,000
Mr. Zhu Jun	540	—	—	—	540
Ms. Zhang Meiying	1,080	658	12,798	12	14,548
	2,620	658	12,798	12	16,088
Independent non-executive directors:					
Mr. Chau Siuwai	120	—	—	—	120
Mr. San Fung	120	—	—	—	120
Mr. Zhu Chengwu	120	—	—	—	120
	360	—	—	—	360
	2,980	658	12,798	12	16,448

	Fees	Salaries and other benefits	Retirement benefits scheme contributions	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Year ended 31 March 2007				
Executive directors:				
Mr. Zhang Hongwei	1,000	—	—	1,000
Mr. Guan Guoliang *(note c)*	—	—	—	—
Mr. Wong Wingming *(note b)*	—	—	—	—
Mr. Zhu Jun	540	—	—	540
Ms. Zhang Meiying *(note a)*	768	257	9	1,034
	2,308	257	9	2,574
Independent non-executive directors:				
Mr. Chau Siuwai	120	—	—	120
Mr. San Fung	120	—	—	120
Mr. Zhu Chengwu	120	—	—	120
	360	—	—	360
	2,668	257	9	2,934

Notes:

a. Appointed on 19 June 2006

b. Resigned on 30 June 2006

c. Resigned on 18 August 2006

There was no arrangement under which a director waived or agreed to waive any emoluments during the years ended 31 March 2008 and 2007.

The five highest paid individuals in the Group during the year included 3 (2007: 3) directors whose emoluments are reflected in the analysis presented above. The emoluments of the remaining 2 (2007: 2) individuals are set out below:

	2008	2007
	HK$'000	*HK$'000* (Restated)
Salaries and other benefits	2,394	1,737
Retirement benefits scheme contributions	12	9
	2,406	1,746

The emoluments fell within the following band:

	Number of individuals	
	2008	**2007**
	HK$'000	*HK$'000*
		(Restated)
Nil to HK$1,000,000	1	1
HK$1,000,001 to HK$1,500,000	—	1
HK$1,500,001 to HK$2,000,000	1	—
	2	2

During the years ended 31 March 2008 and 2007, no emoluments were paid by the Group to any of the directors or the highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office.

13. (Loss)/Earnings Per Share

Basic (loss)/earnings per share is calculated based on (loss)/earnings attributable to equity holders of the Company during the year divided by the weighted average number of ordinary shares in issue. The calculation of the basic earnings per share is based on the following:

	2008	**2007**
	HK$'000	*HK$'000*
		(Restated)
(Loss)/earnings		
(Loss)/earnings for the purpose of calculating basic (loss)/ earnings per share	(101,497)	16,820

	2008	**2007**
		(Restated)
Number of shares		
Weighted average number of ordinary shares for the purpose of calculating basic (loss)/earnings per share	12,033,780,157	11,095,694,733

In determining the weighted average number of ordinary shares in issue, the 5,080,000,000 ordinary shares as consideration of the First Acquisition (note 3 (b)(i)) and the 4,527,108,257 ordinary shares as consideration of the Second Acquisition (note 3 (b)(ii)) were deemed to be in issue since 1 April 2006.

No diluted earnings per share are presented as the Company did not have any dilutive potential ordinary sharing during the two years ended 31 March 2008.

14. Dividend

No dividend has been paid or declared by the Company during the year (2007: Nil).

15. Property, Plant and Equipment

	Land and buildings	Leasehold improvements	Motor vehicles	Furniture, fixtures and equipment	Investment properties under construction	Plant and machinery	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Cost							
At 1 April 2006	450	—	—	299	136,527	—	137,276
Additions	—	1,441	701	770	5,402	—	8,314
Disposals	(450)	—	—	—	—	—	(450)
Exchange differences	—	—	—	13	5,930	—	5,943
At 31 March 2007, as restated	—	1,441	701	1,082	147,859	—	151,083
Additions	3,466	4,582	1,644	946	4,710	31,047	46,395
Deemed disposal of a subsidiary	—	—	(376)	(720)	(163,684)	—	(164,780)
Disposals	—	—	—	(25)	—	—	(25)
Exchange differences	129	154	121	85	11,115	1,158	12,762
At 31 March 2008	3,595	6,177	2,090	1,368	—	32,205	45,435
Accumulated depreciation							
At 1 April 2006	37	—	—	92	—	—	129
Charge for the year	—	480	15	169	—	—	664
Disposals	(37)	—	—	—	—	—	(37)
Exchange differences	—	—	—	4	—	—	4
At 31 March 2007, as restated	—	480	15	265	—	—	760
Charge for the year	101	751	546	371	—	6,209	7,978
Deemed disposal of a subsidiary	—	—	(60)	(228)	—	—	(288)
Disposals	—	—	—	(5)	—	—	(5)
Exchange differences	3	5	22	25	—	232	287
At 31 March 2008	104	1,236	523	428	—	6,441	8,732
Carrying amount							
At 31 March 2008	3,491	4,941	1,567	940	—	25,764	36,703
At 31 March 2007, as restated	—	961	686	817	147,859	—	150,323

At 31 March 2008, the Group was in the process of applying for the title certificates of its land and buildings with an aggregate carrying amount of approximately HK$3,491,000 (2007: Nil). The Directors are of the view that the Group is entitled to lawfully and validly occupy and use the above-mentioned land and buildings. The Directors are also of the opinion that the aforesaid matter does not have any significant impact on the Group's financial position as at 31 March 2008.

At 31 March 2007, the carrying amount of property, plant and equipment pledged as security for the Group's bank loans amounted to approximately HK$102,101,000.

At 31 March 2007, the carrying amount of prepaid land lease payments included in investment properties under construction which amounted to approximately HK$131,937,000 represents payments for land use rights outside Hong Kong under medium term leases.

16. Investment Properties

	2008	**2007**
	HK$'000	*HK$'000*
At beginning of year	161,616	172,523
Disposal	—	(19,570)
Fair value gain	—	2,020
Exchange differences	15,984	6,643
At end of year	177,600	161,616

The fair value of the Group's investment properties as at 31 March 2008 has been arrived at on the basis of a valuation carried out on that date by BMI Appraisals Limited, independent qualified professional valuer not connected with the Group. BMI Appraisals Limited is a member of The Hong Kong Institute of Surveyors, and has appropriate qualifications and recent experiences in the valuation of similar properties in the relevant locations. The valuation prepared in accordance with the HKIS Valuation Standards on Properties (First Edition 2005) published by The Hong Kong Institute of Surveyors was arrived at by reference to market evidence of transaction prices for similar properties.

The Group's investment properties at their carrying amounts are analysed as follows:

	2008	**2007**
	HK$'000	*HK$'000*
Investment properties held under		
Medium-term leases in the PRC	177,600	161,616

At 31 March 2008, the Group was in the process of applying for the building ownership certificate of the above investment properties. The Directors are of the view that the Group is entitled to lawfully and validly occupy and use the above-mentioned investment properties. The Directors are also of the opinion that the aforesaid matter does not have any significant impact on the Group's financial position as at 31 March 2008.

At 31 March 2007, the carrying amount of investment properties pledged as security for the Group's bank loans amounted to HK$161,616,000.

The Group's investment properties held as at 31 March 2008 are rented to an independent third party for periods up to 20 years. At 31 March 2008, the Group's total future minimum lease payments under non-cancellable operating leases are receivable as follows:

	2008	**2007**
	HK$'000	*HK$'000*
Within one year	6,227	5,878
In the second to fifth years inclusive	25,947	24,198
After five years	81,270	82,887
	113,444	112,963

17. INVESTMENT IN AN ASSOCIATE

	2008	**2007**
	HK$'000	*HK$'000*
Unlisted investments in the PRC:		
Share of net assets	86,403	—

Details of the Group's associate at 31 March 2008 are as follows:

Name of entity	**Place of registration and operation**	**Issued and paid up capital**	**Percentage of ownership interest/ voting power/ profit sharing**	**Principal activity**
Shenyang Dadongfang Property Development Company Limited ("Dadongfang")	PRC	Registered capital of US$35,925,700	30%	Property development

The amount due from an associate is unsecured, interest-free and has no fixed repayment terms.

Summarised financial information in respect of the Group's associate is set out below:

	2008	**2007**
	HK$'000	*HK$'000*
At 31 March		
Total assets	804,413	—
Total liabilities	(516,402)	—
Net assets	288,011	—
Group's share of associate's net assets	86,403	—
Year ended 31 March 2008		
Total revenue	1,200	—
Total loss for the year	(17,425)	—
Group's share of associate's loss for the year	(758)	—

18. Properties Under Development

	2008	2007
	HK$'000	*HK$'000*
At beginning of year	367,480	328,854
Additions	162,053	21,312
Transfer from deposits paid for prepaid land lease payments	—	3,030
Deemed disposal of a subsidiary	(558,330)	—
Exchange differences	28,797	14,284
At end of year	—	367,480

The Group's properties under development at their carrying amounts are analysed as follows:

	2008	2007
	HK$'000	*HK$'000*
Prepaid land lease payments	—	265,766
Construction costs and capitalised expenditures	—	66,133
Interests capitalised	—	35,581
	—	367,480

The Group's prepaid land lease payments represent payments for land use rights outside Hong Kong under medium term leases.

At 31 March 2007, the carrying amount of prepaid land lease payments pledged as security for the Group's bank loans amounted to approximately HK$227,594,000.

19. Trade and Other Receivables

	2008	2007
	HK$'000	*HK$'000*
		(Restated)
Trade receivables *(note a)*	—	32
Loan receivables *(note b)*	666,395	74,280
Receivables arising from dealing in listed securities	48,638	—
Deposits and prepayments	1,267	1,564
Others	50	1,387
Total trade and other receivables	716,350	77,263

(a) The Group's trading terms with customers are mainly on credit. The Group allows an average credit period of 30 days to its trade customers. The Group seeks to maintain strict control over its outstanding receivables. Overdue balances are reviewed regularly by the directors.

The following is an aged analysis of trade receivables, based on invoice dates:

	2008	**2007**
	HK$'000	*HK$'000*
Within 60 days	—	29
61 to 90 days	—	3
	—	32

(b) The loan receivables represent advances to an independent third party. The balance is secured by the borrower's investment in 70% equity interests of a sino-foreign equity joint venture established in the PRC which principally engaged in operation of hotel and related business, carrying interest at 8% per annum and repayable on or before 31 December 2008. Approximately HK$513,000,000 out of the balance has been repaid after the balance sheet date.

The loan receivables were arranged at a fixed interest rate, thus exposing the Group to fair value interest rate risk.

20. Deposits Paid for Prepaid Land Lease Payments

	2008	**2007**
	HK$'000	*HK$'000*
At beginning of year	13,398	15,745
Transfer to properties under development	—	(3,030)
Deemed disposal of a subsidiary	(14,401)	—
Exchange differences	1,003	683
At end of year	—	13,398

The amounts represent deposits paid for acquisition of land parcels, of which land use right certificates have not been obtained. However, as advised by the PRC legal adviser, Saverbj Law Firm ("北京市中高盛律師事務所"), the Group can apply for a refund if the vendor is unable to procure land use right certificates in accordance with the relevant contracts.

21. Due from a Director

Amount due from a director disclosed pursuant to section 161B of the Hong Kong Companies Ordinance is as follows:

Name	**Terms of loan**	**Balance at 31 March 2008**	**Balance at 1 April 2007**	**Maximum amount outstanding during the year**
		HK$'000	*HK$'000*	*HK$'000*
Ms. Zhang Meiying	Unsecured, repayable on demand and interest-free	—	5	5

22. Due from a Corporate Shareholder

As disclosed in note 3(b)(ii) and 29(d) to the financial statements, the Company issued 166,859,809 shares at par value of HK$0.01 each to United Energy for acquiring the loan of HK$268,644,000 due to United Energy by United Petroleum before the completion of the Second Acquisition. The 2007 amount represented the loan to be advanced to United Petroleum by United Energy after 31 March 2007 and prior to the completion of the Second Acquisition.

23. Due from a Related Company

Amount due from a related company disclosed pursuant to section 161B of the Hong Kong Companies Ordinance is as follows:

Name	Name of director having beneficial interest	Balance at 31 March 2008	Balance at 1 April 2007	Maximum amount outstanding during the year
		HK$'000	*HK$'000*	*HK$'000*
Oriental Harbour Holding Limited	Mr. Zhang Hongwei	—	69	69

The above advance is unsecured, interest-free and has no fixed repayment terms.

24. Financial Assets at Fair Value Through Profit or Loss

	2008	2007
	HK$'000	*HK$'000*
Equity securities, at market value		
Listed in Hong Kong and held for trading	6,613	6,109

The investments represent investments in listed equity securities that offer the Group the opportunity for return through dividend income and fair value gains. They have no fixed maturity or coupon rate. The fair values of the listed securities are based on current bid prices. In order to minimise credit risk, the directors have delegated a team to be responsible for formulated a credit policy governing the control of credit risk. In this regard, the Directors consider that the credit risk is significantly reduced.

25. Pledged Bank Deposits and Bank and Cash Balances

At 31 March 2008, the bank and cash balances of the Group denominated in RMB amounted to approximately HK$313,100,000 (2007 (restated): HK$268,873,000). Conversion of RMB into foreign currencies is subject to the PRC's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations.

At 31 March 2007, the Group's cash at bank of approximately HK$128,043,000 was pledged to a bank for the issue of a performance bond relating to a production of crude oil contract. The pledged bank deposits were in US$ and at fixed interest rate of 5% per annum. At 31 March 2007, the pledged bank deposits in US$ of approximately HK$128,043,000 was therefore subject to foreign currency risk and fair value interest rate risk.

26. Trade and Other Payables

	2008	2007
	HK$'000	*HK$'000*
		(Restated)
Trade payables *(note)*	—	7,664
Receipts in advance	16,175	10,101
Accrual for operating expenses	15,939	3,180
Salary and welfare payables	95	543
Deposits received	1,119	152
Other tax payables	652	252
Others	25	641
Total trade and other payables	34,005	22,533

Note: The following is an aged analysis of trade payables at the balance sheet dates:

	2008	2007
	HK$'000	*HK$'000*
Within 60 days	—	638
Over 365 days	—	7,026
	—	7,664

27. Bank Loans

The bank loans are repayable as follows:

	2008	2007
	HK$'000	*HK$'000*
On demand or within one year	—	303,030

The carrying amount of the Group's bank loans are denominated in the following currency:

	2008	2007
	HK$'000	*HK$'000*
RMB	—	303,030

The effective interest rate as at 31 March 2007 is 6.27%.

Bank loans are arranged at floating rates, thus exposing the Group to cash flow interest rate risk.

At 31 March 2007, bank loan of HK$303,030,000 is secured by a charge over the Group's property, plant and equipment of HK$102,101,000, investment properties of HK$161,616,000 and properties under development of HK$227,594,000 as disclosed in note 15, 16 and 18 to the financial statements respectively.

28. Deferred Tax Liabilities

The following are the major deferred tax liabilities recognised by the Group.

	Investment properties
	HK$'000
At 1 April 2006	26,572
Charge to income statement for the year *(note 11)*	1,293
Exchange differences	1,155
At 31 March 2007	29,020
Credit to income statement for the year *(note 11)*	(4,513)
Exchange differences	2,702
At 31 March 2008	27,209

At the balance sheet date the Group has unused tax losses and other deductible temporary differences of approximately HK$86,785,000 and HK$885,000 respectively (2007 (restated): HK$17,653,000 and HK$970,000 respectively) that are available for offsetting against future taxable profits. No deferred tax assets have been recognised due to unpredictability of future profit streams. The unrecognised tax losses and other deductible temporary differences may be carried forward indefinitely.

29. Share Capital

	Note	Number of shares	Amount *HK$'000*
Authorised:			
Ordinary shares of HK$0.01 each			
At 1 April 2006		6,497,447,875	64,975
Increase in authorised share capital	*(a)*	13,502,552,125	135,025
At 31 March 2007 and 1 April 2007		20,000,000,000	200,000
Increase in authorised share capital	*(b)*	40,000,000,000	400,000
At 31 March 2008		60,000,000,000	600,000
Issued and fully paid:			
Ordinary shares of HK$0.01 each			
At 1 April 2006, as previously reported		95,985,375	960
New shares issued in connection with the acquisition of Grand Hope Group	*(c)*	5,080,000,000	50,800
New shares issued in connection with the acquisition of United Petroleum	*(d)*	4,527,108,257	45,271
At 1 April 2006, as restated		9,703,093,632	97,031
Issue of shares on placement	*(e)*	1,699,998,000	17,000
At 31 March 2007, as restated		11,403,091,632	114,031
At 1 April 2007, as previously reported		6,875,983,375	68,760
New shares issued in connection with the acquisition of United Petroleum	*(d)*	4,527,108,257	45,271
At 1 April 2007, as restated		11,403,091,632	114,031
Issue of shares on placement	*(f)*	1,374,000,000	13,740
At 31 March 2008		12,777,091,632	127,771

(a) Pursuant to special resolutions passed on 11 May 2006, the authorised share capital of the Company was increased from HK$64,974,479 to HK$200,000,000 by the creation of 13,502,552,125 additional shares of HK$0.01 each, ranking pari passu in all respects with the existing share capital of the Company.

(b) Pursuant to special resolutions passed on 3 December 2007, the authorised share capital of the Company was increased from HK$200,000,000 to HK$600,000,000 by the creation of 40,000,000,000 additional shares of HK$0.01 each, ranking pari passu in all respects with the existing share capital of the Company.

(c) As disclosed in note 3(b)(i) to the financial statements, the Company issued and allotted 5,080,000,000 new shares at HK$0.01 each to He Fu and credited as fully paid in consideration for acquisition of the entire interest in Grand Hope Group on 6 June 2006. The share capital issued for the First Acquisition is deemed to have been in issue throughout the accounting periods presented in these financial statements.

(d) As disclosed in note 3(b)(ii) to the financial statements, the Company issued and allotted 4,360,248,448 new shares at HK$0.01 each to United Energy, United Petroleum Holdings and Kowin Limited and credited as fully paid in consideration for acquisition of the entire interest in United Petroleum on 16 October 2007. In addition, the Company issued and allotted 166,859,809 new shares at HK$0.01 each to United Energy and credited as fully paid in consideration for acquisition of the loan of HK$268,644,000 due to United Energy by United Petroleum on the same date. The share capital issued for the Second Acquisition is deemed to have been in issue throughout the accounting periods presented in these financial statements.

(e) On 6 June 2006, the Company issued and allotted 1,699,998,000 ordinary shares of HK$0.01 each through a placing of the Company's shares at a consideration of HK$0.10 per share. The Company received net proceeds of approximately HK$168,284,000 from this share issue.

(f) On 16 October 2007, the Company issued and allotted 1,374,000,000 ordinary shares of HK$0.01 each through a placing of the Company's shares at a consideration of HK$1.61 per share. The Company received net proceeds of approximately HK$2,184,289,000 from this share issue.

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern and to maximise the return to the shareholders through the optimisation of the debt and equity balance.

The Group monitors capital by maintaining a net cash position throughout the year. The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain the capital structure, the Group may adjust the payment of dividends, new share issues and raise new debts.

The Group's strategy is to maintain a solid base to support the operations and develop of its business in the long term. No changes were made in the objectives, policies or processes during the years ended 31 March 2007 and 31 March 2008.

The only externally imposed capital requirement is that for the Group to maintain its listing on the Stock Exchange it has to have a public float of at least 25% of the shares. The Group receives a report from the share registrars periodically on substantial share interests showing the non-public float and it demonstrates continuing compliance with the 25% limit throughout the year. As at 31 March 2008, 43% (2007: 25%) of the shares were in public hands.

30. Balance Sheet of the Company

	Note	2008 HK$'000	2007 HK$'000
Investments in subsidiaries		8,450,616	2,286,010
Trade and other receivables		715,828	75,079
Financial assets at fair value through profit or loss		6,613	6,109
Due from a director		—	5
Due from a related company		—	69
Due from a subsidiary		313,597	16,219
Bank and cash balances		1,606,368	68,936
Trade and other payables		(2,206)	(2,124)
Due to directors		(5,534)	(3,930)
Due to a subsidiary		(1,456)	—
NET ASSETS		11,083,826	2,446,373
Capital and reserves			
Share capital		127,771	68,760
Reserves	*31(b)*	10,956,055	2,377,613
TOTAL EQUITY		11,083,826	2,446,373

31. Reserves

(a) Group

The amounts of Group's reserves and the movements therein are presented in the consolidated statement of changes in equity.

(b) Company

	Share premium	Share-based payments reserve	Accumulated losses	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
At 1 April 2006	185,685	—	(204,382)	(18,697)
Share issue expenses paid	(1,716)	—	—	(1,716)
Issue of shares on acquisition of subsidiaries	2,235,200	—	—	2,235,200
Issue of shares on placement	153,000	—	—	153,000
Profit for the year	—	—	9,826	9,826
At 31 March 2007	2,572,169	—	(194,556)	2,377,613
At 1 April 2007	2,572,169	—	(194,556)	2,377,613
Issue of shares on acquisition of a subsidiary	8,284,608	—	—	8,284,608
Issue of shares on placement	2,198,400	—	—	2,198,400
Share issue expenses paid	(27,851)	—	—	(27,851)
Recognition of share-based payments	—	35,194	—	35,194
Loss for the year	—	—	(1,911,909)	(1,911,909)
At 31 March 2008	13,027,326	35,194	(2,106,465)	10,956,055

(c) Nature and purpose of reserves

(i) Share premium account

Share premium represents premium arising from the issue of shares at a price in excess of their par value per share and is not distributable but may be applied in paying up unissued shares of the Company to be issued to the shareholders of the Company as fully paid bonus shares or in providing for the premiums payable on repurchase of shares.

(ii) Merger reserve

Merger reserve represents the difference between the nominal value of the shares of subsidiaries acquired and the market value of the shares issued by the Company as consideration for the acquisition.

(iii) Capital reserve

Capital reserve represents the aggregate of:

— the Group's share of an additional equity contribution made from minority shareholder of a subsidiary, Shenyang Shengtaiyuan Logistic Company Limited, on 19 April 2005; and

— the loan waiver made by the ultimate holding company, He Fu International Limited, to a subsidiary, Grand Hope Group Limited.

(iv) Statutory reserve

Statutory reserve, which is non-distributable, is appropriated from the profit after taxation of the Company's PRC subsidiaries under the applicable laws and regulations in the PRC.

(v) Share-based payments reserve

The share-based payments reserve represents the fair value of the actual or estimated number of unexercised share options granted to directors and employees of the Group recognised in accordance with the accounting policy adopted for equity-settled share-based payments in note 3(t) to the financial statements.

32. Share-based Payments

Equity-settled share option scheme

The Company's share option scheme (the "Scheme") was adopted pursuant to the shareholders' resolution passed on 11 May 2006 for the primary purpose of providing opportunity to directors and employees to acquire proprietary interests of the Group and will expire on 10 May 2016. Under the Scheme, the Board of Directors of the Company may grant options to eligible person (including all directors, employees of the Group, consultants, advisors, agents, customers, service providers, contractors and business partners of any members of the Group).

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 30% of the shares of the Company in issue from time to time. The number of shares issued and to be issued in respect of which options granted and may be granted to any individual is not permitted to exceed 10% of the shares of the Company in issue from time to time.

The exercise price is determined by the directors of the Company, and will not be less than the higher of (i) the closing price of the Company's shares on the date of grant; (ii) the average closing price of the share for the five business dates immediately preceding the date of grant; and (iii) the nominal value of the Company's shares.

Share options granted to any director, chief executive or substantial shareholder, or to any of their associates, are subject to approval in advance by the independent non-executive directors. In addition, any share options granted to substantial shareholders or an independent non-executive director of the Company, or to any of their associates, in excess of 0.1% of the shares of the Company in issue at any time or with an aggregate value (based on the price of the Company's shares at the date of grant) in excess of HK$5 million, within 12 month period, are subject to shareholders' approval in advance in general meeting.

The offer of a grant of share options may be accepted within 30 days from the date of offer, upon payment of a nominal consideration of HK$1 in total by the grantee.

Details of the specific categories of options are as follows:

Grantee	Date of grant	Vesting period	Exercise period	Exercise price *HK$*	Number of share options
Directors and employees	04.12.2007	04.12.2007 to 03.12.2008	04.12.2008 to 03.12.2009	1.56	82,500,000
	04.12.2007	04.12.2007 to 03.12.2009	04.12.2009 to 03.12.2010	1.56	55,000,000
	04.12.2007	04.12.2007 to 03.12.2010	04.12.2010 to 03.12.2011	1.56	55,000,000
	04.12.2007	04.12.2007 to 03.12.2011	04.12.2011 to 03.12.2012	1.56	82,500,000
					275,000,000

If the options remain unexercised after a period of 5 years from the date of grant, the options expire. Options are forfeited if the employee leaves the Group before the options vest.

Details of the share options outstanding during the year are as follows:

	2008	
	Number of share options	Weighted average exercise price *HK$*
Granted during the year and outstanding at the end of the year	275,000,000	1.56
Exercisable at the end of the year	—	

The options outstanding at the end of the year have a weighted average remaining contractual life of 4.68 years and the exercise prices is HK$1.56. The estimated fair value of the options granted on 4 December 2007 is HK$231,400,077.

These fair values were calculated using the Black-Scholes Model. The inputs into the model were as follows:

	2008
Grant date share price	HK$1.49
Exercise price	HK$1.56
Expected volatility	105.04%
Risk free rate	1.160% — 2.403%
Expected life	1-4 years

Expected volatility was based on the historical volatility of the Company's share price over the previous 1 year. The expected life used in the model has been adjusted based on the Group's best estimate, for the effects of non transferability, exercise restrictions and behavioral considerations.

33. Deemed Disposal of a Subsidiary

Dadongfang was accounted for as indirectly held subsidiary as at 31 March 2007. In January 2008, another equity holder of Dadongfang increased its share of equity interest in Dadonfang by contributing additional US$20,745,800 (equivalent to HK$161,817,240) to the registered capital of Dadongfang. As a result, the Group's effective equity interests in Dadongfong was diluted from 71% to 30% and Dadongfang ceased to be a subsidiary and became an associate of the Group thereafter.

The details of the net assets of Dadongfang as at date of deemed disposal were as follows:

	HK$'000
Property, plant and equipment	164,492
Properties under development	558,330
Deposits paid for prepaid land lease payments	14,401
Trade and other receivables	3,518
Bank and cash balances	57,426
Trade and other payables	(72,166)
Due to a related company	(13,750)
Due to a minority equity holder	(211,637)
Due to a fellow subsidiary	(65,099)
Bank loan	(325,733)
Minority interests	(31,949)
	77,833
Gain on deemed disposal	7,395
Satisfied by:	
Transfer to investment in an associate	85,228
An analysis of the net outflow of cash and cash equivalents in respect of the deemed disposal of subsidiary is as follows:	
Cash and cash equivalents disposed of	(57,426)

34. Capital Commitments

The Group's capital commitments at the balance sheet dates are as follows:

	2008	2007
	HK$'000	*HK$'000*
		(Restated)
Contracted but not provided for:		
Construction costs	—	185,409
Prepaid land lease payments	—	353,298
Acquisition of property, plant and equipment	180	3,101
Research and development expenditures	3,754	128,436
	3,934	670,244

35. Operating Lease Commitments

At the balance sheet dates the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	2008	2007
	HK$'000	*HK$'000*
		(Restated)
Within one year	1,319	3,133
In the second to fifth years inclusive	6	1,333
	1,325	4,466

Operating lease payments represent rental payable by the Group for certain of its offices and director's quarters. Leases are negotiated for an average term of 2 years and rentals are fixed over the lease terms and do not include contingent rentals.

36. Retirement Benefits Scheme

Hong Kong

The Group participates in the Mandatory provident fund scheme (the "MPF Scheme") established under the MPF Scheme Ordinance. The assets of the MPF Scheme are held separately from those of the Group in funds under the control of an independent trustee. Under the rules of the MPF Scheme, the employer and its employees are each required to make contributions to the scheme at rates specified in the rules. The only obligation of the Group with respect to the MPF Scheme is to make the required contributions under the scheme. No forfeited contributions are available to reduce contributions payable in future years.

The Group's contribution under the MPF Scheme for the year amounted to HK$84,000 (2007 (restated): HK$70,000).

PRC

According to the relevant laws and regulations in the PRC, the Group's subsidiaries in the PRC are required to contribute a specified percentage of the payroll of their employees to the retirement benefits schemes to fund the retirement benefits of their employees. The only obligation of the Group with respect to the retirement benefits schemes is to make the required contributions under the respective schemes.

The Group's contribution under the respective schemes for the year amounted to HK$342,000 (2007 (restated): HK$215,000).

37. Related Party Transactions

In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following transactions with its related parties during the year:

(a) Transactions with related parties:

	2008	2007
	HK$'000	*HK$'000* (Restated)
東方集團能源投資控股有限公司		
— Research and development expenses paid	3,852	—
— Operating lease rental received	139	88

A director of the Company, Mr. Zhang Hongwei, has significant influence over the above related company.

(b) Balances with related parties:

The amounts due to related companies, directors and a minority equity holder are unsecured, interest-free and repayable on demand.

38. Subsidiaries

Particulars of the subsidiaries as at 31 March 2008 are as follows:

Name of subsidiary	Place of incorporation/ registration	Issued and fully paid share capital/ registration capital	Proportion of ownership interest			Principal activities
			Group's effective interest	Held by the Company	Held by subsidiaries	
Fine Profit Corporation Limited	Hong Kong	HK$10,000	100%	100%	—	Provision of administrative services
Grand Hope Group Limited	British Virgin Islands	US$1	100%	100%	—	Investment holding
Shenyang Shengtaicheng Property Development Company Limited ("Shengtaicheng")	PRC	US$13,021,800	71%	—	71%	Property investment
Shenyang Shengtaiyuan Logistics Company Limited ("Shengtaiyuan")	PRC	RMB60,000,000	56.8%	—	80%	Wholesale of household building materials
United Petroleum	British Virgin Islands	US$50,000	100%	100%	—	Production of crude oil in the PRC

Shengtaicheng is a sino-foreign equity joint venture and Shengtaiyuan is a domestic enterprise established in the PRC.

39. Events After Balance Sheet Date

(a) On 11 June 2008 (the "Agreement Date"), the Company and Transmeridian Exploration Incorporated entered into an investment agreement (the "Agreement") whereby the Company will invest an aggregate consideration of approximately US$188.2 million (equivalent to approximately HK$1,468 million) in Transmeridian.

The investment will include a cash injection of US$75 million (equivalent to approximately HK$585 million) in Transmeridian, the acquisition of 100% of the 15% senior redeemable convertible preferred stocks issued by Transmeridian outstanding as of the Agreement Date for a consideration of US$45.1 million (equivalent to approximately HK$352 million) and the acquisition of 100% of the 20% junior redeemable convertible preferred stocks issued by Transmeridian outstanding as of the Agreement Date for a consideration of US$68.1 million (equivalent to approximately HK$531 million).

Details of the transaction are set out in the Company's announcement dated 20 June 2008.

(b) On 20 May 2008, the board of directors approved to grant 330,000,000 share options to the employees of the Group. Each option gives the holders the right to subscribe for one ordinary share of the Company. The terms and conditions of the options granted are as follows:

Grantee	Date of grant	Vesting period	Exercise period	Exercise price *HK$*	Number of share options
Employees	20.05.2008	20.05.2008 to 19.12.2009	20.05.2009 to 19.12.2010	0.902	99,000,000
	20.05.2008	20.05.2008 to 19.12.2010	20.05.2010 to 19.12.2011	0.902	66,000,000
	20.05.2008	20.05.2008 to 19.12.2011	20.05.2011 to 19.12.2012	0.902	66,000,000
	20.05.2008	20.05.2008 to 19.12.2012	20.05.2012 to 19.12.2013	0.902	99,000,000
					330,000,000

The Group is in the process of assessing the fair value of the above share options at the grant date.

40. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 28 July 2008.

A. INTRODUCTION TO THE UNAUDITED PRO FORMA FINANCIAL INFORMATION OF THE ENLARGED GROUP

The accompanying unaudited pro forma financial information of the Enlarged Group has been prepared to illustrate the effect of the proposed investment in Transmeridian (the "Investment") might have affected the financial information of the Group.

The unaudited pro forma consolidated income statement and cash flow statement of the Enlarged Group for the year ended 31 March 2008 are prepared based on the audited consolidated income statement and cash flow statement of the Group for the year ended 31 March 2008 as extracted from the annual report of the Company for the year ended 31 March 2008 and the unaudited combined statement of operations and statement of cash flows of Transmeridian under HKFRSs for the year ended 31 December 2007 as extracted from the Unaudited Combined Financial Information of Transmeridian under HKFRS set out in Appendix II to this circular as if the Investment had been completed on 1 April 2007.

The unaudited pro forma consolidated balance sheet of the Enlarged Group as at 31 March 2008 is prepared based on the audited consolidated balance sheet of the Group as at 31 March 2008 as extracted from the annual report of the Company for the year ended 31 March 2008 and the unaudited combined balance sheet of Transmeridian under HKFRSs as at 31 March 2008 as extracted from the Unaudited Combined Financial Information of Transmeridian under HKFRS set out in Appendix II to this circular as if the Investment had been completed on 31 March 2008.

The unaudited pro forma financial information of the Enlarged Group is prepared based on a number of assumptions, estimates, uncertainties and currently available information, and is provided for illustrative purposes only. Accordingly, as a result of the nature of the unaudited pro forma financial information of the Enlarged Group, it may not give a true picture of the actual financial position, results of operation or cash flows of the Enlarged Group that would have been attained had the Investment actually occurred on the dates indicated herein. Furthermore, the unaudited pro forma financial information of the Enlarged Group does not purport to predict the Enlarged Group's future financial position, results of operation or cash flows.

The unaudited pro forma financial information of the Enlarged Group should be read in conjunction with the financial information of the Group as set out in Appendix III, the US GAAP Combined Financial Information of Transmeridian as set out in Appendix I, the Unaudited Combined Financial Information of Transmeridian under HKFRS as set out in Appendix II and other financial information included elsewhere in this circular.

B. UNAUDITED PRO FORMA CONSOLIDATED INCOME STATEMENT OF THE ENLARGED GROUP FOR THE YEAR ENDED 31 MARCH 2008

	The Group for the year ended 31 March 2008	Pro forma adjustments	The Group for the year end 31 March 2008 after pro forma adjustments	Transmeridian for the year ended 31 December 2007 under HKFRSs	Transmeridian for the year ended 31 December 2007 under HKFRSs	Pro forma adjustments	Notes	Transmeridian for the year ended 31 December 2007 under HKFRSs after pro forma adjustments	Sub-Total	Pro forma consolidation adjustments	Notes	The Enlarged Group for the year ended 31 March 2008
		(Note 5)		*(Note 15)*	*(Note 16)*							
	HK$'000	*HK$'000*	*HK$'000*	*US$'000*	*HK$'000*	*HK$'000*		*HK$'000*	*HK$'000*	*HK$'000*		*HK$'000*
Turnover	4,893		4,893	34,024	265,387			265,387	270,280			270,280
Cost of sales and services rendered	(754)		(754)	(30,110)	(234,858)			(234,858)	(235,612)			(235,612)
Gross Profit	4,139		4,139	3,914	30,529			30,529	34,668			34,668
Other income	55,573	231,161	286,734	494	3,853			3,853	290,587	(231,161)	*6*	227,774
										168,348	*13*	
										(62,813)		
Oil exploitation expenses	(76,875)		(76,875)	–	–			–	(76,875)			(76,875)
Administrative expenses	(97,776)		(97,776)	(24,448)	(190,694)			(190,694)	(288,470)			(288,470)
Loss from operations	(114,939)		116,222	(20,040)	(156,312)			(156,312)	(40,090)			(102,903)
Finance costs	–		–	(37,708)	(294,122)	125,958	*10*	(168,164)	(168,164)			(168,164)
Fair value loss on preferred stock	–		–	(29,636)	(231,161)			(231,161)	(231,161)	231,161	*5*	–
Net loss on derecognition of long term debts	–		–	–	–	(151,422)	*12*	(151,422)	(151,422)			(151,422)
Share of loss of an associate	(758)		(758)	–	–			–	(758)			(758)
Gain on deemed disposal of a subsidiary	7,395		7,395	–	–			–	7,395			7,395
Loss before tax	(108,302)		122,859	(87,384)	(681,595)			(707,059)	(584,200)			(415,852)
Income tax credit	3,823		3,823	–	–			–	3,823			3,823
Loss for the year	(104,479)		126,682	(87,384)	(681,595)			(707,059)	(580,377)			(412,029)
Attributable to:												
Equity holders of the Company	(101,497)	231,161	129,664	(87,384)	(681,595)	125,958	*10*	(707,059)	(577,395)	168,348	*13*	(189,859)
						(151,422)	*12*			219,188	*11*	
						(25,464)				387,536		
Minority interest	(2,982)		(2,982)	–	–			–	(2,982)	(219,188)	*11*	(222,170)
	(104,479)		126,682	(87,384)	(681,595)			(707,059)	(580,377)			(412,029)

C. UNAUDITED PRO FORMA CONSOLIDATED BALANCE SHEET OF THE ENLARGED GROUP AS AT 31 MARCH 2008

	The Group as at 31 March 2008	Pro forma adjustments	Notes	The Group as at 31 March 2008 after pro forma adjustments	Transmeridian as at 31 March 2008 under HKFRSs	Transmeridian as at 31 March 2008 under HKFRSs	Pro forma adjustments	Notes	Transmeridian as at 31 March 2008 under HKFRSs after pro forma adjustments	Sub-total	Pro forma consolidation adjustments	Notes	The Enlarged Group as at 31 March 2008
					(Note 15)	*(Note 16)*							
	HK$'000	*HK$'000*		*HK$'000*	*US$'000*	*HK$'000*	*HK$'000*		*HK$'000*	*HK$'000*	*HK$'000*		*HK$'000*
Non-current assets													
Property, plant and equipment	36,703			36,703	387,584	3,023,155			3,023,155	3,059,858			3,059,858
Investment properties	177,600			177,600	–	–			–	177,600			177,600
Goodwill	–			–	–	–			–	–	546,694	9	546,694
Investment in a subsidiary	–	801,840	3	801,840	–	–			–	801,840	(801,840)	9	–
Investment in an associate	86,403			86,403	–	–			–	86,403			86,403
Other assets	–			–	775	6,045			6,045	6,045			6,045
	300,706			1,102,546	388,359	3,029,200			3,029,200	4,131,746			3,876,600
Current assets													
Crude oil inventory	–			–	539	4,204			4,204	4,204			4,204
Trade and other receivables	716,350			716,350	4,305	33,579			33,579	749,929			749,929
Due from an associate	66,552			66,552	–	–			–	66,552			66,552
Financial assets at fair value through profit or loss	6,613	849,420	1	1,441,033	–	–			–	1,441,033	(1,434,420)	4	6,613
		(849,420)	2										
		1,434,420	2										
		1,434,420											
Bank and cash balances	2,113,460	(717,600)	1	9,020	1,159	9,040	585,000	2	457,987	467,007			467,007
		(585,000)	2				(136,053)	8					
		(801,840)	3										
		(2,104,440)					448,947						
	2,902,975			2,232,955	6,003	46,823			495,770	2,728,725			1,294,305
Current Liabilities													
Trade and other payables	34,005	131,820	1	165,825	38,772	302,421			302,421	468,246			468,246
Current tax liabilities	4			4	–	–			–	4			4
Due to directors	5,534			5,534	–	–			–	5,534			5,534
Due to related companies	3,774			3,774	–	–			–	3,774			3,774
	43,317			175,137	38,772	302,421			302,421	477,558			477,558

	The Group as at 31 March 2008	Pro forma adjustments	Notes	The Group as at 31 March 2008 after pro forma adjustments	Transmeridian as at 31 March 2008 under HKFRSs (Note 15)	Transmeridian as at 31 March 2008 under HKFRSs (Note 16)	Pro forma adjustments	Notes	Transmeridian as at 31 March 2008 under HKFRSs after pro forma adjustments	Sub-total	Pro forma consolidation adjustments	Notes	The Enlarged Group as at 31 March 2008
	HK$'000	*HK$'000*		*HK$'000*	*US$'000*	*HK$'000*	*HK$'000*		*HK$'000*	*HK$'000*	*HK$'000*		*HK$'000*
Net current assets/ (liabilities)	2,859,658			2,057,818	(32,769)	(255,598)			193,349	2,251,167			816,747
Total assets less current liabilities	3,160,364			3,160,364	355,590	2,773,602			3,222,549	6,382,913			4,693,347
Non-current liabilities													
Long term debts	–			–	266,910	2,081,898	(2,081,898)	8	1,212,354	1,212,354			1,212,354
							1,212,354	8					
							(869,544)						
Other long term liabilities	–			–	4,225	32,955			32,955	32,955			32,955
Senior redeemable convertible preferred stock	–			–	47,324	369,127	(369,127)	2	–	–			–
Junior redeemable convertible preferred stock	–			–	83,761	653,336	(653,336)	2	–	–			–
New preferred shares and warrants	–			–	–	–	1,607,463	2	1,607,463	1,607,463	(1,607,463)	4	–
Deferred tax liabilities	27,209			27,209	–	–			–	27,209			27,209
	27,209			27,209	402,220	3,137,316			2,852,772	2,879,981			1,272,518
NET ASSETS/ (LIABILITIES)	3,133,155			3,133,155	(46,630)	(363,714)			369,777	3,502,932			3,420,829
Share capital and reserves													
Share Capital	127,771			127,771	70	546	1,220	8	1,766	129,537	(1,766)	9	127,771
Reserves	2,813,966			2,813,966	(46,700)	(364,260)	800,620	8	368,011	3,181,977	173,043	4	2,987,009
							(68,349)	8			(368,011)	9	
							732,271				(194,968)		
Equity attributable to equity holders of the Company	2,941,737			2,941,737	(46,630)	(363,714)			369,777	3,311,514			3,114,780
Minority interests	191,418			191,418	–	–			–	191,418	114,631	9	306,049
TOTAL EQUITY	3,133,155			3,133,155	(46,630)	(363,714)			369,777	3,502,932			3,420,829

D. UNAUDITED PRO FORMA CONSOLIDATED CASH FLOW STATEMENT OF THE ENLARGED GROUP FOR THE YEAR ENDED 31 MARCH 2008

	The Group for the year ended 31 March 2008	Pro forma adjustments	*Notes*	The Group for the year end 31 March 2008 after pro forma adjustments	Transmeridian for the year ended 31 December 2007 under US GAAP *(Note 15)*	Transmeridian for the year ended 31 December 2007 under HKFRSs *(Note 16)*	Pro forma adjustments	*Notes*	Transmeridian for the year ended 31 December 2007 under HKFRSs after pro forma adjustments	Sub-total	Pro forma consolidation adjustments	*Notes*	The Enlarged Group for the year ended 31 March 2008
	HK$'000	*HK$'000*		*HK$'000*	*US$'000*	*HK$'000*	*HK$'000*		*HK$'000*	*HK$'000*	*HK$'000*		*HK$'000*
CASH FLOWS FROM OPERATING ACTIVITIES													
Loss before tax	(108,302)	231,161	*5*	122,859	(87,384)	(681,595)	125,958	*10*	(707,059)	(584,200)	168,348	*13*	(415,852)
							(151,422)	*12*					
							(25,464)						
Adjustments for:													
Depreciation	7,978			7,978	19,729	153,886			153,886	161,864			161,864
Share of losses of an associate	758			758	—	—			—	758			758
Amortisation of debt financing costs	—			—	2,892	22,558			22,558	22,558			22,558
Debt discount amortisation	—			—	5,628	43,898			43,898	43,898			43,898
Accretion of asset retirement obligation	—			—	60	468			468	468			468
Interest income	(38,807)			(38,807)	(494)	(3,853)			(3,853)	(42,660)			(42,660)
Interest expenses	—			—	29,188	227,666	(125,958)	*10*	101,708	101,708			101,708
Equity-settled share-based payments	35,194			35,194	5,838	45,536			45,536	80,730			80,730
Fair value (gain)/loss on preferred stock	—	(231,161)	*5*	(231,161)	29,636	231,161			231,161	—			—
Net loss on derecognition of long term debts	—			—	—	—	151,422	*12*	151,422	151,422			151,422
Gain on purchases of preferred stock	—			—	—	—			—	—	(168,348)	*13*	(168,348)
(Gain)/loss on disposal of property, plant and equipment	(4)			(4)	340	2,652			2,652	2,648			2,648
Gain in deemed disposal of a subsidiary	(7,395)			(7,395)	—	—			—	(7,395)			(7,395)
Net gain on disposals of financial assets at fair value through profit or loss	(11,521)			(11,521)	—	—			—	(11,521)			(11,521)

	The Group for the year ended 31 March 2008	Pro forma adjustments	*Notes*	The Group for the year end 31 March 2008 after pro forma adjustments	Transmeridian for the year ended 31 December 2007 under US GAAP *(Note 15)*	Transmeridian for the year ended 31 December 2007 under HKFRSs *(Note 16)*	Pro forma adjustments	*Notes*	Transmeridian for the year ended 31 December 2007 under HKFRSs after pro forma adjustments	Sub-total	Pro forma consolidation adjustments	*Notes*	The Enlarged Group for the year ended 31 March 2008
	HK$'000	*HK$'000*		*HK$'000*	*US$'000*	*HK$'000*	*HK$'000*		*HK$'000*	*HK$'000*	*HK$'000*		*HK$'000*
Operating profit/(loss) before working capital changes	(122,099)			(122,099)	5,433	42,377			42,377	(79,722)			(79,722)
Additions to properties under development	(162,053)			(162,053)	—	—			—	(162,053)			(162,053)
Increase in crude oil inventory	—			—	(220)	(1,716)			(1,716)	(1,716)			(1,716)
Increase in other assets	—			—	(275)	(2,145)			(2,145)	(2,145)			(2,145)
(Increase)/decrease in trade and other receivables	(50,809)			(50,809)	3,147	24,547			24,547	(26,262)			(26,262)
Decrease in amount due from a director	5			5	—	—			—	5			5
Decrease in amount due from a related company	69			69	—	—			—	69			69
Increase in trade and other payables	80,738			80,738	17,860	139,308			139,308	220,046			220,046
Increase in amount due to a director	1,604			1,604	—	—			—	1,604			1,604
Increase in amount due to related companies	3,189			3,189	—	—			—	3,189			3,189
Decrease in other long-term liabilities	—			—	(11)	(86)			(86)	(86)			(86)
Increase in amount due to a minority equity holder	176,503			176,503	—	—			—	176,503			176,503
Cash from/(used in) operations	(72,853)			(72,853)	25,934	202,285			202,285	129,432			129,432
Interest paid	—			—	(34,800)	(271,440)	125,958	*10*	(145,482)	(145,482)			(145,482)
Income taxes paid	(1,898)			(1,898)	—	—			—	(1,898)			(1,898)
Net cash generated from/(used in) operating activities	(74,751)			(74,751)	(8,866)	(69,155)			56,803	(17,948)			(17,948)

	The Group for the year ended 31 March 2008	Pro forma adjustments	*Notes*	The Group for the year end 31 March 2008 after pro forma adjustments	Transmeridian for the year ended 31 December 2007 under US GAAP *(Note 15)*	Transmeridian for the year ended 31 December 2007 under HKFRSs *(Note 16)*	Pro forma adjustments	*Notes*	Transmeridian for the year ended 31 December 2007 under HKFRSs after pro forma adjustments	Sub-total	Pro forma consolidation adjustments	*Notes*	The Enlarged Group for the year ended 31 March 2008
	HK$'000	*HK$'000*		*HK$'000*	*US$'000*	*HK$'000*	*HK$'000*		*HK$'000*	*HK$'000*	*HK$'000*		*HK$'000*
CASH FLOWS FROM INVESTING ACTIVITIES													
Decrease in pledged bank deposits	128,043			128,043	—	—			—	128,043			128,043
Acquisition of subsidiaries	—	(801,840)	*3*	(801,840)	—	—			—	(801,840)	95,105	*14*	(706,735)
Loan receivables granted to unrelated companies	(650,000)			(650,000)	—	—			—	(650,000)			(650,000)
Repayments of loan receivables from unrelated company	75,368			75,368	—	—			—	75,368			75,368
Deemed disposal of a subsidiary	(57,426)			(57,426)	—	—			—	(57,426)			(57,426)
Purchases of financial assets at fair value through profit or loss	(168,768)			(168,768)	—	—			—	(168,768)			(168,768)
Sales of financial assets at fair value through profit or loss	179,785			179,785	—	—			—	179,785			179,785
Acquisition of senior and junior redeemable convertible preferred stocks	—	(717,600)	*1*	(717,600)	—	—			—	(717,600)			(717,600)
Purchases of new preferred shares and warrants	—	(585,000)	*2*	(585,000)	—	—			—	(585,000)	585,000	*7*	—
Purchases of property, plant and equipment	(46,395)			(46,395)	(80,635)	(628,953)			(628,953)	(675,348)			(675,348)
Proceeds from disposal of property, plant and equipment	24			24	—	—			—	24			24
Advance from a corporate shareholder	133,724			133,724	—	—			—	133,724			133,724
Interest received	22,412			22,412	494	3,853			3,853	26,265			26,265
Net cash used in investing activities	(383,233)			(2,487,673)	(80,141)	(625,100)			(625,100)	(3,112,773)			(2,432,668)

	The Group for the year ended 31 March 2008	Pro forma adjustments	*Notes*	The Group for the year end 31 March 2008 after pro forma adjustments	Transmeridian for the year ended 31 December 2007 under US GAAP *(Note 15)*	Transmeridian for the year ended 31 December 2007 under HKFRSs *(Note 16)*	Pro forma adjustments	*Notes*	Transmeridian for the year ended 31 December 2007 under HKFRSs after pro forma adjustments	Sub-total	Pro forma consolidation adjustments	*Notes*	The Enlarged Group for the year ended 31 March 2008
	HK$'000	*HK$'000*		*HK$'000*	*US$'000*	*HK$'000*	*HK$'000*		*HK$'000*	*HK$'000*	*HK$'000*		*HK$'000*
CASH FLOWS FROM FINANCING ACTIVITIES													
Proceeds from issue of shares	2,212,140			2,212,140	4,468	34,851			34,851	2,246,991			2,246,991
Proceeds from issue of preferred stock	–			–	51,523	401,880	585,000	*2*	986,880	986,880	(585,000)	*7*	401,880
Proceeds from exercise of stock options	–			–	368	2,870			2,870	2,870			2,870
Peroceeds from exercise or sale of warrants	–			–	21,394	166,873			166,873	166,873			166,873
Repayments of long term debts	–			–	–	–	(136,053)	*8*	(136,053)	(136,053)			(136,053)
Share issue expenses paid	(27,851)			(27,851)	–	–			–	(27,851)			(27,851)
Net cash generated from financing activities	2,184,289			2,184,289	77,753	606,474			1,055,421	3,239,710			2,654,710
NET INCREASE/ (DECREASE) IN CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	1,726,305			(378,135)	(11,254)	(87,781)			487,124	108,989			204,094
Effect of foreign exchange rate changes	26,141			26,141	–	–			–	26,141			26,141
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	361,014			361,014	12,193	95,105			95,105	456,119	(95,105)	*14*	361,014
CASH AND CASH EQUIVALENTS AT END OF YEAR	2,113,460			9,020	939	7,324			582,229	591,249			591,249
ANALYSIS OF CASH AND CASH EQUIVALENTS													
Bank and cash balances	2,113,460			9,020	939	7,324			582,229	591,249			591,249

E. NOTES TO THE UNAUDITED PRO FORMA FINANCIAL INFORMATION OF THE ENLARGED GROUP

1. The adjustment represents the cash payments of HK$717,600,000 (equivalent to US$92,000,000) and Convertible Bonds of HK$131,820,000 (equivalent to US$16,900,000) to be issued for the purchase of all Transmeridian's senior and junior redeemable convertible preferred stocks by the Company.

   Since the terms and conditions and timing of issuance of the Convertible Bonds to be issued by the Company have not yet been finalised as of the date of this Circular, the Convertible Bonds have not yet been issued by the Company as at 31 March 2008 and the amount is classified as trade and other payables.

2. The adjustment represents the issuance of New Preferred Stock and Warrants by Transmeridian to the Company in exchange for the senior and junior redeemable convertible preferred stocks purchased by the Company as set out in note 1 above and cash payment of HK$585,000,000 (equivalent to US$75,000,000) pursuant to the Investment Agreement. The New Preferred Stock and Warrants acquired by the Company are designated as financial assets at fair value through profit or loss in the Company's financial statements.

   The carrying amounts of senior redeemable convertible preferred stock of HK$369,127,000 and junior redeemable convertible preferred stock of HK$653,336,000 recorded in Transmeridian's financial statements are reversed upon issuance of New Preferred Stock and Warrants. The New Preferred Stock and Warrants are recorded at fair value of HK$1,607,463,000 in Transmeridian's financial statements, representing the senior and junior redeemable convertible preferred stock exchanged and the cash payment received from the Company.

3. The adjustment represents the cash payment of HK$801,840,000 (equivalent to US$102,800,000) made by the Company to finance Transmeridian to redeem, repurchase, or acquire any Senior Notes or New Notes with aggregate face value of HK$914,940,000 (equivalent to US$117,300,000) in the Change of Control Offer. The cash payment will be exchanged for a number of common stocks of Transmeridian divided by US$0.45 plus Additional Warrants upon the completion of the Investment.

   Upon the completion of the Investment and assuming no conversion or exercise of the New Preferred Stock, Warrants and Additional Warrants by the Company, the Company will hold 260,666,667 common stocks of Transmeridian's (the "Newly Issued Common Stock"), representing a 69% equity interest in Transmeridian's enlarged share capital before the conversion or exercise of the New Preferred Stock, Warrants and Additional Warrants (the conversion of the New Preferred

Stock represents an 8.5% equity interest in Transmeridian's enlarged share capital before the exercise of the Warrants and Additional Warrants (which in turn would represent an aggregate of approximately 77.5% of Transmeridian's enlarged common stock on a fully diluted basis)). Accordingly, the cash payment is classified as investment in subsidiaries in the Company's financial statements.

The Additional Warrants granted to the Company under the Change of Control Offer should be designated as financial assets at fair value through profit or loss in the Company's financial statements and as financial liabilities at fair value through profit or loss in Transmeridian's financial statements. Since the fair value of the Additional Warrants in the Company's and Transmeridian's financial statements will be eliminated at consolidation, the fair values of the Additional Warrants are not separately recognised and considered for the purpose of compiling the unaudited pro forma consolidated balance sheet of the Enlarged Group.

4. The adjustment represents the elimination of the New Preferred Stock and Warrants in Enlarged Group. The difference between the carrying amounts of New Preferred Stock and Warrants recorded in the Company and Transmeridian of HK$173,043,000 is credited as reserves, assuming the Transactions were completed on 31 March 2008.

5. The adjustment represents the recognition of fair value gain of New Preferred Stock and Warrants for the year ended 31 March 2008. It is assumed that the fair value gain and loss recorded by the Company and Transmeridian respectively in respect of the New Preferred Stock and Warrants is HK$231,161,000 which is equivalent to the fair value loss on senior and junior redeemable convertible preferred stock recorded in the Unaudited Combined Financial Information of Transmeridian under HKFRSs for the year ended 31 December 2007.

6. The adjustment of HK$231,161,000 represents the elimination of fair value gain and fair value loss on the New Preferred Stock and Warrants of the Company and Transmeridian in the Enlarged Group.

7. The adjustment of HK$585,000,000 (equivalent to US$75,000,000) represents the elimination of cash payment from the Company to Transmeridian for purchasing New Preferred Stock and Warrants of Transmeridian.

8. It is assumed that the Exchange Offer is carried out by cash payment of US$101 and issuance of New Notes of principal amount of US$900 each in exchange for each US$1,000 principal amount of Senior Notes to the holders of Senior Notes with aggregate face value of HK$1,347,060,000 (equivalent to US$172,700,000) assuming that the exchange offer had been accepted in full.

The adjustments represent (i) the cash payment of HK$136,053,000 (equivalent to US$17,443,000) for the Exchange Offer described above; (ii) the Senior Notes of carrying amount of HK$2,081,898,000 (equivalent to US$266,910,000) as of 31 March 2008 derecognised; (iii) New Notes issued at fair value of HK$1,212,354,000 (equivalent to US$155,430,000) which represents the principal amount of the New Notes under the Exchange Offer described above; (iv) the issue of 260,666,667 common stocks with par value of US$0.0006 per share to the Company in exchange for the Senior Notes redeemed, repurchased or acquired by the Company in the Change of Control Offer as described in note (3) above and accordingly, HK$1,220,000 is credited as share capital and the remaining HK$800,620,000, representing the funds of HK$801,840,000 provided by the Company over the aggregate par value of the common stocks in issue, is credited as reserve; and (v) the aggregate amount of HK$68,349,000 from the loss on derecognition of the Senior Notes exchanged in the Exchange Offer of HK$108,600,000, which represents the difference between the carrying amount of the portion of the Senior Notes as of 31 March 2008 exchanged and the total of cash payment and the principal amount of the New Notes issued in the Exchange Offer, and the gain on the derecognition of the Senior Notes redeemed, repurchased or acquired by the Company in the Change of Control Offer of HK$40,251,000, which represents the difference between the carrying amount of the portion of the Senior Notes as of 31 March 2008 and funds provided by the Company to redeem, repurchase or acquire the Senior Notes in the Change of Control Offer.

9. The adjustments represent the elimination of the capital and reserves of Transmeridian with an aggregate amount of HK$369,777,000 for the cash payment of HK$801,840,000 paid by the Company in exchange for 69% equity interest in Transmeridian under the Change of Control Offer as described in note (3) above and the recognition of goodwill of HK$546,694,000 and 31% minority interest of HK$114,631,000 upon the completion of the Investment.

10. The adjustment of HK$125,958,000 represents the estimated decrease in interest charge and reduction in interest payments on long term debts of Transmeridian for the year ended 31 December 2007 arising from the Exchange Offer and Change of Control Offer in connection with long term debts restructuring of Transmeridian.

11. The adjustment of HK$219,188,000 represents the results of Transmeridian for the year ended 31 December 2007 shared by 31% minority equity holders.

12. The adjustment represents the net loss on derecognition of Senior Notes assuming the Exchange Offer as described in note (8) above and the Change of Control Offer as described in note (3) above were completed on 1 April 2007. Details of the adjustment is as follows:

	Under the Exchange Offer	**Under the Change of Control Offer**	**Total**
	US$'000	*US$'000*	*US$'000*
Aggregate face value of Senior Notes	172,700	117,300	290,000
Carrying amount of Senior Notes as of 31 December 2006 in Transmeridian	152,607	103,653	256,260
Fair value of New Notes issued	155,430	—	155,430
Fair value of common stocks issued to the Company	—	102,800	102,800
Cash payment by the Company	17,443	—	17,443
Subtotal	172,873	102,800	275,673
Loss/(gain) on derecognition	20,266	(853)	19,413
	HK$'000	*HK$'000*	*HK$'000*
Loss/(gain) on derecognition (HK$)	158,075	(6,653)	151,422

13. The adjustment of HK$168,348,000 represents gain recognised upon elimination of New Preferred Stock and Warrants due to the difference between the carrying amount of New Preferred Stock and Warrants of the Company and Transmeridian, assuming issuance of New Preferred Stock and Warrants was completed on 1 April 2007.

14. The adjustment of HK$95,105,000 represents cash and cash equivalents of Transmeridian as at 1 January 2007, which is assumed to be acquired by the Company upon the Investment and therefore for presentation purpose, such amount is reallocated as acquisition of subsidiaries.

15. The balances are extracted from Unaudited Combined Financial Information of Transmeridian under HKFRS as set out in Appendix II of this circular and have been reclassified to conform with the presentation format of the Group.

16. For the purpose of the unaudited pro forma financial information, the amounts stated in US dollar have been translated to Hong Kong dollar at an exchange rate of US$1 = HK$7.8.

F. ACCOUNTANTS' REPORT ON UNAUDITED PRO FORMA FINANCIAL INFORMATION

The following is the text of a report, prepared for the sole purpose of inclusion in this circular, from the independent reporting accountants, RSM Nelson *Wheeler, Certified Public Accountants, Hong Kong.*

RSM Nelson Wheeler
中瑞岳華(香港)會計師事務所
Certified Public Accountants

30 September 2008

The Board of Directors
United Energy Group Limited

Dear Sirs,

We report on the unaudited pro forma financial information of United Energy Group Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group"), which has been prepared by the directors of the Company, for illustrative purposes only, to provide information about how the proposed investment in Transmeridian Exploration Incorporated might have affected the financial information of the Group presented, for inclusion in Appendix IV to the circular of the Company dated 30 September 2008 (the "Circular"). The basis of preparation of the unaudited pro forma financial information is set out on pages IV-1 to IV-13 of the Circular.

Respective Responsibilities of Directors of the Company and Reporting Accountants

It is the responsibilities solely of the directors of the Company to prepare the unaudited pro forma financial information in accordance with paragraph 29 of Chapter 4 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and with reference to Accounting Guideline 7 "Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA").

It is our responsibility to form an opinion, as required by paragraph 29(7) of Chapter 4 of the Listing Rules, on the unaudited pro forma financial information and to report our opinion to you. We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the unaudited pro forma financial information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.

Basis of opinion

We conducted our engagement in accordance with Hong Kong Standard on Investment Circular Reporting Engagements 300 "Accountants' Reports on Pro Forma Financial Information in Investment Circulars" issued by the HKICPA. Our work consisted primarily of comparing the unadjusted financial information with source documents, considering the evidence supporting the adjustments and discussing the unaudited pro forma financial information with the directors of the Company. The engagement did not involve independent examination of any of the underlying financial information.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the unaudited pro forma financial information has been properly compiled by the directors of the Company on the basis stated, that such basis is consistent with the accounting policies of the Group and that the adjustments are appropriate for the purposes of the unaudited pro forma financial information as disclosed pursuant to paragraph 29(1) of Chapter 4 of the Listing Rules.

The unaudited pro forma financial information is for illustrative purposes only, based on the judgements and assumptions of the directors of the Company, and, because of its hypothetical nature, does not provide any assurance or indication that any event will take place in the future and may not be indicative of:

(a) the financial position of the Group as at 31 March 2008 or any future date; or

(b) the results and cash flows of the Group for the year ended 31 March 2008 or any future periods.

Opinion

In our opinion:

(a) the unaudited pro forma financial information has been properly compiled by the directors of the Company on the basis stated;

(b) such basis is consistent with the accounting policies of the Group; and

(c) the adjustments are appropriate for the purposes of the unaudited pro forma financial information as disclosed pursuant to paragraph 29(1) of Chapter 4 of the Listing Rules.

Yours faithfully,

RSM Nelson Wheeler
Certified Public Accountants
Hong Kong

References in this Appendix to "the Company" and "the Group" are to Transmeridian and Transmeridian and its subsidiaries respectively.

MANAGEMENT DISCUSSION AND ANALYSIS OF TRANSMERIDIAN

The following is the management discussion and analysis of Transmeridian principally extracted from the annual reports of Transmeridian for each of the three years ended 31 December 2005, 2006 and 2007.

For the years ended 31 December 2005, 2006 and 2007

Transmeridian recorded a turnover of approximately US$8.4 million, US$24.7 million and US$ 34.0 million for each of the three years ended December 31, 2007. It incurred net losses of approximately US$20.5 million, US$53.2 million and US$57.7 million for the years ended December 31, 2005, 2006 and 2007, respectively.

The following table presents selected operational and financial data for the years ended December 31, 2007, 2006 and 2005, respectively.

	Year ended December 31,		
	2007	**2006**	**2005**
Revenue, net (in thousands)	$34,024	$24,672	$8,443
Number of barrels sold	746,190	752,342	324,355
Average price per barrel	$47.93	$34.54	$27.62
Production (barrels)	776,024	744,042	400,425
Average daily production (barrels)	2,126	2,038	1,097

Segment Information

Transmeridian's business activities relate solely to oil and gas exploration, development and production. Primary emphasis of Transmeridian since formation in 2000 has been the development of the Field and substantially all of its assets are located in Kazakhstan. For each of the three years ended December 31, 2007 substantially all of its results of operations consisted of revenues, operating, general and administrative, and other costs associated with its operations in Kazakhstan.

Liquidity and Capital Structure

The total assets of Transmeridian amounted to US$406 million as of December 31, 2007, increasing from US$314 million as of December 31, 2006 and US$357 million as of December 31, 2005, mainly due to increase in property and equipment to US$429 million as of December 31, 2007 from US$340 million as of December 31, 2006 and US$231 million as of December 31, 2005. Total current assets has been decreasing over the years under review,

mainly due to decrease in cash and cash equivalent to US$0.9 million as of December 31, 2007 from US$12 million as of December 31, 2006 and US$34 million as of December 31, 2005, as a result of continuous capital expenditure and working capital required in the operation of the filed.

Tramsmeridian's non-current liabilities have increased over the years under review given the issuance of the senior redeemable convertible preferred stock in 2006 and the junior redeemable convertible stock in 2007. Total non-current liabilities increased to US$364 million as of December 31, 2007 from US$313 million as of December 31, 2006 and US$224 million as of December 31, 2005. Total current liabilities has also increased to US$57 million as of December 31, 2007 from US$18 million as of December 31, 2006 and US$34 million as of December 31, 2005, mainly due to increase in accrued liabilities resulted from returns obligations incurred in connection with the issuance of the junior redeemable convertible stock.

Due to the operation losses that have been incurred and increase of liabilities, Transmeridian had a net working capital deficit of approximately $50.8 million and a stockholders' deficit of approximately US$14.8 million at December 31, 2007. Gearing ratio, calculated as total liabilities divided by total assets, as at the end of year 2007, 2006 and 2005 were 103.6%, 92.7% and 81.9% respectively. Current ratio, calculated as current asset over current liabilities, as at the end of year 2007, 2006 and 2005 were 0.12, 1.32 and 2.22 respectively.

It is expected that subsequent to the successful tender offers of Transmeridian's Junior and Senior Preferred Stocks, the liquidity and cash flow positions of Transmeridian will see immediate improvement.

Furthermore, it is expected that with the improvement in the level of production at South Alibek after the investment and necessary capital expenditure funded by the US$75 million cash infusion from United Energy Group, Transmeridian will turn cashflow positive in the near future.

Investments

For the years ended December 31, 2007, 2006 and 2005, Transmeridian capital expenditures were US$86.2 million, US$107.3 million and US$20.7 million, respectively. Total capitalized cost attributable to the Field as of December 31, 2007 was US$427.6 million, which includes US$22.2 million of capitalized interest. Transmeridian have been funding its development operations and working capital requirements through a combination of debt and equity proceeds and cash flow from operations.

Employees

As at 31 December 2005, 2006 and 2007, Transmeridian employed eight, twelve and nine full-time employees in Houston respectively. Transmeridian also maintain three offices in Kazakhstan, the first an administrative office in Aktobe, Kazakhstan, where it leases

approximately 9,020 square feet of office space and employed fifty-nine, seventy-three and seventy-one full-time employees respectively, the second a small administrative office in Almaty, Kazakhstan, where it had seven, seven and five employees respectively and the third a small administrative office in Astana, Kazakhstan, where it had two, two and zero employees respectively. Transmeridian's field operations for the field had approximately 125, 125 and 72 employees respectively.

Major Customers

For the year ended December 31, 2007, four customers of Transmeridian accounted for approximately 24%, 16%, 14% and 11%, respectively, of consolidated revenue. For the year ended December 31, 2006, three customers accounted for approximately 30%, 28% and 17%, respectively, of consolidated revenue. For the year ended December 31, 2005, two customers accounted for approximately 38% and 37%, respectively, of consolidated revenue.

Financial Trading and Prospects of Transmeridian

MANAGEMENT DISCUSSION AND ANALYSIS OF THE GROUP

The following is the management discussion and analysis of the Company principally extracted from the annual reports of the Company for each of the three years ended 31 March 2008, 2007 and 2006.

For the year ended 31 March 2008

Financial Review

Turnover during the year under review was HK$4.89 million (2007: HK$15.93 million), and loss attributable to shareholders was HK$101.50 million (2007: Profit attributable to shareholders was HK$16.82 million).

On 16 October 2007, the Company raised net capital of approximately HK$2,184 million through the placement of 1,374,000,000 ordinary shares at HK$1.61 per share — further enhancing the Group's financial position.

The Group's Audit Committee has reviewed the audited consolidated financial statements for the year ended 31st March 2008. The Audit Committee has reviewed with management the accounting principles and practices adopted by the Group, as well as internal control and financial reporting matters, and found them to be satisfactory.

Acquisitions

The Group continued its aggressive acquisition strategy throughout the year under review.

In October 2007, the Company acquired 100% interest in United Petroleum, an oil production business that holds 60% participating interest in an oil field project located in the Gaosheng Block of China's Bohai Basin. The project is being jointly developed with CNPC, pursuant to an Enhanced Oil Recovery contract.

Subsequent to the end of the financial year, on 11 June 2008 and on 22 September 2008, the Company announced the proposed acquisition of up to 85% stake in TMEI as a fully diluted basis after the exercise of Warrants and Additional Warrants, which holds 100% interest in South Alibek Field in Kazakhstan, as well as a 50% effective interest in Gasha Field in Russia.

Review of the Oil Production Business

1 February 2007 marked the commencement of an Enhanced Oil Recovery ("EOR") contract between CNPC and United Petroleum, when the Company began preparatory work to launch pilot testing.

During the year under review, fieldwork progressed according to schedule, beginning with the assessment and selection of the optimal project implementation scheme. After in-depth discussions and repeated on-site surveillance, one of the three evaluated project implementation schemes was chosen as the most suitable and efficient design for the pilot test area. Fieldwork operations were ramped up as the project design was refined and technical measures were improved.

Drilling of the first well began on 2 July 2007, and fieldwork reached its peak in August and September. Work was completed on 10 December 2007, and steam injection began in March 2008. The steam flood pilot test is currently on schedule.

During the year under review, the Group completed the entire obligated workload stipulated under the EOR contract:

- Completed 11 vertical wells, drilling a total depth of 19,051 metres;
- Completed 6 overhaul wells;
- Rebuilt and expanded one metering station;
- Expanded one steam injection station;
- Installed two steam injection boilers;
- Installed 11 well heads;
- Constructed a total of 19.8 km of well grid and between-station pipelines, as well as 2.1 km of steam injection pipelines; and
- Established pilot test area metering and dynamic detection system.

Segment Information

For the year ended 31 March 2008, the turnover represented rental income and property management service fee income. For the year ended 31 March 2007, the turnover represented rental income, property management service fee income and wholesale of household building materials. All the Group's turnover is derived from the PRC.

Liquidity and Financial Resources

The Group maintained its strong financial position for the year under review, with cash and cash equivalents amounting to HK$2,113 million as at 31 March 2008 (2007: HK$361 million). The significant improvement in the Group's liquidity was largely the result of the issuance of 1,374 million new shares on 16 October 2007, which generated net proceeds of approximately HK$2,184 million in cash.

The Group had no long-term borrowings, therefore the gearing ratio is not applicable. The current ratio improved to 67.02 (2007: 2.90), based on current assets of HK$2,903 million (2007: 1,087 million) and current liabilities of HK$43 million (2007: 375 million).

Capital Structure

As at 31 March 2008, the Group had total assets of HK$3,204 million (2007: HK$1,399 million) which were financed by shareholders' funds of HK$2,942 million (2007: HK$789 million), total liabilities of HK$71 million (2007: HK$404 million) and minority interests of HK$191 million (2007: HK$207 million).

During the financial year, the Group substantially expanded its capital base, mainly due to the acquisition of United Petroleum and acquisition of loan due to United energy Holdings Limited. This was achieved through the allotment and issue of 4,527,108,257 ordinary shares. In addition, the company issued and allotted 1,374,000,000 ordinary shares to raise approximately HK$2,184 million in cash on 16 October 2007.

Orders

In line with its business nature, the Group did not have any order records as at 31 March 2008.

Employees

As at 31st March 2008, the Group employed a total of 50 full time employees, located in Hong Kong and the PRC.

Employees' remuneration packages have been reviewed periodically and determined with reference to the performance of the individual and prevailing market practices. Remuneration packages include base salaries, year end bonus, medical benefits and a contributory provident fund.

Contingent Liabilities

The Group had no significant contingent liabilities as at 31 March 2008.

Exposure to Fluctuations in Exchange Rates and Related Hedges

The Group's transactions are mainly denominated in Hong Kong Dollars, United States dollars and Renminbi. As the exchange rate between these currencies are relatively stable, the exposure to fluctuations in the exchange rate of the currencies is minimal. Accordingly, no hedges on the currencies was made during the period under review.

Major Customers and Suppliers

The Group's largest and five largest customers represented 100% of total turnover, as the Group had only one customer.

Save for the expense of letting business and operating expenses paid, the Group did not make any significant purchases during the year.

Save for the connected transaction disclosed on page 86 of the annual report, none of the Company's directors, their associates or any shareholders of the Company (who, to the knowledge of the Company's directors, hold more than 5% of the Company's shares in issue) had any beneficial interest in the Group's only customer.

For the year ended 31 March 2007

Results

During the year under reviewed, the Group recorded a turnover of approximately HK$16 million and a profit attributable to equity holders of the Company of approximately HK$18 million, as compared with a turnover of approximately HK$236 million and a profit attributable to equity holders of the Company of approximately HK$6 million recorded in last year.

Segment Information

For the year ended 31 March 2007 and 2006, the turnover represented rental income, property management service fee income and wholesale of household building materials.

Liquidity and Capital Structure

The Group continued to be in a strong financial position for the year under review with cash and cash equivalents amounting to HK$355 million as at 31 March 2007. As at 31 March 2007, the total bank borrowings of the Group amounted to HK$303 million (2006: HK$305 million) and are wholly repayable within one year. The Group's borrowings were denominated in Renminbi. Upon signing the cooperation agreement with Beijing Glory on 26 July 2006 for the development of the parcels of land in Shenyang, the Group has been ceased from the pressure for raising fund to develop the land in Shenyang because, according to the cooperation agreement, the Group will contribute no further funds towards the Shenyang Projects while Beijing Glory will be responsible for all additional funding required, which will not be less than RMB1,000 million (equivalent to approximately HK$1,010 million), to develop the remaining parts and the overall management of the Shenyang Project, except the financial and accounting function which will be managed jointly by the Group and Beijing Glory. Beijing Glory will also the responsible for the repayment of the principal and interest of RMB300 million (equivalent to approximately HK$303 million) of banking borrowing and RMB60 million (equivalent to approximately HK$60.6 million) of corporate borrowing.

The Group had no long-term borrowings, therefore the gearing ratio is not applicable. The current ratio was 2.20, based on current assets of approximately HK$819 million and current liabilities of approximately HK$373 million.

Investment

During the year, the Group holds parcels of land in Shenyang with total site area of 328,862.8 square metres and an estimate gross floor area of approximately 568,100 square metres. The Group intends to develop the land for sale and leasing purpose.

In 2006, the government of PRC further enhanced its macro economic austerity measures. It was effective in stabilizing the real estate market in China, and has provided a good foundation for the continuous and healthy development of the real estate market. Based on our positive view of China's long-term real estate market, the Group will proactively seek for potential projects in other locations of PRC which will expand our real estate development business.

Orders

Due to the Group's business nature, as at 31 March 2007, the Group did not have order record.

Employees

At as 31 March 2007, the Group employed a total of 40 full time employees in Hong Kong and PRC.

Employees' remuneration package was reviewed periodically and determined with reference to the performance of the individual and the prevailing market practices. Remuneration package included basis salaries, year end bonus, medical and contributory provident fund.

Major Customers and Suppliers

Of the Group's total turnover of the year, the largest and five largest customers represented approximately 57.97% and 80.85% of the total turnover respectively.

For the year, the five largest suppliers of the Group accounted for 100% due to only five major suppliers. Save for the connected transaction disclosed on page 65 of the annual report, none of the Company's directors, their associates or any shareholders of the Company (who, to the knowledge of the Company's directors, hold more than 5% of the Company's shares in issue) had any beneficial interest in any of the Group's five largest customers and major supplier.

For the year ended 31 March 2006

Results

For the year ended 31 March 2006, the Group recorded a turnover of HK$236,468,000 and a profit attributable to shareholders of HK$6,419,000, as compared with a turnover of HK6,749,000 and a profit attributable to shareholders of HK$1,001,000 recorded last year.

Segment Information

For the years ended 31 March 2006, the turnover represented rental income, property management service fee income and wholesale of household building materials. For the years ended 31 March 2005, the turnover represented rental income derived from property located in Hong Kong.

Liquidity and Financial Resources and Gearing Ratio

As at 31 March 2005 and 2006, the Group operated under liability, with part of the operating capital provided by Oriental Harbour Holding Limited ("Oriental Harbour") (owned by Mr Zhang Hongwei, the controlling shareholder).

As at 31 March 2005 and 2006, the Group's cash and bank deposits amounted to HK$3,476,000 and HK$242,212,000, representing 49.3% and 41.2% of the total current assets respectively.

As at 31 March 2005 and 2006, the Group's gearing ratios are 55% and 42% respectively. Such ratios are calculated by dividing the total liabilities by total assets.

Capital Structure

As at 31 March 2005 and 2006, the Group had outstanding bank mortgage loans of HK$1,101,000 and HK$1,473,000 respectively due within one year. Interest on loans was calculated at variable rates ranging from 3.7% to 7.25% per annum.

Orders

Due to the Group's business nature, as at 31 March 2005 and 2006, the Group did not have order record.

New Businesses and Investments

In September 2005, the Group offered to its controlling shareholder to acquire a large-scale commercial real estate project in Shenyang City, the PRC. The project has a site area of approximately 328,000 square meters and a gross floor area of approximately 568,000 square meters. The acquisition was completed in June 2006. This marks the Group's actual entry into the real estate market of Mainland China, and laid a solid foundation for the Group's future income and profitability.

Major Customers and Suppliers

Of the Group's total turnover of 2006, the largest and five largest customers represented approximately 24.9% and 6.7 % of the total turnover respectively.

Save for the expense of letting business and operating expenses paid, the Group did not have any purchase for the year.

Save for the financial support provided by Oriental Harbour, none of the Company's directors, their associates or any shareholders of the Company (who, to the knowledge of the Company's directors, hold more than 5% of the Company's shares in issue) had any beneficial interest in any of the Group's five largest customers for 2006 (2005: Nil).

Staff and Remuneration Policy

As at 31 March 2006, the Group employed a total of four staffs based on market salary levels. Staff welfare includes insurance, provident scheme and discretionary bonus.

The remuneration policy of the employees of the Group is determined based on employees' performance, qualification and competence. The emoluments of the directors are determined by the board of directors, with reference to the Company's operating results, individual performance of the employees and comparable market data. None of the directors or any of its associates and senior employees was involved in determining their own remunerations.

Trend of Business of the Company

In light of the continued rapid growth of China's economy, as well as strong overall demand for oil throughout Asia and other developed regions, the Group has refocused its strategy on the development of its oil production business.

Reflecting this change in emphasis towards the oil resources industry, the Company changed its name to United Energy Group Limited on 24 December 2007, with unanimous shareholder support. In January 2008, the Group further tightened its strategic focus by restructuring its real estate and building materials businesses, reducing holdings to below 30%.

In October 2007, the Company acquired a 100% interest in United Petroleum & Natural Gas Investments Limited, which holds a controlling interest in an oil field project in Liaohe Field – located in China's Bohai Bay Basin. The project is being jointly developed with China National Petroleum Corporation ("CNPC"), pursuant to an Enhanced Oil Recovery ("EOR") contract; and features net 2P reserves of 61mmbbl.

Financial and Trading Prospects of the Enlarged Group

The Group believes that global economic growth — and especially China's rapidly expanding economy — will continue to fuel increasing demand for oil and natural gas globally.

Given the current market conditions, the Group's production assets in China and Kazakhstan are expected to provide significant cash flows as production capacity increases in the near future.

Leveraging our relationships with major Chinese Oil and Gas E&P players, the Group will continue to expand into new markets internationally, targeting areas such as Central Asia, Southeast Asia, Africa and Latin America. We will also maintain our aggressive growth strategy of acquiring reserves and increasing production through both organic and inorganic initiatives.

With an international asset portfolio, a strong balance sheet and an experienced management team; the Group stands well positioned to gain long-term benefits from the global economy's increasing demand for energy.

1. RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief, there are no other facts not contained herein the omission of which would make any statement contained in this circular misleading.

2. INFORMATION ABOUT THE ISSUE SHARES

	Number of Shares	Amount *(HK$)*
Authorised:		
Ordinary shares of HK$0.01 each	60,000,000,000	600,000,000
Issued and fully paid:		
Ordinary shares of HK$0.01 each	12,777,091,632	127,770,916

3. INDEBTEDNESS STATEMENT

As at the close of business on 31 July 2008 (being the latest practicable date for the purpose of this indebtedness statement prior to the printing of this circular), the Group had outstanding borrowings of approximately HK$20 million, comprising unsecured amounts due to directors of approximately HK$5 million, unsecured amounts due to related companies of approximately HK$4 million and unsecured amount due to an independent third party of approximately HK$11 million.

As at the close of business on 31 July 2008 (being the latest practicable date for the purpose of this indebtedness statement prior to the printing of this circular), the Transmeridian Group had the following outstanding secured notes and redeemable convertible preferred stocks:

(a) senior secured notes of approximately HK$2,262 million (equivalent to approximately US$290 million) bear interest at the rate of 12% per annum, will mature on 15 December 2010 and are fully and unconditionally guaranteed by the Transmeridian Group.

(b) senior redeemable convertible preferred stocks with an aggregate principal amount of approximately HK$377 million (equivalent to approximately US$48 million) bear a dividend rate of 18% per annum and will mature on 1 December 2011.

(c) junior redeemable convertible preferred stocks with an aggregate principal amount of HK$554 million (equivalent to approximately US$71 million) bear a dividend rate of 20% per annum and will mature on 15 March 2012.

Save as aforesaid and apart from intra-group liabilities and normal trade payables in the ordinary course of the business, as at the close of business on 31 July 2008 (being the latest practicable date for the purpose of this indebtedness statement prior to the printing of this circular), the Enlarged Group did not have other outstanding mortgages, charges, debentures or other loan capital, bank overdrafts or loans, other similar indebtedness, finance lease or hire purchase commitments, liabilities under acceptance or acceptance credits, guarantees or other material contingent liabilities.

4. MORTGAGES AND CHARGES OF THE COMPANY

The Enlarged Group had no mortgages and charges as at the Latest Practicable Date.

5. TOTAL AMOUNT OF ANY CONTINGENT LIABILITIES

The Enlarged Group had no significant contingent liabilities as at the Latest Practicable Date.

6. EFFECT OF THE TRANSACTIONS ON THE EARNINGS AND ASSETS AND LIABILITIES OF THE COMPANY

Upon Closing, the Company will be able to control 77.5% voting rights of Transmeridian and the Group will be able to consolidate 100% of its profit/loss and assets/liabilities into the Group's financial statements. Upon conversion of the First Tranche Preferred Shares and the Second Tranche Preferred Shares and exercise of the Warrants and Additional Warrants, Transmeridian will become a 85% owned subsidiary of the Company.

Effect on net asset value

As at 31 March 2008, the audited consolidated net asset value of the Group as extracted from the latest published annual report of the Group for the year ended 31 March 2008 amounted to approximately HK$3,133 million and Transmeridian recorded a net liability of approximately US$47 million (equivalent to approximately HK$364 million). Upon completion of the Transactions, based on the unaudited pro forma balance sheet as set out in Appendix IV to this circular, the unaudited pro forma net asset value, total assets and total liabilities of the Enlarged Group as at 31 March 2008 is estimated to be HK$3,421 million, HK$5,171 million and HK$1,750 million, representing 9% increase, 61% increase and 2,400% increase respectively as a result of the Transactions.

Effect on earnings

For the year ended 31 December 2007, Transmeridian recorded net loss of approximately US$87 million (equivalent to approximately HK$682 million). For the year ended 31 March 2008, loss attributable to equity holders of the Company was approximately HK$101 million.

Based on the unaudited pro forma income statement of the Enlarged Group, the unaudited pro forma combined turnover and net loss attributable to equity holders of the Company were approximately HK$270 million and HK$190 million respectively.

Effect on gearing

As at 31 March 2008, the gearing level of the Group, calculated as total liabilities divided by total assets, as extracted from the latest published annual report of the Group for the year ended 31 March 2008 was approximately 2%. Upon completion of the Transactions, based on the unaudited pro forma balance sheet, the gearing level of the Enlarged Group as at 31 March 2008 will increase to 34%.

The pro forma figures referred to above are calculated on the bases and assumptions set out in detail in Appendix IV to this circular and should be read in conjunction with them.

7. SUBSTANTIAL SHAREHOLDERS' INTERESTS IN SECURITIES

As at the Latest Practicable Date, so far as is known to the Directors and the chief executive of the Company, the following persons (other than a Director or chief executive of the Company) had an interest or short position in the Shares and underlying Shares which fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or recorded in the register kept by the Company pursuant to Section 336 of the SFO or were otherwise notified to the Company were as follows:

Name of shareholder	Number of shares		Percentage of shares held (%)
He Fu International Limited *(Note (b))*	5,128,169,125	(L)	40.14
United Petroleum & Natural Gas Holdings Limited *(Note (b))*	2,223,726,708	(L)	17.40
United Energy Holdings Limited *(Note (b))*	1,649,344,282	(L)	12.91
Kowin Limited	654,037,267		5.12

Notes:

(a) The letter "L" denotes long position in the shares or underlying shares of the Company.

(b) These companies are wholly-owned by Mr. Zhang Hongwei.

So far as is known to the Directors and the chief executive of the Company, as at the Latest Practicable Date, the following shareholders were interested in 10% or more of the equity interests of the following members of the Group:

Name of member of the Group	Name of shareholder	Number of shares held	Percentage of shareholding
Shenyang Shengtaicheng Property Development Company Limited	Beijing Glory Real Estate Co. Ltd.	N/A	29%
Shenyang Shengtaiyuan Logistics Company Limited	Beijing Bailida Logistics Company Limited	N/A	20%

Save as disclosed above, the Directors and the chief executive of the Company were not aware that there was any person (other than a Director or chief executive of the Company) who, as at the Latest Practicable Date, had an interest or short position in the Shares and underlying Shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or who was, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any other member of the Group, or had any options in respect of such capital.

8. DIRECTORS' INTERESTS IN SECURITIES

As at the Latest Practicable Date, save as the options granted to our Directors and chief executive under the Share Option Scheme (the "Options") as disclosed in the table below, the following Directors and chief executive of the Company have an interest or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which will have to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of the Listed Companies.

Name	**Date of Grant**	**Number of Ordinary Shares subject to the Options**	**Exercise price**
			(HK$)
Zhang Meiying	4 December 2007	100,000,000	1.56
Jonathan Soon P. Yeap	20 May 2008	120,000,000	0.902

So far as is known to the Directors and the chief executive of the Company, at the Latest Practicable Date, the following Directors had an interest or short position in the shares of the Company:

Name of Director	**Nature of Interests**	**Number of Shares**	**Percentage of shares held**
			(%)
Zhang Hongwei	Corporate *(Note (b))*	9,001,240,115 (L)	70.45
Zhu Jun	Beneficial	1,443,000 (L)	0.02

Notes:

(a) The letter "L" denotes long position in the shares or underlying shares of the Company.

(b) Out of the 9,001,240,115 Shares, 5,128,169,125 Shares were beneficially held by He Fu International Limited, 2,223,726,708 Shares were beneficially held by United Petroleum & Natural Gas Holdings Limited, and 1,649,344,282 Shares were beneficially held by United Energy Holdings Limited. He Fu International Limited, United Petroleum & Natural Gas Holding Limited and United Energy Holdings Limited are companies wholly-owned by Mr. Zhang Hongwei. Therefore, Mr. Zhang Hongwei is deemed to be interested in those 9,001,240,115 Shares.

Saved as disclosed above, as at the Latest Practicable Date, none of the Directors or chief executive of the Company and their associates had any interests and short positions in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO), the Model Code for Securities Transactions by Directors of Listed Companies and which were required to be entered into the register required to be kept under section 352 of the SFO; and none of the Directors is a director or employee of a company which had an interest or short position in the shares and the underlying shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO.

As at the Latest Practicable Date, none of the Directors was materially interested in any contract or arrangement subsisting at the Latest Practicable Date which was significant in relation to the business of the Group; and none of the Directors had any direct or indirect interest in any assets which had been, since 31 March 2008 (being the date to which the latest published audited accounts of the Company were made up), acquired or disposed of by or leased to any member of the Group, or which were proposed to be acquired or disposed of by or leased to any member of the Group.

9. DIRECTORS' INTERESTS IN CONTRACTS

None of the Directors was materially interested in any contract or arrangement entered into by any member of the Enlarged Group since 31 March 2008, being the date to which the latest published audited financial statements of the Company were made up or subsisting at the Latest Practicable Date, and which was significant in relation to the business of the Enlarged Group taken as a whole.

10. SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors or directors of Transmeridian has entered into, nor is there proposed to be, any service contract with any member of the Enlarged Group which is not expiring or determinable by the employer within one year without payment of compensation other than statutory compensation.

11. COMPETING INTERESTS

As at the Latest Practicable Date, none of the Directors and his/her respective associates was considered to have an interest in a business which competes or is likely to compete, either directly or indirectly, with the business of the Group other than those businesses to which the Directors and his/her associates were appointed to represent the interests of the Company and/or the Group.

12. EXPERTS AND CONSENTS

The following are the qualifications of the professional adviser who has given opinions or advice contained in this circular:

Name	**Qualifications**
RSM Nelson Wheeler	Certified Public Accountants

As at the Latest Practicable Date RSM Nelson Wheeler had given and had not withdrawn its written consent to the issue of this circular with the inclusions of its statements, letters, reports and opinion (as the case may be) as set out in this circular and references to its name in the form and context in which it is included.

As at the Latest Practicable Date, RSM Nelson Wheeler was not beneficially interested in the share capital of the Company and its subsidiaries and did not have any right, whether legally enforceable or not, to subscribe for or nominate persons to subscribe for securities of the Company and its subsidiaries.

As at the Latest Practicable Date, RSM Nelson Wheeler did not have any interests, either direct or indirect, in any assets which have been acquired or disposed of by or leased to or are proposed to be acquired or disposed of by or leased to any member of the Group since 31 March 2008, being the date to which the latest published audited consolidated financial statements of the Company were made up.

13. INTERESTS IN ASSETS

None of the Directors or the experts named in paragraph 12 of this Appendix had, since 31 March 2008, being the date to which the latest published audited financial statements of the Company or Transmeridian were made up, any direct or indirect interest in any assets which have been acquired or disposed of by or leased to any member of the Enlarged Group, or are proposed to be acquired or disposed of by or leased to any member of the Enlarged Group.

14. WORKING CAPITAL

The Directors are satisfied after due and careful enquiry that taking into account the present internal financial resources, the present available credit facilities of the Enlarged Group, the proceeds from the Convertible Bonds and in the absence of unforeseen circumstances, the Enlarged Group has sufficient working capital for its present requirements, that is for at least the next 12 months from the date of publication of this circular.

15. MATERIAL ADVERSE CHANGE

The Directors are not aware of any material adverse change in the financial or trading position of the Company and its subsidiaries since 31 March 2008, the date to which the latest published audited consolidated financial statements of the Company were made up.

16. LITIGATION

As at the Latest Practicable Date, no member of the Enlarged Group was engaged in any litigation or arbitration of material importance and there was no litigation or claim of material importance known to the Directors to be pending or threatened by or against any member of the Enlarged Group.

17. MISCELLANEOUS

(a) The company secretary of the Company is Ho Yuk Ming, Hugo, who is an associate member of the Hong Kong Institute of Certified Public Accountants.

(b) The qualified accountant of the Company is, Ho Yuk Ming, Hugo, who is an associate member of the Hong Kong Institute of Certified Public Accountants.

(c) Tricor Secretaries Limited situated, the Hong Kong branch share register and transfer office of the Company, is located at 26/F., Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong.

(d) The registered office of the Company is Clarendon House, 2 Church Street, Hamilton HM11, Bermuda.

(e) The principal office of the Company is Unit 2112, 21st Floor, Two Pacific Place, 88 Queensway, Hong Kong.

(f) The English text of this circular and the accompanying proxy form shall prevail over its Chinese text.

18. MATERIAL CONTRACTS

The following are the material contracts, not being contracts entered into in the ordinary course of business of the Enlarged Group, which have been entered into by members of the Enlarged Group within the two years immediately preceding the Latest Practicable Date:

(a) a disposal agreement dated 10 November 2006 and an assignment dated 30 March 2007 entered into between Fine Profit Corporation Limited, a wholly-owned subsidiary of the Company and Union Step Limited for the disposal of 5th Floor and 6th Floor and car parking spaces No. 33, 34 and 50, Ground Floor, Kwai Shun Industrial Centre, Nos. 51-63 Container Port Road, Kwai Chung NT at a consideration of HK$33,330,000;

(b) a sale and purchase agreement dated 8 August 2007 and a supplemental agreement dated 14 September 2007 entered into between the Company and United Energy Holdings Limited, United Petroleum and natural Gas Holdings Limited and Kowin Limited for the acquisition of the entire issued share capital of and shareholder's loan owing by United Petroleum and Natural Gas Investments Limited at a consideration of HK$7,288,644,294;

(c) a placing agreement dated 8 August 2007 entered into between the Company and BOCI Asia Limited in relation to the placing of no more than 1,374,000,000 new Shares at a placing price of HK$1.61 per placing share;

(d) a deed of assignment dated 16 October 2007 entered into by the Company, United Energy Holdings Limited and United Petroleum and Natural Gas Investments Limited in relation to the assignment to the Company by United Energy Holdings Limited the shareholders' loan owing by United Petroleum and Natural Gas Investments Limited at a consideration of HK$268,644,294;

(e) on 4 December 2007, the Company entered into a loan agreement with Charm Sea Investments Limited ("Charm Sea"), an independent third party, pursuant to which the Company lent Charm Sea the aggregate principal amount of HK$650,000,000 (the "Charm Sea Loan"), to be used exclusively by Charm Sea and/or a related company for the financing of the purchase of the entire issued share capital of a target company ("Target"), being an independent third party. Pursuant to a separate agreement entered into between the Company and Great Wing Holdings Limited ("Great Wing"), Great Wing being a member of the

same group of companies as Charm Sea, the Charm Sea Loan was secured by way of (i) a guarantee dated 4 December 2007 provided by Great Wing and (ii) a charge over the entire issued share capital of Target, which in turn holds a 70% equity interest in a Sino-foreign equity joint venture established in the People's Republic of China (the "Joint Venture"). The Joint Venture is principally engaged in the operation of hotel and related businesses;

(f) on 11 December 2007, Grand Hope Group Limited ("Grand Hope"), a wholly-owned subsidiary of the Company entered into the Capital Contribution Agreement with Beijing Glory Real Estate Company Limited ("Beijing Glory") pursuant to which the parties have conditionally agreed to increase the total investment and the registered capital of the Shenyang Dadongfang Property Development Company Limited ("Shenyang Dadongfang") from US$30,359,800 to US$71,851,400 and from US$15,179,900 to US$35,925,700, respectively. Under the Capital Contribution Agreement, Beijing Glory will solely contribute the full amount of US$20,745,800 (equivalent to approximately HK$161,817,240) in the increased registered capital. Upon completion of the investment injection, Beijing Glory and Grand Hope will be interested in 70% and 30% of the paid-up registered capital in Shenyang Dadongfang; and

(g) the Transaction Agreements.

Save as disclosed above, none of the members of the Group has entered into any contracts (not being contracts entered into in the ordinary course of business) within the two years preceding the date of this circular that are or may be material.

RSM Nelson Wheeler has given and has not withdrawn its written consent to the issue of this circular with the inclusion herein of its letters and reports (as the case may be) and references to its name in the form and context in which it appears.

As at the Latest Practicable Date, RSM Nelson Wheeler was not beneficially interested in the share capital of any member of the Group, nor did they have any right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group, nor did they have any interest, either direct or indirect, in any assets which had been since 31 March 2008 (being the date to which the latest published audited accounts of the Company were made up) acquired or disposed of by or leased to any member of the Group or which were proposed to be acquired or disposed of by or leased to any member of the Group.

19. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection at Slaughter and May at 47th Floor, Jardine House, One Connaught Place, Central, Hong Kong during normal business hours (Saturdays and public holidays excepted) from the date of this circular until 15 October 2008 (both dates inclusive):

(a) the memorandum of association and bye-laws of the Company;

(b) the annual reports of the Company for the three years ended 31 March 2006, 2007 and 2008;

(c) the audited US combined financial statements of Transmeridian;

(d) the unaudited us combined financial statements of Transmeridian under US GAAP;

(e) the report prepared by RSM Nelson Wheeler in connection with the unaudited pro forma financial information of the Enlarged Group as set out in Appendix IV;

(f) the material contracts referred to in the section headed "Material Contracts" in this Appendix;

(g) the written consents referred to in the section headed "Experts and consents" of this Appendix;

(h) the Transaction Agreements;

(i) this circular;

(j) announcement of the Company dated 15 August 2007 and the circular of the Company dated 17 September 2007 in relation to the major and connected transaction — acquisition of the entire issued share capital of and shareholders' loan owed by United Petroleum & natural Gas investments Limited; and

(k) the announcements of the Company dated 1 December 2005, 1 June 2006 and 26 July 2006, and its circular dated 31 March 2006, in relation to, among others, the acquisition of the entire issued share capital of Grand Hope.

UNITED ENERGY GROUP LIMITED
聯合能源集團有限公司

(incorporated in Cayman Islands and continued in Bermuda with limited liability)

(Stock Code: 467)

NOTICE IS HEREBY GIVEN that an Special General Meeting of the Company will be held at Room 1501-02, 15/F., Hong Kong Club Building, 3A Chater Road, Central, Hong Kong on Thursday, 16 October 2008 at 10:00 a.m. to consider and, if thought fit, pass (with or without amendments) the following resolutions:

ORDINARY RESOLUTION

1. "**THAT**:

(A) (i) the Transactions and the transactions and agreements contemplated under or incidental to the Transactions (including the Investment Agreement, the Senior Preferred Stock Purchase Agreements, the Junior Preferred Stock Agreement, the Investor Rights Agreement, the respective terms and conditions in relation to the New Preferred Stock, the Warrants and the Additional Warrants, collectively defined as the "Transaction Documents") and (ii) the execution, performance and implementation of the Transaction Documents and ancillary matters contemplated thereunder, be and are hereby approved, confirmed and ratified;

(B) conditional upon the Listing Committee of the Stock Exchange granting the listing of, and permission to deal in, the Conversion Shares, the issue of the Convertible Bonds as payment of the consideration under the Investment Agreement and the Senior Preferred Stock Purchase Agreements be and are hereby approved; and

(C) any Director be and is hereby authorised on behalf of the Company to exercise, perfect and deliver all such documents and do all such acts and things and any two Directors or any Director and the company secretary of the Company be and are hereby authorised to affix the Company's seal to all such documents and deliver the same as deeds of the Company, in any such case as may be necessary or desirable to implement or give effect to the terms of the Transaction Documents and the transactions and ancillary agreements or documents contemplated thereunder (including, without limitation, the execution of any

deeds and/or documents in connection with the transactions and agreements contemplated in resolution 1 above and the exercise or enforcement of any rights thereunder) and to make and agree such variations to the terms of the Transaction Documents and ancillary agreements or documents contemplated thereunder as he or she or they, in his or her or their absolute discretion, may consider to be desirable, appropriate or necessary and in the interests of the Company."

By Order of the Board
UNITED ENERGY GROUP LIMITED
Ho Yuk Ming, Hugo
Company Secretary

Hong Kong, 30 September 2008

Principal office in Hong Kong:
Unit 2112, 21st Floor
Two Pacific Place
88 Queensway
Hong Kong

Notes:

1. A form of proxy for use at the meeting is enclosed herewith

2. The instrument appointing a proxy shall be in writing under the hand of the appointer or of his/her attorney duly authorised in writing or, if the appointer is a corporation, either under its seal or under the hand of any officer, attorney or other person authorised to sign the same.

3. Any member entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, vote instead of him/her. A proxy need not be a member of the Company.

4. In order to be valid, the form of proxy, together with the power of attorney or other authority (if any) under which it is signed, or a notarised copy of such power or authority, must be lodged at the office of the Company's Hong Kong branch share registrars and transfer office, Tricor Secretaries Limited, at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong, not less than 48 hours before the time appointed for holding the meeting or any adjourned meeting thereof (as the case may be).

5. Completion and return of the form of proxy will not preclude members from attending and voting in person at the meeting or at any adjourned meeting thereof (as the case may be) should they so wish, and in such event, the form of proxy shall be deemed to be revoked.

6. Where there are joint registered holders of any share, any one of such joint holders may vote, either in person or by proxy, in respect of such share as if he/she was solely entitled thereto, but if more than one of such joint holders are present at the meeting, whether in person or by proxy, the joint registered holder present whose name stands first on the register of members in respect of the shares shall be accepted to the exclusion of the votes of the other registered holders.