

Edgar Filing: CHAPARRAL RESOURCES INC - Form 10-Q

CHAPARRAL RESOURCES INC  
Form 10-Q  
November 14, 2003

FORM 10-Q  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2003

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: 0 - 7261

CHAPARRAL RESOURCES, INC.  
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(Exact Name of Registrant as Specified in Its Charter)

Delaware  
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84-0630863  
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(State or Other Jurisdiction of  
Incorporation or Organization)

(I.R.S. Employer Identification No.)

16945 Northchase Drive, Suite 1620  
Houston, Texas 77060  
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(Address of Principal Executive Offices)

Registrant's telephone number, including area code: (281) 877-7100

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

As of November 10, 2003 the Registrant had 38,209,502 shares of its common stock, par value \$0.0001 per share, issued and outstanding.

Part I - Summarized Financial Information

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Item 1 - Financial Statements

Chaparral Resources, Inc.  
Consolidated Balance Sheets  
(In Thousands)

	September 30, 2003 (Unaudited)	December 31, 2002
	-----	-----
Assets		
Current assets:		
Cash and cash equivalents	\$ 3,857	\$ 4,295
Accounts receivable:		
Oil sales receivable	772	1,993
VAT receivable	3,155	1,999
Prepaid expenses	2,380	2,456
Crude oil inventory	618	548
	-----	-----
Total current assets	10,782	11,291
Materials and supplies	3,353	2,457
Other	--	5
Property, plant and equipment:		
Oil and gas properties, full cost:		
Properties subject to depletion	102,312	84,833
Properties not subject to depletion	9,111	8,814
	-----	-----
	111,423	93,647
Furniture and fixtures and other equipment	9,202	8,210
	-----	-----
	120,625	101,857
Less - accumulated depreciation, depletion, and amortization	(39,806)	(28,302)
	-----	-----
Property, plant and equipment, net	80,819	73,555
	-----	-----
Total assets	\$ 94,954	\$ 87,308
	=====	=====

See accompanying notes.

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Chaparral Resources, Inc.  
Consolidated Balance Sheets (continued)  
(In Thousands)

	September 30, 2003 (Unaudited)	December 31, 2002
	-----	-----
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 6,365	\$ 2,809
Accrued liabilities:		
Accrued compensation	229	227
Other accrued liabilities	2,976	2,432

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Current income tax liability	614	1,939
Accrued interest payable	671	250
Current portion of loans payable to affiliates	9,000	6,000
	-----	-----
Total current liabilities	19,855	13,657
Loans payable to affiliates, net of discount	23,176	27,998
Deferred tax liability	2,649	746
Long-term assets retirement obligation	676	--
Accrued production bonus	606	477
	-----	-----
Long-term liabilities	27,107	29,221
Minority interest	2,871	321
	-----	-----
Total liabilities	49,833	43,199
Stockholders' equity:		
Common stock - authorized, 100,000,000 shares of \$0.0001 par value; issued and outstanding, 38,209,502 shares as of September 30, 2003 and December 31, 2002	4	4
Capital in excess of par value	107,226	107,226
Accumulated deficit	(62,109)	(63,121)
	-----	-----
Total stockholders' equity	45,121	44,109
	-----	-----
Total liabilities and stockholders' equity	\$ 94,954	\$ 87,308
	=====	=====

See accompanying notes.

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Chaparral Resources, Inc.  
Consolidated Statements of Operations (Unaudited)  
(In Thousands, Except Share Data)

	For the Three Months Ended		For the N
	September 30, 2003	September 30, 2002	September 2003
	-----	-----	-----
Revenue	\$ 23,308	\$ 13,446	\$ 39,
Costs and expenses:			
Transportation costs	4,617	2,397	7,
Operating expenses	1,671	2,212	4,
Depreciation and depletion	7,140	3,709	12,
Advisory fee	75	--	
Hedge losses	--	--	--
Accretion expense	17	--	
General and administrative	1,967	1,557	5,
	-----	-----	-----
Total costs and expenses	15,487	9,875	30,
	-----	-----	-----
Income from operations	7,821	3,571	9,
Other income (expense):			
Interest expense	(1,100)	(1,097)	(3,
Minority interest	(2,134)	--	(2,
Currency exchange gain/(loss)	--	7	(
Other	(37)	(16)	

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Total other income (expense)	(3,271)	(1,106)	(6,000)
Income/(loss) before income taxes, extraordinary gain and cumulative effect of change in accounting principle	4,550	2,465	3,000
Income tax expense	(2,479)	(352)	(3,000)
Income (loss) before extraordinary gain and cumulative effect of change in accounting principle	2,071	2,113	0
Extraordinary gain	--	--	0
Cumulative effect of change in accounting principle, net of tax	--	--	1,000
Net income available to common Stockholders	\$ 2,071	\$ 2,113	\$ 1,000
Basic earnings per share:			
Income (loss) per share before extraordinary gain and cumulative effect of change in accounting principle	\$ 0.05	\$ 0.06	\$ (0.00)
Extraordinary gain	\$ --	\$ --	\$ --
Cumulative effect of change in accounting principle	\$ --	\$ --	\$ 0.00
Net income per share	\$ 0.05	\$ 0.06	\$ 0.00
Weighted average number of shares outstanding (basic)	38,209,502	38,209,502	38,209,502

Chaparral Resources, Inc.  
Consolidated Statements of Operations (continued) (Unaudited)  
(In Thousands, Except Share Data)

	For the Three Months Ended		For the N
	September 30, 2003	September 30, 2002	September 2003
Diluted earnings per share:			
Income/(loss) per share before extraordinary gain and cumulative effect of change in accounting principle	\$ 0.05	\$ 0.05	\$ (0.00)
Extraordinary gain	\$ --	\$ --	\$ --
Cumulative effect of change in accounting principle	\$ --	\$ --	\$ 0.00
Net income per share	\$ 0.05	\$ 0.05	\$ 0.00
Weighted number of shares outstanding (diluted)	38,408,726	39,134,622	38,408,726

See accompanying notes.

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Chaparral Resources, Inc.  
Consolidated Statements of Cash Flows (Unaudited)  
(In Thousands)

	For the Nine Months Ended	
	September 30, 2003	September 30, 2002
Cash flows from operating activities		
Net income	\$ 1,012	\$ 4,042
Adjustments to reconcile net income to net cash provided in operating activities:		
Depreciation, depletion, and amortization	12,897	9,708
Loss on disposition of assets	8	15
Deferred income taxes	1,903	419
Cumulative effect of change in accounting Principle	(1,018)	--
Accretion expense	46	--
Hedge losses	--	762
Amortization of debt issuance costs	178	211
Extraordinary gain on restructuring of debt	--	(5,338)
Non cash interest expense	--	2,753
Minority interest	2,550	--
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	65	(5,273)
Prepaid expenses	81	(1,000)
Crude oil inventory	87	(292)
Increase (decrease) in:		
Accounts payable and accrued liabilities	257	(7,564)
Accrued interest payable	421	1,752
Other liabilities	129	(190)
Net cash provided by operating activities	\$ 18,616	\$ 5
Cash flows from investing activities		
Additions to furniture, fixtures, and other equipment	\$ (792)	\$ (649)
Acquisition of 10% interest in KKM, net of cash Required	--	(644)
Additions to oil and gas properties	(15,366)	(5,697)
Materials and supplies inventory	(896)	270
Proceeds from disposition of assets	--	5
Net cash used in investing activities	\$ (17,054)	\$ (6,715)

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Chaparral Resources, Inc.  
Consolidated Statements of Cash Flows (continued) (Unaudited)  
(In Thousands)

For the Nine Months Ended

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	September 30, 2003	September 30, 2002
	-----	-----
Cash flows from financing activities		
Proceeds from loans from affiliates	\$ 4,500	\$ 40,000
Payments on loans from affiliates	(6,500)	(5,000)
Proceeds from sale of stock	--	8,000
Payments on Shell Capital loan	--	(30,450)
Debt restructuring costs	--	(2,518)
Redemption of Series A Preferred Stock	--	(2,300)
	-----	-----
Net cash provided/(used) by financing activities	\$ (2,000)	\$ 7,732
	-----	-----
Net increase (decrease) in cash and cash equivalents	\$ (438)	\$ 1,022
Cash and cash equivalents at beginning of period	4,295	174
	-----	-----
Cash and cash equivalents at end of period	\$ 3,857	\$ 1,196
	-----	-----
Supplemental cash flow disclosure		
Interest paid	\$ 3,207	\$ 239
Supplemental schedule of non-cash investing and financing activities		
Non-cash additions to oil and gas properties	\$ 2,519	\$ --
Common stock issued for 10% interest in KKM	\$ --	\$ 2,701
Discount recognized for note issued with stock warrants	\$ --	\$ 2,466

See accompanying notes.

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Chaparral Resources, Inc.  
Notes to Consolidated Financial Statements  
(Unaudited)

1. General

Chaparral Resources, Inc. ("Chaparral") was incorporated in the state of Colorado on January 13, 1972, principally to engage in the exploration, development and production of oil and gas properties. Chaparral focuses substantially all of its efforts on the exploration and development of the Karakuduk Field, an oil field located in the Central Asian Republic of Kazakhstan. In 1999, Chaparral reincorporated from Colorado to Delaware.

The consolidated financial statements include the accounts of Chaparral and its greater than 50% owned subsidiaries, Closed Type JSC Karakudukmunay ("KKM"), Central Asian Petroleum (Guernsey) Limited ("CAP-G"), Korporatsiya Mangistau Terra International ("MTI"), Road Runner Services Company ("RRSC"), Chaparral Acquisition Corporation ("CAC"), and Central Asian Petroleum, Inc. ("CAP-D"). Chaparral owns 80% of the common stock of CAP-G directly and 20% indirectly

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through CAP-D. Hereinafter, Chaparral and its subsidiaries are collectively referred to as the "Company." All significant inter-company transactions have been eliminated.

Chaparral owns a 60% interest in KKM, a Kazakhstan Joint Stock Company of Closed Type. KKM was formed to engage in the exploration, development, and production of oil and gas properties in the Republic of Kazakhstan. KKM's only significant investment is in the Karakuduk Field, an onshore oil field in the Mangistau region of the Republic of Kazakhstan. On August 30, 1995, KKM entered into an agreement with the Ministry of Oil and Gas Industry for Exploration, Development and Production of Oil in the Karakuduk Oil Field in the Mangistau region of the Republic of Kazakhstan (the "Agreement"). KKM's rights and obligations regarding the exploration, development, and production of underlying hydrocarbons in the Karakuduk Field are determined by the Agreement. KKM is owned jointly by CAP-G (50%), MTI (10%), and KazMunayGaz JSC ("KMG") (40%). KMG is the national petroleum company of Kazakhstan.

KKM's rights to the Karakuduk Field may be terminated under certain conditions specified in the Agreement. The term of the Agreement is 25 years commencing from the date of KKM's registration. The Agreement can be extended to a date agreed between the Ministry of Energy and Mineral Resources and KKM as long as production of petroleum and/or gas is continued in the Karakuduk Field.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. Reference should be made to the relevant notes to the financial statements for both Chaparral and KKM included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

The information furnished herein was taken from the books and records of the Company without audit. However, such information reflects all adjustments, which are, in the opinion of management, normal recurring adjustments necessary for the fair statement of the results for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be expected for any future interim period or for the year.

Certain reclassifications have been made in the periods presented for the 2002 financial statements to conform to the 2003 presentation.

### 2. New Accounting Standards

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") 143, Accounting for Asset Retirement Obligations. SFAS 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Subsequently, the asset retirement cost should be allocated to expense using a systematic and rational method. SFAS 143 is effective for fiscal years beginning after June 15, 2002. The Company adopted SFAS 143 on January 1, 2003. See Note 5 for results of the adoption of SFAS 143.

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Chaparral Resources, Inc.  
Notes to Consolidated Financial Statements (continued)  
(Unaudited)

### 2. New Accounting Standards (continued)

In May 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on

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Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts and hedging activities under SFAS No. 133. The amendments set forth in SFAS No. 149 require that contracts with comparable characteristics be accounted for similarly. SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003 (with a few exceptions) and for hedging relationships designated after June 30, 2003. The guidance is to be applied prospectively only. The adoption of SFAS No. 149 as of July 1, 2003 has had no effect on the Company's financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This statement establishes standards for how an issuer classifies and measures on its balance sheet certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 was effective for financial instruments entered into or modified after May 31, 2003, and was otherwise effective for us as of July 1, 2003. The adoption of the applicable provisions of this statement as of the indicated dates has had no effect on the Company's financial statements.

In November 2002, the FASB issued Interpretation No. (FIN) 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. FIN 45 requires certain guarantees to be recorded at fair value. FIN 45 had a dual effective date. The initial recognition and measurement provisions are applicable on a prospective basis only to guarantees issued or modified after December 31, 2002. The disclosure requirements in the interpretation were effective as of October 1, 2002. The adoption of the applicable provisions of FIN 45 at the indicated dates has had no effect on the Company's financial statements.

In January 2003, the FASB issued Interpretation (FIN) No. 46, Consolidation of Variable Interest Entities (VIEs), in an effort to expand upon and strengthen existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. In general, a VIE is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires a VIE to be consolidated by a company if that company is subject to a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns, or both. FIN 46 also requires disclosures about VIEs that the Company is not required to consolidate, but in which it has a significant variable interest. The consolidation requirements of FIN 46 apply immediately to VIEs created after January 31, 2003, and to other entities no later than the three months ended September 30, 2003. Certain disclosure requirements are required in all financial statements issued after January 31, 2003, regardless of when the VIE was established. The Company has not identified any VIEs that must be consolidated.

### 3. Going Concern

The Company's financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company has a working capital deficiency as of September 30, 2003. In addition, the Company has experienced limitations in obtaining 100% export quota for the sale of its hydrocarbons. These conditions create uncertainties relating to the Company's ability to meet all expenditure and cash flow requirements through the next twelve months. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments to



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reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of these uncertainties.

The Company is seeking to alleviate these conditions by obtaining 100% export of all hydrocarbons produced from the Karakuduk Field through discussions with the Government of Kazakhstan. On July 17, 2003, the Company took the first step toward the commencement of arbitration proceedings in Switzerland for the breach of the Agreement by the Government of Kazakhstan by initiating a required three-month period of consultation with the Government. The Government indicated an interest in trying to resolve this matter during the consultation period.

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### Chaparral Resources, Inc. Notes to Consolidated Financial Statements (continued) (Unaudited)

#### 3. Going Concern (continued)

Although the consultation period has expired, the Company and the Government are continuing to negotiate a possible resolution of this matter. If the matter cannot be resolved in a satisfactory manner, the Company has reserved its right to commence formal arbitration proceedings pursuant to its contractual arrangements with the Government.

In addition, the Company is attempting to obtain additional debt financing to cover any cash flow deficiencies that may occur and refinance the Company's loan with JSC Kazkommertsbank ("Kazkommertsbank") in order to reduce the Company's current interest rate of 14% and alleviate the Company's current working capital deficiency.

No assurances can be provided, however, that if arbitration is instituted, it will be successful or that if successful, the Company will be able to enforce the award in Kazakhstan, or that the Company will be able to export 100% or a significant portion of its production and that the Company will be able to obtain additional financing and cash flow from operations to meet working capital requirements in the future.

#### 4. Crude Oil Inventory

Crude oil inventory represents production costs associated with lifting and transporting crude oil from the Karakuduk Field to the KazTransOil pipeline (the "KTO export pipeline"). Crude oil placed into the KTO export pipeline is held as inventory until formally nominated and delivered for sale. Crude oil inventory as of September 30, 2003 represents approximately 93,000 barrels of crude oil, an increase of 6,000 barrels from 87,000 barrels of crude oil as of December 31, 2002. The increase in crude oil inventory represents less than one day of production.

#### 5. Asset Retirement Obligation

As discussed in Note 2, effective January 1, 2003, the Company changed its method of accounting for asset retirement obligations in accordance with SFAS 143, Accounting for Asset Retirement Obligations. Previously, the Company used an amount equal to the undiscounted cash flows associated with the asset retirement obligation ("ARO") in determining depreciation, depletion, and amortization ("DD&A") rates. Under the new accounting method, the Company now recognize AROs in the period in which they are incurred if a reasonable estimate of a fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset.

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The cumulative effect of the change on prior years resulted in a gain of \$1.02 million, or \$0.03 per share, which is included in income for the period ended September 30, 2003.

Since 1995, the core business of the Company has been the development of the Karakuduk Field. The Company is still in the early stages of development and continues to develop the field by drilling additional wells, expansion of its oil storage capacity, installation of additional gathering and processing facilities, and the full implementation of the central processing facility. The Company is legally required under the Agreement to restore the field to its original condition. The Company recognized the fair value of its liability for an ARO as of January 1, 2003 in the amount of \$516,000 and capitalized that cost as part of the cost basis of its oil and gas properties and depletes it using the units of production method over proved reserves.

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Chaparral Resources, Inc.  
Notes to Consolidated Financial Statements (continued)  
(Unaudited)

5. Asset Retirement Obligation (continued)

On February 12, 2003, the Company commenced a new drilling campaign to further develop and commercially produce the oil reserves in the Karakuduk Field. As a result of the new drilling campaign, the Company revised its estimate of retirement costs to include expected additions to the Karakuduk Field during 2003. This change in estimate did not result in a direct charge to income for the period ended September 30, 2003. The following table describes all changes to the Company's asset retirement obligation liability:

	For three months ended September 30, 2003 (In Thousands)	For nine months ended September 30, 2003 (In Thousands)
	-----	-----
Asset retirement obligation at beginning of period	\$616	\$--
Liability recognized in transition	--	516
Accretion expense	17	46
Revision in estimated cash flows	43	114
	----	----
Asset retirement obligation at end of period	\$676	\$676
	====	====

The pro forma asset retirement obligation assuming the application of SFAS 143 for periods prior to January 1, 2003 as of January 1, 2002 and December 31, 2002 would have been \$469,000 and \$516,000, respectively.

6. Loans from Affiliates

CAIH Note

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In May 2002, the Company borrowed \$4 million from Central Asian Industrial

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Holdings, N.V. ("CAIH") in exchange for a three year note bearing interest at 12% per annum (the "CAIH Note"). Along with the CAIH Note, CAIH received a warrant to purchase 3,076,923 shares of the Company's common stock at \$1.30 per share (the "CAIH Warrant"). The CAIH Note was recorded net of a \$2.47 million discount, based on the fair market value of the CAIH Warrant. The discount is amortized using the effective interest rate over the life of the CAIH Note. The principal balance of the CAIH Note is due on May 10, 2005 and accrued interest is payable quarterly.

In June 2002, the Company repaid \$2 million of the \$4 million outstanding principal balance of the CAIH Note. As a result, the Company recognized an extraordinary loss on the early extinguishment of debt of \$1.22 million from the write-off of 50% of the unamortized discount on the CAIH Note. The Company recognized \$358,000 in interest expense on the CAIH Note for the nine months ended September 30, 2003, including \$180,000 of interest on outstanding principal and \$178,000 in discount amortization.

### KKM Credit Facility

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In May 2002, KKM established a five-year, \$33 million credit line ("KKM Credit Facility") with Kazkommertsbank an affiliate of CAIH. The KKM Credit Facility consists of a \$30 million non-revolving line and a \$3 million revolving line, both of which were fully borrowed by KKM in May 2002. The Company recognized \$3.45 million of interest expense on the KKM Credit Facility for the nine months ended September 30, 2003.

The non-revolving portion of the KKM Credit Facility accrues simple interest at an annual rate of 14% and is repayable over a five-year period with final maturity in May 2007. Accrued interest is payable quarterly, beginning in December 2002. KKM has made quarterly principal payments since May 2003. As of September 30, 2003, the Company has repaid \$2 million in principal.

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Chaparral Resources, Inc.  
Notes to Consolidated Financial Statements (continued)  
(Unaudited)

#### 6. Loans from Affiliates (continued)

The revolving portion of the KKM Credit Facility accrues simple interest at an annual rate of 14%. The revolver is loaned to KKM for short-term periods up to one year, but KKM has the right to re-borrow the funds through May 2006 with final repayment due in May 2007. Accrued interest on the revolving loan is payable at maturity. The initial \$3 million revolving loan to KKM was subject to a three month term. The principal balance was repaid in July 2002 and KKM immediately re-borrowed another \$3 million with a maturity date of July 31, 2003. KKM has repaid the \$3 million due on July 31, 2003 and exercised its right to re-borrow another \$3 million with a maturity date of July 31, 2004.

The original KKM Credit Facility included repayment terms of three years and four years for the non-revolving and revolving portions of the KKM Credit Facility, respectively, with an option to extend the final maturity date for repayment of the entire KKM Credit Facility to five years. KKM exercised the option to extend the repayment term to five years for the entire KKM Credit Facility from May 2002.

The Company is subject to certain pledges, covenants, and other restrictions under the KKM Credit Facility, including, but not limited to, the following:

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- (i) CAP-G pledged its 50% interest in KKM to Kazkommertsbank as collateral for the KKM Credit Facility;
- (ii) Chaparral has provided a written guarantee to Kazkommertsbank that it will repay the KKM Credit Facility in the event KKM fails to do so;
- (iii) KKM may not incur additional indebtedness or pledge its assets to another party without the written consent of Kazkommertsbank; and
- (iv) KKM may not pay dividends without the written consent of Kazkommertsbank.

The KKM Credit Facility stipulates certain events of default, including, but not limited to, KKM's inability to meet the terms of the KKM Credit Facility, KKM's failure to meet its obligations to third parties in excess of \$100,000, and the Company's involvement in legal proceedings in excess of \$100,000 where an adverse judgment against the Company occurs or is expected to occur. If an event of default does occur and is not waived by the lender, Kazkommertsbank has a right to call the KKM Credit Facility immediately due and payable and/or exercise its security interest by enforcing its collateral right on the Company's shares in KKM. Furthermore, in the event of a material adverse change in the financial or credit markets, Kazkommertsbank has a right to unilaterally alter any terms and conditions of the KKM Credit Facility, including the rate of interest, by written request. KKM may either agree to the amended terms or repay the outstanding KKM Credit Facility within 10 days of notification.

The maturity schedule of the Company's indebtedness as of September 30, 2003, is as follows:

Date	Principal Amount Due
----	-----
2003	\$ 1,000,000
2004	10,000,000
2005	10,000,000
2006	8,000,000
2007	4,000,000
Total principal due	\$ 33,000,000
Less:	
Principal due within one year	(9,000,000)
Unamortized debt issue cost	(824,000)
Net long term principal due	\$23,176,000

Chaparral Resources, Inc.  
Notes to Consolidated Financial Statements (continued)  
(Unaudited)

6. Loans from Affiliates (continued)

Line of Credit  
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On April 29, 2003, Kazkommertsbank provided a line of credit for \$2.5 million to the Company to cover necessary operating expenditures ("Line of Credit"). On the same day, the Company accessed \$1.5 million from the line of credit to cover the required transportation costs for the May 2003 oil sale. The \$1.5 million was due on May 29, 2003 and accrued simple interest at an annual rate of 14%. The company repaid the \$1.5 million and all accrued interest on May 22, 2003.

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### 7. Common Stock

During the quarter ended September 30, 2003, stock options to purchase 584 shares of the Company's common stock granted in 1998 to employees of the Company expired. Of the expired options 167 had an exercise price of \$86.40 per share and 417 had an exercise price of \$80.40 per share.

During the quarter ended September 30, 2003, warrants to purchase 333 shares of the Company's common stock granted during 1998 expired. The expired warrants had an exercise price of \$0.60 per share.

### 8. Income Taxes

Income tax expense as reported entirely relates to foreign income taxes provided on the Company's operations within the Republic of Kazakhstan. KKM's principal agreement with the Government of the Republic of Kazakhstan for the exploration, development and production of oil in the Karakuduk Field specifies the income taxes and other taxes applicable to KKM, which is subject to the tax laws of the Republic of Kazakhstan. The Company has used the best estimates available to determine its current and deferred tax liabilities within Kazakhstan.

### 9. Commitments and Contingencies

#### Taxation

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The existing legislation with regard to taxation in the Republic of Kazakhstan is constantly evolving as the Government manages the transition from a command to a market economy. Tax and other laws applicable to the Company are not always clearly written and their interpretation is often subject to the opinions of the local or main State Tax Service. Instances of inconsistent opinions between local, regional and national tax authorities are not unusual.

In December 2002, KKM received a claim from the Ministry of State Revenues of the Republic of Kazakhstan for \$9.6 million (the "Tax Claim") relating to additional unpaid taxes and penalties covering the three years from 1999 to 2001. The original Tax Claim has been successfully reduced to approximately \$2.31 million. KKM has appealed the remaining claim and has contracted legal firms in Kazakhstan to assist with the appeal process. Based on the assessments of KKM's management and legal counsel, it is the Company's opinion that the ultimate resolution of the Tax Claim, after taking into account reserves previously made, will not have a material adverse effect on the financial position or operating results of the Company.

#### Basis of Accounting

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KKM maintains its statutory books and records in accordance with U.S. generally accepted accounting principles ("GAAP") and calculates taxable income or loss using the existing Kazakh tax legislation in effect on August 30, 1995, the date the Agreement was signed. The Company considers these accounting methods correct under the terms of the Agreement. The Republic of Kazakhstan currently requires companies to comply with Kazakh accounting regulations and to calculate tax profits or losses in accordance with these regulations as well as the prevailing tax law.

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(Unaudited)

## 10. Related Party Transactions

During April 2003, the Company approved a one-year agreement with OJSC Kazkommerts Securities ("KKS") an affiliate of Kazkommertsbank. The agreement became effective as of January 7, 2003 and provides for KKS to assist the Company's senior management with financial advisory and investment banking services. In consideration for the services KKS will receive a monthly fee of \$25,000 (the "Advisory Fee").

On August 30, 2003, the Company extended its drilling contract with KazMunayGas-Drilling ("KMGD"), an affiliate of KMG, for the drilling rig currently operating in the Karakuduk Field until December 31, 2004. The rig was originally contracted until February 6, 2004.

## 11. Subsequent Events

A payment of principal and interest was due on the KKM Credit Facility on November 6, 2003. The Company paid the current interest due, but the Company and Kazkommertsbank have agreed to defer the repayment of \$1 million in principal to a date that is currently being negotiated.

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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### 1. Liquidity and Capital Resources

#### Going Concern

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Our financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. We have a working capital deficiency as of September 30, 2003. In addition, we have experienced limitations in obtaining 100% export quota for the sale of our hydrocarbons. These conditions create uncertainties relating to our ability to meet all expenditure and cash flow requirements through the next twelve months. These conditions raise substantial doubt about our ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of these uncertainties.

Our short and long-term liquidity is impacted by local oil sales obligations imposed on oil and gas producers within Kazakhstan to supply local energy needs, and our ability to obtain export quota necessary to sell our crude oil production on the international market. Under the terms of the Agreement, we have a right to export, and receive export quota for, 100% of the production from the Karakuduk Field. The domestic market does not permit world market prices to be obtained, resulting in approximately \$10 to \$12 lower cash flow per

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barrel. Furthermore, the Government has not allocated sufficient export quota to allow us to sell all of our available crude oil production on the world market. We are taking steps to reduce our local market obligations and to obtain an export quota that will enable us to sell all of our crude oil production. On July 17, 2003, we took the first step toward the commencement of arbitration proceedings in Switzerland for the breach of the Agreement by the Government of Kazakhstan by initiating a required three-month period of consultation with the Government. The Government indicated an interest in trying to resolve this matter during the consultation period. Although the consultation period has expired, the Company and the Government are continuing to negotiate a possible resolution of this matter. If the matter can not be resolved in a satisfactory manner, we have reserved our right to commence formal arbitration proceedings pursuant to our contractual arrangements with the Government.

The Company has been successful in 2003 in increasing its export sales and reducing its local market deliveries. As of September 30, 2003, the Company has sold approximately 1,917,000 barrels of its current year production, of which approximately 1,814,000 barrels, or 95%, have been sold at world market prices and 103,000 barrels, or 5%, have been sold at domestic market prices. This represents a significant increase in sales at world market prices and corresponding decrease in local market sales from the year 2002.

In addition, we are continuing with our efforts to obtain additional debt financing to cover any short-term working capital deficiencies and to refinance the KKM Credit Facility with terms and structure that are satisfactory to all parties. If we are successful in these efforts, we plan to use the resulting capital infusion to restructure the KKM Credit Facility with Kazkommertsbank and eliminate or significantly reduce our current working capital deficiencies.

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No assurances can be provided, however, that the Company will be able to obtain additional financing and/or sufficient cash flow from operations to meet working capital requirements in the future. Nor can any assurance be provided that if arbitration is instituted, it will be successful or that if successful, the Company will be able to enforce the award in Kazakhstan, or that the Company will be able to sell a significant portion of its production at world market prices.

### Karakuduk Field Operations

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We are presently engaged in the development of the Karakuduk Field, which requires substantial cash expenditures for drilling, well completions, workovers, oil storage and processing facilities, pipelines, gathering systems, plant and equipment (generators, pumps, communications, etc.) and other field facilities. We expect to finance the continued development of the Karakuduk Field primarily through cash flows from the sale of crude oil. Our short-term operational priorities will have a high probability of increasing our daily production levels through the use of the following proven methods: (i) water injection, (ii) down-hole pumps, (iii) hydraulic fracturing, and (iv) further drilling. Accordingly, management expects the Karakuduk Field production to increase approximately 25% from its current production capacity of approximately 10,000 barrels of oil per day to in excess of 12,000 barrels of oil per day by year-end. Our current daily production has been below our existing production capacity due to input restrictions on the main KTO export pipeline imposed by KazTransOil. While management is currently working to remove the input restrictions, no assurances can be provided that these restrictions will be removed in the near term or that the Company will be able to sell a significant portion of its production at world market prices.

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In 2003, KKM has made considerable improvements with respect to reservoir management by maintaining an active drilling program, installing artificial lift support, and establishing a good fracture stimulation record. The activities in these areas to date are in line with expectations and will continue. Production from the Karakuduk Field is expected to increase further due to: (i) the introduction of additional new wells, (ii) the ongoing hydraulic fracturing program, (iii) the ongoing installation of down hole pumps, and (iv) the implementation of a water injection program.

KKM has successfully completed every well drilled to date. In February 2003, we started an aggressive drilling program. As of November 10, 2003, we have drilled 11 new wells, 8 of which have been completed, with 5 more expected to be completed by year-end. This will increase our total well stock to 49 wells by year-end. The 11 wells drilled during 2003 have been drilled to depths between 10,170 feet (3,100 meters) and 11,300 feet (3,450 meters) accessing zones J1, J2, J3, and J7. Karakuduk Wells No. 159 and 177 were drilled to depths of 10,512 feet and 10,170 feet, respectively, in less than 9 days.

The positive oil rate response following hydraulic fractures in three wells (Nos. 101, 158, and 186) during April 2003, is an indication that other wells will benefit in a similar fashion. We are expanding the hydraulic fracturing program by performing up to 8 additional fractures during the 4th quarter 2003.

The water injection plan for 2003 includes injection into a total of 5 wells. The water injection plan is already underway and management is optimistic that the plan will maintain current production levels and increase proven reserves. Actual changes in reserve estimates, if any, will be realized during the year-end reserves determination process.

### Capital Commitments and Other Contingencies

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Our operations may be subject to regulations or other restrictions instituted by the Government of the Republic of Kazakhstan or other regulatory bodies responsible for the area in which the Karakuduk Field is located. In addition to taxation, customs declarations and environmental controls, regulations may govern such things as export quotas, local oil sales requirements, and commissioning and approval of surface production facilities. It is possible these regulations may limit the amount of revenue and cash flow obtainable from crude oil production and sales, increase the costs of doing business, and/or prevent or delay the starting or continuation of any given exploration or development project.

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All regulations are subject to future changes by legislative and administrative action and by judicial decisions. Such changes could adversely affect the entire petroleum industry. It is virtually impossible to predict the effect that any current or future proposals or changes in existing laws or regulations will have on our operations.

## 2. Results from Operations

Results of Operations for the Three Months Ended September 30, 2003 Compared to the Three Months Ended September 30, 2002

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Our operations for the three months ended September 30, 2003 resulted in a net income of \$2.07 million compared to a net income of \$2.11 million for the three months ended September 30, 2002. The \$42,000 decrease in our net income is the result of (i) higher revenues recognized during the three months ended September



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30, 2003, offset by (ii) higher transportation, depletion, income tax, and minority interest costs for the same period.

Revenue. Revenues were \$23.31 million for the three months ended September 30, 2003 compared with \$13.45 million for the three months ended September 30, 2002. The \$9.86 million increase is the result of higher volumes sold and higher oil prices received during the three months ended September 30, 2003. The increase in volumes sold during the three months ended September 30, 2003, was the result of increased sales quotas obtained for the period and the delay of delivery of approximately 200,000 barrels of oil, contracted during June 2003, until July 2003. The net value of this sale amounted to approximately \$4.3 million and was recognized as revenue in the month of July 2003. During the three months ended September 30, 2003, we sold approximately 1,098,000 barrels of crude oil, recognizing \$23.31 million, or \$21.23 per barrel, in revenue. Comparably, we sold approximately 731,000 barrels of crude oil, recognizing \$13.45 million in revenue, or \$18.40 per barrel, for the three months ended September 30, 2002.

Transportation and Operating expenses. Transportation costs for the three months ended September 30, 2003 were \$4.62 million, or \$4.21 per barrel, and operating costs associated with sales were \$1.67 million, or \$1.52 per barrel. Comparatively, transportation costs for the three months ended September 30, 2002 were \$2.39 million, or \$3.27 per barrel, and operating costs associated with sales were \$2.21 million, or \$3.03 per barrel. The increase in transportation costs per barrel is mainly due to higher tariffs imposed on the Company during 2003. The decrease in operating cost per barrel is mainly due to (i) higher volumes of oil sold during the period, (ii) significantly lower transportation costs from the wellhead to entry point of the KTO export pipeline, following the commission of the KKM pipeline, and (iii) lower work-over cost for the current year due to the increase in capital activities during the year 2003.

Depreciation and Depletion. Depreciation and depletion expense was \$7.14 million for the three months ended September 30, 2003 compared to \$3.71 million for the three months ended September 30, 2002. The \$3.43 million increase is the result of higher effective depletion rates and higher volumes of oil sold during the three months ended September 30, 2003. During the three months ended September 30, 2003, the Company recognized a total depletion expense of \$6.95 million or \$6.33 per barrel, compared to \$3.54 million or \$4.84 per barrel in depletion expense for the three months ended September 30, 2002. The increase in the effective depletion rate of \$1.49 per barrel is due to increased estimated capital expenditures for the development of the field for future years and reductions to the Company's estimated proved reserves.

Interest Expense. Interest expense for the three months ended September 30, 2003 remained the same as interest expense for the three months ended September 30, 2002.

General and Administrative Expense. General and administrative costs increased from \$1.56 million for the three months ended September 30, 2002 to \$1.97 million for the three months ended September 30, 2003. The \$410,000 change is the result of higher legal fees in connection with the arbitration proceedings and tax claim of \$112,000 and the increase of labor costs due to a \$278,000 production bonus given to the employees of the Company for achieving 10,000 barrels per day in production and 1 million tons (approximately 8 million barrels) cumulative production.

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Our operations for the nine months ended September 30, 2003 resulted in a net income of \$1.01 million compared to a net income of \$4.04 million for the nine months ended September 30, 2002. The \$3.03 million decrease in our net income is the result of several factors: (i) higher sales revenue during 2003, offset by (ii) higher transportation and depletion costs, (iii) a \$5.34 million extraordinary gain recognized as a result of the restructuring of our indebtedness during 2002, (iv) recognition of a \$1.02 million gain as a result of the adoption of SFAS 143 on January 1, 2003, and (v) lower interest costs.

Revenue. Revenues were \$39.59 million for the nine months ended September 30, 2003 compared with \$32.47 million for the nine months ended September 30, 2002. The \$7.12 million increase is the result of higher oil volumes sold and higher prices received for our oil during the nine months ended September 30, 2003. During the nine months ended September 30, 2003, we sold approximately 1,917,000 barrels of crude oil, recognizing \$39.59 million, or \$20.65 per barrel, in revenue. Comparably, we sold approximately 1,881,000 barrels of crude oil, recognizing \$32.47 million in revenue, or \$17.26 per barrel, for the nine months ended September 30, 2002. The result is a favorable price variance of \$6.51 million and a favorable volume variance of \$0.61 million.

Transportation and Operating expenses. Transportation costs for the nine months ended September 30, 2003 were \$7.92 million, or \$4.13 per barrel, and operating costs associated with sales were \$4.2 million, or \$2.19 per barrel. Comparatively, transportation costs for the nine months ended September 30, 2002 were \$7.03 million or \$3.74 per barrel, and operating costs associated with sales were \$5.95 million, or \$3.16 per barrel. The increase in transportation costs per barrel is mainly due to higher tariffs imposed on the Company during 2003. The decrease in operating cost per barrel is mainly due to (i) higher volumes of oil sold during the period, (ii) significantly lower transportation costs from the wellhead to entry point of the KTO export pipeline, following the commission of the KKM pipeline, and (iii) lower work-over cost for the current year due to the increase in capital activities during 2003.

Depreciation and Depletion. Depreciation and depletion expense was \$12.90 million for the nine months ended September 30, 2003 compared to \$9.71 million for the nine months ended September 30, 2002. The \$3.19 million increase is the result of higher oil volumes sold and higher effective depletion rates during 2003. During the nine months ended September 30, 2003, the Company recognized a total depletion expense of \$12.33 million or \$6.43 per barrel, compared to \$9.16 million or \$4.87 per barrel in depletion expense for the nine months ended September 30, 2002. The increase in the effective depletion rate of \$1.56 per barrel is due to increased estimated capital expenditures for the development of the field for future years and reductions to the Company's estimated proved reserves.

Interest Expense. Interest expense decreased from \$4.45 million for the nine months ended September 30, 2002 to \$3.36 million for the nine months ended September 30, 2003. The \$1.09 million decrease is due to the lower financing costs of our restructured indebtedness. Our cost of financing the development of the Karakuduk Field has improved from a pre-restructuring annual interest rate of LIBOR plus 19.75% compounded daily during the first five months in 2002, to a simple fixed annual interest rate of 14%, generating savings of approximately \$600,000 per quarter. In addition, interest expense for the period ended September 30, 2003 reflects a loan discount of \$178,000 and is net of capitalized interest of \$371,000.

General and Administrative Expense. General and administrative costs increased from \$4.84 million for the nine months ended September 30, 2002 to \$5.13 million for the nine months ended September 30, 2003. The \$290,000 increase was due to higher legal fees as a result of our arbitration proceedings of \$118,000 and higher labor costs of \$352,000 due to a production bonus given to the employees

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of the Company for achieving 10,000 barrels per day in production and 1 million tons (approximately 8 million barrels) cumulative production, net of \$180,000 in cost savings in other general and administrative areas.

Cumulative effect of change in accounting principal. As a result of the adoption of SFAS 143, the Company recognized a gain of \$1.02 million as a cumulative effect of change in accounting principal for the nine months ended September 30, 2003. In addition, the Company recognized \$46,000 in accretion expense to account for changes in the ARO liability. See Note 5 of our consolidated financial statements.

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### 3. Commodity Prices for Oil and Gas

Our revenues, profitability, growth and value are highly dependent upon the price of oil. Market conditions make it difficult to estimate prices of oil or the impact of inflation on such prices. Oil prices have been volatile, and it is likely they will continue to fluctuate in the future. Various factors beyond our control affect prices for oil, including supplies of oil available worldwide and in Kazakhstan, the ability of OPEC to agree to maintain oil prices and production controls, political instability or armed conflict in Kazakhstan or other oil producing regions, the price of foreign imports, the level of consumer demand, the price and availability of alternative fuels, the availability of transportation routes and pipeline capacity, and changes in applicable laws and regulations.

### 4. Inflation

We cannot control prices received from our oil sales and to the extent we are unable to pass on increases in operating costs, we may be affected by inflation. The devaluation of the Tenge, the currency of the Republic of Kazakhstan, can significantly decrease the value of the monetary and other assets that we hold in Kazakhstan that are based on the Tenge. KKM retains the majority of its cash and cash equivalents in U.S. dollars, but KKM's statutory tax basis in its assets, tax loss carryforwards, and VAT receivables are all denominated in Tenge and subject to the effects of devaluation. Local tax laws allow basis adjustments to offset the impact of inflation on statutory tax basis assets, but there is no assurance that any adjustments will be sufficient to offset the effects of inflation in whole or in part. If not, KKM may be subject to much higher income tax liabilities within Kazakhstan due to inflation and or devaluation of the local currency. Additionally, devaluation may create uncertainty with respect to the future business climate in Kazakhstan and to our investment in that country. As of September 30, 2003, the exchange rate was 148.93 Tenge per U.S. Dollar.

### 5. Critical Accounting Policies

Application of GAAP requires the use of estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and revenues and expenses during the reporting period. In addition, alternatives can exist among various accounting methods. In such cases, the choice of accounting method can also have a significant impact on reported amounts.

Our determination of proved oil and gas reserve quantities, the application of the full cost method of accounting for exploration and production activities, and the application of standards of accounting for derivative instruments and hedging activities require management to make numerous estimates and judgments.

Oil and Gas properties (Full Cost Method). The Company follows the full cost

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method of accounting for oil and gas properties. Accordingly, all costs associated with the acquisition, exploration, and development of oil and gas reserves, including directly related overhead costs, are capitalized.

All capitalized costs of proved oil and gas properties, including the estimated future costs to develop proved reserves, are amortized on the unit-of-production method using estimated proved reserves. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized cost to be amortized.

Sales of proved and unproved properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves of oil and gas, in which case the gain or loss is recognized in income. Abandonments of properties are accounted for as adjustments of capitalized costs with no loss recognized.

Cost Excluded. Oil and gas properties include costs that are excluded from capitalized costs being amortized. These amounts represent costs of investments in unproved properties and major development projects. The Company excludes these costs until proved reserves are found or until it is determined that the costs are impaired. All costs excluded are reviewed quarterly to determine if impairment has occurred. Any impairment is transferred to the costs to be amortized. For operations where a reserve base has not yet been established, an impairment requiring a charge to earnings may be indicated through evaluation of drilling results or relinquishing drilling rights.

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Capitalized Interest. SFAS 34, Capitalization of Interest Costs, provides standards for the capitalization of interest costs as part of the historical cost of acquiring assets. FIN 33 provides guidance for the application of SFAS 34 to the full cost method of accounting for oil and gas properties. Under FIN 33, costs of investments in unproved properties and major development projects, on which DD&A expense is not currently taken and on which exploration or development activities are in progress, qualify for capitalization of interest. Capitalized interest is calculated by multiplying the weighted-average interest rate on debt by the amount of costs excluded. Capitalized interest cannot exceed gross interest expense.

Ceiling Test. Companies that use the full cost method of accounting for oil and gas exploration and development activities are required to perform a ceiling test each quarter. The full cost ceiling test is an impairment test prescribed by SEC Regulation S-X Rule 4-10. The ceiling test is performed on a country-by-country basis. The test determines a limit, or ceiling, on the book value of oil and gas properties. That limit is basically the after tax present value of the future net cash flows from proved crude oil and natural gas reserves. This ceiling is compared to the net book value of the oil and gas properties reduced by any related deferred income tax liability. If the net book value reduced by the related deferred income taxes exceeds the ceiling, an impairment or non-cash write down is required. A ceiling test impairment can give the Company a significant loss for a particular period, however, future DD&A expense would be reduced.

Reserves. Estimates of our proved oil and gas reserves are prepared by Ryder Scott Company in accordance with guidelines established by the SEC. Those guidelines require that reserve estimates be prepared under existing economic and operating conditions with no provisions for increases in commodity prices, except by contractual arrangement. Estimation of oil and gas reserve quantities

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is inherently difficult and is subject to numerous uncertainties. Such uncertainties include the projection of future rates of production, export allocation, and the timing of development expenditures. The accuracy of the estimates depends on the quality of available geological and geophysical data and requires interpretation and judgment. Estimates may be revised either upward or downward by results of future drilling, testing or production. In addition, estimates of volumes considered to be commercially recoverable fluctuate with changes in commodity prices and operating costs. Our estimates of reserves are expected to change as additional information becomes available.

**Derivative Financial Instruments and Hedging Activities.** We account for our investment in derivative financial instruments in accordance with SFAS 133, Accounting for Derivative Financial Instruments and Hedging Activities, as amended. As a result, we recognize all derivative financial instruments in our financial statements at fair value, regardless of the purpose or intent for holding the instrument. Changes in the fair value of derivative financial instruments are recognized periodically in income or in shareholders' equity as a component of comprehensive income depending on whether the derivative financial instrument qualifies for hedge accounting, and if so, whether it qualifies as a fair value hedge or cash flow hedge. Generally, changes in fair values of derivatives accounted for as fair value hedges are recorded in income along with the portions of the changes in the fair values of the hedged items that relate to the hedged risks. Changes in fair values of derivatives accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income net of deferred taxes. Changes in fair values of derivatives not qualifying as hedges are reported in income.

**Legal, Environmental and Other Contingencies.** A provision for legal, environmental and other contingencies is charged to expense when the loss is probable and the cost can be reasonably estimated. Determining when expenses should be recorded for these contingencies and the appropriate amounts for accrual is a complex estimation process that includes the subjective judgment of management. In many cases, management's judgment is based on interpretation of laws and regulations, which can be interpreted differently by regulators and/or courts of law. Chaparral's management closely monitors known and potential legal, environmental and other contingencies and periodically determines when Chaparral should record losses for these items based on information available to us.

### 6. Special Note Regarding Forward-Looking Statements

Some of the statements in this Quarterly Report on Form 10-Q constitute "forward-looking statements." Forward-looking statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "estimates," "believes," "predicts," "potential," "likely," or "continue," or by the negative of such terms or comparable terminology.

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Forward-looking statements are predictions based on current expectations that involve a number of risks and uncertainties. Actual events may differ materially. In evaluating forward-looking statements, you should consider various factors, including the risks discussed above. These factors may cause our actual results to differ materially from any forward-looking statement.

Although we believe that these statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements, and you are encouraged to exercise caution in considering such forward-looking statements. Unless otherwise required by law, we are not under any duty to update any of the forward-looking statements after the date of this Quarterly Report on Form 10-Q

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to conform these statements to actual results.

### Item 3 - Quantitative and Qualitative Disclosures About Market Risks

#### Foreign Currency

The functional currency is the U.S. Dollar. All transactions arising in currencies other than U.S. dollars, including assets, liabilities, revenue, expenses, gains, or losses are measured and recorded into U.S. dollars using the exchange rate in effect on the date of the transaction.

Cash and other monetary assets held and liabilities denominated in currencies other than U.S. dollars are translated at exchange rates prevailing as of the balance sheet date (148.93 and 155.60 Kazakh Tenge per U.S. Dollar as of September 30, 2003 and December 31, 2002, respectively). Non-monetary assets and liabilities denominated in currencies other than U.S. dollars have been translated at the estimated historical exchange rate prevailing on the date of the transaction. Exchange gains and losses arising from translation of non-U.S. dollar amounts at the balance sheet date are recognized as an increase or decrease in income for the period.

The devaluation of the Tenge, the currency of the Republic of Kazakhstan, can significantly decrease the value of the monetary assets that we hold in Kazakhstan as well as our assets in that country that are based on the Tenge. KKM retains the majority of cash and cash equivalents in U.S. dollars in bank accounts within Kazakhstan, but KKM's statutory tax basis in its assets, tax loss carryforwards, and VAT receivables are all denominated in Tenge and subject to the effects of devaluation. Local tax laws allow basis adjustments to offset the impact of inflation on statutory tax basis assets, but there is no assurance that any adjustments will be sufficient to offset the effects of inflation in whole or in part. If not, KKM may be subject to much higher income tax liabilities within Kazakhstan due to inflation and/or devaluation of the local currency. Additionally, devaluation may create uncertainty with respect to the future business climate in Kazakhstan and to our investment in that country.

The Tenge is not a convertible currency outside of the Republic of Kazakhstan. The translation of Tenge denominated assets and liabilities in these financial statements does not indicate Chaparral could realize or settle these assets and liabilities in U.S. dollars.

#### Commodity Prices for Oil

Our revenues, profitability, growth and value are highly dependent upon the price of oil. Market conditions make it difficult to estimate prices of oil or the impact of inflation on such prices. Oil prices have been volatile, and it is likely they will continue to fluctuate in the future. Various factors beyond our control affect prices for oil, including requirements to supply a portion of our crude oil production to the Kazakhstan local market to meet domestic energy needs, supplies of oil available worldwide and in Kazakhstan, the ability of OPEC to agree to maintain oil prices and production controls, political instability or armed conflict in Kazakhstan or other oil producing regions, the price of foreign imports, the level of consumer demand, the price and availability of alternative fuels, the availability of transportation routes and pipeline capacity, and changes in applicable laws and regulations.

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### Item 4 - Controls and Procedures

An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures conducted within 90 days of the date of

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filing this Form 10-Q, was carried out by the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). Based on that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures have been designed and are being operated in a manner that provides reasonable assurance that the information required to be disclosed by the Company in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. A controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within an entity have been detected. Subsequent to the date of the most recent evaluation of the Company's internal controls, there were no significant changes in Chaparral's internal controls or in other factors that could significantly affect the internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

### Part II- Other Information

#### Item 1 - Legal Proceedings

In December 2002, KKM received a claim from the Ministry of State Revenues of the Republic of Kazakhstan for \$9.6 million (the "Tax Claim") relating to additional unpaid taxes and penalties covering the three years from 1999 to 2001. The original Tax Claim has been successfully reduced to approximately \$2.31 million. KKM has appealed the remaining claim and has contracted legal firms in Kazakhstan to assist with the appeal process. Based on the assessments of KKM's management and legal counsel, it is the Company's opinion that the ultimate resolution of the Tax Claim, after taking into account reserves previously made, will not have a material adverse effect on the financial position or operating results of the Company.

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#### Item 6 - Exhibits and Reports on Form 8-K

- (a) Exhibits  
None
- (b) Reports on Form 8-K  
None.

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#### Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

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Dated: November 14, 2003

Chaparral Resources, Inc.

By: /s/ Nikolai D. Klinchev

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Nikolai D. Klinchev  
Chief Executive Officer

By: /s/ Richard J. Moore

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Richard J. Moore,  
VP Finance and Chief Financial Officer  
(Principal Financial and Accounting Officer)

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Certifications

I, Nikolai D. Klinchev, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Chaparral Resources, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our



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evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2003

/s/ Nikolai D. Klinchev

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Nikolai D. Klinchev  
Chief Executive Officer

I, Richard J. Moore, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Chaparral Resources, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our

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evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2003

/s/ Richard J. Moore

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Richard J. Moore  
Chief Financial Officer